Tax & Super Australia

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Mr Justin Dearness
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Australian Taxation Office
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Draft Taxation Ruling TR 2022/D1
Income tax: Section 100A Reimbursement Agreements
Submission of Comments

By email – justin.dearness@ato.gov.au

Dear Justin,

We refer to the aforementioned draft Taxation Ruling – TR 2022/D1('the draft ruling') issued on 23 February 2022 in respect of the Commissioner's (the Commissioner) opinion with regard to the application of section 100A (Section 100A) of the Income Tax Assessment Act 1936 (ITAA 1936)**.**

On behalf of Tax and Super Australia (TSA) and its members, and further to our submission made to you dated 18 February 2022 in respect of Section 100A, please find in the attached our comments (Attachment A) in respect of the draft ruling.

Tax and Super Australia (TSA) is a not-for-profit member organisation that has assisted tax and superannuation professionals for over 100 years.

With a subscriber base of approximately 13,000, including 4,000 members, the organisation has evolved to meet the challenges of Australia's modern tax and superannuation system and remains at the forefront of educating and empowering today's tax and superannuation professionals.

Whilst there has been an expressed consternation within the taxation profession with regard to the draft ruling, and notwithstanding our reply as provided in the following commentary, TSA commends, and continues to support the Commissioner in undertaking the necessary steps in furthering this process.

The focus of our comments is not necessarily to contest the interpretation of the provisions as made by the Commissioner.

However, in preface to our comments in Attachment A, we submit more broadly the following:

1. The Commissioner should not seek to finalise the draft ruling until the decision in *Guardian AIT Pty Ltd ATF Australian Investment Trust v Commissioner of Taxation [2021] FCA 1619* is finalised. Whilst the interpretation and acceptance of the factual circumstances made by Logan J in the Federal Court may be at issue with respect to the meaning of 'ordinary commercial and family dealing', it is nevertheless the current law. We would consider it prudent for the Commissioner to await the final outcome with regard to that case before finalising the draft rulings and other guidelines.

2. More broadly, the contentious issue with respect to the interpretation of 'ordinary family dealing' would appear to lay in the scope and breadth of 'family members' potentially subject to distributions of a family trust. In particular, family members in which there are differing marginal income tax rates in receipt of distributions not supported by cash distributions, are more likely to be at issue.

   We therefore suggest that in the context of 'ordinary family dealing' the definition and scope of such be broadened to include the direct family (parent and children). Whilst this definition may concede the effect of the provision in contrast to the draft guidelines as issued by the Commissioner, and would to that effect, facilitate 'income splitting' for taxation purposes, the practice of distributing from a business structure to beneficiaries is well accepted in taxation law. If, for example, the derivation of income by the family trust was primarily due to the personal exertion of one member of the family (the parent), and income was 'split' between family members, it would appear that the application of Part IVA of the ITAA 1936 would be a more effective tool to rectify the practice.

   We therefore submit that the Commissioner gives due consideration to the scope and breadth of the 'family' in the context of Section 100A (13) of the ITAA 1936.

In the absence of the Commissioner amending the scope of 'ordinary family dealing' it is our focus to ensure that the clarity under which the Commissioner's opinion is understood is communicated to our members and respective practitioners in an unambiguous manner.

In Attachment A, as per the following, we have concentrated our immediate response to the examples as provided in the draft ruling and request that the Commissioner review such to make the understanding of the proposed application of Section 100A beyond doubt.

We will be providing a separate response to the draft Practical Compliance Guidelines PCG 2022/D1 and this response should be read in conjunction with our reply to PCG 2022/D1.

If you have any questions in relation to this submission, please contact Phillip London on 0400 819 698 or p.london@taxandsuperaustralia.com.au

Yours Faithfully,

Phillip London
Head of Tax

Attachment A

Our Comments are as follows:

1. **The date of effect with respect to the Ruling.**

1.1 Paragraph 39 states that the date of effect of the final ruling will apply to arrangements entered by taxpayers both before and after the issue of the final ruling.

1.2 We understand that the Commissioner's approach, is generally to apply taxation rulings in such a manner and adhere accordingly to administrative requirements and other arrangements.

1.3 On 7 April 2022, the Honourable Michael Sukkar, Assistant Treasurer, issued a press release which stated, in part as follows:

'*The Government welcomes the Australian Taxation Office (ATO) clarifying yesterday that its draft guidance on 'section 100A' (draft TR 2022/D1 and draft PCG 2022/D1) will not apply on a retrospective basis.*

Confirmation that taxpayers can continue to rely on the 2014 guidance for matters that arose while that guidance was in place will be welcomed by small businesses who in good faith followed this guidance.

The ATO's clarification that ordinary advice services provided in exchange for an advisory fee are not subject to the promoter penalty provisions will also be welcomed'.

1.4 The 2014 Guidance states as follows:

'*The administrative position outlined in this guidance remains applicable to present entitlements to income of a trust estate conferred before 1 July 2022, to the extent that* ***it is more favourable*** *to you than PCG 2022/D1'.*

1.5 The TSA, on behalf of its members welcome the confirmation by the Australian Taxation Office that, it will not seek 'retrospectivity' in relation to the potential application of section 100A of the ITAA 1936, on the basis of a more **favourable** outcome for the taxpayer in the 2014 guidance.

1.6 We submit that the draft ruling should include the foregoing statement in the final ruling and state the subject of the intention of the ATO with regard to such matters in an unambiguous manner.

1.7 Please note our comments in relation to Example 4 in the 2014 Guidance as a matter of context in determining whether that Guidance is placed on more favourable terms for a taxpayer when applying the draft ruling.

2. 2014 Guidance – Example 4

2.1 The primary concern of TSA members is whether distributions to adult beneficiaries made during the income years post 1 July 2014, in which the economic resources of the 'cash distribution' has not followed that of the 'tax distribution', gives rise to an application of section 100A. The primary issue at hand is whether such arrangements will be the subject of the 'blue' or 'red' zone application of Practical Compliance Guidance PCG 2022/D1 ('the draft PCG'), and/or the draft ruling as broadly provided in examples 3-6 of the draft ruling.

2.2 Further, we note the Assistant Treasurer's statement on 7 April and the statement by the ATO in the 2014 Guidance which states as follows:

'*This guidance was on our website from July 2014 to 23 February 2022 and has been replaced by draft Practical Compliance Guideline PCG 2022/D1 Section 100A reimbursement agreements - ATO compliance approach.*
This guidance was first published on our website in response to a request from the tax profession. The request is recorded in the minutes to the NTLG meeting held in September 2013.

The administrative position outlined in this guidance remains applicable to present entitlements to income of a trust estate conferred before 1 July 2022, to the extent that it is ***more favourable*** *to you than PCG 2022/D1.*

If you follow this information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take'.

2.3 Example 4 of the 2014 Guidance provides the example of the Charlene Family Trust and is reiterated in the following:

> The Charlene Family Trust is a discretionary trust controlled by Charlene and administered for the benefit of Charlene and her family.
>
> Each year, the trust makes a range of individual Australian-resident beneficiaries presently entitled to trust income. Typically, the entitlements remain unpaid, except for sufficient cash to enable the beneficiaries to pay tax on their share of the trust's net income.
>
> This pattern continues for several years, with unpaid balances building up over time. The trustee lends the remaining cash to Charlene on commercial terms, requiring the payment of principal and interest over time.
>
> In the absence of other factors, the ATO would not seek to apply section 100A to this arrangement.

2.4 Given the concern as expressed paragraph 2.1, to determine whether the 2014 Guidance is more favourable to the taxpayer and therefore can be relied on, Example 4 would appear to be the most relevant example for practitioners to consider when determining the issue of distributions to adult beneficiaries.

2.5 The respective examples in the draft ruling (Examples 3 to 6) generally refer to differing marginal income tax rates as a determinant of whether the Commissioner may apply Section 100A to the circumstances provided in the example.

2.6 In terms of Example 4 we note however, that the relevant marginal tax rates of the 'family' in Example 4 have not been provided or are considered as part of the outcome.

We therefore comment accordingly in respect of Example 4:

- The factual background does not state the marginal income tax rates of the beneficiaries.

- The factual matter states that it is a discretionary trust for the benefit of Charlene's family. It further states that distributions are made to 'Australian-resident' beneficiaries. Whilst presumably the beneficiaries as stated are members of Charlene's family given the purpose of the trust, it is not clear that such is the case.

- No factual matter is provided in relation to the accumulation of the unpaid balances. For example, are the balances invested on sub trust for the beneficiaries? Are they utilised in the working capital of the family trust during the period prior to the lending of the funds to Charlene?

- The trustee lends to Charlene on commercial terms. Are the funds held by the trustee and provided to Charlene as a beneficiary of the trust been the subject of distributions to the beneficiaries (other than Charlene) in which those beneficiaries are on lower marginal tax rates than Charlene?

- The example provides a favourable outcome to the trustee and the beneficiaries 'in the absence of other factors'. What are those factors?

2.7 We submit that inclusive of the process in finalising the draft ruling the foregoing issues/questions be addressed either in the updated ruling or by the Commissioner in the 2014 Guidance.

3.0 Draft Ruling – Example 3

3.1 Example 3 in the draft ruling states as follows:

> ***Example 3 - gift from parents to a child***
>
> 114. Assume the same facts as Example 2 of this Ruling. In one year, Lisa and Matthew's eldest child, Kate, purchases a property. Lisa and Matthew pay for the deposit with funds attributable to their distribution from the Rosegum Family Trust. The making of gifts between family members for ordinary familial purposes, such as parents contributing to the purchase of a house, without additional facts, would usually be ordinary dealing, as able to be explained as achieving ordinary familial objects without the need for further explanation.
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> 115. A different outcome might arise if, for example:
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> - parents gift money received from a trust to their children repeatedly and the parent has a lower marginal tax rate and lesser means than the adult child who is also capable of benefitting under that trust in their own right (such as retired parents repeatedly gifting trust entitlements to higher marginal tax rate children in lieu of the trustee distributing to the adult child directly), or
>
> - the situation is reversed, so that Kate, who is less financially advanced, gifted money to Lisa and Matthew, particularly where the adult child has a lower marginal tax rate than the parent (see Example 4 of this Ruling).

3.2 With respect, and to clarify the scope 'ordinary family dealing' within the context of the example and section 100 A (13) of the *Income Tax Assessment Act 1936,* the example needs clarity with regard to the following:

- In the context of a parent assisting an adult beneficiary, the example refers to assistance with a 'deposit' on the acquisition of a property.

  If the parents made follow up 'gifts' in relation to the acquisition of the property by the adult beneficiary and such amounts were provided from cash distributions received by the parents, in following years, does that still fall within the understanding of 'ordinary family dealing'?

- In the context of the example, where a parent made a financial commitment of the 'gift' in **year one** such that the parent would assist the adult beneficiary with the acquisition of the property to 50% of its value, and the acquisition is financed from cash distributions from the trust, is that 'ordinary family dealing'?

- The application of Section 100A would appear to rest on the issue of differing marginal income tax rates between the family members (paragraph 115). We suggest this statement be made without doubt and therefore suggest that statements such as '*a different outcome might arise*' be excluded from paragraph 115.

3.3. Our reading of the example is that where beneficiaries of a family/discretionary trust receive a 'gift' from another beneficiary, to fall with the ordinary family dealing exception, that gift is a 'one off' gift only. Repeated 'gifts' are likely to give rise to review and utilisation of compliance resources of the ATO to the taxpayer's factual circumstance.

3.4 In contrast, where beneficiaries are entitled to trust distributions, and the beneficiaries are on equivalent marginal income tax rates – the lending/gifting of funds to each family member on a repeated basis would appear to fall within the meaning of 'ordinary family dealing' (example 6 – preliminary to the comment in relation to differing outcomes).

3.5 With respect, it is submitted that the example be conclusive in its outcome rather than 'inferring' or 'alluding' to an outcome. As such, if the ATO's intention is to review an arrangement where there is repeated assistance from a parent to a child, that conclusion be stated in plain language by the ATO. On that basis, we request the following be provided in the Example 3:

1. Factual background with regard to the marginal income tax rates of each of the beneficiaries;

2. Clarity that a 'one off gift' or family commitment in relation to the assistance by a parent to an adult beneficiary for the purchase of a property is acceptable and within the meaning of 'ordinary family dealing'.

3. Repeated 'gifts' or assistance by the parent to the adult beneficiary for such measures will result in the application of review and compliance resources by the Commissioner for such a circumstance. For example, repeated mortgage payments by a parent to an adult child sourced from cash distributions to the parent where the parent is on a lower marginal tax rate than the adult child is in breach of the provision. This would be concluded on the basis that the repeated gifting is undertaken on the basis of the beneficiaries receiving a tax

benefit rather than entering the arrangements in the ordinary course of family dealings.

4.0 Draft Ruling – Example 4

4.1 Example 4 in the Draft Ruling states as follows:

> 116. The trustee of the Gallagher Family Trust makes Pauline, who is an adult full-time student, presently entitled to trust income for a particular year. Pauline's entitlement is determined so her taxable income will not exceed certain marginal tax rate thresholds. Pauline gifts her entitlement back to the trustee.
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> 117. The creation of an entitlement and gifting back indicates there may be an agreement, arrangement or understanding between the parties which is connected to Pauline's present entitlement. An arrangement between family members where the overt acts achieve a particular favourable tax result but cannot otherwise be seen to result in the achievement of any regular familial object will not be entered into in the course of ordinary dealing simply because it is among family members. For these reasons, the gifting back of Pauline's entitlement calls for explanation.
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> 118. In circumstances where Pauline gifts her entitlement back to the trustee every year, it may be reasonable to infer that the dealing is not made for the furtherance of any familial or commercial object and was instead made for the reduction of tax. The dealing appears artificial, contrived and to involve the trustee and beneficiary acting cooperatively to achieve a particular tax outcome.
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> 119. The evidence may more closely exhibit tax avoidance where the arrangement is repeated in subsequent years. However, it would still be open depending on the facts to demonstrate that a reimbursement agreement existed at the time when Pauline's present entitlement arose in year one, or in the event that the arrangement did not continue after the first year.
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> 120. Additional factors which may indicate the dealing more closely exhibits tax avoidance than ordinary dealing would include:
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> - the trustee loaned funds attributable to Pauline's entitlement to her parents on interest-free terms for an undefined period, or
> - instead of gifting back to the trust, Pauline gifts her trust entitlements to her parents, or
> - instead of gifting back to the trust, Pauline applies her trust entitlements to repay her parents for costs incurred by them on her maintenance, education and financial support while Pauline was a minor.

4.2 Fundamentally, Example 4 will require further explanation from taxpayers where they gift their entitlements in the instance that the marginal income tax rates of beneficiaries differ.

4.3 In this example the gift is made to the trustee. However, the example then refers to 'an arrangement between family members' and discusses familial arrangements.

4.4. In broad terms, it concludes that repetitive gifting to the 'trustee' is contrived and more likely to be evidence of tax avoidance.

4.5 With respect, Example 4 should include the following to provide clearer instructive direction to practitioners:

- The example should be consistent in defining the recipient of the gift. It would appear to imbricate or overlap the recipient as the trustee or as the parent.

  A trustee may not necessarily be a family member. Further, a gift to the trustee may have alternative outcomes for the trust in contrast to a gift to a parent. For example, a gift to a Trustee could infer that the economic entitlement gifted is more likely to be used in the Trust's enterprise as working capital. A gift to a parent implies that the economic entitlement gifted will be used for private purposes by the parent.

  Therefore, the example, should confirm the identity and relationship of the trustee to the beneficiary (is it the parent? or if a corporate – is the parent a director and controlling interest of the trust).

- The example should also confirm the use of the funds by the recipient. In either case where the recipient is an arm's length trustee or the parent, how have the funds received by way of gift been utilised? That is, have the funds been used for private purposes or in the working capital of the trust's business operations.

- What is the outcome if the gift is placed on arm's length lending terms by the donor? That is, does the gift change in character if made as a loan to the donee and therefore alter the outcome of the potential application of section 100A. Is such an arrangement then considered an ordinary commercial arrangement?

5.0 Draft Ruling – Example 5

5.1 Example 5 states as follows:

> 121. From time to time, the trustee of the Davidson Family Trust makes John, who is a family member, presently entitled to a share of trust income. John's entitlement is determined so his taxable income will not exceed certain marginal tax rate thresholds. John is a full-time student and does not have income from other sources. In a particular year, funds underlying the present entitlement are set aside to be held by the trustee upon a separate trust for the sole benefit of John, who has indicated he may be unlikely to call for his entitlements until such time as he purchases a home or makes a similar investment. Nonetheless, John is at liberty to call for his trust entitlements at any time.
>
> 122. John's tax-free threshold reduces the overall tax on the trust net income. However, in the absence of additional factors, the arrangement would likely be entered into in the course of ordinary dealing.
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> 123. A different outcome may arise if, for example, instead of setting funds aside for John upon a separate trust, the trustee:
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> • loans the funds on interest-free terms for an undefined period to another person, or
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> • otherwise applies the trust's funds in a way inconsistent with an intention to satisfy John's entitlements, should the trustee be called upon by John to do so.

5.2 Example 5 would appear to clearly confirm that the holding of entitlements by a trustee for the future benefit of a beneficiary should not give rise to the application of section 100A.

5.3 It is assumed that the funds are placed in a benign investment source e.g. a term deposit.

5.4 The example should clarify such arrangements as follows:

- If the funds placed on a separate trust arrangement are invested into the trust's working capital – does this cause concern for the ATO? Example 2 (Paragraphs 53-58) of the draft Practical Compliance Guideline 2022/D1, provides an example under which beneficiaries allow the trustee to utilise entitlements in the working capital of the trust without issue.

We further note the 'guidelines' of the 'Green Zone' in the draft PCG, in relation to retention arrangements states as follows:

21. For the purposes of this scenario:

(a)'Trustee retention of funds' refers to the beneficiary allowing the trustee to retain funds for a period of time or indefinitely that they would otherwise receive in satisfaction of their entitlement. This could be in the form of lending the funds representing their entitlement back to the trustee, or by not yet calling for that entitlement to be satisfied.

(b)The 'use of funds condition' means that the trustee, as permitted by the trust deed, uses the funds (in its capacity as trustee) that represent the beneficiary's entitlement only

(i) in the working capital of a business that it actively carries on
(ii) for the acquisition, maintenance or improvement of investment assets of the trustee, and/or
(iii) to lend the funds to an associate, on terms that satisfy section 109N, and the associate uses the funds in a way that satisfies either of the criteria above.

(c)The use of funds condition is not satisfied if any associate of the trust benefits, except as described at paragraph 21(b)(iii) of this Guideline, from that use of funds (for example, being able to use a trust asset for less than market value consideration).

- On the facts as presented in Example 5, it could be concluded that funds held on a separate trust and utilised in the Trust's working capital could be done so without issue or by reference to Section 100A.

5.5 We suggest, in relation to Example 5:

1. Further background facts with respect to the utilisation of the beneficiary entitlements in the separate trust be included (i.e. how are the funds invested by the trustee?);

2. Example 5 be reconciled to Example 2 in the PCG, that is, clarify whether beneficiary entitlements placed into the trust's working capital are benign in terms of the potential application of Section 100A by the ATO;

3. The reference in Example 5 to marginal tax rates appears to be inconsequential to the outcome or the potential application of Section 100A. In such case, the reference should be deleted or a statement to

the effect that, notwithstanding the difference in marginal tax rates, or the 'capping' of a tax obligation of the family, effective to John's marginal tax rate in this instance, it should not give rise to the application of Section 100A.

4. With regard to paragraph 123, clarify that if the beneficiary entitlements are loaned to a third party or another person, or another beneficiary of the trust, on commercial loan terms, is there an issue or a potential application of Section 100A in the said circumstance of the Example 5?

6.0 Draft Ruling – Examples 7 and 8

6.1 **Example 7** refers to loan arrangements provided to the trustee of a widely held unit trust by arm's length beneficiaries.

6.2 The focus of Section 100A has been with regard to closely held family trusts involving either 'washing machine' arrangements involving a bucket company or the distribution of the tax entitlement to adult beneficiaries of a family trust, without the transfer of the cash entitlement.

6.3 As such, Example 7 appears peripheral to the substance of the issue and the relevant interest and priority of taxpayers and tax practitioners.

6.4 We submit Example 7 be deleted or excluded from the final ruling.

6.5 **Example 8** provides an instance of an arrangement in which franking credits are utilised to entitle primary beneficiaries with a capital distribution on the basis of a share buy back. It is proposed in the draft ruling that the arrangement does not satisfy Section 100A (13), in that taken as a whole, it is a not an ordinary commercial dealing.

6.6 Notwithstanding the conclusion in the draft ruling, Example 8, appears to consider substantially more issues with respect to structuring transactions and income tax planning, by utilising respective income tax provisions beyond, what to that point in the draft ruling, has been a discussion concentrated on family arrangements within family groups.

6.7 We suggest that the Example be deleted from the final ruling.

7.0 Draft Ruling – Examples 9

7.1 Example 9 identifies an example of a 'washing machine' structure under the corporate beneficiary distributed franked dividends to its shareholder – the family trust on a repetitive basis.

7.2 It is evident that funds remain in the trust for the trustee should be able to utilise for its business ends or other purposes.

7.3 As stated in the context of draft PCG 2022/D1, (Example 3 – paragraph 21 (b) and (c)), such an arrangement entered and conducted by a corporate beneficiary and a trustee will not be the subject of Section 100A where the corporate beneficiary provides the funds under a complying loan agreement.

7.4 As such, and for the purposes of completeness, the example should include this factual detail or at least an alternative outcome consistent with PCG 2011/D1 in this regard. In the absence of such, Example 9 is misleading and gives rise to a potential outcome that appears to confuse the issue rather than clarify an outcome.