

TRUST SERIES – PART 4

The integrity and anti-avoidance rules applicable to trusts

Presented by

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Please ask questions through the Q & A pod not on the chat pod.

Not Answered Questions will be emailed to you along with the **webinar recording**



This webinar predominately relates to the topical application of section 100A.

It will address three broad questions:

- How does it work?
- What is the current lay of the land?
- What is the context of the judgements and the ATO rulings?

Other topics:

- Section 100A vs Part IVA
- Division 7A
- Owies is a trustee's discretion truly unfettered?



Introduction cont'd

- Deals with what is known as trust stripping or reimbursement agreements
- It is a specific anti-avoidance measure (note Part IVA more recently Guardian)
- The wording of the law has not recently changed, but it has essentially been enlivened by the ATO
- Now you need to the know about it
- Was originally targeted at more egregious bottom of the harbour arrangements, but wording is so broad
- Introduced in 1978 one of a few anti avoidance measures (then Treasurer John Howard)
- EM made it clear it was targeting trust stripping
- No mention of family dealings in fact, the exemption was put in place that has been relied on
- Query: what does Part IVA have to say about all of this. A sleeper in the grass if this gets all too controversial...

PART A: HOW DOES IT WORK



- The legislation uses the concept of a reimbursement agreement in relation to a present entitlement, which rests on three basic requirements, plus an exception:
 - Connection requirement: The present entitlement has to arise out of or in connection with an express or implied agreement, understanding or arrangement. – must be pre-existing -Guardian
 - Benefit to another requirement: The agreement must provide for the payment of money or the transfer of property to an entity or person other than the beneficiary.
 - **Tax reduction purpose requirement:** The purpose of one or more of the parties to the agreement must be that a person would be liable to pay less tax in the income year.
 - Ordinary dealing exception: Section 100A does not apply to arrangements entered into in the course of ordinary family or commercial dealings. – this is the contentious one! Logan J in Guardian – "lacks artificiality"
- Where s 100A applies, the beneficiary is treated as never having been entitled to the distribution and the trustee is liable to tax on the present entitlement at the top marginal rate



- Unlimited time period it is a tax avoidance provision
- There is scope for an overreach by the ATO!
- Does not relate to capital distributions only income
- If section 100A operates, it will treat the "in form" beneficiary as not being presently entitled to the distribution that is being made to it. That means there is no beneficiary presently entitled to the distribution which will result in the trustee being assessed on the distribution under s.99A at a rate of 47%.
- Some recent, and blatant examples where it does and should apply: distribution from the trust to pay school fees. School is tax exempt. Therefore school fees paid with pre-tax income.



Part IVA vs s100A

Feature	Part IVA	Section 100A
Purpose	Identifies and counteracts tax avoidance schemes.	Makes trustees liable for tax on income they distribute to beneficiaries under certain circumstances.
Key Requirements	 Scheme Tax benefit Sole or dominant purpose of the scheme is to obtain a tax benefit Fewer enabling provisions, but sole or dominant purpose (vs <u>a purpose</u>) 	 Agreement Benefit to another Tax reduction purpose Not ordinary family or commercial dealing Enabling provisions more complex – but tax benefit needs only to be <u>a purpose.</u>
Triggering Mechanism	Applies to a wide range of tax avoidance arrangements, not limited to trusts.	Specifically applies to discretionary trusts.
Tax Consequences	Tax can be imposed on any party involved in the scheme, including beneficiaries.	Tax on the income is assessed on the trustee at the marginal tax rate.
Penalties	Can attract additional penalties for tax avoidance.	No additional penalties beyond the tax liability.



PCG 2022/2 examples

RED ZONE (high risk)

- Low tax adult beneficiary, made presently entitled to trust income, not receiving the true economic benefit – gift or loan back
- Low tax adult beneficiary made presently entitled to income, offset against payments by the parent whilst beneficiary was a minor

GREEN ZONE (low risk)

- UPEs repaid within 2 years
- UPEs for more than 2 years, used in working capital or to fund an asset, on commercial terms
- Distribution by a parent to fund house deposit of adult child
- Distribution to a company with losses
- Cultural or custom giving a point of contention // be careful

Also follows a sniff test, e.g., what is the compliance history of the beneficiaries?

WHITE ZONE (no ATO compliance action)

Pre 2014 (i.e., there is some retrospective application – only as it relates to the ATO website)

PART B: WHAT IS THE CURRENT LAY OF THE LAND?



What is the current lay of the land?

- Law around since 1978
- 2022
 - Draft PCG
 - Draft TR
 - Taxpayer alert
- Highly contentious debate
- First hearings of Guardian and BBlood
- Finalised rulings and PCG
- Appeal decisions of Guardian and BBlood
- Ultimate state of flux; but we know what the ATO thinks
- 'Ordinary family dealings' not meaningfully ventilated before the courts

PART C: WHAT IS THE CONTEXT OF THE JUDGEMENTS AND THE ATO RULINGS



What is the context of the judgements and the ATO rulings

- Highly contentious
- Not telling you what to do
- Advisors need all knowledge and context
- Guardian and BBlood this is getting harder, not easier
- Part IVA



What is the context of the judgements and the ATO rulings cont'd...

The taxation ruling system was introduced as a method of publishing and disseminating decisions on interpretation of the law administered by the Commissioner of Taxation.

- Method of Commissioner expressing opinion to general public
- Idea: to provide clarity and mitigate uncertainty
- But: lore, now law. Expression of opinion Key to the context
- The Court places little probative value on rulings as they are seen as just one party's view of the application of the applicable law. **note recent case in Tribunal**
- BUT can provide relief and procedural fairness **by 'protecting you from increases in tax'** (subsection 357-5(2)(d) of the TAA 1953).



- Useful for taxpayers in Court proceedings if they help a taxpayer's case, the taxpayer should seek to rely on the ruling and draw the ruling to the Commissioner's attention (noting that the Commissioner is bound by the ruling). If the ruling is not helpful to the taxpayer, the taxpayer should look to argue that the ruling is not binding and merely the Commissioner's view on the application of the law.
- A taxpayer is deemed to have relied upon a ruling if they act in accordance with the ruling, even if they were unaware of the existence of the ruling (subsection 357-60(1) of the TAA 1953).



• There are generally two parts to a public ruling: the ruling and the explanation. The ruling itself is binding on the Commissioner; however, the explanation section is not.

Public rulings bind the Commissioner from the time it is published and cannot retrospectively apply to taxpayers. Public rulings must contain a subject heading and a number for identification and will apply from the time it is published.



General

"They are intended to be an 'early warning' of significant new and emerging higher risk tax planning issues or arrangements that the ATO has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed."



TA 2022/1

23. We are concerned that taxpayers are entering into these arrangements to avoid tax on the net income of the trust by utilising the lower marginal tax rate applying to the Children in circumstances where the benefit from these arrangements is, in substance, enjoyed by the Parents as:

- the Children are paying amounts for expenses that would ordinarily be met by their Parents, or
 - the Children's entitlements are otherwise being applied for the benefit of the Parents either directly, or by the charging of excessive amounts, and/or
 - there are elements of contrivance.



24. From our review of these arrangements, we consider that the following consequences may arise:

- the purported entitlement of the Children to trust income may be a sham or otherwise ineffective for trust law purposes
 - the arrangement may constitute a reimbursement agreement under section 100A of the *Income Tax Assessment Act 1936* (ITAA 1936)
 - subsections 95A(1) and 97(1) of the ITAA 1936 may apply to treat the Parents as presently
 entitled where the means by which the trustee permits the use of the funds evidences the
 exercise of a discretion to pay or apply those amounts to the Parents (notwithstanding that
 the appointments are recorded as 'beneficiary loans'), or
 - the general anti-avoidance provisions in Part IVA of the ITAA 1936 could apply.



- Loans for Div7A purposes?
- *Bendel* (taxpayer succeeded; now on appeal) Tribunal held:
 - 'a loan within the meaning of s109D(3) does not reach so far as to embrace the rights in equity created when entitlements to trust income (or capital) were created but not satisfied and remained unpaid. The balance of an outstanding or unpaid entitlement of a corporate beneficiary of a trust, whether held on a separate trust or otherwise, was not a loan to the trustee of that trust.'



- *'Real and genuine consideration' vs truly unfettered discretion*
- Fiduciary duty still applies



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