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Tax Insights

New ATO guidance for private and family groups

Snapshot

On 23 February, the ATO released a number of long-awaited guidance products for private and family groups with a particular focus on trust arrangements. These products are:

- TR 2022/D1 - Section 100A reimbursement agreements
- PCG 2022/D1 - Section 100A reimbursement agreements – ATO compliance approach
- TA 2022/1 - Parents benefitting from the trust entitlements of their children over 18 years of age ; and
- TD 2022/D1 - Division 7A: when will an unpaid present entitlement or amount held on sub-trust become the provision of 'financial accommodation'?

Apart from the Tax Alert, the guidance products are in draft form and consultation is open until 8 April 2022.

TR 2022/D1 - Section 100A reimbursement agreements

Broadly Section 100A[1] is an income tax anti-avoidance provision that may apply when a trust beneficiary is made presently entitled to a share of income of the trust estate that **arose out of, or in connection with**, **a reimbursement agreement;** being an arrangement:

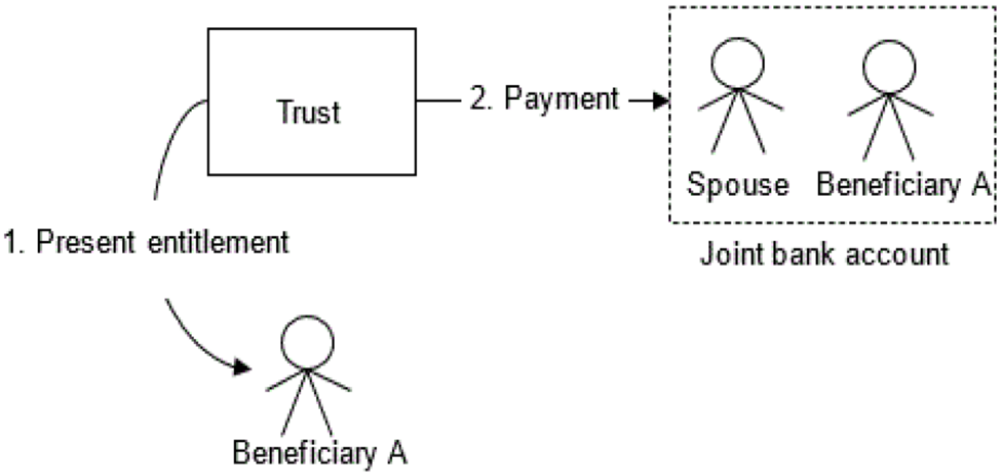
- Involving a **benefit being provided to another person**
- Intended to have the result of **reducing someone's tax liability**, and
- Entered into **outside the course of ordinary family or commercial dealings**.

When finalised, the Ruling is intended to apply to trust arrangements both before and after its issue.

The ATO have provided a number of examples in the guidance products to illustrate the broad operation and scope of Section 100A.

Example of a basic reimbursement agreement (but excluded under the ordinary family or commercial dealing exception)[2]

Diagram 1



The Rosegum Family Trust is controlled by spouses, Lisa and Matthew Rosegum, who are the primary beneficiaries of the trust. The trust has a widely drawn objects clause which includes family members of Lisa and Matthew and their related entities.

Each year, the trust makes Lisa presently entitled to the income of the trust. Funds paid to Lisa are mixed with Matthew's funds (for example, paid to a joint bank account) or used for joint family purposes, and/or benefit a person who is a dependent of the beneficiary.

Lisa and Matthew have shared financial responsibilities and fund their lifestyle from a common pool of assets. Absent any additional factors taking the arrangement beyond those ordinarily encountered in the organisation of financial affairs between spouses, the arrangement would likely be entered into in the course of ordinary dealing.

This basic example has historically not attracted compliance activities from the ATO.

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[1] Income Tax Assessment Act 1936
[2] Example compiled from two similar examples within PCG 2022/D1(p.5) and TR 2022/D1 (p.22)

Connection requirement

For Section 100A to apply, a relevant connection is required between the trust beneficiary's present entitlement and the relevant reimbursement agreement.

The draft ruling notes that an exact understanding of the nature and extent of the reimbursement agreement (or of its benefits) is not required between all of its parties, and the agreement can be a plan comprising a series of steps undertaken individually or collectively by those parties over a period of time.

Further, that agreement must have been in existence prior to the entitlement arising (or before the resulting payment or application of income). However, neither the presently entitled beneficiary nor the trustee needs to necessarily be a party to the agreement or even in existence when the agreement is made. This is surprising and potentially widens the application of the reimbursement rules considerably.

Benefits provided to another person

A reimbursement agreement must provide for:
- The payment of money including
  - Loans; or
  - The release, abandonment, failure to demand payment of, or
  - The postponing of the payment of a debt; or
- Transfer of property to; or
- Provision of services; or
- Other benefits

for one or more persons other than the beneficiary alone.

The draft ruling notes that an agreement that a trust beneficiary will not demand payment of their present entitlement would represent the provision of a benefit for the purposes of a reimbursement arrangement.

There is no requirement that the relevant benefit provided to a person other than the beneficiary alone, be sourced from, equal to or otherwise be referrable to the share of trust income the beneficiary is presently entitled to receive, was paid or that was applied on their behalf.

A tax reduction purpose

The draft ruling states that one or more of the parties to the agreement must have entered into it for a purpose (which need not be a sole, dominant or continuing purpose) of securing that a person would be liable to pay less tax in an income year than they otherwise would have been liable to pay. This can include a purpose of deferring a party's tax to a later income year.

It is not necessary that the person impacted by the tax reduction is a party to the agreement, nor is it necessary for the reduction in tax liability to be achieved.

Importantly, where a party acts in accordance with advice from an adviser, the purpose of that adviser can be imputed to the party.

Ordinary family or commercial dealing exception

Agreements 'entered into in the course of ordinary family or commercial dealing' are not reimbursement agreements for the purposes of section 100A.

The draft ruling (and the associated PCG and Tax Alert) are of particular import given that the term 'ordinary family or commercial dealing' is undefined, which the ATO states is an "evaluative standard" to be applied to the facts of each case.

The ATO view is that a dealing is not an ordinary family or commercial dealing merely because it is commonplace or involves no artificiality. It is does not apply simply because all parties to an agreement are family members. To be in the course of 'ordinary dealing', the transactions between family members and their entities must be capable of explanation as achieving normal or regular familial or commercial ends.

Nevertheless, the absence of dealings at arm's length or market value does not, of itself, prevent a dealing from being explained as achieving the ordinary commercial objectives of the parties to the transactions.

The ATO considers that the presence of features in an agreement which appear to be tax driven are relevant to the objective enquiry to determine whether an agreement is entered into in the course of ordinary dealing.

In the explanatory notes, the ATO states that the following features may indicate that a dealing that is being tested is not an ordinary dealing, as the transactions cannot be properly explained without reference to the purpose of avoiding tax. The factors are not exhaustive and no one factor is decisive:

- An arrangement, or part of an arrangement, has artificial or contrived features, taking into account:
    - The manner in which the arrangement was carried out;
    - Whether there was a more direct way to achieve the family or commercial goals; for example, **could the arrangement instead have provided the benefit to the person who actually benefited, more simply or directly, such as by making that person presently entitled to trust income**; and
    - The complexity of the arrangement (noting that 'complex' does not necessarily mean 'artificial').

- There is conduct or circumstances inconsistent with the legal or economic consequences of the beneficiary's entitlement; for example:
    - It appears unlikely that beneficiaries will ultimately receive their trust entitlements, which may occur when:
        - Assets or funds representing the entitlement are purportedly lent to others without any intention of being returned or repaid;
        - Funds representing the entitlement are invested in ways inconsistent with that entitlement; or
        - Funds representing the entitlement are dealt with in a way that is inconsistent with the beneficiary's right to demand the entitlement;
    - Beneficiaries are not compensated for being kept 'out of the money' (for example, by way of interest, although noting that loans without interest may, depending on the cultural and other familial circumstances, qualify as an ordinary dealing);
    - Beneficiaries are not informed of their entitlements;
    - Where income entitlements have actually been remitted to the beneficiary, amounts were subsequently returned or other benefits or services were provided, by way of gift or otherwise to another person (such as the trustee, another beneficiary, or an associate, whether by:
        - The beneficiary or by the trustee either independently or under a power of attorney); and
        - Income entitlements have not been remitted to the beneficiary, and the reasons given are false having regard to the reasons given for the purported distribution.

- The proportion of the trust net income distributed to the beneficiary as compared to other beneficiaries; and

- The relationship between the beneficiary, settlor, trustee, and default beneficiaries.

Consequences

Where section 100A applies,

- The beneficiary is deemed not to be, and never to have been presently entitled to the trust income
- The relevant trust income is deemed not to have been paid or applied to the beneficiary.

This does not allow for the entitlement to be treated as having arisen for another person (such as a default beneficiary)[3]. Generally, the trustee will be liable to tax[4] at the top marginal rate of the relevant trust entitlement[5].

Where a beneficiary would otherwise be 'specifically entitled' to a capital gain or franked distribution, in the ATO's view, the operation of section 100A will result in no beneficiary being specifically entitled to that gain or distribution and will result in an allocation according to the parties' adjusted Division 6 percentages (as relevantly modified by the application of section 100A), within the meaning of the streaming rules.[6].

Comment

The settled view of various aspects of section 100A is currently subject to litigation. The decision of the Federal Court in *Guardian AIT Pty Ltd ATF Australian Investment Trust v Commissioner of Taxation [2021] FCA 1619* referenced several times in the draft ruling, which was decided in favour of the taxpayer, is the subject of an appeal.

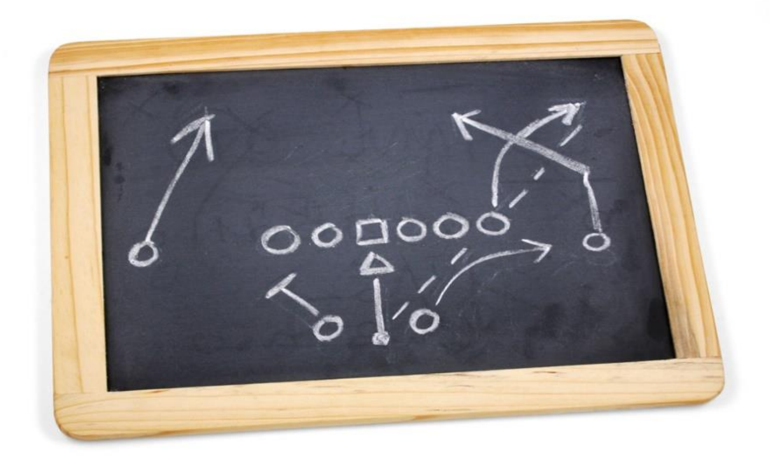
PCG 2022/D1 - Section 100A reimbursement agreements – ATO compliance approach

The ATO has also released its draft compliance guideline and risk assessment framework in relation to Section 100A reimbursement agreements.

When finalised, this Guideline is proposed to apply to present entitlements to income of a trust estate conferred before or after its date of issue. However, for entitlements conferred before 1 July 2022, the Commissioner will stand by any administrative position reflected in the ATO's web guidance Trust taxation – reimbursement agreement, which was first published in July 2014 to the extent it is more favourable to the taxpayer's circumstances than the PCG.

Breadth of dealings potentially within Section 100A

To illustrate the potential scope of Section 100A, the PCG notes that *prima facie*, an agreement that includes the creation of a present entitlement to funds that are retained by a trustee will satisfy the basic elements of the definition of a reimbursement agreement, as it will involve a present entitlement and the provision of a benefit to the trustee.



[3] Paragraph 99 TR2022/D1
[4] Paragraph 35 TR2022/D1
[5] Without the benefit of the 50% CGT discount on any capital gains that the trust has derived or realised, or is taken to have derived or realised, in that income year.
[6] See Paragraph 37,105 & 106 TR2022/D1. An alternate view is noted in Paragraphs 168 to 171

ATO's risk assessment framework

A risk assessment framework sets out the Commissioner's view on the level of compliance risk. This Guideline denotes the different risk ratings according to four coloured zones.

Risk Zone	ATO treatment	Example arrangements
White Low risk	The ATO will not commence any new compliance activities to consider the application of section 100A for income years ended before 1 July 2014, unless it is outside the green zone and: • they are otherwise considering your income tax affairs for those years • you have entered into an arrangement that continues before and after that date, or • the trust and beneficiary tax returns that were required to be lodged for those years were not lodged before 1 July 2017.	
Green Low risk	The ATO will not dedicate compliance resources to consider the application of section 100A to green zone arrangements, other than to confirm that the features of the relevant scenario are present in your circumstances. Taxpayers should document how your circumstances meet the requirements for the green zone.	An individual beneficiary is made presently entitled to income of the trust estate and the funds paid to the beneficiary are mixed with their spouse's funds (for example, paid to a joint bank account) or used for joint family purposes, and/or benefit a person who is a dependent of the beneficiary.
		A beneficiary that is an individual or a private company is made presently entitled to income of the trust estate and there is a 'trustee retention of funds for use: • In the working capital of a business that it actively carries on; • For the acquisition, maintenance or improvement of investment assets of the trustee; and/or • 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.
Blue Medium	The ATO may contact you to understand your arrangement and resolve any areas of difference including whether section 100A applies to your arrangement. The ATO suggests that taxpayers can engage with them by emailing ReimbursementAgreement@ato.gov.au to assist with determining what (if any) modifications to your arrangement may be appropriate.	Arrangements involving the retention of funds by the trustees if they have one or more of the following features: • The arrangement is a red zone arrangement; • The beneficiary makes a gift of their trust entitlement or an associated amount receivable from the trust (e.g., conversion into a loan); • The beneficiary disclaims their entitlement or forgives or releases the trustee from its obligation to pay their trust entitlement or an associated amount receivable from the trust;

		• The income of the trust estate is less than the net income as a result of the trustee exercising a power, or the deed being amended, to affect the quantum of income of the trust estate;
		• A beneficiary's trust entitlement is satisfied by payments that are sourced from that beneficiary, or a beneficiary's trust entitlement has been made subject to a loan agreement and the repayments of that loan are sourced from payments or loans from that beneficiary. For example,
		    • Where a dividend payable by a corporate beneficiary to the trustee is set-off against the amount payable by the trust;
		    • Where the trustee issues units in the trust to the beneficiary and the amount owed for the units is set-off against the amount payable by the trust; or
		    • Where the trustee is made entitled to income of another trust that is comprised of franked distributions paid by the beneficiary;
		• The arrangement involves one or more features that may be explicable by a tax avoidance purpose.

Red High risk	The ATO will conduct further analysis on the facts and circumstances of your arrangement as a matter of priority. If further analysis confirms the facts and circumstances of your arrangement are high risk, they may proceed to audit where appropriate. If you have an arrangement in the red zone, the ATO recommends taxpayers engage by emailing ReimbursementAgreement@ato.gov.au.	Where the: • Beneficiaries' entitlements appear to be motivated by sheltering the trust's (taxable) net income from higher rates of tax; • Arrangement involves contrived elements directed at enabling someone other than the presently entitled beneficiary to have use and enjoyment of the economic benefits referable to the trust net income. Examples include: 1. Arrangements where the presently entitled beneficiary lends or gifts some or all of their entitlement to another party and there is a tax benefit obtained under the arrangement; 2. Arrangements where trust income is returned to the trust by the corporate beneficiary in the form of assessable income and the trust obtains a tax benefit; 3. Arrangements where the presently entitled beneficiary is issued units by the trustee (or related trust) and the amount owed for the units is set-off against the beneficiary's entitlement; 4. Arrangements where the share of net income included in a beneficiary's assessable income is significantly more than the beneficiary's entitlement; 5. Arrangements where the presently entitled beneficiary has losses; and 6. Arrangements subject to a Taxpayer Alert i.e., TA 2022/1

TA 2022/1 - Parents benefitting from the trust entitlements of their children over 18 years of age

The ATO issues Tax Alerts to the market from time to time to provide an early warning of their concerns about new or emerging higher risk tax arrangements that they have under risk assessment.

TA 2022/1 describes trust arrangements where parents enjoy the economic benefit of trust income appointed to their children who are over 18 years of age. The common feature of the arrangements is that trust income is appointed between members of the family group but in substance it is the parents who exercise control over and enjoy the economic benefit of the income.

While the Alert specifically considers arrangements involving the children of controlling individuals, similar arrangements involving other family members of controlling individuals that would have lower marginal tax rates than those of the controlling individuals are also subject to ATO concerns.

This particular alert is consistent with the messaging within the PCG and TR about arrangements which would **not** fall under the ordinary family and commercial dealing exception within Section 100A (reimbursement agreements).

The arrangements may display all or most of the following features:

- The trustees of a discretionary trust, or the directors of a corporate trustee, are either one or two individuals who are the parents in a particular family;
- Income derived by the Trust is used during the year of derivation to meet the expenses of the Parents. These may be recorded as beneficiary loans made from the trustee to the Parents throughout the year;
- Resolutions of the trustee for the year show one or more of the children presently entitled to a share of the income of the Trust;
- The entitlements are for substantial amounts but do not generally result in the children's taxable income exceeding the threshold for the top marginal tax rate ($180,000);
- Amounts are not paid to the children. Rather, at the actual or purported direction of the children, the entitlements are satisfied by the amounts being either:
  - Paid to their parents, or
  - Applied against any beneficiary loans owed by the parents;
- The parties contend that the entitlements are paid or applied in this manner because:
  - The children are required to repay their parents for expenses incurred **in relation to their upbringing or while they were minors** (for example, school fees, school uniform costs or their share of the family holidays);
  - The children are required to pay or repay their parents amounts to meet their share of family costs for the current year **in excess of amounts** it would reasonably be expected an adult child would meet for their personal living expenses while they remain living at home or otherwise supported to some extent by their parents (those amounts being, for example, a reasonable rate for their board, lodgings or rent if living away from home, or car expenses); or
  - There is an agreement that the parents will manage the pooled family members' entitlements from the Trust for the benefit of the family members;
- There is no expectation or understanding that the children's income they derive from sources other than the Trust distributions will be used to either repay their parents for expenses incurred when they were a minor or pay more than their reasonable share of the household expenditures or be placed in a pool to be managed by the Parents for the benefit of the family members.

The ATO notes that there may be no contemporaneous evidence of the claimed obligation of the children to repay their Parents. In addition, the Children may or may not be aware of their purported entitlements, or obligations, or the application of their entitlements against relevant expenses incurred on their behalf by their Parents.

Deloitte comments
It is a common feature of many family trusts whereby distributions are made to adult children (e.g., University students). It should be noted that what is a reasonable share of family costs will vary depending on family circumstances. Private and family groups should review their arrangements as soon as possible, particularly where their arrangements have some or all of the characteristics mentioned in the Alert.

TD 2022/D1 - Division 7A: when will an unpaid present entitlement or amount held on sub-trust become the provision of 'financial accommodation'?

Within private and family groups, it is common practice for trustees to appoint trust income to a related private company beneficiary and either:

- That entitlement remains unpaid (an unpaid present entitlement (UPE)); or
- The trustee sets aside an amount from the main trust fund (main trust) and holds it on a new separate trust (sub-trust) for the exclusive benefit of the private company beneficiary.

These arrangements may subsequently fall within Division 7A[7] where either:

- the trust does not make a distribution of the entitlement to that private company and the Commissioner may deem that amount to be a loan or another form of financial accommodation for the purposes of Division 7A; or

- the trust itself makes relevant payments, loans, or forgives amounts to the private company's shareholders or their associates whilst also maintaining a UPE in favour of that private company.

In this respect the Commissioner 's interpretation of what constitutes a form of financial accommodation has changed significantly since 1997 when Division 7A was introduced. Initially a UPE was not considered a debt (and he introduced Subdivision EA) and on or around 2009 changed his view on the characterisation of a UPE. This then required taxpayers to convert UPEs conferred on private companies into a complying Division 7A loan or adopt a sub trust approach (as outlined in PSLA 2010/4 and TR 2010/3).

The draft Determination acknowledges that the phrase 'financial accommodation' in paragraph 109D(3)(b) has a wide meaning but removes some of the timing concessions provided in PSLA 2010/4 and TR2010/3. It does this adopting a view that the UPE becomes a Division 7A loan at the time an entity with a trust entitlement has knowledge of a quantifiable amount that it can demand and does not call for payment.

When finalised, it is proposed the TD will apply to trust entitlements arising on or after 1 July 2022.

Unpaid present entitlements

The draft determination states that a private company beneficiary with a UPE, consents to the trustee retaining that amount to continue using it for trust purposes if the company:

- has knowledge of an amount that it can demand immediate payment of from the trustee, and

- does not demand payment.

This constitutes the provision of financial accommodation to the trustee under paragraph 109D(3)(b). As a result, the private company beneficiary makes a loan to the trustee under the extended definition of a 'loan' in subsection 109D(3), when the financial accommodation is provided.

This will occur at the point in time when the private company beneficiary has knowledge of an amount that it can demand immediate payment of from the trustee and does not demand payment of the amount. The ATO considers the time when the amount of a beneficiary's entitlement is known will depend on how that entitlement is expressed.

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[7] Part III of the Income Tax Assessment Act 1936

Beneficiary entitlement	Timing entitlement known
A fixed amount of trust income	Immediately as able to demand immediate payment of that amount from the trustee
A percentage of trust income, or identified in a calculable manner	Typically after the end of the income year, as able to demand payment when the trust income is calculated.

Consequently where the trustee's distribution resolution on 30 June determines a fixed amount to be payable to the corporate beneficiary, the earliest time the Division 7A loan arises is at that time.

By way of contrast, where the trustee distribution resolution does not quantify an amount but is expressed in another form (e.g. 100% of the trust income, or the balance of the trust income) then the Division 7A loan is deemed to arise when the amount is quantified, and the relevant private company is considered to have knowledge of that amount.

In this respect, assuming there is a 'controlling mind', it appears the Commissioner adopts the view that on the determination of a present entitlement and the amount being calculated as fixed sum there is a right to demand payment and therefore a Division 7A loan arises.

By way of contrast, under the current rules, the UPE does not constitute a Division 7A loan unless and until the trust's tax return is due to be lodged at which point if it has not been paid or entered into a sub-trust arrangement it becomes a loan for the purposes of Division 7A

Sub trust arrangements

The draft TD explains that where a private company beneficiary is made presently entitled to trust income and the trustee sets aside an amount from the main trust and holds it on sub-trust for the exclusive benefit of the private company beneficiary, the present entitlement to income is paid and there is no UPE.

The amount set aside by the trustee ceases to be an asset of the main trust and forms the corpus of the sub-trust (the sub-trust fund). The trustee's obligation in respect of the entitlement to distributed income comes to an end and a new obligation arises for the sub-trustee under a separate trust.

Whilst the private company beneficiary has a new right to call for payment of the sub-trust fund, a choice by the private company not to exercise that right does not constitute financial accommodation in favour of the trustee in its capacity as trustee of the sub-trust, because the sub-trust fund is held for private company beneficiary's sole benefit. We understand this to mean that all future income and capital gains attributable to the funds held in the sub trust are held for the benefit of the company.

However, where the private company beneficiary by arrangement, understanding or acquiescence, consents to the sub-trustee allowing those funds to be used by the private company beneficiary's shareholder or their associate (including the main trust itself if:

- All or part of the sub-trust fund is used by that entity, and
- The private company beneficiary has knowledge of this use.

The ATO is of the view that **this constitutes the provision by the private company beneficiary of financial accommodation to the entity using the sub-trust fund** under paragraph 109D(3)(b). This will be the case whether or not the use of the sub-trust fund is on commercial terms. ***As a result, the private company beneficiary makes a loan to the entity using the sub-trust fund under the extended definition of a 'loan' in subsection 109D(3),*** when the financial accommodation is provided; that is, the point in time when the private company beneficiary has knowledge of the use of an amount of the sub-trust fund and does not call for payment of that part of the sub-trust fund by the private company beneficiary's shareholder or their associate.

In essence the Division 7A loan arises at that point of time and the trust and private company beneficiary need to put the loan on complying terms.

Arrangements involving pre-1 July 2022 trust entitlements

It is proposed to withdraw existing guidance in TR 2010/3 and PS LA 2010/4 with effect from 1 July 2022. In that guidance it was accepted that a private company beneficiary did not provide 'credit or any other form of financial accommodation' to a trustee where the funds representing a UPE were held on sub-trust and re-invested in the head trust on particular terms.

The ATO will not devote compliance resources to sub-trust arrangements that correspond to the guidance in TR 2010/3 and PS LA 2010/4 where the trust entitlement has been created on or before 30 June 2022. For the avoidance of doubt, this would include a sub-trust arrangement commenced on or after 1 July 2022 in respect of a trust entitlement arising before that date.

The ruling provides timelines of when financial accommodation arrangements should be put in place to comply with Division 7A.

Comments and next steps

The proposed changes to the treatment of UPEs for the purposes of Division 7A do not apply to entitlements created prior to 1 July 2022 and existing arrangements continue to benefit from the treatment prescribed in TR 2010/3 and PSLA 2010/4.

However, for entitlements arising after 30 June 2022, the ability to enter into certain sub-trust arrangements as described in PSLA 2010/4 (essentially 7-year or 10-year interest only 'loans') will end which potentially brings forward the timing of when Division 7A loans are recognised.

Further, going forward, these changes potentially call into question how subdivision EA and EB may apply for relevant payments, loans, and forgiveness from the distributing trusts especially if there are no pre-December 2009 UPEs or sub-trust arrangements in place.

Pleasingly, the draft TD continues the practice of sheltering pre-16 December 2009 UPEs from Division 7A. Nevertheless, the potential application of section 100A (noting the concessional approach in PCG 2022/D1) will need to be considered.

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