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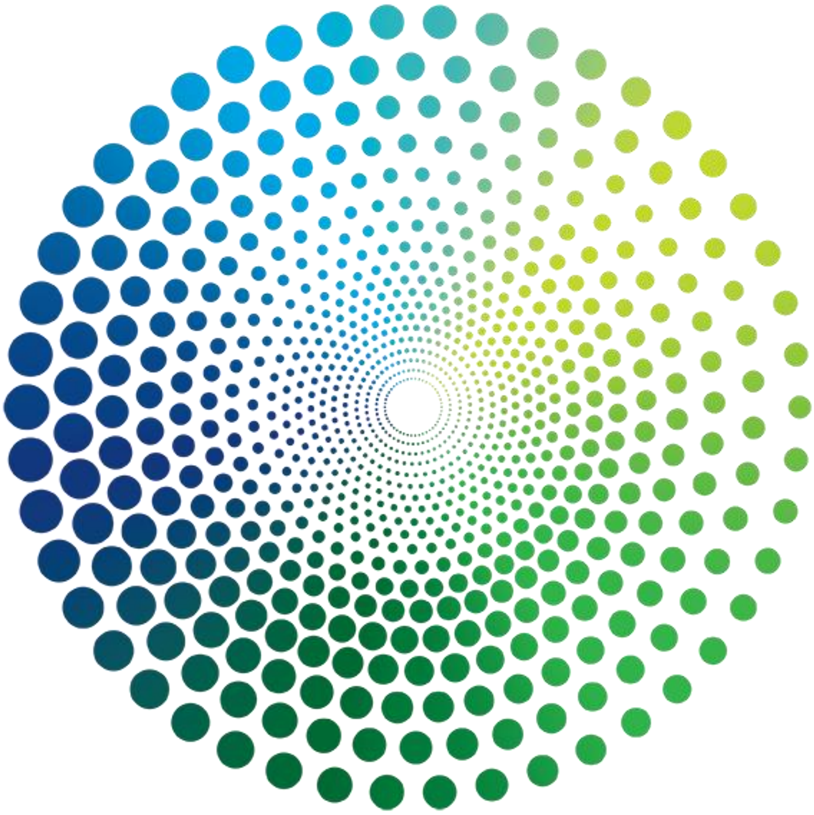

Tax Insights

ATO finalizes rulings on tax treatment of amounts from nonresident trusts

Snapshot

On 27 November 2024, the Australian Taxation Office (ATO) released the following guidance:

- TD 2024/9 Income tax: factors taken into account applying paragraphs 99B(2)(a) and (b) of the Income Tax Assessment Act 1936; and
- PCG 2024/3 Section 99B of the Income Tax Assessment Act 1936 – ATO compliance approach.

Key takeaways

Renewed focus and broader application

The focus by the ATO on section 99B, despite the provision being over 45 years old, has increased over recent years. The Commissioner of Taxation ("the Commissioner") is applying the provision more broadly than historically understood, potentially capturing common family arrangements.

Compliance framework

The ATO has established parameters for low-risk arrangements:

- Deceased estates: Distributions under AUD 2 million within 24 months of death.
- Commercial arrangements: Market-rate terms with contemporaneous documentation.

Documentation burden

Record-keeping requirements are stringent, with the onus entirely on beneficiaries to prove reductions under the exceptions to section 99B in subsection 99B(2). Failure to maintain adequate documentation may result in full taxation of distributions, regardless of their true character.

Practical implications

Early planning and contemporaneous record-keeping are essential. The challenges of obtaining historical documentation from overseas trustees, combined with the ATO's strict evidentiary requirements, make retroactive compliance particularly difficult.

Legislative uncertainty

The interaction between section 99B and subsequent tax provisions remains unclear. The provision's broad scope, combined with limited judicial guidance, creates uncertainty for practitioners and taxpayers.

These factors highlight the importance of proactive compliance strategies and early professional advice, particularly for families with overseas connections or those planning international moves. While the ATO's guidance provides some clarity, the fundamental issues with section 99B's design continue to create practical challenges in its modern application.

Who this affects

The new guidance on section 99B is particularly relevant for:

- Multinational high-net-worth families;
- Australian residents receiving distributions from overseas trusts;
- Beneficiaries of foreign deceased estates;
- Trustees and advisors managing cross-border trust arrangements; and
- Public funds management entities with nonresident trust structures.

Background

Section 99B requires an Australian resident beneficiary to include in their assessable income an amount of trust property that is paid to, or applied for their benefit. The provision was introduced to address foreign-source income following the *Union Fidelity Trustee Co of Australia Ltd v FCT* (1969) 119 CLR 177, which limited division 6 application to Australian-source income.

For present purposes, the provision contains two key exceptions:

- The "corpus exception"—excludes trust corpus unless attributable to amounts that would have been assessable to a hypothetical resident taxpayer; and

- The "non-taxable exception"—excludes amounts that would not have been assessable to a hypothetical resident taxpayer.

ATO’s binding tax determination in respect of the application of the hypothetical resident taxpayer tests

Scope of the determination

TD 2024/9 provides guidance on the ATO’s approach to the hypothetical resident taxpayer tests contained in paragraphs 99B(2)(a) and (b) (the corpus exception and non-taxable exception, respectively). The determination applies both prospectively and retroactively, other than for taxpayers who have existing settlements with the ATO.

Application of the hypothetical taxpayer test

The ATO’s view is that Australian residency is the only relevant characteristic when applying the hypothetical taxpayer test.

According to the determination, the hypothetical taxpayer's entity type is irrelevant, which means specific tax attributes such as marginal rates, the capital gains tax (CGT) discount, and small business concessions cannot be considered. The ATO has noted, however, that certain provisions, such as the division 128 cost base rules for deceased estates, remain applicable.

Circumstances giving rise to the relevant amount

In applying the hypothetical resident taxpayer test, the ATO's position is that certain factual circumstances must be examined to determine whether, and to what extent, an amount would be assessable. Without considering these specific facts about the tested amount, the ATO maintains it would be impossible to make a proper assessment.

For capital asset distributions, the acquisition details and initial tax attributes, including cost base, are relevant circumstances. The determination states that pre-CGT asset status (acquired before 20 September 1985) will be recognized. Notably, the ATO's view is that post-acquisition actions by the trustee, including changes in ownership structure or trust residency, are irrelevant to the assessment.

Source of the distribution

According to ATO, taxpayers are required to trace and understand the complete history of how particular amounts became trust assets. This involves examining the origin and character of funds or property at the time they entered the trust, rather than just their status at the time of distribution. For example, if a distribution represents the proceeds from the sale of a capital asset, taxpayers need to understand how and when that asset was originally acquired by the trust, as well as any relevant tax attributes at that time. This is because the corpus exception's application depends on whether the underlying amounts making up the corpus would have been assessable to a hypothetical resident taxpayer when originally derived.

The ATO's position on this tracing requirement has significant practical implications, as it may require beneficiaries to obtain and maintain detailed historical records about trust assets and transactions, potentially spanning many years before the actual distribution.

Comments

The ATO's final determination TD 2024/9 addresses many questions around the hypothetical resident taxpayer test, though adopts a less concessional position than many practitioners had hoped. While the determination provides welcome clarity through additional examples and refined analysis, particularly regarding pre-CGT assets and trust residency changes, it maintains the main conclusions from the draft version of the determination.

The ATO’s position on paragraphs 99B(2)(a) and (b) requires examining how property became a trust asset. This approach means beneficiaries need robust evidence tracing trust property origins.

ATO compliance approach—PCG 2024/3

Application

PCG 2024/3 sets out the ATO’s compliance approach to section 99B when resident beneficiaries receive distributions from nonresident trusts. The practical compliance guideline (PCG) covers direct distributions from nonresident trusts and distributions of property that was accumulated during periods when the trust was a nonresident.

While section 99B technically applies to untaxed amounts from both resident and nonresident trusts, the ATO has indicated that its compliance activities will focus on distributions of property accumulated during periods of nonresidency.

The guideline has both prospective and retroactive application, meaning its principles apply to past distributions as well as future arrangements.

Overview

The ATO's guidance addresses three main areas in applying section 99B.

- First, it examines common scenarios where section 99B considerations arise, with particular attention to distributions from nonresident trust estates and deceased estates.
- Second, the guideline outlines the practical record-keeping requirements necessary to support reductions under subsection 99B(2). These requirements are crucial for beneficiaries seeking to reduce amounts that would otherwise be included in their assessable income.
- Third, it details the ATO's compliance framework, identifying arrangements the Commissioner considers low risk and specifying the documentation needed to substantiate this status. This risk-based approach provides greater certainty for trustees and beneficiaries in managing their tax obligations.

Examples

A critical aspect of PCG 2024/3 relates to the timing of distributions from nonresident trusts.

Example 7 from the PCG illustrates this important principle:

> *During the 2025 income year, Christine migrates to Australia and becomes a resident for tax purposes. A week before Christine migrates, her father in his capacity as trustee of a non-resident trust, distributes $500,000 to Christine to assist her with the move.*
>
> *The non-resident trust has been in existence for many years and the profits generated are normally reinvested in the trust assets.*
>
> *As Christine has received an amount of trust property from a non-resident trust during a year of income in which she is a resident of Australia for tax purposes (at any point during the income year), she needs to consider the application of section 99B with respect to the 2025 income year, including whether one of the reductions in subsection 99B(2) apply.*

This example demonstrates a fundamental principle: distributions received before becoming an Australian resident may still fall within section 99B's scope if received in the same income year as residency commences.

This creates significant implications for pre-migration tax planning, as the timing of distributions relative to both residency changes and the Australian income year becomes crucial. The principle would logically extend to other trust benefits, including the use of trust assets or properties.

Early professional advice is essential for individuals planning to migrate to Australia who may receive trust distributions or benefits.

Record keeping

The PCG acknowledges the practical challenges beneficiaries face in obtaining documentation from nonresident trustees, particularly given jurisdictional barriers and relationship dynamics. However, the ATO's position remains firm: resident beneficiaries must substantiate any claimed reductions under subsection 99B(2).

The core documents sought by the ATO include:

- The signed trust deed or will;
- Trustee resolutions or distribution statements confirming corpus distributions; and
- Financial accounts prepared under the relevant jurisdiction's accounting principles

Failure to provide adequate evidence may result in the ATO treating the entire distribution as assessable income. Given these significant consequences, beneficiaries receiving distributions from nonresident trusts should:

- Proactively maintain comprehensive records from the outset;
- Document attempts to obtain information from overseas trustees; and
- Consider engaging early with advisors to identify alternative forms of evidence where standard documentation is unavailable.

The PCG indicates that while the ATO understands the difficulties, it will not compromise on the requirement for objective evidence to support claimed reductions.

Low risk compliance approach to deceased estates

The ATO considers an arrangement will be low risk (and is unlikely to apply further compliance resources) in respect of a nonresident deceased estate where:

- The trust property, including cash or proceeds from the sale of trust assets, is distributed to the resident beneficiary within 24 months of the date of death; and

- The total value of trust property received, whether in multiple payments or in one lump sum payment, by the resident beneficiary does not exceed AUD 2 million at the time the amount is paid or applied to the resident beneficiary.

The compliance approach is confined to a nonresident deceased estate and does not extend to any testamentary trust established under the will of the deceased.

The beneficiary should obtain all relevant information and documentation to evidence that the amount received meets the criteria.

Low-risk compliance approach—provision of trust property on commercial terms

The ATO has established a practical framework for arrangements where resident beneficiaries borrow, hire, or use property from nonresident trusts. These arrangements will be considered low-risk where they operate on genuine commercial terms and meet specific criteria.

To qualify for low-risk treatment, the arrangement must be governed by an agreement (written or verbal) established on commercial terms, with the beneficiary making actual payments to the trustee equal to market rate interest, hire, or usage fees. The beneficiary must maintain documentation that objectively demonstrates the commercial nature of the arrangement from its inception.

For monetary loans, the ATO provides a simplified "safe harbor" option. Under this approach, arrangements using the division 7A prescribed rates and terms will generally be considered to be on commercial terms.

Comments

PCG 2024/3, while maintaining consistency with its draft version, reflects a rigorous approach to section 99B compliance. The introduction of specific low-risk thresholds for deceased estates (AUD 2 million within 24 months) and the division 7A safe harbor for commercial arrangements provides welcome certainty. However, these bright-line tests come with significant practical challenges.

The record-keeping requirements remain particularly demanding. While the ATO acknowledges the difficulties in obtaining historical documentation from nonresident trustees, it offers no practical concessions or alternative approaches. This creates significant challenges for beneficiaries dealing with long-standing family trusts or complex overseas structures, where documentation may span decades or cross multiple jurisdictions.

Of particular concern is the PCG's approach to tracing requirements. The burden of proving the character and source of distributions falls entirely on the beneficiary, with no de minimis thresholds or simplified approaches for smaller amounts. This may result in compliance costs disproportionate to the amounts involved, especially for historical family arrangements where complete records may not exist.

For practitioners and beneficiaries, early planning becomes crucial. The PCG's strict documentation requirements suggest that contemporaneous record-keeping should be prioritized from the outset of any nonresident trust arrangement, rather than attempting to reconstruct evidence when distributions occur. This is especially important given the ATO's position that insufficient evidence will result in full taxation of distributions.

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