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Navigating the Complexities of Section 100A: A Look at the Future of Trust Taxation in Australia

Charles Ho Wang MAK*

Abstract:
Section 100A of the Income Tax Assessment Act of 1936 is a provision designed to prevent arrangements in which a distribution is made to a beneficiary with a low tax rate, yet the economic benefit is conveyed or paid to a second beneficiary with a higher tax rate. The Australian Taxation Office provided its final guidance on this provision very recently. This article provides an overview of the guidance, analyses cases regarding the application of Section 100A, and assesses the guidance's potential future implications on trust taxation in Australia.

Introduction:
In Australia, the use of trusts to evade taxes has been a topic of controversy for years. The government has implemented section 100A of the Income Tax Assessment Act of 1936 to guarantee that trusts are taxed in a manner that accurately reflects their true nature. This provision is meant to prevent circumstances in which a beneficiary with a low tax rate receives a distribution, yet, the economic benefit is transferred or given to a second beneficiary with a higher tax rate. Section 100A achieves this by determining that the first beneficiary, who is now entitled to the trust's income, is not to be entitled if his or her present entitlement is the result of a 'reimbursement arrangement'. The trustee is then taxed at the highest marginal tax rate upon that income.

Recently, the Australian Taxation Office ('ATO') issued its final guidance on section 100A,[1] following consultations on draft versions earlier in 2022[2] and a Taxpayer Alert highlighting section 100A as a potential anti-avoidance rule that could apply in cases where parents benefit from the trust entitlements of their over-18-year-old children.[3] The final guidance provides the ATO's views on the four primary conditions for section 100A to apply, including the exception for 'ordinary family or commercial dealings'.[4] This article summarises the guidance, reviews

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[1] Australian Taxation Office, *Taxation Ruling TR 2022/4* (Australian Taxation Office 2022); and Australian Taxation Office, *Practical Compliance Guideline PCG 2022/2* (Australian Taxation Office 2022).
[2] Australian Taxation Office, *Draft Taxation Ruling TR 2022/D1* (Australian Taxation Office 2022); and Australian Taxation Office, *Draft Practical Compliance Guideline PCG 2022/D1* (Australian Taxation Office 2022).
[3] Australian Taxation Office, *Taxpayer Alert TA 2022/1* (Australian Taxation Office 2022).
[4] Australian Taxation Office, *Taxation Ruling TR 2022/4* (Australian Taxation Office 2022), para 5.

cases regarding the application of section 100A, and evaluates the guidance's potential future implications on trust taxation in Australia.

Overview of the Section 100A of the Income Tax Assessment Act 1936:

The current state of trust taxation in Australia is a complex and continually changing landscape. In Australia, trusts have long been a popular instrument for asset protection and wealth management, but their taxation regulations have experienced significant changes in recent years. The Taxation Laws Amendment (Trust Loss and Other Deductions) Act 1998, the Family Trust Distribution Tax (Primary Liability) Act 1998, and the Family Trust Distribution Tax (Secondary Liability) Act 1998 all contributed to the significant changes in the family trust distribution tax in Australia. These Acts established the family trust distribution tax rules, which apply to trusts that are classified as family trusts under Australian tax law. Despite these changes, trusts continue to be a popular asset protection and wealth management vehicle in Australia, particularly among high-net-worth individuals and their families. Nevertheless, trust taxation in Australia is complex and constantly evolving.

Section 100A of the Income Tax Assessment Act 1936 is a crucial provision governing the taxation of Australian trusts and trust distributions. This broad provision prohibits taxpayers from utilising trust structures to minimise their tax liabilities by addressing arrangements in which the economic benefit of a distribution is transferred or given to a second beneficiary with a higher tax rate. To achieve this, the provision determines the first beneficiary, who would ordinarily be entitled to the income of the trust, not to be presently entitled if his or her right is based on a 'reimbursement arrangement'.[5] As a consequence, the trustee is assessed the highest marginal tax rate on this income under section 99A of the Income Tax Assessment Act of 1936.[6] It is crucial to note that section 100A (8) of the Income Tax Assessment Act 1936 excludes from its scope any agreements that were not made or implemented to reduce a person's income tax liability for a particular income year. In addition, section 100A (13) excludes 'ordinary family or commercial dealing' from this provision's reach. In general, section 100A is a broad anti-avoidance provision that permits the Commissioner of Taxation to disregard trust distributions that are part of a 'reimbursement arrangement' and instead levy tax at the highest marginal tax rate on the trustee. Its purpose is to prohibit taxpayers from using trust structures to decrease their tax liabilities and to ensure that the appropriate tax rate is paid.

In addition to section 100A, Division 7A of the Income Tax Assessment Act of 1936 prohibits taxpayers from utilising trusts to lower their tax liability. Section 100A applies when a distribution is given to a lower tax-rate beneficiary, but the economic benefit is transferred to a second beneficiary with a higher tax rate. Certain unpaid present entitlements and loans from private companies to shareholders or their affiliates are subject to Division 7A. Both regulations are meant to guarantee that the appropriate tax rate is paid. Another part of Australian tax law, Division 7A of the Income Tax Assessment Act 1936, prohibits taxpayers

[5] Income Tax Assessment Act 1936, section 100A (1) (a) and (b).
[6] ibid, section 100A (4) (a) and (b).

from using trusts to avoid or reduce tax. It does this by demanding that some 'unpaid present entitlement' ('UPE') provided by private companies to shareholders or their associates be taxed as dividends.[7]

Cases Regarding the Application of Section 100A:

There are two notable cases addressing the implementation of section 100A, including *Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT*[8] and *BBlood Enterprises Pty Ltd v Commissioner of Taxation.*[9] These two cases have significant ramifications for the taxation of trusts and distributions from trusts.

Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT[10] involves the Australian Investment Trust ('AIT') and two of its key players, Mr Springer and AIT Corporate Services Pty Ltd ('AITCS'). Mr Springer served as the trustee of the AIT, a discretionary trust established on 25 June 1998, until 14 November 1999, when Guardian AIT Pty Ltd took on the responsibility of the corporate trustee.[11] AITCS was formed in June 2012, with Guardian as the sole shareholder. [12] Mr Springer, as the principal of the AIT, appointed AITCS as a co-beneficiary of the trust.[13] In 2012 and 2013, AITCS was made eligible to receive the AIT's income for those tax years, and AIT paid AITCS cash to pay the tax liability associated with the distribution.[14] The remaining balance between AIT and AITCS was recorded as a UPE.[15] In subsequent years, AITCS declared a fully franked dividend to AIT, which was then distributed to non-resident Mr Springer, who was not liable for the additional tax on the dividend.[16] In 2014, AITCS was again entitled to receive the income of AIT for that tax year, and a similar procedure as in prior years was followed, except for placing the UPE balance on Division 7A-compliant terms.[17]

In this case, the Commissioner claimed that the sequence of transactions, including the payment of trust income to a corporate beneficiary, the return of a franked dividend to the trustee (the only shareholder) in the following year, and the subsequent distribution of that dividend to a non-resident person constituted a 'reimbursement agreement' as defined by section 100A.[18] These transactions were intended to convert the original trust income into franked dividend income, which would be taxed at the reduced corporate rate as opposed to the higher individual rate that would have applied if the trust income had been transferred directly to the non-resident individual.

[7] ibid, section 109B.
[8] [2021] FCA 1619.
[9] [2022] FCA 1112.
[10] [2021] FCA 1619.
[11] ibid, [6].
[12] ibid, [7-8].
[13] ibid, [7].
[14] ibid, [9, 12, 15-18].
[15] ibid, [9].
[16] ibid, [11].
[17] ibid, [14].
[18] ibid, [23].

Logan J ruled in favour of the taxpayer in reference to section 100A for the income years of 2012, 2013, and 2014. First, he agreed with Hill J.'s judgement in *East Finchley Pty Ltd v Federal Commissioner of Taxation*[19] that a reimbursement agreement, as defined in section 100A (7), 'must necessarily precede "the payment of money or the transfer of property to, or the provision of services or other benefits'.[20] Logan J. ruled, after reviewing all of the available evidence, that there was no solid evidence (i.e., it did not exist) prior to June 2012 indicating that Mr Springer and Guardian had a genuine or implicit reimbursement arrangement or even a foundation inference to that effect.[21] While he acknowledged that a repayment arrangement might be informal and implied, he decided that such an agreement could not have existed until many months later, when '[i]t is only many months later that even the possibility of the declaring of a dividend by AITCS emerges'.[22] While a franked dividend was paid prior to creating the present entitlement for the 2013 and 2014 income years, it was not anticipated that AITCS would pay another dividend for those years.[23] Logan J also held that,

> '[e]ven if there were such an "agreement", s 100A could still have no application, because that agreement did not provide for "the payment of money or the transfer of property to, or the provision of services or other benefits for, a person or persons other than the beneficiary or the beneficiary and another person or other persons". As was stated in Raftland, at [61], with reference to s 100A(7), "It is, however, necessary that a reimbursement agreement provide for the payment of money, transfer of property or the provision of services or other benefits to a person other than the beneficiary." The agreement made in June 2012 provided only for the payment of money to a beneficiary, AITCS. It went no further. It could not therefore be a "reimbursement agreement".' [24]

Therefore, section 100A did not apply to the 2012 income year, and AITCS was entitled to the relevant trust income of the AIT for that year, as it always has been. Logan J. then analysed whether the current arrangement qualified as an 'ordinary family or commercial dealing' under section 100A. (8). It has been held that

> 'for reasons which follow, the agreement was entered into in the course of ordinary family or commercial dealing. And, as already found, no element of the agreement, arrangement or understanding as made in June 2012 in any way entailed the future payment of a dividend by AITCS.
>
> [..]

[19] [1989] FCA 481
[20] [2021] FCA 1619, [128-130], citing *East Finchley Pty Ltd v Federal Commissioner of Taxation* [1989] FCA 481, *Federal Commissioner of Taxation v Prestige Motors Pty Ltd* (1998) 82 FCR 195, and section 100A (7) of the Income Tax Assessment Act 1936.
[21] ibid, [131-133].
[22] ibid, [132].
[23] ibid, [168].
[24] ibid, [155].

> Read in context, the adjective “ordinary” in “ordinary family or commercial dealing” has particular work to do. It is used in contradistinction to “extraordinary”. It refers to a dealing which contains no element of artificiality. This is confirmed by reference to the relevant explanatory memorandum, where one finds reference to addressing the mischief of specially introduced beneficiaries having a fiscally advantageous status. This explanatory memorandum confirms what a reading of s 100A would suggest, which is that the section is directed to addressing, according to its terms, “trust-stripping”.’[25]

In sum, the Federal Court in *Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT*[26] ruled in favour of the taxpayer on the issue of section 100A, held that section 100A did not apply to a situation in which a trust makes a corporate beneficiary eligible to receive trust income and the corporate beneficiary pays tax on that income before returning a fully franked dividend to the trust. This is one of the first cases in which the court has examined the meaning of "ordinary family or commercial dealing" as defined under section 100A (13). Since the term 'ordinary family or commercial dealing' is not defined in the Income Tax Assessment Act of 1936, its applications are not entirely obvious. While Logan J.'s reasoning shows that the court is willing to apply this exception in certain cases, his judgment does not give much clarification on the characteristics or characteristics of 'ordinary family or commercial dealings', other than the fact that they are not artificial.

The Federal Court's ruling in the case of *BBlood Enterprises Pty Ltd v Commissioner of Taxation*[27] was released on 19 September 2022 and provides further guidance on the application of section 100A of the Income Tax Assessment Act 1936. This ruling follows the earlier decision in *Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT*.[28]

In *BBlood Enterprises Pty Ltd v Commissioner of Taxation*,[29] a trust received over $10 million in revenues from the buy-back of its own company's shares.[30] Due to amendments made to the trust deed just before the buy-back, these proceeds were not included in the definition of trust income.[31] The trustee established a newly constituted corporation entitled to around $300,000 in trust income from related entities.[32] Except for the operation of section 100A and other integrity rules, the corporate beneficiary was subject to tax on the taxable receipts of the trust, including the $10 million buy-back dividend.[33] Since the share buy-back dividend was fully franked, the beneficiary corporation had no additional tax liability.[34] The buy-back proceeds, to which the corporate beneficiary had no right, were held as the trust's corpus and used for collective purposes.[35]

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[25] ibid, [136 and 144].
[26] ibid.
[27] [2022] FCA 1112.
[28] [2021] FCA 1619.
[29] [2022] FCA 1112.
[30] ibid, [1].
[31] ibid.
[32] ibid.
[33] ibid, [2].
[34] ibid, [32].
[35] ibid, [111].

In this case, the court examined two crucial issues arising from the application of section 100A, namely 'reimbursement agreement' and 'ordinary family or commercial dealing'. The first one is 'whether a "reimbursement agreement" for the purposes of s 100A requires that the "payment" referred to in s 100A (7) be, in substance, a reimbursement for the relevant beneficiary being made presently entitled to the income of the trust'.[36] The second one is 'whether the agreement, arrangement or understanding was entered into in the course of ordinary family or commercial dealing'.[37]

The Commissioner assessed the trustee of the trust on the grounds that a sequence of steps constituted a 'reimbursement agreement'.[38] The court rejected the relevant appeal by the applicant. Thawley J held that

> 'the word "reimbursement" does not limit or control the meaning of the definition by requiring that the payment be as a matter of substance a "reimbursement" of the beneficiary's present entitlement. The phrase "reimbursement agreement" is no more than a convenient label. That is made plain by the language of s 100A (7) and by context and purpose. It is true that some "reimbursement agreements" are aptly described as agreements which involve an element of "reimbursement". It is also true that the label might be apt to describe the kinds of arrangement which were of immediate concern at the time s 100A was introduced. However, the statutory context does not suggest that the label "reimbursement agreement" was intended to limit or control the definition in s 100A (7)'.[39]

Through this approach, Thawley J. confirmed that the term 'reimbursement agreement should not limit section 100A's applicability. The term 'reimbursement agreement' is meant to embrace all forms of arrangement, regardless of whether they entail a traditional reimbursement.

Regarding the second issue concerning the 'ordinary family or commercial dealing', Thawley J held that

> 'It might be said that a buy-back is an ordinary commercial transaction. The statutory question, however, is whether the agreement as a whole was entered into in the course of an "ordinary family or commercial dealing". In any event, even viewed in isolation, the applicants did not establish a sensible commercial or family rationale for adopting the buy-back procedure. As is explained further below, the explanations given for the buy-back component of the agreement are unlikely. The buy-back was not conducted for the purpose of simplifying the corporate structure as suggested. Nor was it done for succession planning purposes as suggested'.[40]

In order to determine whether an arrangement qualifies as an 'ordinary family or commercial dealing' (a section 100A exception), it is required to examine the arrangement as a whole. It is not sufficient to infer that the arrangement itself is an 'ordinary family or commercial dealing' simply because one or more of the arrangement's steps might be defined as 'ordinary'.

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[36] ibid, [76].
[37] ibid.
[38] ibid, [2].
[39] ibid, [120].
[40] ibid, [102].

This case demonstrates the Commissioner of Taxation's willingness to use Section 100A widely. Specifically, the Commissioner may attempt to apply the provision to a wide variety of business transactions that seem to give a tax benefit, even if the beneficiary is not the original recipient of the benefit.

Australian Taxation Office Final Guidance on 'Reimbursement Agreements':
As demonstrated, the definitions of 'reimbursement agreement' and 'ordinary family or commercial dealing' have been the topic of debate, resulting in the ATO's section 100A guidance being under development for a considerable time. The ATO provided guidelines on section 100A in 2014, detailing its administrative stance concerning a 'reimbursement agreement' for trustees and beneficiaries of a trust.[41] The Commissioner of Taxation released draft guidance on this provision in February 2022, offering more information on its implementation and applicability to specific taxpayers. On December 8, 2022, the ATO released its final guidance on 'reimbursement agreements' under this Act section.[42]

The ATO issued two essential guidance on section 100A of the Income Tax Assessment Act on December 8, 2022, including Taxation Ruling and Practical Compliance Guideline.[43] This guidance follows prior consultations on draft versions and a Taxpayer Alert highlighting section 100A as a potential anti-avoidance provision that might apply where parents benefit from the trust entitlements of children over 18 years old.[44]

The Taxation Ruling states the ATO's position on the four fundamental elements for section 100A to apply and the exemption for 'ordinary family or commercial dealings'. Regarding section 100A, the definition of 'ordinary family or commercial dealings' has been the topic of much dispute. Despite the ATO's seeming retreat from its prior stance that a transaction is not 'ordinary' solely because it is widespread (this view is no longer expressed in the binding part of the ruling), a similar position is detailed in the ruling's explanation section. Specifically, the explanation states that 'an arrangement that is commonplace, but which does not achieve family or commercial objectives, is not entered into in the course of ordinary family or commercial dealing'.[45]

The Practical Compliance Guideline offers taxpayers and their advisers a risk assessment approach for determining the amount of risk connected with their trust distribution arrangements. The Guideline classifies such arrangements into three 'zones' - white, green, and red - and defines the ATO's compliance strategy for each zone. The initial draft was revised to incorporate many major revisions, including (1) more 'green zone' scenarios, which include low-risk circumstances where the ATO does not expect to spend compliance resources; (2) the

[41] Australian Taxation Office, Trust taxation - reimbursement agreement (Australian Taxation Office 2014).
[42] Australian Taxation Office, *Taxation Ruling TR 2022/4* (Australian Taxation Office 2022).
[43] Australian Taxation Office, *Taxation Ruling TR 2022/4* (Australian Taxation Office 2022); and Australian Taxation Office, *Practical Compliance Guideline PCG 2022/2* (Australian Taxation Office 2022).
[44] Australian Taxation Office, *Taxpayer Alert TA 2022/1* (Australian Taxation Office 2022).
[45] Australian Taxation Office, *Taxation Ruling TR 2022/4* (Australian Taxation Office 2022), para 103.

elimination of the 'blue zone' to simplify the advice; and (3) the addition of more practical examples to explain the functioning of green and red zone scenarios.

Potential Impacts of the Guidance on the Future of Trust Taxation in Australia:

The final guidance on section 100A[46] apply both prospectively and retrospectively. For entitlements awarded before July 1 2022, however, the ATO will adhere to any administrative position provided in its earlier advice that is more favourable to the taxpayer's circumstances than the Practical Compliance Guideline.[47] In addition, the ATO has stated that it will generally only apply section 100A within four years of a trustee filing their tax return and that it will not assess arrangements before July 1, 2014, save in the extraordinary situations specified in the Practical Compliance Guideline.[48]

Despite this, the ATO has opted to complete its guidance while the case *Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT*[49] is being appealed to the Full Federal Court. The appeal to the Full Court was heard in August 2022, and the ruling is pending. It is predicted that possible past exposure to section 100A will be a priority for the ATO as it continues to concentrate on high-wealth private organisations via its Next 5000 compliance programme (i.e. a tax performance program sponsored by the Tax Avoidance Taskforce, which seeks to ensure the public that Australia's biggest privately owned and affluent groups are paying their fair share of taxes). This program aims to convince the public that Australia's largest privately owned and wealthy groups are paying their fair share of taxes.[50] Given that there is no time restriction on the Commissioner's ability to alter assessments to adjust according to section 100A, such actions would impact all private organisations running a discretionary trust.

Conclusion:

In conclusion, Section 100A of the Income Tax Assessment Act of 1936 is a provision meant to avoid arrangements in which a distribution is given to a beneficiary with a low tax rate, but a second beneficiary with a higher tax rate finally receives the economic advantage. This article provides an overview of the Australian Taxes Office's recently-issued final guidance on this provision and examines its likely effects on the future of trust taxation in Australia. Via its analysis of relevant cases and ATO advice, it is evident that this provision is an essential instrument for safeguarding the integrity of Australia's tax system and preventing the manipulation of tax obligations through trust arrangements.

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[46] Australian Taxation Office, *Taxation Ruling TR 2022/4* (Australian Taxation Office 2022); and Australian Taxation Office, *Practical Compliance Guideline PCG 2022/2* (Australian Taxation Office 2022).

[47] Australian Taxation Office, *Practical Compliance Guideline PCG 2022/2* (Australian Taxation Office 2022).

[48] ibid.

[49] [2021] FCA 1619.

[50] Australian Taxation Office, Next 5,000 private groups tax performance program (Australian Taxation Office 2022).