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MCEC Melbourne

20 CPD Hours

Spark change



The latest on section 100A – Part 1

Presenter:

Frank Hinoporos, CTA, Hall & Wilcox Lawyers

Session outline

1. A little bit about 100A: a creature of its environment
2. ATO Interpretative Guidance: background and key changes
3. Practical strategies to diagnose and mitigate 100A risk
4. Key principles from the case law: *Guardian AIT* and *BBlood*
5. The ‘bigger picture’: what is the future of trusts?

1.1 100A: a creature of its environment

- Section 100A has been in the Act since 1979
- Introduced in the aftermath of:
 - rampant tax avoidance and 'bottom of the harbour' schemes
 - 'Strict literalism' of the High Court under Barwick CJ
 - a narrow base, high rates tax system
 - a constrained administrative capacity in terms of resources and anti-avoidance tools
- Preceded Part IVA, CGT, Imputation, Division 7A, Schedule 2F



1.2 Section 100A: A product of evolution

- Parliament drafted 100A broadly so that it is pliable and adaptable (the '*better mousetrap*' principle):
 - Only expressly circumscribed by the '*ordinary family or commercial dealing*' [**s100A(13)**] and '*tax reduction purpose*' [**s100A(8)**] conditions
 - Attempts to '*read down*' the broad scope of 100A by reference to the Extrinsic Materials that accompanied its introduction have not found judicial favour:
Prestige Motors (1998), *Hill and Sackville JJ* at 218 to 219
 - Judicial interpretation in just six cases in 43 years, dealing with artificial arrangements: '*Hard cases make bad law*'
 - Unlimited amendment period



2.1 ATO Interpretative Guidance: a long and winding road for trusts

- The ATO has called for greater ‘rigour’ in the tax management of trusts in the context of private groups:
 - 2009/10: Division 7A administrative guidance concerning Unpaid Present Entitlements (UPE) to corporate beneficiaries: **TR 2010/3** and **PS LA 2010/4** (now withdrawn)
 - 2011/12: Repeal of **IT 328** and **IT 329** (trust distributions) and administrative guidance on Division 6
 - 2013/14: budget funding over four years (since extended) to fund a **Tax Avoidance Taskforce – Trusts**
 - 2019: **Top 500, Next 5,000** focused compliance project for privately held groups (heavy focus on trusts)
- Calls for ATO Guidance from the profession on section 100A

2.2 ATO interpretative guidance: the journey so far

- Administrative guidance in ATO Guidance materials:
 - **ATO Factsheet**, July 2014 (updated 2016 and 2022)
 - **Taxation Ruling TR 2022/D1**, April 2022 (draft)
 - **Practical Compliance Guideline PCG 2022/D1**, April 2022 (draft)
 - **Taxation Ruling TR 2022/4**, December 2022 (final)
 - **Practical Compliance Guideline PCG 2022/2**, December 2022 (final)
- Legislative guidance through tax appeals and test cases:
 - **Guardian AIT (2021)** and **BBlood (2022)**
 - Full Federal Court appeals handed down in both cases (2023)



2.3 ATO Interpretative Guidance: Baseline risk assessment

- A ‘split’ of the present entitlement and the enjoyment of the related financial benefit to different entities: e.g. retention by the trustee or use to financially benefit another beneficiary
- A tax ‘arbitrage’: e.g.
 - income sheltered at company tax rate but retained in a trust environment
 - income distributed to lower tax taxpayer but enjoyed by a higher tax taxpayer
 - The Division 6 ‘proportionate’ approach causing a mismatch of trust and tax income
- A rationale that is not validated by the objective facts, legal reality e.g. trust distributions applied to reduce expenses incurred by parents when the beneficiary was a minor
- There are manufactured ‘facilitative steps’ e.g. Trust Deed amendment or introduction of new beneficiary is required to facilitate tax outcome

2.4 TR 2022/4 vs Draft TR 2002/D1

- Key principles remain largely intact :
 - Of note is the added emphasis on the purpose of advisors following ***BBlood v CoT***: [para 24]
- Four new examples (*Examples 1 to 4*) illustrate the importance of **context** in illuminating purpose:
 - medical needs of family members (*Example 1*)
 - established cultural practices (gifting entitlements (*Example 2*), supporting older relatives (*Example 3*), not accepting entitlements (*Example 4*) – *the trouble will be proof*)
- Existing examples show some ‘softening’ of the language: e.g. *Example 9* (formerly *Example 5*) – individual beneficiary (adult child) allowing their entitlement to ‘sit’ with the trustee without being set aside and held on a separate trust

2.5 TR 2022/4: Example 9

Example 59 – unpaid entitlements held on separate trust

- ~~111.~~ 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~~John's entitlement is determined so his taxable income will not exceed certain marginal tax rate thresholds.
- ~~145.~~ ~~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~~John has indicated to the trustee that he may be unlikely to ~~will not~~ call for the payment of the amount of 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~~ enforce his rights as beneficiary to recover those amounts at any time.
146. ~~John's~~John's tax-free threshold reduces the overall tax on the trust net income. However, in the absence of additional factors, the arrangement that involves John simply delaying the time when he would realise the benefit of his original trust entitlement would likely be entered into in the course of ordinary dealing.
147. A different outcome may arise if, for example, ~~instead of setting funds aside for John upon a separate trust~~, the trustee:
- (a) ~~loans the funds on interest-free terms for an undefined period to another person, or~~
 - (b) ~~otherwise applies the trust's funds in a way that is inconsistent with an intention to satisfy John's~~that John would ultimately receive the amount of his entitlements, ~~should the trustee be called upon by John to do so.~~

2.6 PCG 2022/2 vs Draft PCG 2022/D1

- Undergone more significant surgery!
- Seven new examples (*Examples 2, 3, 5, 6, 9, 10 and 13*)
- The former ‘**Blue Zone**’ category has been eliminated – instead there are more ‘**Green Zone**’ and ‘**Red Zone**’ examples
- An important addition [paras 49 to 52] about record keeping and documentation (we’ll get back to that later)
- Some existing examples have been clarified – e.g. *Example 7* (formerly *Example 2*) – retention of funds by the trustee of a business operating trust for ‘working capital purposes’ vs creation of family wealth

2.7 Scenario 1: Distributions within the family group

- **Green Zone** Scenarios:
 - **The Hares** (PCG – Example 5): trust distribution to kid, kid is informed of their entitlement, calls for part payment to fund tax, receives balance within **2 years** (funds retained by the trustee used to fund an investment portfolio - 2 year requirement expressed in PCG para 25)
- **Red Zone** Scenarios:
 - **The Patels** (PCG – *Example 14*): distributions to kids applied to reduce an outstanding debt owed by the kids to the parents in respect of education expenses and their share of household expenses before they turned 18
 - **The Rosegums** (Ruling – *Example 7*): less likely to be an ‘ordinary family or commercial dealing’ if the low tax beneficiaries gift entitlements to high tax beneficiaries and there are no circumstances (cultural or otherwise) which explain why the gift was made

2.8 100A: De-risking the arrangement

- In every case:
 - Match the present entitlement and the financial benefit e.g. pay distributions
 - Make permitted use of ‘other people’s money’ e.g. Division 7A compliant loan arrangements or the ‘safety zones’ in the Guidance (2 year retention, ‘use of funds’ for working capital or investment)
 - Make the parties actors in the arrangement and not spectators e.g. document and agree matters to the same level and with the same understanding as you would for arm’s length parties
 - Apply rigour to the administration and management of a trust’s legal affairs
- If you have a ‘red zone’ on your hands: Don’t panic – apply the law e.g. ***Guardian AIT (2022)***

2.9 Practical compliance and trust administration

- PCG, paras. 49 to 52 are a new inclusion:

49. You should prepare and keep good records that explain the transactions that have happened. Having a clear understanding as to why a beneficiary has chosen to deal with their entitlement in the way they have and knowledge of the relevant parties to the transaction or arrangement will help support your position. It will also assist in the timely resolution of any compliance activity we undertake.
50. While each arrangement depends on its facts, the following documents and records are important and should be kept wherever possible:
- (f) the trust deed (including amendments), trustee resolutions and contact details of the trustee and former trustees
 - (g) notes, contemporaneous documents and records of discussions or meetings explaining the transactions that have happened or calculations that have been made
 - (h) details of how the beneficiary was notified of their present entitlement to trust income
 - (i) details of how the present entitlement to trust income was satisfied and, where practical, used by the beneficiary
 - (j) details of how the trustee utilised the underlying funds; for example, to satisfy the trustee retention of funds or the trustee working capital condition referred to in paragraph 25 of this Guideline
 - (k) copies of loan agreements and records showing how the loan repayments were satisfied from time to time.
51. We acknowledge that family arrangements are typically conducted with a greater level of informality than dealings between unrelated parties. Nonetheless, to the extent possible, the trustee or their registered tax agent should maintain contemporaneous records that are ordinarily created which demonstrate the objectives an arrangement was intended to achieve and how it would achieve them. For example, this could be in the form of a file note of a meeting between the trustee and registered tax agent.
52. The maintenance of contemporaneous records by the trustee is part of good governance arrangements for managing the trust's affairs and dealing with the ATO. Notwithstanding that an arrangement is fully documented, section 100A may still apply, particularly where the arrangement is contrived or artificial, is overly complex or has tax-driven features so that the dealings cannot be explained by ordinary family or commercial purposes.²⁰

- 'Why a beneficiary has chosen to deal with the way they have'**
- "knowledge of the relevant parties"**
- "Notification of present entitlement"**
- "how the trustee has utilised the underlying funds"**
- "contemporaneous records (as a matter of 'good governance arrangements for managing a trust's affairs')**

2.10 Practical compliance and trust administration

Dear Beneficiary

Notification of appointment

Trustee acts as the trustee of the Trust, and has resolved in the income year ended 30 June 2023 to make you presently entitled to \$1 (**Appointment**).

The purpose of this letter is to inform you of the Appointment, and to request that you confirm that you have been notified of the Appointment, and that you are aware of your entitlement from the Trust, by signing the acknowledgement at the bottom of this page and returning this document to Trustee.

Kind regards

Trustee

*I, Beneficiary, hereby acknowledge that I am aware that I have been made presently entitled to the Appointment.
I ask that the Trustee (select the appropriate option):*

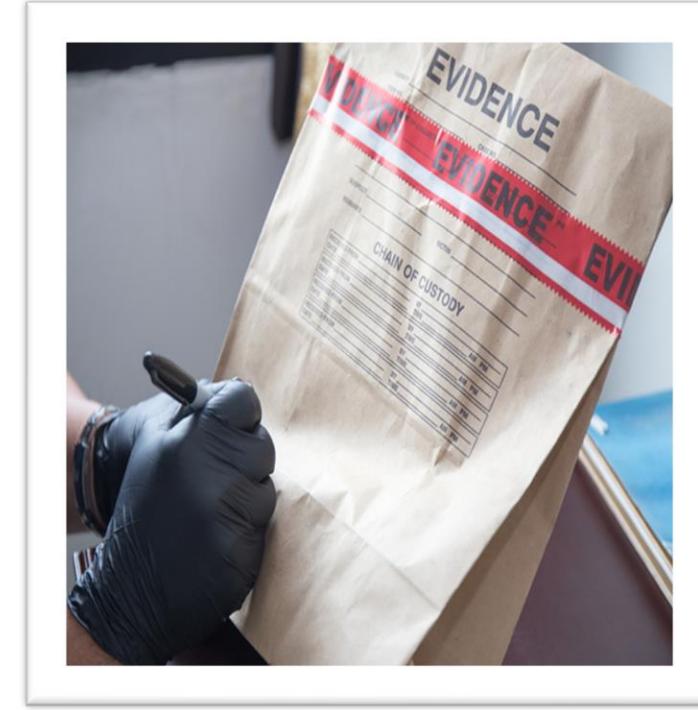
- Pay me the entirety of the Appointment.*
- Pay me so much of the Appointment as is necessary to fund any income tax liability associated with it and hold and apply the remainder for the benefit of the business/activities of the Trust until I call for payment.*
- Hold the Appointment and apply it for the benefit of the business/activities of the Trust until I call for payment.*

Date:

Signed:

3.1 Guardian AIT and BBlood: evolving our understanding

- **Guardian AIT** and **BBlood** address ‘high-risk’ 100A arrangements under the ATO Guidance
 - *Guardian AIT*: circulating distributions (‘washing machine’)
 - *BBlood*: share buyback + trust vs. tax law distributions
- The facts of each case, as demonstrated by the evidence, determined the outcome – for the Taxpayer in **Guardian AIT** and for the Commissioner in **BBlood**
- Appeals in both cases to the Full Federal Court determined

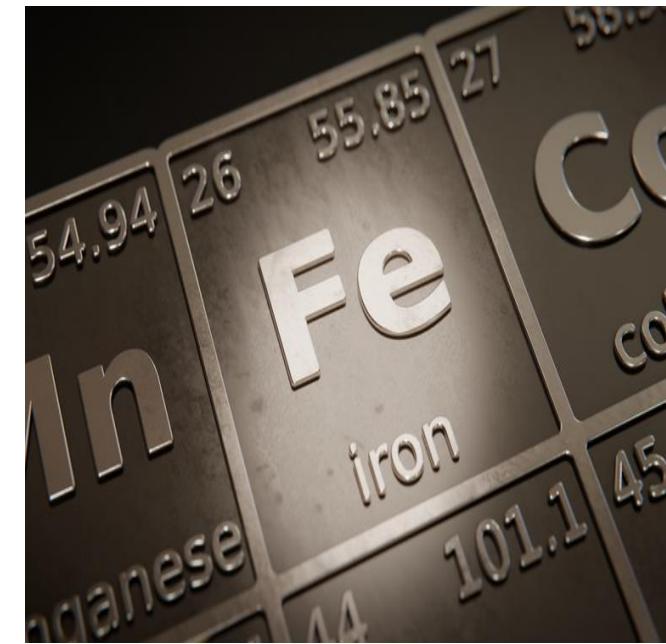


3.2 A bit about evidence

- Taxpayer bears the onus of proof: section 14ZZO(b), Tax Administration Act
- Commissioner has expansive information gathering powers with respect to documents and powers to interview taxpayers (Section 353)
- Commissioner will look to test a taxpayer's awareness of transactions and the purported drivers (family, commercial, succession, asset planning) of those transactions
- Be mindful of the limitations of the Accountant's Concession vs. Legal Professional Privilege
- Commissioner may also call on cross-border information exchange agreements with revenue authorities abroad

3.3 The elements of section 100A

- **Agreement, arrangement and understanding (and causation) that is a ‘reimbursement agreement’:** subsection 100A(1) and subsection 100A(13)
- **Ordinary family or commercial dealing:** subsection 100A(13)
- **Tax reduction purpose:** subsection 100A(8)



3.4 Agreement, arrangement or understanding (and causation)

Formulation of the test	Factors	Evidence
<p>Guardian AIT</p> <p>Temporal sequence:</p> <ul style="list-style-type: none"> ▪ a ‘reimbursement agreement’ must exist before a present entitlement [<i>Guardian AIT</i> at 128] ▪ the agreement must not be a matter which is ‘entirely conjectural’ or a mere expectation [<i>Guardian AIT (FFC)</i> at 117] ▪ ‘Agreement’ invokes a requirement of ‘consensus and adoption’ (in particular, or professional advice) [<i>Guardian AIT (FFC)</i> at 124] 	<ul style="list-style-type: none"> ▪ Does the timing and sequence of the executive steps or events show that there is a coincidence in those executive steps or events? ▪ Does the taxpayer (assessed prospectively) apply any process and formality to financial and tax affairs: are decisions made in advance or ‘ad hoc’ and reactive year-by-year? 	<ul style="list-style-type: none"> ▪ Timing of the executive steps or events (chronological sequence) did not show a link or connection between the steps [<i>Guardian AIT</i> at 132] ▪ Timing (and content) of advice from professional advisors [<i>Guardian AIT</i> at 117] ▪ Contemporaneous correspondence with advisors regarding distribution decisions (around year-end) made it clear that distribution decisions were made in ‘real time’ and independent [<i>Guardian AIT</i> at 59] ▪ Year-end planning workpapers (multi-year) revealed there was no overall tax planning strategy or distribution approach – it was ‘ad hoc’ and reactive rather than pre-ordained [<i>Guardian A/T</i> at 59]

3.5 Agreement, arrangement or understanding (and causation)

Formulation of the test	Factors	Evidence
<p>BBlood</p> <p>Singular, unified arrangement: a connected series of steps that were intended to operate in conjunction with each other as part of an overall agreement, arrangement or understanding [BBlood at 80]</p>	<ul style="list-style-type: none"> ▪ Is there a pre-ordained strategy/series of executive steps or events intended to operate in an integrated fashion and implemented in a unified way? ▪ Does the timing of events reveal or indicate a unity e.g. has the recipient of the distribution been incorporated shortly before the distribution being made to it? ▪ Is the arrangement implemented by way of an integrated set of documents prepared at the same time and by the same authors, showing that: <i>they were perceived to form one overarching transaction or arrangement by those who prepared them, those who advised in respect of them, and those who entered into them</i> [BBlood at 82] 	<ul style="list-style-type: none"> ▪ Professional advice received by the taxpayer's preceding implementation of the agreement and presents the necessary executive steps and events and the tax outcome [BBlood at 81] ▪ Transaction documents were prepared as a 'suite' of documents, at the same time, by a single advisor [BBlood at 82] ▪ The evidence revealed that the advisors had implemented similar arrangements for multiple other clients [BBlood at 82]

3.6 Ordinary family or commercial dealing

Formulation of the test	Factors	Evidence
Guardian AIT Artificiality: Does the arrangement as a whole (but looking at its individual steps or parts) reveal any 'artificiality', in respect of any executive step or event [Guardian A/T at 144]	<ul style="list-style-type: none"> ▪ Is the arrangement explicable by a desire to achieve asset protection? If so, will the desired asset protection be achieved by the arrangement in fact and substance? ▪ Is the arrangement explicable by a desire to achieve a commercial, succession (personal or business) or a family purpose? Is so, will that commercial, succession or family purpose be achieved by the arrangement in fact and substance? ▪ Does the taxpayer (not their advisor) have a practical understanding of how asset protection will be achieved by implementing the arrangement? 	<ul style="list-style-type: none"> ▪ The taxpayer's professional and business activities (including the recent sale of his business meant there was a real and appreciable risk of personal liability [Guardian A/T at 150]) ▪ The taxpayer was transitioning to retirement and had taken steps consistent with that course [Guardian A/T at 151] ▪ The structure implemented actually achieving his desired asset protection by introducing a 'clean skin' corporate beneficiary with no prior trading history [Guardian A/T at 151] ▪ Taxpayer's evidence showed he had a personal and practical understanding of the rationale of the arrangement and its effect. [Guardian A/T at 147] ▪ The taxpayer's historical pattern of distributions showed that trust distributions (comprising franked dividends) had been made previously [Guardian A/T at 148]

3.7 Ordinary family or commercial dealing

Formulation of the test	Factors	Evidence
<p>BBlood</p> <p>Non-tax rationale: Viewing the arrangement and the executive steps and events comprising it as a cohesive whole (not by its individual events or steps):</p> <p>(a) is the arrangement contrived, artificial or 'overly complex' such that it involves more than is needed to achieve the objective; and</p> <p>(b) does the arrangement exhibit an absence of commercial motivation, justification or necessity [BBlood at 95 to 96]</p>	<ul style="list-style-type: none"> ▪ Is the arrangement complex, involving multiple steps or events? ▪ Is the arrangement explicable by a desire to achieve a commercial, succession (personal or business) or a family purpose? If so, will that commercial, succession or family purpose be achieved by the arrangement in fact and substance? ▪ Are there steps involved which 'facilitate' the overall tax outcome desired to be achieved e.g. The introduction of a new beneficiary or a variation to the terms of the trust deed. 	<ul style="list-style-type: none"> ▪ When assessed against the taxpayer's stated commercial or family purpose for the arrangement (to 'simplify' the corporate structure and future succession planning by removing IP Trust as a shareholder of IP Co), that purpose was not achieved by the arrangement [BBlood at 200]. ▪ The executive steps or events required to give effect to the arrangement are only explicable by reason of the fact that they facilitate the ultimate tax outcome desired to be achieved by the arrangement, including: <ul style="list-style-type: none"> ➤ Distributions and dividends paid to IP Trust (without which there would be no 'trust' income) where there was no previous history of doing so; ➤ Amendment of the terms of the IP Trust deed; ➤ Introduction of a 'new' corporate beneficiary (BE Co) a week prior to the transaction being implemented and a distribution to that beneficiary <p>[BBlood at 101, 193 to 195]</p>

3.8 Tax reduction purpose

Formulation of the test	Factors	Evidence
<p><i>Guardian AIT</i></p> <p>Objective test (informed by subjective evidence):</p> <ul style="list-style-type: none"> when viewed objectively, with reference to a 'counterfactual' grounded in practical reality given the prevailing commercial, personal or family circumstances of the taxpayer (shown objectively), is a purpose of the scheme the reduction of tax? <p>[<i>Guardian AIT</i> at 163]</p>	<p>▪ What are the taxpayer's commercial, personal or family circumstances and objectives or purpose in context of those circumstances (informed by subjective evidence)?</p> <p>▪ By what means, other than the arrangement entered into, could the taxpayer's commercial, personal or family objectives have been achieved?</p>	<p>▪ In light of the taxpayer's personal circumstances, need for asset protection, and transition to retirement (see previous), the court accepted that as a 'counterfactual' to what actually occurred, the taxpayer could have otherwise:</p> <ul style="list-style-type: none"> Paid the UPE by the AI Trust to AITCS; or Putting in place a Division 7A compliant loan agreement between AITCS and AI Trust <p>[<i>Guardian AIT</i> at 171]</p>

3.9 Tax reduction purpose

Formulation of the test	Factors	Evidence
<p>BBlood</p> <ul style="list-style-type: none"> ▪ The taxpayer's purpose is to be informed by a consideration of: (a) The objective facts, including the financial taxation and other consequences of the arrangement entered into; (b) Direct evidence from a relevant party (including advisors) as to that party's purpose (either in contemporaneous documents or testimony in court tested under cross-examination) [BBlood at 135] ▪ Must be the purpose of a 'party' to the agreement ascertained at the time of entry into the agreement - historical behaviour and patterns will be given weight [BBlood FFC at 46 to 64] 	<ul style="list-style-type: none"> ▪ When the executive steps and events in the arrangement are considered objectively, what are the tax and financial outcomes which arise from those executive steps and events? ▪ Did the taxpayer's advisors present the arrangement as one which was productive of a tax outcome that was beneficial for the taxpayers? ▪ Are there steps involved which 'facilitate' the overall tax outcome desired to be achieved e.g. The introduction of a new beneficiary or a variation to the terms of the trust deed. 	<ul style="list-style-type: none"> ▪ The tax, financial and commercial consequences of the executive steps and events in the arrangement (considered objectively): Tax outcome facilitated distribution of retained earnings from IP Co to IP Trust (then to BE Co, with a full tax offset on account of the franking credits) and allowed those funds to be retained by IP Co as trust corpus with no s 99A assessment [BBlood at 180 to 182] ▪ Advice about the arrangement was instigated by the professional advisors rather than by the taxpayers [BBlood at 215] and the taxpayer's testimony revealed that they had a limited understanding of the arrangement but did appreciate its tax consequences [BBlood at 236] ▪ Arrangement involved a number of 'facilitative' steps (see previous)

4. The end game for trusts (or the end)?

- Trusts are a huge repository of private wealth in Australia
- Unique to Australia to be used as a business structure
- Dealing with an antiquated model of trust tax and no appetite for reform
- Trust administration is complex (and getting harder and taking longer)
- The tax landscape is changing: company tax rate is progressively decreasing and the ‘margin’ between company and trust/individual tax because of the CGT discount is compressed
- Difficulties on capital introduction and exit
- More taxpayers are reassessing their structuring options and the long-term utility of trusts



Thank you

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Spark change

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