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PRACTITIONER ARTICLE

100A developments: what advisers need to know…

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The Challenges Ahead…

In December 2022, the Australian Taxation Office ("ATO") released its highly anticipated guidance on section 100A,[2] namely, finalised Taxation Ruling 2022/4 and Practical Compliance Guideline 2022/2. This follows the ATO's controversial draft releases published in February 2022,[3] which were regarded by many tax advisers and professional bodies as regulatory overreach.[4]

Since the issue of the above ATO releases, the Full Court of the Federal Court of Australia has also now handed down its decision in the *Guardian AIT* appeal,[5] in which the Full Court unanimously held in favour of the taxpayer in relation to the section 100A issues on appeal (but not in relation to Part IVA).

Whilst some of the concerns raised with the ATO's initial draft releases now appear to have been addressed, there remain some major areas of uncertainty and unresolved issues. This will present many challenges in practice for advisers involved with trust structures. The situation is not assisted in that another significant Federal Court case, namely *BBlood Enterprises*,[6] is on appeal to the Full Federal Court. Further, the section 100A issues in *Guardian AIT* may not be at an end if the taxpayer chooses to appeal (and the ATO cross appeals) to the High Court (of course with the need to obtain special leave to appeal).

This article is *not* intended to be a legal treatise on section 100A. Instead, it provides a brief overview of the recent case law and the finalised ATO releases. It then turns to some of the challenging, but nonetheless widespread, practical issues for advisers arising from these developments.

It is hoped that this article will provide advisers with some helpful insights so they may "prepare the ground" to minimise their clients' risk exposure in this area, whilst still achieving commercial and tax effective outcomes.

First Principles

Criteria and Effect

Despite its potential reach, section 100A is intended to be a specific anti-avoidance measure. Broadly, for section 100A to apply, the following elements must be satisfied:

- a beneficiary of a trust estate (who is not under a legal disability) must be presently entitled to income of the trust estate ("trust income");[7]
- there must be a connection between the beneficiary's present entitlement to the trust income and an agreement under which another person will benefit;[8]
- the agreement must have had the purpose (or purposes including) of reducing income tax that would otherwise be payable;[9] and
- the agreement in question (labelled in the legislation as a *reimbursement agreement*) must not be entered into in the course of ordinary family or commercial dealing.[10]

The agreement itself need not be in writing or legally enforceable, nor does it need to result in any "reimbursement" (according to the ordinary meaning of that term).[11]

Where section 100A applies, the legislation deems the beneficiary not to be, and to never have been, presently entitled to the share of trust income connected with the agreement for income tax purposes.[12] The practical result is that no beneficiary will be presently entitled to that share of income. Therefore, a section 99A assessment will arise to the trustee at the top marginal rate with respect to the tax net income[13] referable to the affected share of income.

Aside from the relevant tax net income being taxed to the trustee at the top marginal rate, there are a number of other consequences that flow from a beneficiary being deemed not to be presently entitled to trust income. These include:

- the denial of franking credit offsets to beneficiaries intended to receive a franked distribution;[14]
- any taxable capital gain affected by section 99A will not qualify for the 50% discount;[15]
- the absence of trust income derived by the beneficiaries may mean that a significant individual or CGT concession stakeholder does not exist for the trust taxpayer for a particular income year,[16] resulting in certain small business CGT concessions not being available; and
- any purported trust income distributions to loss entities (whether companies, trustees of trusts or individuals) may be deemed ineffective, resulting in the losses not being able to be used.

The application of section 100A can therefore have far reaching consequences.

Significance of Case Law

The ATO has been at some pains to emphasise that the criteria in section 100A are broad.

Whilst a cursory review of the words and concepts in section 100A reveals that they are broadly defined, in the authors' view this arises primarily because the provision is an anti-avoidance measure. The legislation therefore necessarily contains some flexibility so that the Courts are not overly constrained and can instead consider the context of the provisions in any application to a specific set of facts. Whilst Courts are given wide scope to apply section 100A, that does not mean that Courts will necessarily seek to do so as a matter of course. The case law, therefore, is of considerable significance in defining the scope of section 100A.

Indeed, historically the case law has suggested that section 100A is confined to relatively aggressive or contrived arrangements such as loss trafficking[17] and distributions to non-residents that are never called upon.[18]

A detailed review of the case law is outside the scope of this article. However, we have briefly commented on the recent Federal Court (and Full Federal Court) judgments of *Guardian AIT*[19] and *BBlood Enterprises* – the latter of which is currently on appeal to the Full Federal Court. Advisers should monitor the progress of the latter case and any further ATO pronouncements in relation to these cases generally as they may result in further changes to, or at least refinement of, the ATO's existing compliance approach.

Latest Developments in the Federal Court

The first of the two cases is the decision of Logan J of the Federal Court in *Guardian AIT*, which was handed down in December 2021 before the release of the draft ATO material, and which was upheld (in relation to section 100A) by the Full Federal Court in the *Guardian Appeal* handed down on 24 January 2023.

In broad terms, *Guardian AIT* involved a discretionary trust ("AIT") distributing its trust income to a private company ("AITCS") that was wholly owned by AIT, creating an unpaid present entitlement ("UPE") in favour of AITCS.

Subsequent to calling for partial payment of the UPE to fund its tax liability on the distribution, AITCS declared a fully franked dividend in favour of AIT. The dividend income was appointed by AIT in favour of the controller of the group, namely Mr Springer, who was a non-resident for tax purposes.

As Mr Springer was a non-resident, the fully franked dividends derived by Mr Springer were not subject to withholding tax or any further tax liability in Australia.[20]

The Commissioner of Taxation ("Commissioner") sought to apply section 100A to the above arrangement.

In understanding this case, it is important to recognise that tax would have been imposed on Mr Springer based on marginal rates for non-resident taxpayers (effectively the highest marginal rate here) had AIT simply appointed its income to Mr Springer and not distributed anything to AITCS.[21] The effect of the arrangement was therefore that Mr Springer was able to receive income comprising of a fully franked dividend that was not subject to withholding tax or further tax in Australia.

The Federal Court at first instance held that section 100A did not apply for a number of reasons. The Court held that for section 100A to apply, the agreement must precede the creation of the UPE. None of the evidence suggested that this had occurred. In particular, the Federal Court held that the payment of the dividend by AITCS was not contemplated at the time the UPE was created in its favour.[22] This finding was not disturbed by the Full Federal Court in the *Guardian Appeal.* In particular, the Full Court held that while there may have been an *expectation* that an arrangement concerning the payment of a dividend *could* be entered into after creating the UPE, this was not sufficient to show there was an "agreement" to pay such a dividend at the time the UPE was created.[23]

Moreover, the steps taken to incorporate AITCS, appoint it as a beneficiary of AIT and then make AITCS presently entitled to the income were considered by the Federal Court at first instance to arise in the course of ordinary family or commercial dealing.[24] Given the Full Court's finding above that there was no relevant agreement for section 100A purposes, it was unnecessary for the Full Court to consider the issue of ordinary family or commercial dealing in the *Guardian Appeal*. The Full Court did, however, observe that the mere inclusion of a corporate beneficiary as an eligible beneficiary of a trust, and the fact that a distribution may be made to such a beneficiary, is not itself sufficient to demonstrate that the arrangement fails to qualify as an ordinary family or commercial dealing.[25] Instead, the Commissioner's position that the arrangement arose outside the course of ordinary family or commercial dealing was premised on the inclusion of the decision for AITCS to pay a dividend in the scope of the arrangement.

The Federal Court at first instance also held that there were valid commercial reasons for Mr Springer incorporating AITCS, a new company, and using it as a corporate beneficiary. The evidence suggested Mr Springer undertook this action to minimise his risks in retirement by creating a new separate legal entity that had no trading history (and therefore no potential exposure) as a vehicle for wealth accumulation and passive investment.[26] Moreover, the Court held that AITCS, as a company, had no inherent tax advantages.[27] The Full Federal Court took issue with this reasoning, holding that Part IVA applied to the arrangement in relation to the 2013 income year.[28] That said, this finding did not impact on the section 100A determination given the absence of a relevant "agreement" that included the payment of a dividend.

One further noteworthy aspect of the Full Court's judgment in the *Guardian Appeal*, insofar as the differences between section 100A and Part IVA as anti-avoidance provisions are concerned, is the distinction in the Court's ability to impute the knowledge, purpose or intention of an adviser to the taxpayer.

In relation to section 100A, the Full Court held that there was no basis for imputing any understanding of the advisers to Mr Springer given that there was no evidence of a subjective "consensus and adoption" concerning the subsequent dividend payment to Mr Springer.[29] To this end, the Court held that the scope for attribution from an adviser to the taxpayer in the context of section 100A is "far more limited" than in the context of Part IVA.[30] In the absence of a communication between the advisers and Mr Springer evidencing a plan, it would have been necessary for the Commissioner to show that the advisers had authorisation to act on behalf of the entities in giving effect to the transactions (i.e. as an authorised representative of the entities).[31] This was not found to exist on the facts of *Guardian AIT*.

In light of the above comments, it might be suggested that *Guardian AIT* sets a relatively high benchmark in terms of when section 100A will apply, particularly in terms of the threshold of evidence required to establish that there is an "agreement". Of course, the *Guardian Appeal* does raise separate issues concerning the application of Part IVA, a discussion of which issues is outside the scope of this article.

Unlike *Guardian AIT,* the more recent case of *BBlood Enterprises* handed down on 19 September 2022 was decided in favour of the Commissioner on the section 100A issue.

Broadly, the case involved the following situation:

- A shareholding discretionary trust ("IP Trust") entered into a share buy-back during the 2014 income year. The sale proceeds received gave rise to a fully franked deemed dividend to the IP Trust for approximately $10,000,000 under the share buy-back provisions ("Buy-Back Dividend").
- The IP Trust received distributions of approximately $300,000 of ordinary income from other entities within the group for the 2014 income year.
- Prior to 30 June 2014, the trust deed for the IP Trust was amended to redefine the trust income from a tax net income definition to an "ordinary concepts" definition.
- Also prior to 30 June 2014, the IP Trust created a UPE in its trust income (i.e. $300,000) in favour of a newly incorporated company ("BE Co").
- Applying the proportionate approach endorsed in *Bamford's* case,[32] BE Co was assessed on all of the tax net income (including the $10,000,000 Buy-Back Dividend) based on its present entitlement to all of the trust income. This was the case notwithstanding that BE Co only had a present entitlement to trust income of approximately $300,000.
- BE Co used the franking credits it accrued on the Buy-Back Dividend to offset its tax payable.

The purported end-result of this arrangement was that no tax was payable on the deemed dividend, with the sale proceeds from the share buy-back accrued as capital of the IP Trust.

The Court accepted the Commissioner's contention that section 100A applied to strike down BE Co's present entitlement to the trust income and assess the tax net income to the trustee of the IP Trust.

Some key aspects of the Court's decision may be summarised as follows:

- The Court confirmed that the term "reimbursement" should not limit the application of section 100A. The definition of a "reimbursement agreement" is clearly intended to capture all manner of arrangements which may or may not involve a reimbursement in the ordinary sense of the term.[33]
- When determining if an agreement was entered into in the course of "ordinary family or commercial dealing", it is necessary to consider the arrangement as a whole.[34]
- When viewed as a whole, the Court found that the arrangement did not arise in the course of ordinary family or commercial dealing in that the arrangement was overly complex and unusual in nature. In particular, the steps involved were not necessary to achieve the stated objectives of simplifying the corporate structure and facilitating succession planning outcomes.[35]

Justice Thawley also held that the arrangement was one which possessed the necessary tax reduction purpose. In this regard, it was only necessary that one of the purposes for implementing the arrangement was to reduce income tax.[36]

The Court regarded the following factors as being important to its finding:

- statements by the taxpayer's advisers;
- the use of IP Trust for the receipt of distributions for the first time and its essential role in creating a mismatch between trust income and tax net income;
- the variation of the trust deed of the IP Trust, which hard-wired the treatment of the buy-back sale proceeds as trust capital; and
- the adoption of the buy-back procedure, which could not be adequately explained by reference to the objectives claimed by the taxpayer (e.g. simplification of the group structure and succession planning).

BBlood Enterprises is significant in that, whilst the Court took the view that the evidence strongly supported that the scheme was tax-driven,[37] it is difficult to see that the tax reduction purpose was clearly made out in circumstances where BE Co was not subject to tax only due to the franking credits it received on its buy-back dividend income. In saying this, it is notable that section 100A was applied here notwithstanding that the funds were retained in the IP Trust and were not subject to a capital distribution or loan to Mr Blood or any family members.

It will be of significant interest to advisers to see if the Full Federal Court adopts similar reasoning to the *Guardian Appeal* decision on the issue of imputing a professional tax adviser's purposes to the taxpayer. The Full Court might be expected to comment on this issue given the significant role tax lawyers and accountants played in the arrangement on the facts of *BBlood Enterprises*.[38]

Having now summarised some of the core concepts arising from the recent case law, it is useful to turn to the finalised ATO releases.

Finalised ATO Releases

Preliminary Observations

In the authors' view, PCG 2022/2 ("PCG") and TR 2022/4 ("Tax Ruling") are a significant improvement – at least in clarity of expression – on the previous ATO draft releases.

One sensible outcome is that the Commissioner has largely seen fit to apply compliance resources prospectively, focusing on the year ending 30 June 2023 ("2023 year"). This is significant given that the usual amendment periods do not apply in the context of section 100A.[39]

Central to understanding the stance taken by the Commissioner on timing issues is the 2014 ATO statement on section 100A entitled "Trust Taxation – Reimbursement Agreement" ("2014 ATO Statement").

In this regard, the Commissioner has now stated that the ATO will not dedicate compliance resources to entitlements arising before 1 July 2022:

- to the extent the 2014 ATO Statement is more favourable to the taxpayer's circumstances than the PCG; or
- if the taxpayer can demonstrate reasonable care in applying the 2014 ATO Statement.

In the authors' view, this should generally mean that taxpayers who have complied with the 2014 ATO Statement should not be targeted by the ATO under section 100A in relation to pre-1 July 2022 entitlements.

In addition, a narrow exclusion from ATO compliance activity applies where a taxpayer's circumstances fall within the white zone. That is, where the arrangement was entered into prior to 1 July 2014, and:

- the ATO is not otherwise considering the taxpayer's affairs for those years; and
- the arrangement did not continue before and after 1 July 2014.

A disappointing outcome is that the Commissioner has not withdrawn (or modified) Taxpayer Alert TA 2022/1. Although one of the examples the Commissioner identifies as a breach in TA 2022/1 (Example 2) has been sufficiently explored in the PCG and Tax Ruling, the other example identified as a breach (Example 1) has not been addressed.[40] This latter example involves a trustee applying trust funds attributable to UPEs to adult children in favour of their parents' mortgage offset account. As this example does not go into any detail that is consistent with the red zone examples set out in the finalised ATO releases, it is unhelpful for it to be left unaddressed.

Practical Compliance Guideline

The PCG by definition is limited to outlining the areas of concern to which the Commissioner proposes to apply compliance resources. It is not intended as a statement of the law and is not legally binding on the Commissioner.

The PCG does, however, appear to be administratively binding. The PCG states in this regard that if a taxpayer falls within its terms, then the Commissioner will apply the PCG as long as the taxpayer is acting in good faith.[41]

The broad approach taken by the Commissioner in the PCG may be summarised as follows:

- The Commissioner will not dedicate compliance resources to taxpayers whose circumstances fall within the white zone (only applicable to pre-1 July 2014 arrangements – see above) or the various green zone scenarios described in the PCG (see below).[42]
- By contrast, taxpayers who fall within the various situations described as red zone scenarios will attract the ATO's attention and will be subject to further scrutiny as a priority, potentially resulting in an audit.
- Where the arrangement does not fall within any of the zones, the arrangement is not of itself to be treated as a high section 100A risk.[43] The ATO may nevertheless engage with the taxpayer to better understand the arrangement, including the risk of section 100A applying.

Clearly, the assurances given by the Commissioner in relation to the green zone means that there will be much interest in falling within, or structuring a taxpayer's affairs to fall within, these scenarios.

There are five green zone scenarios (scenarios 1-4, including scenarios 3A and 3B). Regrettably, these are relatively narrow situations, particularly given the exclusions that apply (see below). All the same, given the protection the green zone scenarios offer, their circumstances warrant close examination.

The green zone scenarios specifically include:

- Situations where a UPE is created in favour of an individual but the cash relating to such income is deposited into the joint bank account of the individual and their spouse for use in meeting household expenditure, making personal superannuation contributions or making donations to deductible gift recipients.[44] This might be referred to as a "common pool of assets" situation.
- Circumstances where a UPE is created and is then paid to or applied on behalf of the beneficiary within two years of its creation and "used" to purchase goods or services, meet liabilities or expenses or is invested for the beneficiary. Importantly for these purposes, the Commissioner accepts that a beneficiary that is a trustee of a further trust or a company "uses" their entitlement by making a distribution to the beneficiaries or members (respectively). This scenario does not, however, apply if there is a non-commercial transaction by the beneficiary with a related party.[45]
- A UPE is created in favour of an individual beneficiary but the funds are retained by the trustee and used for working capital in a business or for reinvestment purposes. Importantly, this scenario does not apply where loans are made by the trustee to related entities other than on commercial terms (which is defined in the PCG as meeting the requirements of a complying division 7A loan agreement).[46]
- There is a UPE in favour of a company or trustee beneficiary and the funds are retained by the distributing trust in circumstances where the UPE with the company or trustee beneficiary is on commercial terms (again requiring terms consistent with a complying division 7A loan agreement).[47]

The last-mentioned scenario is curious. It may give rise to a situation where, in order to attract green zone status, unpaid distributions between trusts must be placed on complying division 7A loan agreements even where there is no UPE in favour of a corporate beneficiary.

All of the green zone scenarios are subject to an exclusion under paragraph 32 of the PCG. Paragraph 32 provides 11 features which will automatically exclude the arrangement from green zone status. Some of the pertinent paragraph 32 exclusions include (but are not limited to):

- the beneficiary making a gift of funds received either in satisfaction of their trust entitlement or an associated amount paid by the trustee (for example, if the UPE was converted into a loan);[48]
- the beneficiary disclaiming their entitlement or releasing the trustee from its obligation to pay the UPE (which the ATO considers includes converting a UPE to a loan);
- the beneficiary's entitlement is less than the beneficiary's share of the tax net income assessed to the beneficiary, franked dividends of the trust and trust capital gains as a result of the trustee exercising a power, or the deed being amended or varied, to affect the quantum of the trust income;
- the beneficiary being a private company that uses its UPE to fund a distribution that is made directly or indirectly to a non-resident;

- the beneficiary being a private company or trust that uses its entitlement to fund a distribution that is made directly or indirectly to the trustee that made the beneficiary presently entitled to the income;
- the beneficiary not being notified by the trustee of their entitlement to trust income by the earlier of the trustee's due date and actual date of lodgment; and
- the beneficiary using the trust entitlement to pay excessive consideration where the parties are not dealing at arm's length.

It might be expected that many of these exclusions will arise in practice and therefore make it difficult to achieve green zone status. For instance, it would not be unusual of itself (and certainly not tax driven) for a beneficiary's entitlement to be converted to a loan. This occurs in a wide variety of circumstances in practice.

As to the red zone, the types of scenarios covered include, among others:

- distributions to adult children being satisfied by way of offset against loans made by other beneficiaries, particularly where the loans (or purported loans) relate to costs incurred when the low-income beneficiaries were minors;[49]
- distributions to non-residents, particularly where there is use of the funds benefitting residents;[50]
- situations where there is an excess of tax net income over trust income, particularly where the arrangement has been structured into by a deed amendment or the exercise of a trust power[51] – a share buy-back in the nature of *BBlood Enterprises* is given as an example (although the ATO example requires one further step than *BBlood Enterprises* by including a capital distribution being made from the trust); and
- use of hybrid trusts, in particular where the structure allows access to the corporate tax rate without an indebtedness of the trust to the corporate beneficiary.[52]

Clearly, it is necessary for advisers to be familiar with these arrangements (and similar arrangements with consistent themes) as the Commissioner can now be regarded as having given fair warning on red zone arrangements.

Tax Ruling

Unlike the PCG, the Tax Ruling is a public ruling and is therefore binding on the Commissioner according to its terms. The Tax Ruling represents the Commissioner's considered view on the law in this area. Consequently, considerable legal authority is set out in the Tax Ruling in an effort to support the Commissioner's views.

The Commissioner has persisted in his view that section 100A has the ability to impact trust beneficiaries specifically entitled to capital gains and franked dividends under the trust streaming legislation.[53] Although not without doubt, the authors consider this to be the correct position given that creating a specific entitlement in capital gains and franked dividends commonly involves creating, in accordance with the terms of the trust deed, a present entitlement to trust income at first instance.[54]

Amongst other things, the Tax Ruling explores the "ordinary family and commercial dealing" exclusion in some detail. In this respect, the Commissioner has relied upon Thawley J's decision in *BBlood Enterprises* in asserting that the historical behaviour of the parties may be relevant and also whether the dealing:

- is artificial or contrived;
- is overly complex;
- contains steps that are not needed to achieve the family or commercial objectives; or
- contains steps that might be explained by objectives different to those said to be behind the ordinary family or commercial dealing.[55]

Whilst not committing on the issue entirely, the Commissioner appears to have moved away from previous statements in the draft releases that emphasised that artificiality or contrivance is not necessary for an arrangement to fall outside the ordinary family and commercial dealing exception.[56] Possibly with the exception of *BBlood Enterprises*, the existing Court authority appears to place significant emphasis on artificiality and contrivance in concluding that an arrangement falls outside the course of ordinary family or commercial dealing (and hence that section 100A can apply). Indeed, even in *BBlood Enterprises*, a considerable part of Thawley J's judgment is dedicated to casting doubt on the taxpayer's suggested motives and concluding that the underlying purpose of the transaction was tax avoidance.[57]

Planning Issues

ATO Review and Audit Issues

It is important to recognise that a number of taxpayers will fall within red zone areas due to past practices and in scenarios that do not qualify for the white zone exclusion.

Sometimes these arrangements have arisen in the context of the taxpayer receiving poor advice or no advice in situations where they now have new advisers. Where clients have potential exposure due to past activities described in the 2014 ATO Statement that do not fall within the white zone, voluntary disclosure to the ATO should, at the very least, be considered as a potential option to minimise the client's exposure.

Preparing for Year-End

The majority of taxpayers will now need only look to the 2023 year onwards to get their "house in order" on section 100A. A major issue to consider will be the necessary preparation of year-end distribution resolutions for the 2023 year, as well as movements in beneficiary accounts during that year.

In the authors' experience, advisers have needed to observe far greater care and diligence in preparing year-end trust distribution resolutions in recent years. This has arisen for a variety of reasons including:

- case law developments in terms of *Bamford*'s case and similar cases dealing with an excess of tax net income over trust income;[58]
- the trust streaming measures for capital gains and franked dividends;[59] and
- administrative ATO changes that require that trust distribution resolutions for discretionary trusts are made on or before year-end.[60]

Section 100A should therefore be added to the checklist of issues advisers should consider when preparing and advising on year-end distribution resolutions. It is worthwhile emphasising that movements in prior year UPE balances during the 2023 year should also be subject to close scrutiny and may be undertaken as part of briefing the client in the lead-up to year-end.

Larger private groups in particular will need to be extensively briefed and supported on these issues and should be encouraged to engage in a comprehensive review of their affairs.

In the authors' view, a number of key issues should now be considered in preparing year-end trust distributions and monitoring transactions that will impact on trust financial statements for the 2023 year onwards. These might include:

- The need to exercise care with debit entries in the trust accounts. For instance, the reduction of liabilities by way of satisfaction of UPE accounts, particularly in the case of low-income beneficiaries, should be carefully considered. The creation of debit loans in favour of high-income beneficiaries which subsist with unpaid distributions made to low-income beneficiaries should also be diligently reviewed.
- Following from the above point, any satisfaction of UPEs of low-income beneficiaries by way of set-off, forgiveness or by the trustee paying amounts to high-income beneficiaries in discharge of inter-beneficiary loans will also deserve close scrutiny.
- Reviewing and retaining contemporaneous evidence such as bank statements and evidence of cash transfers to demonstrate the use to which trust funds have been put in satisfying UPEs will also be important. Advisers may also wish to consider evidence concerning the "tracing" or "quarantining" of funds within a trust to show that amounts applied for purposes other than satisfying UPEs were not sourced from the amounts supporting a UPE.
- Where spouses are involved, considering whether transactions can be structured in a manner that makes use of the "common pool of assets" themes reflected in the examples in the PCG and Tax Ruling.[61]
- Considering whether green zone outcomes can be readily achieved without placing unnecessary and unrealistic constraints on the trust's utility or unnecessarily increasing compliance costs. In this regard, the PCG refers to taxpayers needing to document the basis for satisfying the green zone criteria.[62] This is perhaps best achieved by way of working papers to be retained on the client file.
- Taking care with arrangements involving beneficiaries never being physically paid their underlying UPEs, including because they are, for instance, gifted back to the trustee or forgiven.[63]
- Giving careful scrutiny to arrangements involving distributions to non-residents, loss entities or companies where the company has a significant excess of tax net income over its trust income.
- Where viable, considering whether trust distributions to loss entities should in fact be paid (perhaps within two years) rather than left as UPEs to ensure the loss beneficiary has benefited from the distribution of trust income and not some other person or entity.
- Exercising caution in "converting" UPEs to loans in circumstances where the green zone is sought to be relied upon.

Other Family/Private Group Issues

Apart from year-end issues, invariably other practices involving private groups may need revisiting. For instance, it is not unusual for large UPEs to be forgiven or assigned under the provisions of a beneficiary's Will. Could this potentially create a section 100A exposure, especially if the forgiveness was in contemplation when the UPEs were created? In the authors' view, in most cases the necessary connection between the relevant events is likely to be too remote. That said, the possibility of section 100A issues arising in a succession planning context should not be overlooked.

Similarly, family groups may often seek to extinguish UPEs in favour of individuals by way of forgiveness or set-off as an asset protection measure. Whilst these types of arrangements may not be tax driven, it may now be appropriate to document the commercial basis of dealings with UPEs to reflect the parties' intentions at the time such forgiveness is occurring. Establishing that there is no tax reduction purpose may also be helpful in minimising any client exposure in these situations. Thoughtful and contemporaneous company or trustee resolutions reflecting the substance of the transactions may prove critical here.

In all scenarios, it should be borne in mind that the burden of proof is on the taxpayer (and, by extension, their advisers) to establish that the arrangement was entered into in the course of ordinary family or commercial dealing.[64]

Preparing the Ground

It may be seen that there are now significant section 100A issues to consider when dealing with trust structures.

For the majority of clients and advisers, the focus is overwhelmingly on the 2023 year and subsequent years. Therefore, the timing is now right for advisers to review their client base and the potential issues that arise in each family or private group's particular circumstances. In the authors' experience, this should considerably assist in mitigating against risk exposures without compromising the numerous advantages to be gained through the use of trust structures.

Footnotes:

1 The authors wish to thank and acknowledge Amy Lancaster, Law Clerk in Cowell Clarke's Tax & Revenue group, for her assistance in the preparation of this article.

2 Of the *Income Tax Assessment Act 1936* (Cth) ("ITAA36").

3 Draft TR 2022/D1 and Draft PCG 2022/D1. Taxpayer Alert TA 2022/1 was also released at this time.

4 See, for instance, Chartered Accountants ANZ submissions dated 29 April 2022 at page 7 and Law Council of Australia submissions dated 6 May 2022 at page 7.

5 *FC of T v Guardian AIT Pty Ltd ATF Australian Investment Trust* 2023 ATC ¶20-850; [2023] FCAFC 3 ("*Guardian Appeal*").

6 *BBlood Enterprises Pty Ltd & Anor v FC of T* 2022 ATC ¶20-840; [2022] FCA 1112.

7 Section 100A(1)(a) ITAA36. Note that "trust income" and "income" are used interchangeably throughout this article.

8 Sections 100A(1)(b) and (7).

9 Section 100A(8).

10 Section 100A(13).

11 In the authors' view, this is clear from the terms of section 100A, but has been emphasised in the *BBlood Enterprises* decision.

12 Section 100A(1).

13 In this article, "tax net income" is a reference to "net income" as defined by section 95(1).

14 Sections 207-45 and 207-50(3)(b) of the *Income Tax Assessment Act 1997* (Cth) ("ITAA97"). The trustee may nonetheless still be entitled to franking credit offsets on tax payable under the section 99A assessment: see section 207-45(c).

15 Section 115-222(4).

16 This is because these requirements will often rely on the distribution of income or capital being made to an individual and "income" for these purposes is trust income.

17 *Hart v FC of T* 2018 ATC ¶20-653; [2018] FCAFC 61; *Idlecroft Pty Ltd & Ors v FC of T* 2005 ATC 4647; [2005] FCAFC 141; *FC of T v Prestige Motors Pty Ltd* 98 ATC 4241; (1998) 153 ALR 19; *Raftland Pty Ltd v FC of T* 2008 ATC ¶20-029; (2008) 246 ALR 406.

18 *East Finchley Pty Ltd v FC of T* 89 ATC 5280; (1989) 90 ALR 457.

19 *Guardian Appeal* (as cited above) and at first instance: *Guardian AIT Pty Ltd (as trustee of Australian Investment Trust) & Anor v FC of T* 2021 ATC ¶20-813; [2021] FCA 1619 ("*Guardian First Instance*"). For ease of reference, *Guardian Appeal* and *Guardian First Instance* are referred to collectively as "*Guardian AIT*" in this article where appropriate.

20 See sections 128B(3)(ga)(i) and 128D ITAA36.

21 Section 98A(1).

22 *Guardian First Instance* at [150].

23 *Guardian Appeal* at [111], [116] (emphasis added).

24 *Guardian First Instance* at [152].

25 *Guardian Appeal* at [126].

26 *Guardian First Instance* at [184].

27 At [150].

28 *Guardian Appeal* at [191]-[192], [196], [215], [221].

29 At [124].

30 At [122]-[124].

31 At [124].

32 *FC of T v Bamford & Ors; Bamford & Anor v FC of T* 2010 ATC ¶20-170; [2010] HCA 10.

33 *BBlood Enterprises* at [120].

34 At [102].

35 At [102].

36 At [132].

37 At [228].

38 See *BBlood Enterprises* at [81]-[82], [138]-[140], [201]-[206], [215]-[230].

39 Section 170(10) ITAA36 at item 17. Usual limitation periods are two to four years (in the absence of fraud or evasion).

40 Note, however, that paragraph 48 of the PCG provides that any examples of concern to the Commissioner regarding section 100A that are the subject of a Taxpayer Alert will fall into the red zone.

41 See preamble to the PCG.

42 Other than to confirm that the features of a green zone scenario are present.

43 Paragraph 15.

44 Scenario 1 at paragraphs 20 and 21.

45 Scenario 2 at paragraphs 22 to 24.

46 Scenario 3A at paragraphs 26 and 27.

47 Scenario 3B at paragraphs 28 and 29. There is also a scenario 4 which covers any arrangements "relevantly identical" to the favourable examples given in Appendix 2 of the Tax Ruling (dealing with arrangements entered into in the course of ordinary family or commercial dealing).

48 Except where the gift itself meets green zone scenario 1.

49 Scenario 1 at paragraphs 34(a) and 34(b).

50 Scenario 1 at paragraph 34(c).

51 Scenario 4 at paragraph 43.

52 Scenario 3 at paragraph 41.

53 Paragraphs 39-42 and 126-134 of the Tax Ruling.

54 This is generally necessary to ensure that the beneficiary is reasonably expected to receive the net financial benefit referable to the capital gain or franked dividend.

55 Paragraph 27 of the Tax Ruling.

56 See, for instance, paragraph 79 of Draft TR 2022/D1.

57 In particular, the evidence of the accountant's intention was imputed to the taxpayer: at [196]-[237].

58 See *Cajkusic & Anor* v *FC of T (No 2)* 2006 ATC 4752; [2006] FCAFC 164; *Colonial First State Investments Ltd* v *FC of T* 2011 ATC ¶20-235; [2011] FCA 16; *FC of T* v *Greenhatch* 2012 ATC ¶20-322; [2012] FCAFC 84.

59 Subdivisions 115-C and 207-B ITAA97.

60 The ATO's former position is contained in Taxation Rulings IT 328 and IT 329. The ATO's current position is contained in website guidance on trustee resolutions (QC 44411) and the ATO Notices of Withdrawal associated with these Taxation Rulings.

61 Example 7 at paragraphs 138 to 142 of the Tax Ruling; Example 4 at paragraphs 69 to 75 of the PCG.

62 Paragraph 18 of the PCG.

63 Paragraphs 32(b) and 32(c) of the PCG.

64 *Prestige Motors Pty Ltd* v *FC of T* 97 ATC 4392, 4404.