Tax Astute
TRAINING

TAX SNAPSHOT

Applying the ATO's finalised s 100A ITAA 1936 guidance to Trust Distributions

On 8 December 2022, the ATO released TR 2022/4 and PCG 2022/2 (**finalised s 100A Guidance**) replacing its previously released draft compliance approach to the s 100A *ITAA* 1936 (**s 100A**) anti-avoidance provision regarding trust distributions (previously released as TR 2022/D1 and PCG 2022/D1 in March 2022).

This Tax Astute Training Snapshot explains:

- How to identify when and how s 100A ITAA 1936 might potentially apply to a beneficiary's entitlement arising from a trust distribution (see s 100A overview from page 2 or go to online recording at page 3); and

- How to determine the ATO's most likely s 100A compliance approach to any given trust distribution under the rewritten PCG 2022/2 (including how to access the ATO's concessional s 100A compliance approach by achieving White or Green Zone status) – from page 4 or go to the online recording at page 9.

IMPORTANT NOTE

Given that s 100A *ITAA* 1936 is not the only trust distribution issue the ATO is likely to be reviewing (e.g. there are various current Part IVA ITAA 1936 issues of relevance) it is anticipated that a range of trust distributions could be queried by the ATO. Successful compliance management of trust distributions (past, present and future) for s 100A purposes will generally involve accessing the ATO's concessional compliance approach in PCG 2022/2, by satisfying either White Zone or Green Zone requirements (see the flowchart and online recording on page 9 and/or background commentary from page 4 for more details).

It is important to note that s 100A *ITAA* 1936 has always had an unlimited amendment period (i.e. unlike most tax provisions, the ATO is not restricted to a 2 or 4 year review period). The ATO therefore has the statutory right to review any past distribution for the potential application s 100A ITAA 1936 (regardless of how many years ago the beneficiary entitlement may have arisen). As expected, the finalised s 100A Guidance applies both before and after its date of issue and the issues summarised in this Tax Astute Training Snapshot can therefore apply to past present or future trust distributions/beneficiary entitlements.

Actions of beneficiaries (including corporate beneficiaries) can also have a bearing on how concessionally (or otherwise) a particular trust is likely to be treated for s 100A compliance purposes.

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When and how might s 100A apply to a beneficiary's entitlement arising from a trust distribution? (s 100A overview)

The following diagram illustrates how to identify whether s 100A ITAA 1936 might potentially apply to a given trust distribution (and the consequences where this occurs) using concepts from and references to the ATO's finalised TD 2022/4 (including key paragraph references). A key initial indicator of a possible s 100A problem involves the difference shown at A below between:

- The entitled beneficiary (**EB**) – the individual or entity made entitled for tax and legal purposes; and
- The actual recipient (**AR**) – the trust or other person or entity which actually retained or otherwise received the benefit behind the EB's entitlement.

As explained in TR 2022/4, three additional requirements also need to be present (as illustrated at B, C and D in the diagram and explained in the recording below) in order for s 100A to tax a trustee at the penalty 47% s 99A *ITAA* 1936 rate. There is no question that numerous distributions involving item A will ultimately escape application of s 100A due to a favourable outcome regarding purpose or the ordinary dealing exception (as recognised by the ATO in their comments). There are a number of important new technical developments outlined in TR 2022/4 which will be important, particularly for more complex/higher risk s100A scenarios – Tax Astute Training clients will receive further details of key developments in their forthcoming training session and/or recording.

GUIDANCE TIP

For the majority of trust distributions, given the complexity of s 100A itself (and associated case law) even if a taxpayer successful after undergoing a s 100A technical review by the ATO, the compliance time and costs required to manage such a complex review are likely to be significant.

Given that the ATO is likely to review a wide variety of trust distributions for a number of current reasons (including recent Part IVA *ITAA* 1936 developments) we have provided details to assist taxpayers and their professional advisers in understanding how to access the ATO's concessional compliance approach in PCG 2022/2 – see the Guidance Tip and flowchart (including online recording) on pages 4 and 9 for more details and use the overview diagram and recording below to broadly understand the background behind the flowchart's application.

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To watch Tax Astute Training's online explanation of the below diagram, please use this link:
http://taxastute.adobeconnect.com/plsxbocak8dx/
This link connects with the Adobe Connect website.
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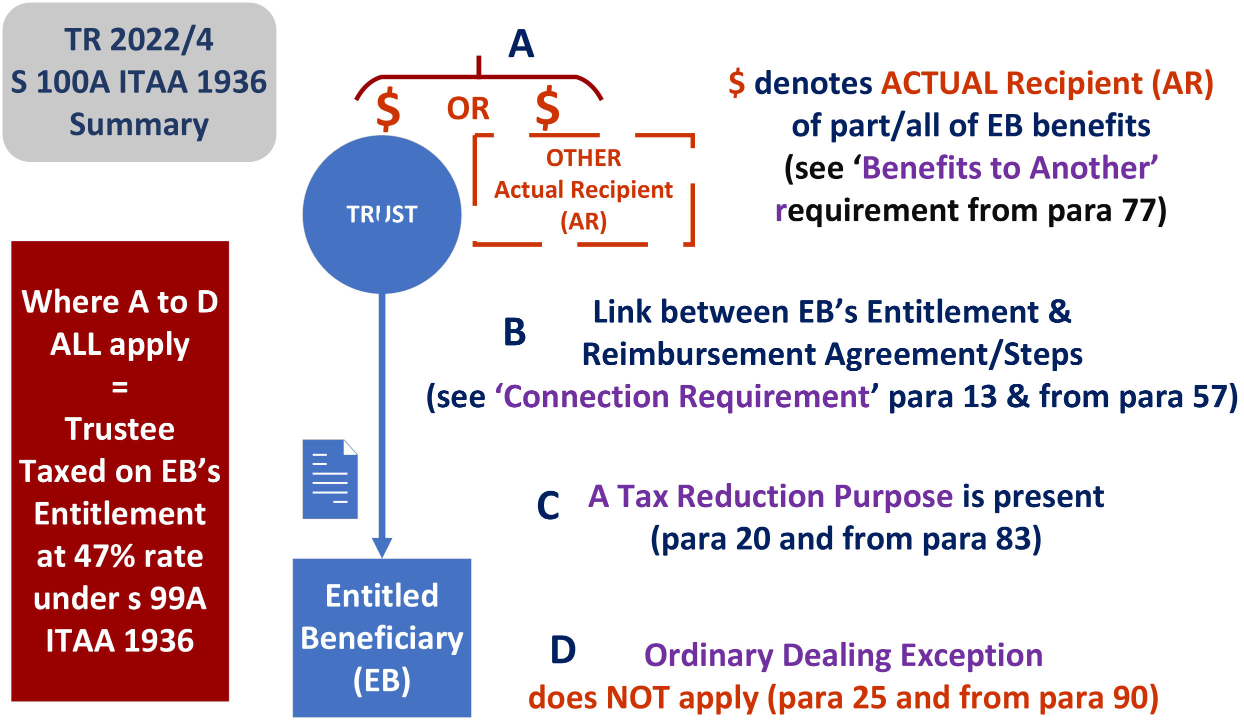

IMPORTANT NOTE

The above diagram provides a non-exhaustive overview of the operation of s 100A and its potential adverse implications. A variety of additional more complex technical information is available in the TR 2022/4 paragraphs noted above but is beyond the scope of this overview Tax Astute Training Snapshot. Tax Astute Training clients will receive further details in all training sessions from this week and/or in their online recordings.

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TAX SNAPSHOT

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How to determine the ATO's likely s 100A compliance approach to any given trust distribution?

In practice, the most cost-effective and efficient management of a s 100A risk is generally likely to involve keeping appropriate records and evidence that the relevant beneficiary entitlement should be eligible for concessional compliance treatment by the ATO. In the event of initial questions from the ATO regarding beneficiary entitlements (past present and future given the unlimited s 100A *ITAA* 1936 amendment period) a good understanding of PCG 2022/2 and maintenance of good documentary evidence to support access to the ATO's proposed concessional compliance treatment (see below and PCG 202/2) is likely to provide the best compliance risk management in the majority of cases. This flowchart is designed to assist tax practitioners and their clients in understanding where to find relevant information within PCG 2022/2 when reviewing trust distributions for s 100A compliance risk issues. It is noted that some scenarios will be easier to address than others, depending on the specific circumstances involved.

GUIDANCE TIP

As illustrated in the flowchart below, the ATO's Compliance Concession (where available per PCG 2022/2 para 4 and the flowchart below) would generally involve any ATO compliance activity being limited to establishing that the requirements of the White Zone, Green Zone or, in rare cases, the ATO's previous 2014 document (see Guidance Tip at page 6 for details) have been satisfied, as opposed to a full complex technical compliance review regarding how s 100A might potentially apply to a given distribution.

If the ATO compliance concession cannot be achieved, the ATO notes that this does not necessarily mean that there is a high risk of s 100A actually applying. However, there is a higher risk of a full ATO s 100A technical compliance review, thereby increasing the risk of higher compliance costs arising (whether ultimately successful or not).

As illustrated in the flowchart (at page 9) below:

- One of the simplest s 100A compliance solutions involves maintaining appropriate records/evidence (see PCG 2022/2 paras 49 to 52 for more) showing that an Entitled Beneficiary (**EB**) immediately received their entitlement (i.e. that the Entitled Beneficiary and Actual Recipient (**AR**) of the benefit are one and the same such that s 100A cannot apply – see A below and also the page 3 diagram and recording for background). An example of such a scenario might involve a 19-year-old university student '*child*' who has received up-front payments for their numerous living costs, fees and similar during the year such that there is no mismatch between EB and AR at any time. Note that where there is instead a delay in providing actual benefits to an EB, a different solution will be required (e.g. in most cases the Green Zone noted at C below).

- If however, there is any type of (fully or partly) unpaid beneficiary entitlement involved (a very common scenario) then the first required flowchart step will involve considering the numerous new PCG 2022/2 concessional compliance 'carve outs' in paragraph (**para**) 32 (**see B** below).

  Where it applies, application of para 32 will effectively '*switch off*' access to the ATO's concessional s 100A compliance approach in PCG 2022/2 para 4, leaving the entitlement exposed to a higher risk of a full s 100A technical review (with associated significant time and costs involved even if ultimately successful).

  Adverse Item B/paragraph 32 factors may present due to any one of:

  - the Red Zone requirements being satisfied (**see F**); or
  - certain administrative/trust law issues being present; or
  - an EB's actual benefits being diverted elsewhere in specified circumstances (e.g. a corporate beneficiary on-distributing to a non-resident beneficiary is a para 32 example but there are also numerous other examples and some exceptions).

It is therefore essential to understand and rule out para 32 as an initial step to ensure that the entitlement is potentially eligible for concessional White Zone or Green Zone status – this approach will be required regardless of how old the entitlement is (i.e. pre-1 July 2014 arrangements are equally affected). If any element of para 32 is present, then the Red Zone outcome item E must be considered as shown.

Assuming that para 32 has been checked and ruled out **at B**, the next question involves determining whether or not the arrangement was entered into (generally where the entitlement arose) pre 1 July 2014 (**see C**). While many pre-1 July 2014 arrangements/entitlements may ultimately access the ATO's compliance concessions at PCG 2022/2 para 4, via the White Zone (see also the Guidance Tip on page 4) it is important to note that there are White Zone carve outs/exclusions (see thhe paragraphs noted **at D**) which must first be checked. If all White Zone requirements are met then the PCG 2022/2 ATO compliance concession should apply as shown.

GUIDANCE TIP

While expected to be relatively rare in its application, as illustrated with an * in the flowchart below, to the extent that a beneficiary entitlement arose at any time prior to 1 July 2022 and the ATO's previous 2014 document 'Trust taxation – reimbursement agreement' (**ATO 2014 document**) was applicable and provided a superior outcome to the ATO's December 2022 Finalised s 100A Guidance then the ATO will accept application of its 2014 document. While a full analysis is beyond the scope of this Tax Astute Training Snapshot, in rare cases where the ATO 2014 document was applied to a pre-1 July 2022 scenario, it is arguably likely to provide a more concessional definition of *'loan on commercial terms'* than the ATO's December 2022 Finalised s 100A Guidance (see more details at E below).

Subject to the above Guidance Tip and (and application of other items such as para 32 **at B**) where either:

- the arrangement/entitlement arose since 1 July 2014; or
- a '*carve out*' to White Zone status applies (see the PCG 2022/2 paragraphs noted **at D**)

then the only way to access the ATO's s 100A compliance concession (see Guidance Tip at page 4 for details) is to satisfy the Green Zone requirements shown at item E below.

While a full analysis is beyond the scope of this Tax Astute Training Snapshot, there are various new '*Green Zone'* scenarios (and a variety of new detailed examples) explained from PCG 2022/2 para 18 which may be broadly summarised as follows:

- Green Zone Scenario 1 which may allow an individual EB to divert entitlement benefits received to their spouse or dependant family members or use the benefits to donate to a deductible gift recipient (subject to further specific conditions noted in PCG 2022/2); or

- The new 2-year rule in Green Zone Scenario 2, which may allow Green Zone status provided that all actual benefits are paid or applied to the EB within 2 years of entitlement (subject to some carve out conditions noted in PCG 2022/2); or

- Trustee retention of funds solutions under Green Zone Scenarios 3A and 3B which may facilitate Green Zone status if specified working capital/investment conditions are satisfied regarding the trustee's use of the retained entitlement (including additional requirements such as specified 'family group' and other relationships between parties and requirements for Division 7A *ITAA* 1936 compliant loan agreements (**s 100A Division 7A loans**) to be in place where 'commercial terms' borrowing conditions are required.

To the extent that Green Zone Status cannot be met **at E** (or para 32 previously applied **at B** to deny access to White or Green Zone status) then it will be impossible to access the ATO compliance concession regarding the distribution. As noted by the ATO, this does not necessarily mean that s 100A will apply but in practice either:

- there will be a high risk of a full ATO s 100A technical compliance review (if Red Zone requirements are satisfied – **see F** below); or

- the arrangement/entitlement may not fall into any zone (as contemplated at PCG 2022/2 para 15 – referred to as a '*No Zone'* scenario in our page 9 flowchart) such that there is no specific compliance protection available under PCG 2022/2 and the taxpayer and their advisers should be prepared for some risk of a full ATO technical compliance review.

IMPORTANT NOTE

While beyond the scope of this Tax Astute Snapshot, the presence of Red Zone issues at **F below** are undesirable because they significantly increase the risk of a full ATO technical s 100A review. Non-exhaustive examples include (but are not limited to) distributions to adult children which fall foul of TA 2022/1, round-robin-type entitlement arrangements, arrangements similar to those considered by the Federal Court *BBlood Enterprises Pty Ltd* v FCT [2022] FCA 1112 decision (and more as explained in the PCG 2022/2 paragraphs shown at F below).

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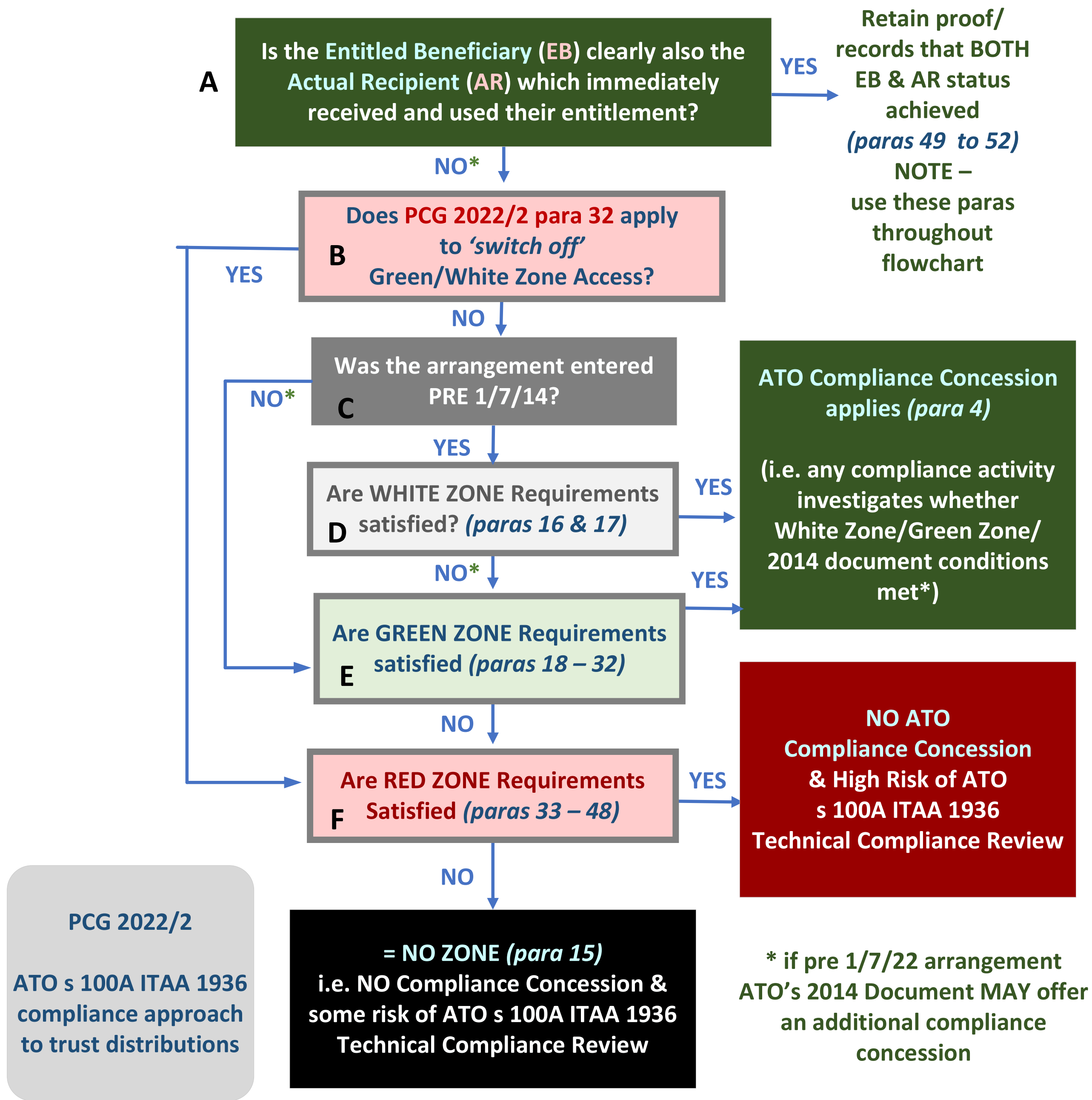

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WANT MORE DETAILS?

In addition to details available at www.taxastute.com.au, Tax Astute Training clients receive more information and specific details, interactive questions and answers underlying this snapshot summary above as a part of their:

- Tax Astute Online or Face to Face/Hybrid Training Seminar;
- Tax Astute Training Seminar Reference Notes; and
- Tax Astute Training Online Multimedia Recording.