Family trust income: the ‘new world’ of ATO attention (part 1)

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Family Trust Income – The ‘New World’ of ATO Attention (Part 1 of 2 Tax Alerts)

The metamorphosis of ATO integrity measures targeting family trust income and beneficiaries continues, with the Commissioner of Taxation issuing new draft interpretations in the form of

the following:

- **Draft Tax Ruling TR 2022/D1**:section 100A reimbursement agreements
- **Draft Practical Compliance Guideline PCG 2022/D1**: section 100A reimbursement agreements – ATO compliance approach
- **Taxpayer Alert TA 2022/1**: Parents benefitting from the trust entitlements of their children over 18 years of age
- **Draft Tax Determination TD 2022/D1**: Division 7A: when will an unpaid present entitlement or amount held on sub-trust become the provision of 'financial accommodation'?

The draft pronouncements include new, and greatly expanded detail on the ATO's interpretation and administrative practices relevant to some important tax integrity measures that relate to family trusts, namely section 100A and Division 7A of the Tax Act(s). Whilst these new pronouncements are still in draft form only, should they be released in their current form, they will represent a shift in the taxation practices that family trusts are able to utilise into the future.

In Part 1 of 2 Fordham Tax Alerts relating to Family Trust tax integrity measures, we discuss below Section 100A. In Part 2, we discuss Division 7A.

Section 100A – A greatly expanded role in policing the taxation of trust income

Section 100A was introduced into the Tax Act over 40 years ago. It was originally intended to apply to examples of blatant 'trust stripping' which included arrangements whereby a trustee appointed income to a beneficiary (who generally had a much lower, or nil tax rate), but the benefit of the appointment was effectively provided to another taxpayer. The effect of the provision could be to tax the trustee on the relevant income at the top marginal tax rate (currently 47%).

Section 100A includes an exception to its application which was intended to provide relief for many family trust arrangements. The exception applies where an arrangement is part of an "*ordinary family or commercial dealing*". This exemption has historically meant that for most family trusts and beneficiaries, section 100A has not had significant 'day to day' practical application.

Notwithstanding historic administrative practice, the ATO has issued the abovementioned pronouncements which confirm the ATO's increasing interest in arrangements which may come within the integrity measure. The ATO's new draft view is that the section 100A exemption (ordinary family or commercial dealings) should be read somewhat narrowly thereby resulting in further arrangements falling within the integrity measure.

The ATO has said in their new pronouncements that just because a situation is common practice of the family, or indeed in the community, that does not mean it is an “ordinary family or commercial dealing”. Taxpayers cannot rely on their arrangements being “ordinary” simply because everyone else is doing it.

Included within the ATO’s guidance are examples of when they now see that section 100A may or may not apply. By way of background, Taxpayer Alert 2022/1 provides an example of section 100A potentially applying to circumstances where a family trust makes a distribution of trust income to adult children, but where the parents ultimately receive the underlying economic benefit. Over the course of 303 paragraphs of analysis, TR 2022/D1 and PCG 2022/D1 provide a number of examples including (but not limited to) :-

- Trusts established under a will;
- Gifts from parents to children;
- Trust entitlement gifted to trustee;
- Non-commercial loan between family members;
- Share-buy back arrangement;
- Circular flow of funds;
- Distributions from a family business;
- Non-resident beneficiary making a loan or gift to associate;
- Issuing of Units by a beneficiary;
- Beneficiary with Losses;

The ATO has proposed to use a colour coded risk system to identify when the ATO will allocate further resources to review taxpayers. The pronouncements are also potentially retrospective, as s100A does not have any amendment period limitation (normally the Commissioner can only go back and issue amendments for up to the previous four financial years)

It is noted that notwithstanding the ATO’s draft views on section 100A, the Australian courts will have the opportunity to provide further clarity in the near future. In fact, a recent Federal Court decision (the *Guardian* case) provided some favourable comments for the taxpayer in regard to how s100A applies. The decision has been appealed by the ATO.

If you have a family trust, it will be important to consider whether these new section 100A interpretations and views of the ATO could be problematic for you. Whilst these new ATO views are draft only, considering the issues and addressing them well before 30 June 2022 will be vital. Trusts will continue to provide many benefits and will continue to be an effective structure for managing family wealth, however the taxation of trust income will become far more complex under these new guidelines. Many family groups will need to revisit their distribution strategies in the lead up to 30 June 2022.

In addition, taxpayers should consider how overall tax, audit risk, cash flow, accounting entries, trust distribution resolutions, and written documentation may be impacted. As noted in the previously issued Fordham Tax Alert on Business Structures, it is also important to periodically consider the adequacy of a business structure, particularly now in light of the ATO's increasing interest in family trust integrity measures.

To discuss how these changes might impact you and the best ways to manage your situation, please contact your Fordham Partner.

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