Tax and trusts - Responding to recent changes

5 October 2022

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Overview

- Recent ATO guidance and legal decisions on tax issues related to trusts have raised some challenges to long-established practices.
- With an increasing focus on trust arrangements by the ATO, tax practitioners should consider the relevant guidance, risk assess their clients' arrangements and review their practices.

These slides will cover:

- Current tax issues for trusts
- Good administrative practices
- Tips and traps for practitioners.

Current issues

Section 100A – final ATO ruling & guidance

- ATO taxation ruling (TR 2022/4) and practical compliance guideline (PCG 2022/2) on reimbursement agreements
  - ATO finalised the public advice on section 100A on 8 December 2022
  - Specific changes made to the PCG:
    - Expand the green zone scenarios
    - Remove the blue zone
    - Include more practical examples to illustrate the operation of the green and red zone scenarios
  - ATO made clear that section 100A does not apply where there is no agreement, or where the beneficiary simply receives and enjoys the benefit of the distribution they are liable to tax on
- ATO issued final guidance on managing section 100A for the 2021-22 income year
- ATO will only apply section 100A within 4 years of a trustee lodging their tax return.
- ATO will not be reviewing arrangements prior to 1 July 2014, other than in exceptional circumstances as outlined in the guidance
- Also, see ATO taxpayer alert in relation to parents benefiting from children's trust entitlements (TA 2022/1)

Section 100A – Changes from the drafts

More green zone examples

1. Distributions involving a trustee undertaking a farming business
2. Distributions to a loss company
3. Time lag between a beneficiary becoming entitled and that entitlement being satisfied
4. Time lag between a loss trustee beneficiary becoming entitled and that entitlement being satisfied
5. Testamentary trust

Removal of the blue zone from the PCG

References to the recent decisions in *BBlood Enterprises Pty Ltd v Commissioner of Taxation* [2022] FCA 1112, and *Guardian AIT Pty Ltd ATF Australian Investment Trust v Commissioner of Taxation* [2021] FCA 1619 in the TR.

Section 100A - litigation

- *Guardian AIT Pty Ltd ATF Australian Investment Trust v Commissioner of Taxation* [2022] QUD 36
  - On appeal following decision by Justice Logan [2021] FCA 1619 that the arrangements did not constitute a "reimbursement agreement" as the arrangements were part of ordinary family or commercial dealings.
  - Full Court hearing held on 25 August 2022

- *Bblood Enterprises Pty Ltd v Commissioner of Taxation* [2022] FCA 1112
  - Buy-back with the deed amended to make the buy-back dividend the corpus of the trust
  - Justice Thawley found in favour of the ATO
  - The taxpayer has appealed to the full Federal Court.
  - See example 8 in TR 2022/D1

Div 7A UPEs

- ATO taxation determination on unpaid present entitlements now finalised (TD 2022/11)
- The finalised Determination broadly mirrors the draft, with changes including clarifying the timing of financial accommodation and how the private company's entitlement to income is expressed
- In particular, paragraph 12 states:

  The time when the amount of a beneficiary's entitlement is known will typically arise after the end of the income year, that is, in the following income year, in which the entitlement arises. This will be the case whether the entitlement is expressed as:

    - *a fixed amount from the trust income*
    - *a percentage of trust income, or some other part of trust income identified in a calculable manner, or*
    - *a combination of fixed and calculable amounts.*
- Applies to present entitlements arising on or after 1 July 2022.

Disclaimers of trust income

- Commissioner of Taxation v Carter [2022] HCA 10
    - The High Court agreed with the Commissioner and held that legally valid trust disclaimers after year end did not operate retrospectively so as to disapply s 97(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- ATO decision impact statement (DIS) states the decision "tells us that such disclaimers do not disturb what would otherwise be the tax result. Beneficiaries who have an interest in, or entitlement to, trust income should now take this into account if they were otherwise considering not accepting that interest or entitlement and instead looking to disclaim it."
- ATO Interpretative Decision ATO ID 2010/85 is now withdrawn.

Managing trusts in your practice

Practical steps

Understand key clauses of the trust deed

- Income of the trust estate
- Beneficiaries including default beneficiaries
- Distributions by the trustee
- Vesting date of the trust

Determine the impact of potential trust distributions on trust beneficiaries from a taxation perspective

- Application of proportionate approach
- Limits on trust income for “notional amounts”
- Distributions made outside the family group

Prepare and execute binding written trustee resolutions effecting such distributions

- Estimating annual trust income
- Identifying potential beneficiaries and their tax position
- Executing an effective resolution

Ensure that trustee resolutions are completed before the trust’s stipulated year-end date

- Must be in writing
- If not done correctly, default beneficiaries will become presently entitled and be proportionally assessed in accordance with the trust deed
- In the absence of default beneficiaries, the trustee is assessed at the highest effective marginal tax rate.

See CPA Australia’s Trustee Resolution Guide for more details and checklist

Considerations

- Ensure that trustees are informed of the tax consequences of trust arrangements and administer the trust properly
- Ensure that beneficiaries are aware of their entitlements and tax obligations
- Ensure that resolutions are made in writing by the required date
- Maintain sufficient records to satisfy any ATO enquiries and ensure documentary records that are relevant to issues are retained for period the years that remain open to review

Are beneficiaries aware of their trust entitlements?

Do they know how to call for payment of their entitlement?

Are both trustees and beneficiaries aware of the tax consequences which flow from trust entitlements?

Are trustees seeking tax advice on proposed entitlements before the end of the financial year?

Are beneficiaries aware of the consequences of disclaiming an entitlement from a trust?

Dealing with section 100A risks

1. Notify clients of existence of ATO guidance products
2. Undertake conflict checks and set up confidentiality protocols to ensure that there is no conflict in acting for a trust and its beneficiaries and that there is no sharing of confidential information
3. Have discussions with clients about future trust distributions, objectives sought to be achieved, documentation requirements and how they are likely to be risk profiled by the ATO
4. In documenting arrangements, consider including either in trust distribution minutes or separate records an explanation of the trustee's rationale for distributing income as it is distributed
5. Advise clients that the ATO could ask what they intend to use funds for and that it will be a potential problem if the funds are to be loaned or gifted to related parties and applied against an existing loan
6. Seek authorisations for distributions from all parties involved. Best practice to protect an advisor's position would be to obtain authorities from each of the advisor's client/s, the trustee and the beneficiaries as to how funds are to be distributed
7. For arrangements regarded by the tax advisor as having risk, inform the client and consider recommending:
   - seeking a second opinion
   - consultation with the ATO (such as by way of private ruling), or
   - implementation but lodging tax returns in accordance with the ATO guidance products then self-objecting to the assessment to the extent the taxpayer wants to challenge the position.