

Section 100A Detailed Tax Alert

“The Income Splitting Party Is Dead. Trust Me.”

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Summary

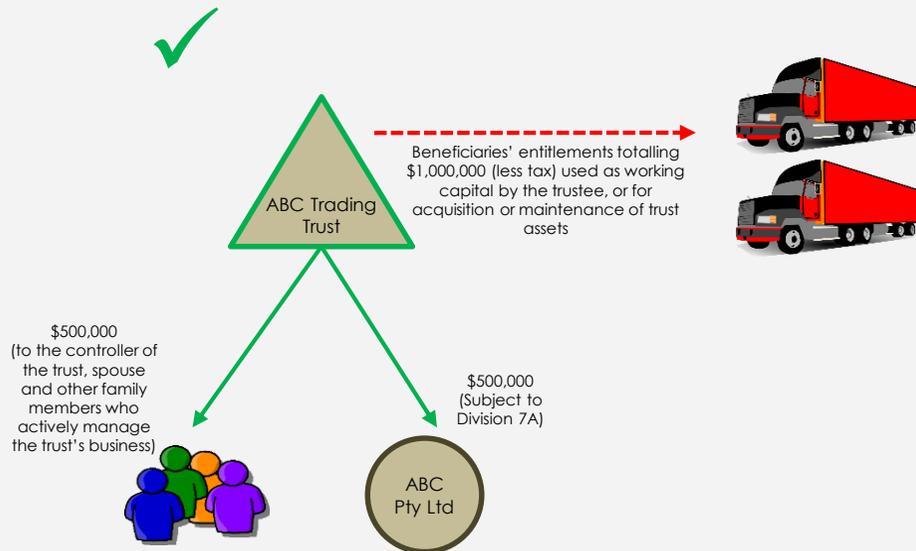
- The Australian Taxation Office (**ATO**) released three significant publications on 23 February 2022 that affect clients who employ trusts in their group structures.
- The publications indicate that the ATO will be taking a more proactive and aggressive approach to arrangements that use trusts to reduce or limit tax liabilities.
- The publications set out the ATO's view and administration of section [100A of the ITAA36 \(s 100A\)](#), an anti-avoidance provision originally enacted in the late 1970s in response to trust asset stripping.
- Broadly, s 100A applies to arrangements where there is a mismatch between who is liable for tax on a trust distribution and who receives the economic benefit of the distribution.
- If s 100A applies, then the trustee (and not the beneficiary) of the trust is taxed at the highest marginal tax rate (45%+), and significant penalties and interest can also apply.
- The benefit of significant tax concessions (such as losses and capital gains tax concessions) may also be lost.
- The ATO has introduced four new risk zones which determine its compliance response to particular arrangements.
- **What next?**
 - **We recommend practitioners and clients review historical trust distributions for compliance with s 100A and ensure that all future arrangements are at least reasonably arguable.**
 - **Practitioners should also be mindful of promoter penalty rules and referrals to the Tax Practitioners Board.**

Preliminary view of the ATO's publications

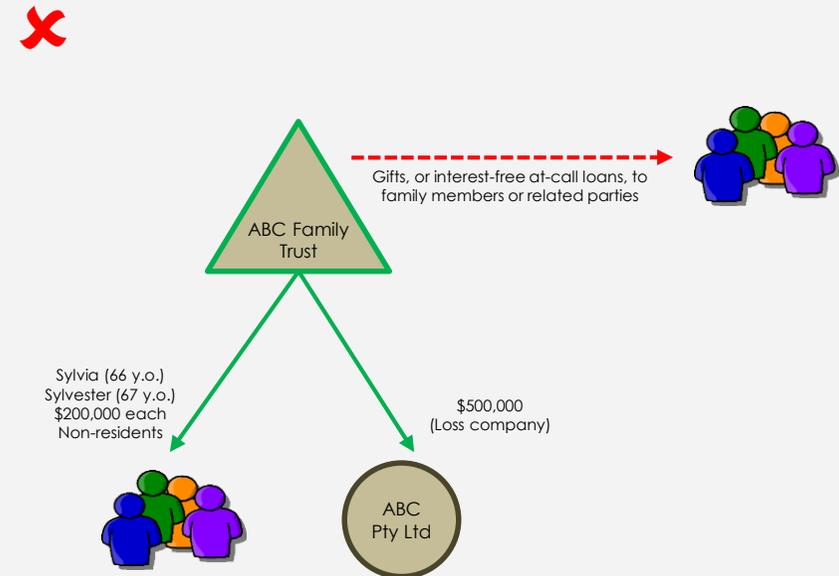
- The publications have wide-ranging consequences for clients who employ trusts in their group structures. In particular, for high net worth individuals, wealthy family groups and private clients.
- There is no clear judicial authority about crucial elements of s 100A. However, there is presently a matter before the Full Federal Court on appeal which could clarify the law over the coming months.
- At present, the ATO's view of the application of these laws is very broad and a substantial departure from the purpose for which the provisions were originally enacted in 1979.
- We are concerned that, at present, the publications are retrospective, albeit that the ATO says it won't audit clients in certain circumstances.
- Further, many aspects of the publications are subjective and open to different ATO officers taking a different view of when s 100A should and should not apply.
- We see a practical risk for clients who are under review or audit by the ATO and may have had arrangements in place, which with hindsight, purportedly have features of artificiality or contrivance. This is particularly significant for clients whose arrangements achieve beneficial tax outcomes, albeit that such outcomes were not the intended purpose or objective of the arrangement.
- We intend to keep you updated as we engage with the ATO on these issues and as the publications are made available in final form.

Examples flagged by the ATO

Green Zone – the ATO says it may not review or audit clients



Red Zone – the ATO says it will review and audit clients, and is seeking suitable test cases



The ATO provides approximately 12 examples of arrangements that it says may or may not trigger s 100A. Accordingly, it is crucial that practitioners review all of the examples before determining if their clients' arrangements are low risk.

s 100A and Draft tax ruling TR 2022/D1

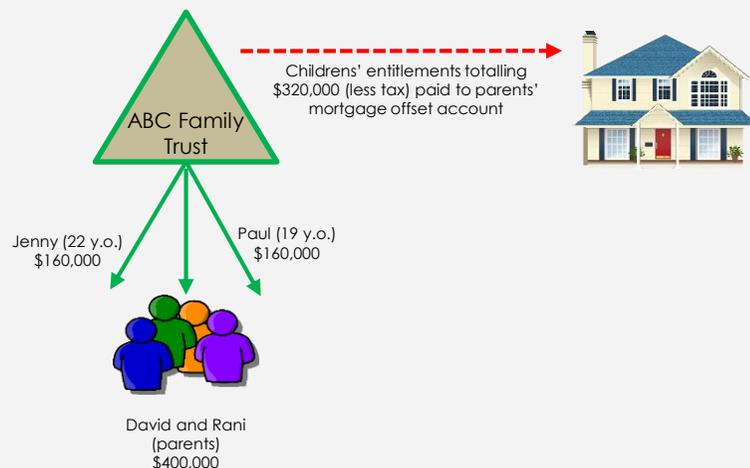
- **Broadly, the following elements must be satisfied for s 100A to apply (adapted from the ruling):**
 - **'Connection requirement' – there must be a present entitlement...to trust income which has arisen out of a reimbursement agreement (see below);**
 - **'Benefit to another requirement' - the agreement must provide for the payment, transfer or provision or benefits to a person other than that beneficiary;**
 - **'Tax reduction purpose requirement' - a purpose of the agreement must be that a person pays less tax; and**
 - **'Ordinary dealing exception' - the agreement must not be one that has been entered into in the course of 'ordinary family or commercial dealing'.**
- There is no period of review to limit the ATO's power to raise tax assessments when s 100A applies and accordingly, it could raise assessments for historical years in certain circumstances. We have seen audits dating back to 1990.
- There is no clear judicial authority about crucial components of s 100A. For example, the 'ordinary family or commercial dealing' exception, and how s 100A applies (if at all) to streamed capital gains and franked dividends.

Draft practical guideline PCG 2022/D1

Risk level	Zone	Description and ATO compliance approach (summary)
Low	White	<p>The white zone only applies to arrangements entered into prior to 1 July 2014.</p> <p>The ATO says that it will not devote compliance resources to a period before 1 July 2014 unless a client is already under review or audit for those years, an arrangement continues before and after that time or a client's tax returns are not up to date.</p> <p>We consider that such circumstances would be extremely rare.</p>
Low	Green	<p>The green zone applies to arrangements limited to those which distribute income within the nuclear family and/or fully comply with Division 7A, and do not otherwise fall into the blue zone or red zone.</p> <p>The ATO says that it will not devote compliance resources to those arrangements.</p>
Medium	Blue	<p>The blue zone applies to arrangements that do not fall within any of the other zones.</p> <p>The ATO says that it may contact clients to determine their risk zone, but such arrangements are less likely to attract its attention compared to the red zone.</p>
High	Red	<p>The red zone applies to arrangements that have features of artificiality and contrivance, including gifts and loan backs, manipulation of trust and tax income, distributions to foreign residents, and the use of corporate beneficiaries with losses.</p> <p>The ATO says that it will review and audit such arrangements.</p>

Taxpayer alert TA 2022/1

- The ATO is reviewing arrangements where parents receive the economic benefit of income derived by a trust, where the tax liability for that income is directed to adult children who pay a lower marginal rate of tax (or no tax at all).
- The diagram below provides a simplified example of an arrangement now being targeted by the ATO (see, example 1 of TA 2022/1).



- The ATO says that arrangements that it is targeting usually have some or all of the following features:
 - a discretionary trust is controlled by one or two individuals (either personally or via a corporate trustee) and those individuals are parents in a particular family unit;
 - income derived by the trust is used to pay the parents' expenses, including by debiting / crediting loan accounts;
 - trust resolutions appoint income to adult children beneficiaries;
 - adult children purportedly receive distributions. However, those distributions generally do not exceed \$180,000 (inclusive of the children's other income);
 - the children do not actually receive any amounts from the trust; and
 - amounts are instead used by parents to set-off obligations from when the children were minors (school fees, etc) and / or used to satisfy general family expenses and / or the parents' personal obligations.

Risks for practitioners

- Practitioners also face significant risks if they have assisted clients to plan or implement the types of arrangements set out in the publications

“...29. Penalties may apply to participants in, and promoters of, this type of arrangement. This includes serious penalties under Subdivision 290-B of Schedule 1 to the Taxation Administration Act 1953 for promoters. Registered tax agents involved in the promotion of this type of arrangement may be referred to the Tax Practitioners Board to consider whether there has been a breach of the Tax Agent Services Act 2009...”

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