

29 April 2022

Mr Christopher Ryan
Office of the Chief Tax Counsel
Australian Taxation Office
C/- 2 Narellan Street
Canberra ACT 2601

**Draft Practical Compliance Guideline PCG 2022/D1
Income tax: Section 100A Reimbursement Agreements
Submission of Comments**

By email – Christopher.Ryan@ato.gov.au

Dear Christopher,

We refer to the aforementioned draft Taxation Guideline – Practical Compliance Guideline PCG 2022/D1 (‘the draft PCG’) issued on 23 February 2022 in respect of the Commissioner of Taxation’s (the Commissioner) opinion with regard to the application of section 100A of the Income Tax Assessment Act 1936 (Section 100A).

On behalf of Tax and Super Australia (TSA) and its members, and further to our submission made to you dated 18 February 2022 in respect of Section 100A, please find in the attached our comments (Attachment A) in respect of the draft PCG.

Tax and Super Australia (TSA) is a not-for-profit member organisation that has assisted tax and superannuation professionals for over 100 years.

With a subscriber base of approximately 13,000, including 4,000 members, the organisation has evolved to meet the challenges of Australia’s modern tax and superannuation system and remains at the forefront of educating and empowering today’s tax and superannuation professionals.

Whilst there has been an expressed consternation within the taxation profession with regard to both the draft PCG and related draft Taxation Ruling TR 2022/D1, and notwithstanding our reply as provided in the following commentary, TSA commends, and continues to support the Commissioner in undertaking the necessary steps in furthering this process.

If you have any questions in relation to this submission, please contact Phillip London on 0400 819 698 or p.london@taxandsuperaustralia.com.au

Yours Faithfully,

A handwritten signature in black ink, appearing to be 'P. London', written in a cursive style.

Phillip London
Head of Tax

Attachment A

1.0 Guardian decision

- 1.1 Before finalising either draft Taxation Ruling TR 2022/D1 (the 'draft ruling') or draft Practical Compliance Guideline PCG 2022/D1 (the 'draft PCG') the outcome of the Commissioner's appeal to the Full Court of the Federal Court of Australia in the Guardian case should be awaited (as well as any subsequent Special Leave application that might be made to the High Court of Australia).
- 1.2 While the draft ruling acknowledges the decision by Logan J and says it disagrees with it, his Honour's decision about the absence of artificiality nevertheless represents the current state of the law. Until the issue is clarified on a final appeal, it would not be appropriate to finalise either product.

2.0 Breadth of 'Ordinary Family Dealing' – Distributions to Adult Beneficiaries – Safe Harbour

The TSA is of the opinion that the contentious issue with regard to the draft proposals (both the draft PCG and draft ruling) is with respect to the 'breadth' of what is considered or interpreted to be an 'ordinary family dealing' within section 100A (13) of the Income Tax Assessment Act 1936.

The examples in the draft PCG and the draft ruling would appear to concentrate on distributions made to adult beneficiaries which will give rise to a breach of Section 100A where the marginal income tax rates of beneficiaries differ.

That is, the provision of the economic resource to a beneficiary other than the beneficiary who is in receipt of the trust distribution, is generally at issue where the marginal income tax rates of the beneficiaries differ, but not necessarily in contention when the marginal income tax rates of beneficiaries do not differ.

It is our contention that 'ordinary family dealings' should be defined to allow distributions within a 'family group' regardless of the taxation obligations of each member of the group.

For the purposes of the application of Section 100A the 'ordinary family group' be defined inclusive only of parents and direct children.

Whilst this 'safe harbour' definition may concede the effect of the provision in contrast to the draft guidelines as issued by the Commissioner, the practice of distributing from a

business structure to beneficiaries is acknowledged as a legitimate commercial feature of family trusts. If, for example, the derivation of income by the family trust was primarily due to the personal exertion of one member of the family (the parent), and income was 'split' between family members, it would appear that the application of the personal services rules in Division 86 (or in cases of tax avoidance, Part IVA) of the ITAA 1936 would be more effective and appropriate tools to rectify the practice.

We therefore submit that the Commissioner gives due consideration to the scope and breadth of the 'family' in the context of Section 100A (13) of the ITAA 1936 and adopt a 'safe harbour' for distributions made to closely related beneficiaries, and amend (or withdraw) TaxPayer Alert 2022/1 to reflect the proposed 'safe harbour'.

3.0 Additional compliance burden

- 3.1 The suggestion in para 10 of the draft PCG that the law imposes an obligation to an enquiry into "the facts of each case" would impose a significant and unwarranted new compliance burden on small family businesses.
- 3.2 For every trust distribution made to any beneficiary, taxpayers and their advisers would need to firstly determine whether there was a reimbursement agreement and, if there was, whether or not the beneficiary's present entitlement was dealt with in a manner that can be explained by reference to a familial or commercial factor or factors.
- 3.3 As suggested and submitted in Section 2.0 in the above, a safe harbour for distributions made to closely related beneficiaries (i.e. the parents or children of the controlling individuals) would significantly reduce the scope of such additional compliance work without unduly putting revenue at risk. In our submission, the way those beneficiaries deal with their present entitlements would almost invariably satisfy the conditions for the exception.

4.0 Impact of PCG 2022/D1

- 4.1 The adoption of a broader definition of 'ordinary family dealing' would facilitate a clearer understanding of the scope of the application of the provision.
- 4.2 It follows that the Green Zone scenario 3 (retention of funds by the trustee) analysis is, in our view, unduly restrictive. The Green Zone applies in that scenario only in relation to beneficiaries who are themselves controlling individuals of the trust or trust business managers and will not apply where a beneficiary forgives or otherwise releases the trustee from their obligation to pay over the present entitlement.
- 4.3 In our view, such actions can in most cases be readily explained by familial relationships – for example, a young adult beneficiary might make a gift of their present entitlement to

a parent for the purpose of paying down the mortgage over the family home, which they expect to inherit in due course, or they might leave their present entitlement in the family business to improve its profitability for their own indirect benefit over time. In most families, where the parents are better off, so too are their children, including their adult children.

- 4.4 In example 7 of the appendix, the Commissioner indicates that compliance resources would be applied to the offsetting of Simon's and Sam's present entitlements against purported outstanding debts arising from education and household expenditure incurred by their mother, Bronwyn, before they turned 18.
- 4.5 In our view, however, it should not even be necessary for the such indebtedness to be purported. Simon and Sam should be able to leave their present entitlement in the Brown trust (net of the tax liabilities) or gift the net amount to Bronwyn if they wish. As children of the controlling individual such actions should be seen as falling under the "ordinary family or commercial dealing" exception.

5.0 Retrospectivity

- 5.1 We note that the ATO's website guidance on the scope of Section 100A posted in 2014 has recently been prefaced in the following way:

"This guidance was on our website from July 2014 to 23 February 2022 and has been replaced by draft Practical Compliance Guideline PCG 2022/D1"

And:

"The administrative position outlined in this guidance remains applicable to present entitlements to income of a trust estate conferred before 1 July 2022, to the extent that it is **more favourable** to you than PCG 2022/D1."

- 5.2 This is broadly consistent with what the Assistant Treasurer's 7 April 2022 Media Release said about protecting small business from the retrospective application of the ATO's current view of the application of Section 100A. While the Assistant Treasurer's comments are somewhat reassuring, it does become critically important to be clear about exactly what the 2014 ATO website says and doesn't say.
- 5.3 The webpage briefly outlines the law, in particular what constitutes a reimbursement agreement and the potential scope of the "ordinary family or commercial dealing" exception, but it would not appear to be a detailed legal analysis (which we acknowledge is not what ATO webpages are generally used for).

- 5.4 The webpage uses five examples to help guide taxpayers, two of which result in the application of s 100A (examples # 1 and #5, which are relatively blatant) and three of which do not (examples #2, #3 and #4, which are over simplified?).
- 5.5 Example #1 involves the trustee making a distribution to a low tax beneficiary who is low tax because they are a tax-exempt entity, a foreign resident not subject to Australian withholding tax, a loss entity or is “otherwise subject to a lower tax rate”. Example #5 involves a kind of washing machine arrangement where the use of a corporate beneficiary results in a circular flow of franked dividends.
- 5.6 Example #2 involves corporate beneficiary lending back their present entitlement to the trustee under a Division 7A complying loan agreement. Example #3 involves a minor beneficiary.
- 5.7 Example #4 involves beneficiaries leaving their present entitlements in the trust (except for their tax liability). The trustee then lends those funds to the trust’s controlling individual on commercial terms. Example 4 is likely to be the reference to which most tax practitioners will rely on in determining whether the 2014 Guidance is ‘more favourable’ to their circumstance and thus able to rely on in determining whether Section 100A potentially applies. It is therefore necessary to expand the factual matter of that example including the following:
- The factual background does not state the marginal income tax rates of the beneficiaries.
 - The factual matter states that it is a discretionary trust for the benefit of Charlene’s family. It further states that distributions are made to ‘Australian-resident’ beneficiaries. Whilst presumably the beneficiaries as stated are members of Charlene’s family given the purpose of the trust, it is not clear that such is the case.
 - No factual matter is provided in relation to the accumulation of the unpaid balances. For example, are the balances invested on sub trust for the beneficiaries? Are they utilised in the working capital of the family trust during the period prior to the lending of the funds to Charlene?
 - The trustee lends to Charlene on commercial terms. Are the funds held by the trustee and provided to Charlene as a beneficiary of the trust been the subject of distributions to the beneficiaries (other than Charlene) in which those beneficiaries are on lower marginal tax rates than Charlene?
 - The example provides a favourable outcome to the trustee and the beneficiaries ‘in the absence of other factors’. What are those factors?

- 5.8 In claiming to have relied on the webpage, does a taxpayer have to show that they did something the webpage said was acceptable or that they didn't do what it said was not acceptable? Or is the handful of examples given just meant to leave taxpayer with a general impression? If so, taxpayers and their advisers can be excused for thinking that a webpage that uses two fairly blatant examples to illustrate when a specific anti-avoidance provision such as section 100A will apply was not intended to suggest that it would apply in less blatant circumstances.
- 5.9 Advisers would also be entitled to point out that the ATO does not seem to have sought to apply section 100A in cases involving, for example, beneficiaries who are adult children in the eight or so years the 2014 webpage has been on the public record.