Australian Government
Australian Taxation Office

Trust taxation – reimbursement agreement

This guidance was on our website from July 2014 to 23 February 2022 and has been replaced by draft Practical Compliance Guideline PCG 2022/D1 *Section 100A reimbursement agreements – ATO compliance approach*.

This guidance was first published on our website in response to a request from the tax profession. The request is recorded in the minutes to the NTLG meeting held in September 2013.

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.

If you follow this information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

This information is for trustees and beneficiaries of a trust where the entitlement of a beneficiary (who is not under a legal disability) to trust income arises out of a reimbursement agreement.

Generally, where a beneficiary is presently entitled to a share of trust income and isn't under a legal disability, a corresponding proportion of the trust's net income is assessed (taxed):

- to the beneficiary, if they are an Australian resident, or
- to the trustee, if the beneficiary is a foreign resident (but only to the extent to which that proportion of the trust's net income is from Australian sources).

However, to the extent a beneficiary's entitlement arises out of a reimbursement agreement, section 100A of the *Income Tax Assessment Act 1936* (ITAA 1936) disregards it. This means that the net income that would otherwise have been assessed to the beneficiary (or trustee on their behalf) is instead assessed to the trustee at the top marginal tax rate.

The ATO has an unlimited period within which to make an assessment under section 100A.

Reimbursement agreement

A reimbursement agreement generally involves making someone presently entitled to trust income in circumstances where both:

- someone other than the presently entitled beneficiary actually benefits from that income, and
- at least one party enters into the agreement for purposes that include getting a tax benefit.

'Benefit' includes the payment or loan of money, the transfer of property, the provision of services or other benefits; or the release, abandonment, failure to demand payment, or postponed payment, of a debt.

'Agreement' is defined widely to include arrangements and understandings that can be informal, express or implied. An agreement can comprise a series of steps or transactions. An agreement need not be enforceable or even intended to be enforceable.

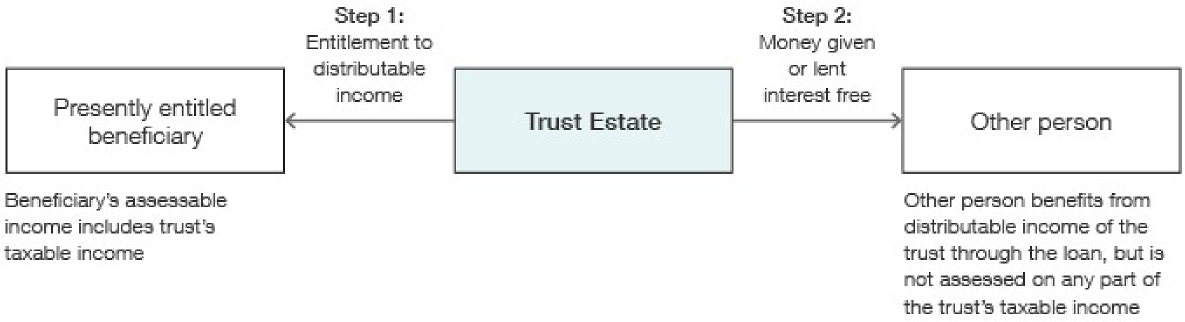
The trust doesn't have to exist at the time of the agreement.

Example 1 – trust estate

The trustee of a trust estate makes a beneficiary entitled to trust income.

Instead of paying the amount of trust income to the beneficiary, the trustee gives, or lends on interest-free terms, the money to another person. The other person benefits from the trust income, but is not assessed on any part of it.

The arrangement does not constitute ordinary commercial or family dealing.



This arrangement would generally constitute a reimbursement agreement if it was intended that the beneficiary who was made presently entitled to the trust income pays a lower amount of tax than would have been payable by the person who actually enjoyed the economic benefits of that income.

In this example, the presently entitled beneficiary may pay less (or no) tax because it:

- *is a tax-exempt entity*
- *is a foreign resident and the net income of the trust includes foreign source income or income subject to withholding tax in Australia*
- *has tax losses or excess deductions or capital losses or an unapplied net capital loss, or*
- *is otherwise subject to a lower rate of tax.*

In *Commissioner of Taxation v Prestige Motors Pty Ltd* [1998] FCA 221, the Court held that there was no reason why the present entitlement of a beneficiary to trust income cannot be said to arise out of an act or transaction that occurred as a result of a reimbursement agreement, merely because the agreement predated the creation of the trust.

The beneficiary entitled to trust income does not have to be a party to the reimbursement agreement. The Court in *Idlecroft Pty Ltd v Commissioner of Taxation* [2005] FCAFC 141 held that the provision that the agreement must be 'in relation to a beneficiary' does not require the beneficiary to be a party to the agreement. In that case, the beneficiaries' entitlements arose by operation of the trust deed, but section 100A was held to apply because the relevant provisions in the deed were triggered as a result of the reimbursement agreement.

Ordinary family or commercial dealing and other exclusions

Section 100A doesn't apply where:

- an agreement has been entered into in the course of an ordinary family or commercial dealing (see below), or
- the presently entitled beneficiary is under a legal disability (for example, a minor).

Section 100A may also not apply where the presently entitled beneficiary is the trustee of another trust.

Ordinary family or commercial dealing

Whether a particular agreement constitutes an ‘ordinary family or commercial dealing’ (which isn't defined), and is therefore not a reimbursement agreement for the purposes of section 100A, will depend on all of the relevant facts. The courts have made it clear that the exclusion must be considered having regard to all of the steps comprising the reimbursement agreement – not merely components of it.

An agreement won't necessarily be considered to have been entered into in the course of an ordinary family dealing merely because all of the entities involved are members of the same ‘family group’.

Loans as ordinary commercial and family dealings

Bona fide loans are a feature of many ordinary commercial and family dealings.

Where a trustee lends money on terms that require repayments of principal and interest, this would generally indicate an ordinary commercial dealing.

However, a loan made in the course of ordinary family dealings may qualify for the exclusion even if it is not made on commercial terms. For example, where money is lent by a trustee to a family member on terms that require repayments of principal only (and such repayments are intended to be made) this could still indicate an ordinary family dealing when considered together with all the other relevant facts.

Example 2 – ordinary commercial dealing

The Charles Family Trust is a discretionary trust controlled by Charles and administered for the benefit of Charles and his family. It was established in 2010. The trust carries on a business and has trust income and net income in each year.

The trustee of the Charles Family Trust makes Charles Co Pty Ltd, an Australian resident company owned by Charles, presently entitled to all of the trust income.

The trust ensures that all entitlements of Charles Co Pty Ltd are placed on Division 7A complying loan terms or sub-trust arrangements that comply with the options in Law Administration Practice Statement PS LA 2010/4 *Division 7A: trust entitlements (with annual repayments made over seven or 10 years).*

The trustee uses the funds as working capital for the business.

Where the funds are lent back to the trust under a Division 7A complying loan (or an unpaid entitlement held on terms described in [PS LA 2010/4]() *and retained in the trust as working capital, the ATO would, in the absence of other factors, not consider this arrangement to be a reimbursement agreement.*

Example 3 – ordinary family dealing

A trust established under a will provides that William, the grandson of the deceased, is entitled to all of the trust income, although it is not to be paid to him until he is 25 years of age. At the time the trust is created, William is 15. The income is used by the trustee to make further income-producing investments.

Section 100A doesn't apply in relation to the entitlement to income of a beneficiary who is a minor. Additionally, even after William turned 18 (and ceased to be a minor) the ATO accepts that this is an ordinary family dealing, and so doesn't consider the arrangement to be a reimbursement agreement.

Example 4 – ordinary family or commercial dealing (hybrid)

The Charlene Family Trust is a discretionary trust controlled by Charlene and administered for the benefit of Charlene and her family.

Each year, the trust makes a range of individual Australian-resident beneficiaries presently entitled to trust income. Typically, the entitlements remain unpaid, except for sufficient cash to enable the beneficiaries to pay tax on their share of the trust's net income.

This pattern continues for several years, with unpaid balances building up over time.

The trustee lends the remaining cash to Charlene on commercial terms, requiring the payment of principal and interest over time.

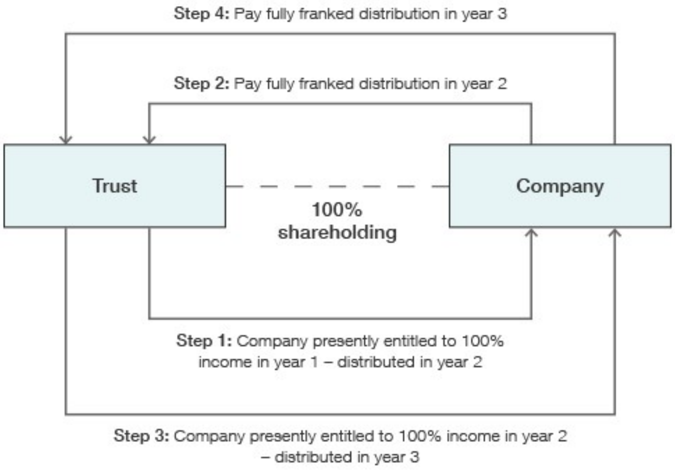
In the absence of other factors, the ATO would not seek to apply section 100A to this arrangement.

Example 5 – ATO considers section 100A applies

The ATO considers that the following arrangement would constitute a reimbursement agreement:

- *The trustee of a trust owns all of the shares in a private company. The company is also a beneficiary of the trust and undertakes no activity, but derives a small amount of bank interest on its own account.*
- *The directors of the trustee company and the beneficiary company are the same (or related) individuals.*
- *The trustee resolves to make the company presently entitled to all, or some part of, trust income at the end of year 1, and distributes it to the company in year 2 before the company lodges its year 1 income tax return.*
- *The company includes its share of the trust's net income in its assessable income for year 1 and pays tax at the corporate rate (Division 7A does not apply because the company's entitlement is paid before it lodges its income tax return for the year in which the entitlement arose).*

- *The company pays a fully franked dividend to the trustee in year 2, sourced from the trust income, and the dividend forms part of the trust income and net income in year 2.*
- *The trustee makes the company presently entitled to all, or some part of, the trust income at the end of year 2 (possibly including the franked distribution). The arrangement is repeated.*



The reimbursement agreement results in the distribution benefitting a party other than the beneficiary (it instead benefits the trustee). The reimbursement agreement provides for the payment of income from the trustee to the company on the understanding (implied from the repetition in each income year and their common control) that the company would pay a dividend to the trustee of a corresponding amount (less the tax paid).

The agreement is designed to achieve a reduction in tax that would otherwise be payable had the trustee simply accumulated the income.

This agreement is not an ordinary commercial dealing because the ownership structure and, particularly, the perpetual circulation of funds, serve no commercial purpose.

Interaction of section 100A with Division 7A

Both section 100A and Division 7A of Part III of the ITAA 1936 may apply in certain circumstances.

Where a loan from a beneficiary to a trust is a complying loan under Division 7A (or an unpaid entitlement is held by the trust on terms described in PS LA 2010/4 and the funds retained in the trust are used as working capital, the ATO would consider the arrangement, in the absence of other factors, to be in the course of an ordinary commercial dealing.

The ATO has not sought to apply Division 7A to mere unpaid entitlements created before 16 December 2009. The ATO will also not devote compliance resources to the application of section 100A to these entitlements where the relevant funds are retained as working capital of the trust.

Where Division 7A applies to an unpaid entitlement created on or after 16 December 2009 and the retained funds are used as working capital of the trust, the ATO will not generally seek to devote compliance resources to considering the question of whether or not section 100A would also apply to that arrangement.

The compliance approach outlined above does not apply if the trustee owns shares in the beneficiary company – see Example 5. But this doesn't mean that mere ownership of a corporate beneficiary will trigger the application of section 100A.

Other integrity provisions

You might also need to consider whether the following integrity provisions apply to an arrangement, and their potential interaction with section 100A:

- where the beneficiary is a tax-exempt entity – sections 100AA and 100AB or Division 9C of Part III of the ITAA 1936
- where the beneficiary is both under a legal disability and a prescribed person, and the assessable income may be excepted trust income – section 102AG of the ITAA 1936
- where the beneficiary is a company – Division 7A of Part III of the ITAA 1936
- where the beneficiary has either tax losses or excessive deductions – Division 175 of the *Income Tax Assessment Act 1997* (ITAA 1997) for corporate beneficiaries and Division 270 of Schedule 2F of the ITAA 1936 for trustee beneficiaries
- where a distribution, etc is made from a family or interposed entity to someone outside of the family group – Division 271 of Schedule 2F of the ITAA 1936.
- where the beneficiary is a superannuation entity – the non-arm's length income rules in section 295-550 of the ITAA 1997
- Part IVA of the ITAA 1936 (see Taxation Determination TD 2005/34 *Income tax: what are the results for income tax purposes of entering into a profit washing arrangement as described in Taxpayer Alert TA 2005/1?*, which outlines an arrangement where Part IVA rather than section 100A would apply). Similarly, Part IVA was applied in *McCutcheon v Commissioner of Taxation* [2008] FCA 318 to an arrangement involving the interposition of a series of trusts which appeared to serve no commercial purposes other than to avoid the application of section 100A
- the *Trust Recoupment Tax Assessment Act 1985* – which applies to schemes designed to circumvent the operation of section 100A
- the *Crimes (Taxation Offences) Act 1980* – which provides for certain offences in respect of transactions undertaken to secure the non-payment of tax by a trustee.