# *TR 2022/D1 - Income tax: section 100A reimbursement agreements*

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There is a Compendium for this document: **TR 2022/4EC** .

Status: **draft only – for comment**

# Draft Taxation Ruling

# Income tax: section 100A reimbursement agreements

**Relying on this draft Ruling**

This publication is a draft for public comment. It represents the Commissioner's preliminary view on how a relevant provision could apply.

If this draft Ruling applies to you and you rely on it reasonably and in good faith, you will not have to pay any interest or penalties in respect of the matters covered, if this draft Ruling turns out to be incorrect and you underpay your tax as a result. However, you may still have to pay the correct amount of tax.

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## What this draft Ruling is about

1. It is common for trust beneficiaries to be made presently entitled to trust income.

2. Sometimes (though much less commonly), a beneficiary's present entitlement to a share of trust income arises out of, or in connection with, an arrangement:

- involving a benefit being provided to another person
- intended to have the result of reducing someone's tax liability, and
- entered into outside the course of ordinary family or commercial dealing.

3. In these cases, section 100A of the *Income Tax Assessment Act 1936*[1] generally applies to make the trustee, rather than the presently entitled beneficiary, liable to tax at the top marginal rate.

4. This draft Ruling provides the Commissioner's view about these arrangements and the four basic requirements for section 100A to apply, namely the:

- 'Connection requirement' – for section 100A to apply, broadly stated there must be a present entitlement, or deemed present entitlement, of a beneficiary (other than a beneficiary under a legal disability)[2] to a share of trust income, which has arisen out of, in connection with or as a result of a reimbursement agreement (being an agreement, understanding or arrangement that has the three qualities described in the following dot points).
- 'Benefit to another requirement' – the agreement must provide for the payment of money or transfer of property to, or provision of services or other benefits for, a person other than that beneficiary.
- 'Tax reduction purpose requirement' – a purpose of one or more of the parties to the agreement must be that a person would be liable to pay less income tax for a year of income.
- 'Ordinary dealing exception' – the agreement must not be one that has been entered into in the course of 'ordinary family or commercial dealing'.

**Note:** At the time of the release of this draft Ruling[3], the decision of the Federal Court in *Guardian AIT Pty Ltd ATF Australian Investment Trust v Commissioner of Taxation* [2021] FCA 1619 (*Guardian*), referred to in this Ruling, is the subject of an appeal.

# Ruling

## Connection requirement

5. Section 100A will apply to so much of the share of trust income that a beneficiary is presently entitled to, has been paid to them or that has been applied on their behalf (**that share**) as:

- meets the connection requirement, whereby either
  - the beneficiary is (in fact) presently entitled to that share and their present entitlement to that share arose
    - out of a reimbursement agreement, or
    - by reason of any act, transaction or circumstance that occurred in connection with or as a result of a reimbursement agreement[4]

  or

[1] All legislative references in this draft Ruling are to the *Income Tax Assessment Act 1936,* unless otherwise indicated.
[2] In this Ruling, unless otherwise specified, all subsequent references to a beneficiary are to a beneficiary that is not under a legal disability.
[3] All further references to 'this Ruling' refer to the Ruling as it will read when finalised. Note that this Ruling will not take effect until finalised.
[4] Subsection 100A(1).

- the beneficiary would otherwise be deemed to be presently entitled to that share and that share was paid to them or applied for their benefit as a result of
  - a reimbursement agreement, or
  - any act, transaction or circumstance that occurred in connection with or as a result of a reimbursement agreement[5],

and

- meets the non flow-through requirement, whereby, and to the extent that, if the beneficiary (trustee beneficiary) were otherwise presently entitled or deemed to be presently entitled to that share in their capacity as a trustee of another trust (interposed trust), there is income of the interposed trust attributable to that share to which no beneficiary of the interposed trust estate is presently entitled or deemed to be present entitled to.[6]

6. To satisfy the connection requirement, there needs to be a relevant connection between:

- a legally-effective entitlement, payment or application giving rise to an actual or deemed present entitlement to a share of the income of a trust estate, and
- an agreement (that meets the requirements to be a reimbursement agreement).

### *Agreement*

7. An 'agreement' is defined widely for section 100A to include arrangements and understandings.[7] Those terms have their ordinary and legal meaning in the context in which they appear. An agreement can be informal, express or implied, and need not be enforceable or intended to be enforceable. An agreement may be inferred from the surrounding circumstances or the conduct of the parties.

8. While an agreement requires two or more parties:

- an exact understanding of the nature and extent of the agreement (or of the benefits to be provided under it) is not required between all of its parties, and
- the agreement can be a plan comprising a series of steps undertaken individually or collectively by those parties over a period of time.

### *Relevant connection between entitlement and agreement*

9. For section 100A to apply, a relevant connection is required between the present entitlement (or payment or application giving rise to a deemed present entitlement) to all or part of a share of trust income and the relevant reimbursement agreement. This need not be a direct causal connection. It is sufficient for the present entitlement to have arisen from (or relevant payment or application to have resulted from) another act, transaction or

[5] Subsection 100A(2).
[6] Subsections 100A(3) to (3C).
[7] Subsection 100A(13).

circumstance that occurred in 'connection with' or 'as a result of' the reimbursement agreement.

10. Without limiting the scope of the connection sufficient for section 100A to apply, where the amount of trust income a beneficiary is made presently entitled to (or is paid or has applied for their benefit) exceeds the amount that they would have been (or could reasonably be expected to have been) made so entitled to (or so paid or applied for their benefit) absent either the reimbursement agreement or relevant act, transaction or circumstance occurring in connection with the reimbursement agreement, that excess is taken to have arisen out of (or have been paid or applied as a result of) the reimbursement agreement.[8]

11. The amount the taxpayer would have been made entitled to (or have been paid or had applied for their benefit) absent the reimbursement agreement (or absent the relevant act, transaction or circumstance occurring in connection with the reimbursement agreement) involves a prediction as to events which would have otherwise taken place. The prediction must be sufficiently reliable for it to be regarded as reasonable.

12. For an entitlement to arise from (or payment or application to result from) a reimbursement agreement, that agreement must have been in existence prior to the entitlement arising (or before the resulting payment or application of income). However:

- conduct of the parties before and after that time may be relevant to establishing the existence of an agreement at that time, and
- neither the presently entitled beneficiary nor the trustee needs to necessarily be a party to the agreement or even in existence when the agreement is made.

## Benefits to another requirement

13. For an agreement to be a reimbursement agreement, it must provide for the payment of money (including via loans or the release, abandonment, failure to demand payment of or the postponing of the payment of a debt), transfer of property to or provision of services or other benefits for one or more persons other than the beneficiary alone.[9]

14. An agreement that (or which includes that) a beneficiary will not demand payment of an amount to which they are presently entitled to would be one providing for the provision of benefits for a person other than the beneficiary alone.

15. Despite the label given to 'reimbursement agreements', the payment of money to, transfer of property to or provision of services or other benefits for a person other than the beneficiary alone need not necessarily be a 'reimbursement' as such to meet the requirements of subsection 100A(7). In particular, there is no requirement that the relevant money, property, services or other benefits provided to a person other than the beneficiary alone, be sourced from, equal to or otherwise be referrable to the share of trust income the beneficiary is presently entitled to receive, was paid or that was applied on their behalf.

## Tax reduction purpose requirement

16. For an agreement to be a reimbursement agreement, one or more of the parties to the agreement must have entered into it for a purpose (which need not be a sole, dominant or continuing purpose) of securing that a person would be liable to pay less tax in an

[8] Subsections 100A(5) and (6).
[9] Subsection 100A(7).

income year than they otherwise would have been liable to pay in respect of that income year (a tax reduction purpose).[10]

17. A tax reduction purpose includes a purpose of deferring a party's tax to a later income year.

18. For there to be a tax reduction purpose, it is not necessary that the person whose tax liability is intended by one of the parties to the agreement to be reduced is themselves a party to the agreement or that a reduction in their tax liability actually be achieved.

19. Where a party acts in accordance with advice from an adviser, the purpose of that adviser can be imputed to the party.

## Ordinary dealing exception

20. Agreements 'entered into in the course of ordinary family or commercial dealing' are not reimbursement agreements for the purposes of section 100A.[11]

21. 'Ordinary family or commercial dealing' is a composite phrase that is undefined, and takes its meaning in the context where it appears in section 100A. The test is an evaluative standard to be applied to the facts of each case.

22. The essential feature of ordinary family or commercial dealing is that it is ordinary. Acts undertaken in the course of ordinary family or commercial dealing are capable of explanation by the familial and/or commercial objects they are apt to achieve.

23. A dealing is not an ordinary family or commercial dealing merely because it is commonplace or involves no artificiality.

### *Dealing*

24. It is the whole dealing 'in the course of' which the agreement is entered into (including the transaction, set of transactions or other actions which implement and give effect to the agreement) which must have the quality of 'ordinary family or commercial dealing' for the exception to apply.

### *Ordinary familial or commercial objects*

25. Whether the agreement was entered into in the course of ordinary dealing is an objective enquiry to be addressed, at least principally, from the perspective (and in the context) of the persons whose purposes are relevant to the operation of section 100A.

#### *Familial objects*

26. 'Family' in 'ordinary family or commercial dealing' takes its ordinary meaning. It refers to a relationship of natural persons based on birth, affinity or co-residence. Family is not limited to any particular type of family relationship that is more common at a point in time than others.

27. The ordinary dealing exception does not apply simply because all parties to an agreement are family members. To be in the course of ordinary dealing, the transactions

[10] Subsection 100A(8).
[11] Subsection 100A(13).

between family members and their entities must be capable of explanation as achieving normal or regular familial or commercial ends.

#### *Commercial objects*

28. For a dealing to be capable of explanation as achieving ordinary commercial objects, the parties would be expected to advance their respective interests and commercial objects.

29. The absence of dealings at arm's length or market value does not, of itself, prevent a dealing from being explained as achieving the ordinary commercial objectives of the parties to the transactions.

### ***The presence of tax-driven features***

30. The presence of features in an agreement which appear to be tax driven are relevant to the objective enquiry to determine whether an agreement is entered into in the course of ordinary dealing.

## Consequences of section 100A – trustee liable for income tax and beneficiary relieved

### ***Deeming***

31. Where it applies, the deeming in section 100A creates a fictitious set of facts which are substituted for reality and are stated to apply for the purposes of the Act.

32. Specifically, to the extent that the share of income of a trust estate that a beneficiary is presently entitled to (or that has been paid to them applied for their benefit) meets the connection, benefits to another and tax reduction purpose requirements, and the ordinary dealing exception does not apply, section 100A will apply as follows:

- Where the beneficiary is in fact presently entitled to that share, they shall be deemed not to be, and never to have been, so presently entitled to the trust income. The fictitious set of facts created by the deeming in section 100A in these cases is that the beneficiary does not have the rights or entitlements that would cause them to be presently entitled to the relevant income of the trust estate.
- Where the beneficiary was in fact paid that share, or it was in fact applied for their benefit, it will be deemed not to have been so paid or applied.

33. The substitution of the fictitious set of facts under the section 100A deeming is limited and does not extend to treat an entitlement as having arisen for another person (such as a default beneficiary).

### ***Division 6 consequences***

34. Any assessment of the net income of the trust estate to a beneficiary that would otherwise arise under section 97 will be proportionately reduced by the share of the income of the trust estate section 100A deems the beneficiary not to be presently entitled to or to have received or had applied for their benefit. Any proportionate assessment of the net income of the trust estate to the trustee that would otherwise have arisen under

section 98 in respect of such a share would be likewise reduced, with section 98A then having no application in respect of that share.

35. The trustee is assessed and liable to pay tax on the proportionate share of the net income of the trust under section 99A relating to so much of the income of the trust estate covered by the section 100A deeming, as section 100A has created the statutory fiction that no beneficiary is presently entitled to this part.

### *Capital gains and franked distributions*

36. For the 2010–11 and following income years, the allocation of capital gains and franked distributions included in the net income of a trust estate between the trustee and beneficiaries is no longer determined under Division 6. It is determined by the application of specific rules in Subdivisions 115-C and 207-B of the *Income Tax Assessment Act 1997* (ITAA 1997) (the streaming rules). This allocation is a purpose for which the fictional state of affairs deemed by section 100A would apply.

37. Where some beneficiary would otherwise be 'specifically entitled' (within the meaning of the streaming rules) to a capital gain or franked distribution (or part thereof) included in the income of the trust estate (**a gain or distribution**) on the basis that they have received or have an entitlement to receive (and therefore expect to receive) the financial benefits in respect of that gain or distribution, the operation of section 100A (in creating a statutory fiction where that receipt or entitlement did not arise) will result in no beneficiary being specifically entitled to that gain or distribution. It will therefore also result in the allocation of the amount of the gain or distribution between the parties according to their respective adjusted Division 6 percentages (within the meaning of the streaming rules), worked out in that fictional state of affairs.

38. Where no beneficiary would otherwise be so specifically entitled, the operation of section 100A in creating a statutory fiction will result in an adjustment of the parties' adjusted Division 6 percentages for the purposes of assessing that gain or distribution.

### Date of effect

39. When the final Ruling is issued, it is proposed to apply to arrangements both before and after its issue. However, the Ruling will not apply to you to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

**Note:** The Commissioner has published Draft Practical Compliance Guideline PCG 2022/D1 *Section 100A reimbursement agreements – ATO compliance approach* that includes proposed bases on which compliance resources will not be directed to certain arrangements, including particular arrangements entered into in current and prior income years.

**Commissioner of Taxation**
23 February 2022

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# Appendix 1 – Explanation

***This Explanation is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.***

## Background

40. Section 100A is an anti-avoidance provision that was enacted in 1979. Broadly, and subject to the ordinary dealing exception, section 100A applies in cases where a beneficiary has become presently entitled to trust income where it has been agreed that another person will benefit, and that agreement is made by any of its parties with the purpose that some person will pay less or no income tax as a result, in a particular year of income.

41. Unlike the general anti-avoidance provisions in Part IVA, section 100A does not require the making of a determination by the Commissioner[12]; it is a self-executing provision which operates according to its terms.

42. According to the Explanatory Memorandum[13], section 100A:

> … look[s] to the existence of an agreement or arrangement that is entered into otherwise than in the course of ordinary family or commercial dealing and under which present entitlement to a share of trust income is conferred on a beneficiary in return for the payment of money or the provision of benefits to some other person, company or trust.
>
> …
>
> Sub-section (8) will effectively exclude from the scope of section 100A any agreement that was not entered into or carried out for a purpose of securing for any person a reduction in that person's liability to income tax in respect of a year of income, i.e., section 100A is only concerned with tax avoidance arrangements.

43. While section 100A may be concerned with tax avoidance arrangements, decided cases confirm that it is not limited to traditional trust stripping arrangements involving specially-introduced beneficiaries.[14]

44. As set out in the Rulings section of this draft Ruling, there are four basic requirements for section 100A's operation:

- the connection requirement (see paragraphs 46 to 64 of this Ruling)
- the benefits to another requirement (see paragraphs 65 to 69 of this Ruling)
- the tax reduction purpose requirement (see paragraphs 70 to 75 of this Ruling), and
- the ordinary dealing exception (see paragraphs 76 to 96 of this Ruling).

45. The consequences of section 100A applying are that the trustee (and not the beneficiary) will be liable for income tax on amounts that would generally otherwise be included in the assessable income of the beneficiary in respect of the present entitlement. (see paragraphs 97 to 106 of this Ruling).

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[12] See section 177F.

[13] Pages 6 and 36 respectively of the Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 5) 1978.

[14] See, for example, *Commissioner of Taxation v Prestige Motors Pty Ltd as Trustee of the Prestige Toyota Trust* [1998] FCA 221; 82 FCR 195 (*Prestige Motors*) at [214–215], per Hill and Sackville JJ, with whom Beaumont J agreed.

## Connection requirement (subsections 100A(1) to (6))

46. Subsection 100A(1) provides that where:

> (a) … a beneficiary of a trust estate who is not under a legal disability is presently entitled to a share of the income of the trust estate; and
>
> (b) … that share or to a part of that share …arose out of a reimbursement agreement or arose by reason of any act, transaction or circumstance that occurred in connection with, or as a result of, a reimbursement agreement;
>
> the beneficiary shall, for the purposes of this Act, be deemed not to be, and never to have been, presently entitled to the relevant trust income.

47. Subsection 100A(2) applies, with similar effect, for cases where a beneficiary is deemed to be presently entitled to income of the trust estate because it was paid to them or applied for their benefit.[15]

48. It follows, from the text of subsections 100A(1) and (2), that for the application of the section there must be an actual or deemed present entitlement for a beneficiary, and the existence of all or part must have the required connection with an identified agreement, arrangement or understanding that is a 'reimbursement agreement'.

49. The application of subsections 100A(1) and 100A(2) is modified where the beneficiary (trustee beneficiary) is presently entitled as trustee of another trust estate (the interposed trust estate).[16]

50. The non flow-through requirement in subsection 100A(3A) provides that subsection 100A(1) does not apply to so much of the trust income to which a trustee beneficiary is presently entitled (distributable trust income) that, broadly, the trustee beneficiary in turn passes on to beneficiaries of the interposed trust. Specifically, it will not apply to the extent that a beneficiary of that interposed trust estate is presently entitled to income of the interposed trust that is attributable to the distributable trust income.

51. Subsection 100A(3B) applies similarly to exclude from the operation of subsection 100A(2) income of a trust estate that is paid to, or applied for the benefit of, a trustee beneficiary to the extent that one or more beneficiaries of the interposed trust estate are presently entitled to income attributable to the amounts paid or applied for the benefit of the trustee beneficiary.

### *A present entitlement*

52. Arrangements to which section 100A applies involve a person being presently entitled to or having been paid income of a trust estate, or having had income of a trust estate applied for their benefit, in connection with a reimbursement agreement.[17]

[15] That is, on the operation of section 101 and subsection 95A(1).
[16] Subsections 100A(3), (3A) and (3B).
[17] Subsections 100A(1), (2) and (7).

53. Section 100A is applied to the facts. Where actions taken to purportedly create a present entitlement are a sham (not intended to have their stated legal consequences), the purported appointment of income to that beneficiary is not legally effective.[18] Consequently, section 100A cannot apply in relation to that purported entitlement.[19]

54. The same result applies where a purported appointment of income is not effective for reasons other than sham. For example, if a trustee purports to appoint income to a party that is not a beneficiary of the trust.[20]

### *An identified agreement, arrangement or understanding*

55. Subsection 100A(13) provides that, in section 100A:

> ***agreement*** means any agreement, arrangement or understanding, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings, but does not include an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing.

56. The meaning of the term 'agreement' is informed by the surrounding text, the context in which it appears and case law in which the phrase in subsection 100A(13) has been interpreted. Drawing on these sources, the term 'agreement':

- expressly extends to 'arrangements' and 'understandings', which can be informal, express or implied, and need not be enforceable or even intended to be enforceable
- has been described by the Full Federal Court as having its widest meaning[21], and
- is one for which the terms 'agreement, arrangement or understanding' take their ordinary contextual meanings, which often overlap. There is no requirement to draw an artificial distinction between them by specifically identifying an 'arrangement' as one or the other. Rather, what is required for the operation of the section is that the nature and scope of the relevant 'agreement' be specified.[22]

[18] *Raftland Pty Ltd as trustee of the Raftland Trust v Commissioner of Taxation* [2008] HCA 21 (*Raftland*) at [129–159], per Kirby J (Gleeson CJ, Gummow and Crennan JJ agreeing at [85]; Heydon J in dissent at [171–173]).

[19] If there is no other beneficiary presently entitled to the income which is the subject of the ineffective appointment, the result for the trustee is that they are liable to tax under the ordinary operation of section 99A. Where the consequence of legal ineffectiveness is that another beneficiary (a default beneficiary) is presently entitled, the terms of section 100A may, depending on the other facts of the arrangement, be satisfied in relation to the entitlement of that default beneficiary.

[20] *Idlecroft Pty Ltd v Commissioner of Taxation* [2005] FCAFC 141 (*Idlecroft*).

[21] *Prestige Motors* at [216], per Hill and Sackville JJ.

[22] *Prestige Motors* at [207], per Hill and Sackville JJ, followed by the Full Court in *Raftland Pty Ltd v Commissioner of Taxation* [2007] FCAFC 4 at [72], per Edmonds J (Conti and Dowsett JJ agreeing).

57. While, for the purposes of section 100A, an agreement requires two or more parties[23], the agreement does not require:

- an exact understanding of the parties to the nature and extent of the agreement and benefits to be provided and can, depending on the facts, be a plan comprising a series of steps undertaken individually by those parties over a period of time[24], or
- the presently entitled beneficiary to be a party or even in existence when made[25], or
- the relevant trust to be in existence when made.[26]

58. Case law apart from subsection 100A(13) is another relevant source. Consistent with the approaches of Courts where the meaning of the words agreement, arrangement or understanding have been considered:

- Where, as provided by subsection 100A(13), an agreement can be implied, it is open to infer that an agreement exists from the surrounding circumstances or the conduct of the parties.[27] In the particular context of section 100A, an example where it is possible that this inference may be drawn is where the conduct of the trustee and others is inconsistent with the rights and duties imposed by the trust deed and the general law.
- While an 'arrangement or understanding' must have been entered into consensually, parties' acceptance or adoption may be tacit and it is not essential that they be committed, or bound, to support it. The arrangement may be both informal and unenforceable, and the parties may be free to withdraw from it or to act inconsistently with it, notwithstanding their adoption of it.[28] An arrangement or understanding may lack formality and precision.[29]
- An 'arrangement' could be informal concerted action by which two or more parties may arrange their affairs towards a purpose.[30] An example in the particular context of section 100A would be an 'arrangement or understanding' that the beneficiary would act in accordance with the wishes of another person or group.

[23] The subsection refers to an 'agreement, arrangement or understanding' whether 'formal or informal', express or implied, [enforceable] or not enforceable. These characteristics point to an arrangement which is bilateral or multilateral. It also refers to 'agreements' which are 'entered into'. The language is similar to that used in section 260, though there the words 'made or entered into' are used. The Privy Council in *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1 (*Newton*) decided that for an arrangement to fall within section 260 it must have been between two or more persons, and the High Court decided equally for a similarly-worded provision in *Commissioner of Taxation (Cth) v Lutovi Investments Pty Ltd* [1978] HCA 55; 140 CLR 434 (*Lutovi Investments*) at [443–444], per Gibbs and Mason JJ.

[24] See *Raftland Pty Ltd v Commissioner of Taxation* [2006] FCA 109 at [96], per Keifel J and *Lutovi Investments* at [445].

[25] *Prestige Motors*, per Hill and Sackville JJ.

[26] *Prestige Motors*, per Hill and Sackville JJ.

[27] See *Lutovi Investments* at [443–444], per Gibbs and Mason JJ and *Commissioner of Taxation v BHP Billiton Limited* [2011] HCA 17 at [53], per French CJ, Heydon, Crennan, and Bell JJ.

[28] *Lutovi Investments* at [444], per Gibbs and Mason JJ.

[29] *Commissioner for Taxation of the Commonwealth of Australia v Lutovi Investments Pty Ltd* [1978] FCA 53, 78 ATC 4289 at [4291–4292], per Bowen CJ.

[30] *Jaques v Federal Commissioner of Taxation* [1924] HCA 60, per Isaacs J; *Bell v Federal Commissioner of Taxation* [1953] HCA 99; *Newton*.

### *An entitlement that occurs in connection with or as a result of the reimbursement agreement*

59. For section 100A to apply, it must be the case that the present entitlement[31]:

> … arose out of a reimbursement agreement or arose by reason of any act, transaction or circumstance that occurred in connection with, or as a result of, a reimbursement agreement.

60. These express terms describe the width of the provision, which extends beyond cases where there is a direct causal connection or relationship between the existence of the present entitlement and the reimbursement agreement.

61. It is sufficient for there to be a connection between the reimbursement agreement and some other act, transaction or circumstance from which the entitlement has arisen. If the beneficiary's present entitlement were one of the consequences of any act, transaction or circumstance that occurred in 'connection with' or 'as a result of' the reimbursement agreement, this aspect of subsection 100A(1) would be satisfied.[32] The existence of such a connection will depend on the facts of a particular case.

62. Where a present entitlement arises from an agreement or a payment or application of trust income resulting from an agreement, naturally, the relevant agreement must be in existence at the time when the present entitlement arises, payment is made or funds applied.[33] However, that existence can be established by evidence of the conduct of the parties before and after that time.[34]

63. Subsections 100A(5) and (6) complement subsections 100A(1) and (2), respectively, by deeming relevant trust amounts to have arisen out of or resulted from reimbursement agreements, without otherwise limiting the scope of the connection sufficient for section 100A to apply. Specifically, where the amount by which a beneficiary's present entitlement (or an amount which is paid or is applied for their benefit) (the increased amount) exceeds the amount the beneficiary would have been (or could reasonably be expected to have been) presently entitled to (or paid or applied for their benefit) absent either the reimbursement agreement or an act, transaction or circumstance that occurred in connection with, or as a result of, the reimbursement agreement (the original amount), that excess is taken to have arisen out of or resulted from the reimbursement agreement.

64. The taxpayer has the onus of establishing a reasonable expectation that the beneficiary would have been presently entitled to the original amount if the reimbursement agreement had not been entered into.[35] A 'reasonable expectation' requires more than a possibility. It involves a prediction as to events which would have taken place if the reimbursement agreement had not been entered into. The prediction must be sufficiently reliable for it to be regarded as 'reasonable'.[36]

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[31] Paragraphs 100A(1)(b) and (2)(b).
[32] *Idlecroft*.
[33] *East Finchley Pty Ltd v Commissioner of Taxation* [1989] FCA 720 (*East Finchley*), per Hill J; *Guardian* at [128–129], per Logan J.
[34] See *Raftland* at [49], per Gleeson CJ, Gummow, and Crennan JJ.
[35] *Idlecroft*.
[36] *Commissioner of Taxation (Cth) v Peabody* [1994] HCA 43.

## Benefits to another requirement (subsections 100A(7), (11) and (12))

65. A reimbursement agreement must satisfy the conditions in subsection 100A(7). As observed by the Courts, it is not necessary for there to be a reimbursement in the ordinary sense in order to satisfy the definition of 'reimbursement agreement'.[37]

66. Subsection 100A(7) states that:

> Subject to subsection (8), a reference in this section, in relation to a beneficiary of a trust estate, to a reimbursement agreement shall be read as a reference to an agreement, whether entered into before or after the commencement of this section, that provides for the payment of money or the transfer of property to, or the provision of services or other benefits for, a person or persons other than the beneficiary or the beneficiary and another person or persons.

67. Subsection 100A(7) does not limit who can be the provider of the money, property, services or other benefits. It also does not require that a benefit be provided directly. For example, it could be satisfied in a case where the person intended to benefit holds equity, shares, units or a similar interest in the presently entitled beneficiary. Similarly, it is not a requirement of subsection 100A(7) that the 'relevant trust income', to which the beneficiary is presently entitled or has been paid or applied for their benefit, be the relevant benefits to be provided to another person under the agreement.

68. The reference to 'persons other than the presently entitled beneficiary' can be anyone, including the trustee[38], another beneficiary of the trust, or any other person.

69. The meaning of 'payment of money' is extended by subsections 100A(10) and (12) to include a payment by way of loan and to the release, abandonment, failure to demand payment or postponement of payment of a debt. It follows there is a 'payment of money' where a beneficiary loans the amount of their entitlement to the trustee. The inclusion of the words 'or other benefits' means that that condition could be satisfied in the case of an 'agreement' where funds are not distributed but retained in the trust.

## Tax reduction purpose requirement

70. Subsection 100A(8) excludes certain agreements from the definition of reimbursement agreement. It states:

> A reference in subsection (7) to an agreement shall be read as not including a reference to an agreement that was not entered into for the purpose, or for purposes that included the purpose, of securing that a person who, if the agreement had not been entered into, would have been liable to pay income tax in respect of a year of income would not be liable to pay income tax in respect of that year of income or would be liable to pay less income tax in respect of that year of income than that person would have been liable to pay if the agreement had not been entered into.

71. An agreement is entered into for a tax reduction purpose if any of the parties to the agreement entered into the agreement for that purpose.[39] However, the person whose tax liability is to be reduced or eliminated need not be a party to the reimbursement agreement.[40] There is no requirement that the tax reduction purpose need be the sole or dominant purpose of the party or parties for entering into the agreement. It need only be one of the purposes of the relevant party or parties for entering into the agreement.

[37] *Prestige Motors*, at [220], per Hill and Sackville JJ.
[38] Subsection 100A(11).
[39] Subsection 100A(9).
[40] *Prestige Motors* at [219–220], per Hill and Sackville JJ.

72. While there is some structural similarity, the tax reduction purpose requirement in subsection 100A(8) is substantially different to the purpose requirement in the general anti-avoidance rule in section 260 which was operative when section 100A was enacted. Subsection 260(1) refers to a '… contract, agreement, or arrangement ... [that] has or purports to have the purpose or effect… ' of avoiding tax in a described way. Subsection 100A(8) does not refer to the 'purpose or effect' of an agreement and instead refers to the purpose of one or more parties to the agreement.

73. The matters to be considered to determine purpose include the parties' own evidence as to their purposes for entering into the agreement, and any inference as to their purpose that may be drawn from all the known circumstances.[41]

74. The purpose of a party's adviser can be imputed to the party where that party acts in accordance with the adviser's advice.[42] A person can have a purpose of securing a reduction in tax for subsection 100A(8) even where that purpose is not achieved[43] or ceases to be held at some time following the entry into the agreement.

75. The income tax liability to be reduced can be in relation to any year of income, meaning that a purpose of deferring tax to a later year would be sufficient to demonstrate the tax reduction purpose.

## Ordinary dealing exception

76. A further exception to the operation of section 100A is contained in the final words of subsection 100A(13):

> ***agreement*** … does not include an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing.

77. The exception is satisfied where an agreement has the quality of not being entered into in the course of ordinary family or commercial dealing. The composite phrase 'ordinary family or commercial dealing' is not defined for the purposes of section 100A and so takes its ordinary and legal meaning, having regard to its statutory context.

78. Statutory context is relevant. Section 100A is an income tax anti-avoidance provision. As observed in the leading judgment of Hill and Sackville JJ in *Prestige Motors*[44]:

> The wording of the exclusion in s 100A(13) derives from the judgment of Lord Denning, on behalf of the Privy Council, in *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1, at 8. There his Lordship, in discussing s 260 of the *ITAA*, contrasted an arrangement implemented in a particular way to avoid tax with "transactions that are capable of explanation by reference to ordinary business or family dealing".

79. The essential feature of ordinary family or commercial dealing is that it is ordinary. Consistent with the approach of the Court in *Newton*, dealing is ordinary where a person can examine the acts and predicate that they can be explained by the familial and/or

[41] *Prestige Motors* at [217–218], per Hill and Sackville JJ; *Australian Competition and Consumer Commission v Cascade Coal Pty Ltd* [2019] FCAFC 154 at [167]; cf *Guardian* at [163], per Logan J.
[42] *Prestige Motors* at [217–218], per Hill and Sackville JJ. Also see *Commissioner of Taxation (Cth) v Bidencope* [1978] HCA 23, per Gibbs J.
[43] See, for example, *Idlecroft* in which the nominated present entitlements were not achieved, and *Raftland,* in which the nominated entitlements were shams.
[44] *Prestige Motors* at [221–222], per Hill and Sackville JJ, Beaumont J agreeing. That the Parliament had deliberately chosen to use the phrase 'ordinary family or commercial dealing' in the text of subsection 100A(13) following *Newton* has been more recently confirmed in *Guardian* at [137–138], per Logan J.

commercial objects they are apt to achieve without further explanation.[45] This predication test is an evaluative standard that requires an examination of the facts and circumstances of each case. It is the test by which the composite phrase 'ordinary family or commercial dealing' is interpreted in the statutory context in which it appears (an anti-avoidance provision). This test cannot be substituted with an approach that classifies transactions by reference to a dictionary meaning or synonym for the word 'ordinary' separate from statutory context. Dealing is not ordinary just because it is commonplace.[46] Similarly, dealing can fail to be ordinary dealing even where it is not artificial.[47]

### *Dealing*

80. The definition of agreement provides it is the dealing 'in the course of' which the agreement is entered into that is examined against the evaluative standard of 'ordinary family or commercial dealing'. The Oxford Dictionary sets out that 'dealing', among other things, refers to business relations, trading or conduct in relation to others.[48]

81. The dealing to be tested is identified by reference to the subject matter and terms of the agreement; that is, the transaction, set of transactions or other actions which implement and give effect to the agreement. In order to engage the exception, it is these transactions or other actions which must have the quality of ordinary dealing.[49]

82. The whole course of dealing contemplated by the agreement must be examined. For example, the sale of a business between related entities may of itself be ordinary dealing. However, the sale may be one element of a larger transaction or series of transactions contemplated by the agreement. The larger transaction or other steps in the transaction may be very different from a straightforward business sale and not be ordinary dealing.[50]

83. While the dealing to be tested is the conduct of the transaction, set of transactions or other actions to give effect to the agreement, contextual facts and circumstances are highly relevant. Context may inform the commercial and family objectives of an agreement. These may include, for example, the relationship or association between the parties and their economic or other relevant circumstances. For example, assume in an income year, family members agree to gift their trust distributions to one family member, Paul, who has

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[45] In the formulation in *Newton*, without further explanation was 'without necessarily being labelled as a means to avoid tax'. See the following passages from *Newton* [1958] 2 All ER 759 at [763-764]:

> Their Lordships are of opinion that the word "arrangement" is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons – a plan arranged between them which may not be enforceable at law. But it must in this section comprehend, not only the initial plan, but also all the transactions by which it is carried into effect – all the transactions, that is, which have the effect of avoiding taxation, be they conveyances, transfers or anything else. …
>
> Applying these principles to the present case, the first question is – Was there an arrangement? The answer is "Yes". The whole complicated series of transactions must have been the result of a concerted plan; and the nature of the plan is to be ascertained by the overt acts done in pursuance of it.

[46] Gibbs CJ in *Commissioner of Taxation (Cth) v Gulland* [1985] HCA 83 (*Gulland*) observed that the phrase adopted by the Privy Council in *Newton* was intended to '… refer to what was normal or regular, rather than to what had become common or prevalent' and was made 'by way of contrast to the words "without necessarily being labelled as a means to avoid tax" …'.

[47] In our view, the observations of Logan J in Guardian at [144–145] are illustrative of a type of dealing that is not ordinary family or commercial dealing; and are not strictly contrary to the view that there may be other categories of dealing which similarly cannot be so classified.

[48] Gwynn M (ed.) and Laugesen A (ed) (2017) *Australian Concise Oxford Dictionary*, 6th edition, Oxford University Press, Melbourne.

[49] See *Newton* and *Prestige Motors* at [221–223], per Hill and Sackville JJ. A textual factor that lends support to this conclusion is that the Parliament in subsection 100A(13) has chosen to refer to 'ordinary family or commercial dealing' and not 'an ordinary family or commercial dealing'.

[50] *Prestige Motors* at [222–223], per Hill and Sackville JJ.

significant medical bills. The arrangement is implemented via trust distributions to the family members and a gift by each of them to Paul. That Paul has significant medical bills is not a construct of the agreement; however, it is a highly relevant contextual fact which bears on what are familial objectives. In this context, there is nothing extraordinary about the arrangement or the transactions (trust distributions and gifts) which give effect to the agreement.

84. The application of the ordinary dealing exception can raise questions about how to assess the achievement of familial or commercial objects or the presence of tax-driven elements in a dealing, and the relevance of the operation of other tax laws.

### *Familial or commercial objects*

85. Whether the agreement was entered into in the course of ordinary dealing is an objective enquiry to be addressed, at least principally, from the perspective of the persons whose purposes are relevant to the operation of the section.[51]

86. 'Family' in 'ordinary family or commercial dealing' takes its ordinary meaning. It refers to a relationship of natural persons based on birth, affinity or co-residence. Family is not limited to any particular type of family relationship that is more common at a point in time than others.

87. To explain that acts achieve familial objects without the need for further explanation, a person would need to objectively conclude that the transactions entered into among family members (including via their entities) are adopted as a means to achieve normal or regular familial ends. The characteristics of the dealing, including the circumstances of the parties, the economic and other results of the dealing, and the type of relationship between the parties will be relevant. For example, a dependent child gifting money attributable to a family trust distribution to their parents who could otherwise have been made presently entitled to the trust income would in most cases not have the quality of ordinary dealing.

88. If carried out via one or more of the family member's entities, it would also be necessary to consider the types of entities used, and the degree of control and ownership of those entities.

89. The dealing must be capable of explanation as being for the advancement of normal or regular familial objects. This objective enquiry can accommodate extraordinary or unusual features that apply to a particular family. However, the test is not of what is common practice for either a family or for the community.[52] For example, an arrangement between family members where the overt acts achieve a particular favourable tax result will not be ordinary dealing simply because the arrangement has become prevalent, unless it can otherwise be seen to result in the achievement of a familial or commercial object.

90. For a dealing to be capable of explanation as achieving ordinary commercial objects, the parties would be expected to advance their respective interests. It is ordinary commercial dealing where it would be normal or regular if seen in trade or commerce as a means to advance commercial objects. A complex commercial dealing may nonetheless be 'ordinary' if that complexity is needed to achieve the identified commercial objects.[53]

[51] *Prestige Motors* at [222–223], per Hill and Sackville JJ. These persons are any of the parties to the agreement; see subsection 100A(9).
[52] See footnote 46 of this Ruling.
[53] *Rippon, J.T. v Commissioner of Taxation* [1992] FCA 199 (*Rippon*), per Heerey J.

91. Parties to a commercial dealing can have commercial objectives for that dealing, even in the absence of market value or where they do not deal at arm's length. To test whether this is the case, the intended use of funds that an entity obtains from a part of a dealing can be relevant.

### *The presence of tax-driven features*

92. As explained in paragraph 79 of this Ruling, there will be ordinary dealing where a person could predicate that the acts can be explained by the familial or commercial objects they are apt to achieve, without the need for further explanation. Regular familial and commercial objects can still be advanced in transactions which are chosen for the reason that they are tax effective when compared to similar alternatives to achieve those objects.

93. However, a dealing that includes features that are clearly tax driven and which make the arrangement appear contrived and artificial requires close examination, as does a dealing where the method of implementation suggests that tax is driving the arrangement instead of any familial or commercial object. The Court in *Prestige Motors* identified the form of the transactions and the tax advantages obtained as a part of the exercise of identifying whether there was an agreement entered into in the course of ordinary commercial dealing.[54]

94. In the context of section 100A, an income tax anti-avoidance provision, a commercial or familial object of reducing collective income tax liabilities to maximise post-tax group wealth, would not of itself satisfy the ordinary dealing exception. For example, a trustee making a lower-taxed beneficiary presently entitled to trust income while paying the underlying funds to another person or persons who would otherwise pay higher tax, will not be an agreement entered into in the course of ordinary dealing solely because it can be explained as increasing collective post-tax family or group wealth.

95. The following features may indicate that a dealing that is being tested is not ordinary dealing, as the transactions cannot be properly explained without reference to the purpose of avoiding tax. The factors are not exhaustive and no one factor is decisive:

- An arrangement, or part of an arrangement, has artificial or contrived features, taking into account
  - the manner in which the arrangement was carried out
  - whether there was a more direct way to achieve the family or commercial goals; for example, could the arrangement instead have provided the benefit to the person who actually benefited, more simply or directly, such as by making that person presently entitled to trust income, and
  - the complexity of the arrangement (noting that 'complex' does not necessarily mean 'artificial').[55]

[54] In *Prestige Motors*, the Court noted that the wording of the exclusion in subsection 100A(13) had been derived from the judgment of Lord Denning, on behalf of the Privy Council, in *Newton*. It was clear from the decision in *Newton* that section 260 was regarding as involving a dichotomy between a transaction predicated on tax avoidance and ordinary dealing. The Court did not ultimately need to decide if section 100A imports a similar dichotomy. Rather, the Court in *Prestige Motors* concluded both transactions were the consequence of an agreement entered into only for tax avoidance purposes. (See *Prestige Motors* at [222–223], per Hill and Sackville JJ.)

[55] *Commissioner of Taxation v John Thomas Rippon* [1992] FCA 728, per Lockhart, Beaumont and Foster JJ.

- There is conduct or circumstances inconsistent with the legal or economic consequences of the beneficiary's entitlement; for example
  - it appears unlikely that beneficiaries will ultimately receive their trust entitlements, which may occur when
    - assets or funds representing the entitlement are purportedly lent to others without any intention of being returned or repaid
    - funds representing the entitlement are invested in ways inconsistent with that entitlement, or
    - funds representing the entitlement are dealt with in a way that is inconsistent with the beneficiary's right to demand the entitlement
  - beneficiaries are not compensated for being kept 'out of the money' (for example, by way of interest, although noting that loans without interest may, depending on the cultural and other familial circumstances, qualify as ordinary dealing)
  - beneficiaries are not informed of their entitlements
  - where income entitlements have actually been remitted to the beneficiary, amounts were subsequently returned or other benefits or services were provided, by way of gift or otherwise to another person (such as the trustee, another beneficiary or an associate, whether by the beneficiary or by the trustee either independently or under a power of attorney), and
  - income entitlements have not been remitted to the beneficiary, and the reasons given are false having regard to the reasons given for the purported distribution.
- The proportion of the trust net income distributed to the beneficiary as compared to other beneficiaries.
- The relationship between the beneficiary, settlor, trustee and default beneficiaries.

### *Application of other tax laws*

96. Section 100A is a specific provision with an anti-avoidance object. While the application of other tax laws would be considered by parties that are entering into transactions which may serve a familial or commercial object, whether those laws apply to a transaction is not a substitute for the test of ordinary dealing. For example, the application of other provisions such as the income injection rules in Division 175 of the ITAA 1997 would not, in and of itself, prevent section 100A from applying.

Status: **draft only – for comment**

### Consequences – trustee liable for income tax and beneficiary relieved

97. The consequences of the application of section 100A are achieved by the statutory device of deeming. When section 100A applies:

> (1) ... the beneficiary shall, for the purposes of this Act, be deemed not to be, and never to have been, presently entitled to the relevant trust income.

or

> (2) ... the relevant trust income shall, for the purposes of this Act, be deemed not to have been paid to, or applied for the benefit of, the beneficiary.

98. Deeming creates a statutory fiction that is to be applied for limited purposes.[56] The deeming in section 100A creates a fictitious set of facts which are substituted for reality, stated to apply for the purposes of the Act.[57] In a case where:

- subsection 100A(1) applies, the fictitious set of facts is that the beneficiary does not have the rights or entitlements that would cause them to be presently entitled to the relevant income of the trust estate[58], or
- subsection 100A(2) applies, the fictitious set of facts is that the beneficiary has not received a payment of that relevant income, and no amount has been applied for their benefit.[59]

99. The substitution of the fictitious set of facts does not extend to cause an entitlement to arise for another person (such as a default beneficiary). This limit on the scope of the statutory fiction promotes the legislative purpose of section 100A 'to bring about the result that trust income dealt with under reimbursement agreements would be taxed under section 99A'.[60]

### *Division 6 consequences*

100. Any assessment of the net income of the trust estate to a beneficiary that would otherwise arise under section 97 will be proportionately reduced by the share of the income of the trust estate section 100A deems the beneficiary not to be presently entitled to or to have received or had applied for their benefit. Any proportionate assessment of the net income of the trust estate to the trustee that would otherwise have arisen under section 98 in respect of such a share would be likewise reduced, with section 98A then having no application in respect of that share.

101. The trustee is assessed and liable to pay tax on the proportionate share of the net income of the trust under section 99A relating to so much of the income of the trust estate covered by the section 100A deeming, as section 100A has created the statutory fiction that no beneficiary is presently entitled to this part.

### *Capital gains and franked distributions*

102. For the 2010–11 and following income years, the allocation of capital gains and franked distributions that would have been included in the net income of a trust estate

[56] *Muller v Dalgety & Co Limited* [1909] HCA 67, per Griffith CJ; *Commissioner of Taxation v Comber, A.H.* [1986] FCA 92, per Fisher J. See also the views of Gibson J in *Marshall (Inspector of Taxes) v Kerr* [1994] 3 All ER 106, cited with approval by Jagot J in *Ellison v Sandini Pty Ltd* [2018] FCAFC 44.
[57] 'This Act' includes the ITAA 1997. Refer definition of 'this Act' in subsection 6(1).
[58] Subsection 100A(1).
[59] Subsection 100A(2).
[60] *East Finchley*, per Hill J.

between a trustee and beneficiaries is no longer determined under Division 6. It is determined instead by the application of specific rules in Subdivisions 115-C and 207-B of the ITAA 1997 (the **streaming rules**).[61]

103. The operation of the streaming rules to allocate trust capital gains and franked distributions is a purpose of the ITAA 1997 for which the deeming in section 100A applies. Where the terms of that section are satisfied for the facts of an arrangement, the streaming rules are applied to the fictitious set of facts deemed to exist rather than the actual facts.[62]

104. Whether and how this will have the result that the trustee will be liable to tax instead of a beneficiary will depend on the facts.

105. One way that a beneficiary includes an amount of a capital gain or franked distribution in assessable income is that they are 'specifically entitled', as they have or can reasonably expect to receive a financial benefit referrable to the gain or distribution, in accordance with the terms of the trust.[63] The circumstance in which a beneficiary is specifically entitled will commonly involve actual or expected present entitlement to income of the trust comprising such a benefit, or the distribution of such income.[64] Where section 100A applies, the application of the law to a fictitious set of facts (where a payment does not happen or entitlement does not arise) may have the result that the beneficiary is taken not to be specifically entitled to an amount. As a result, the allocation of the gain or distribution will be made according to the parties' adjusted Division 6 percentages (as relevantly modified by the application of section 100A), within the meaning of the streaming rules.

106. The other way that a beneficiary includes a capital gain or franked distribution is that no person is specifically entitled to an amount, and the beneficiary includes a share according to their adjusted Division 6 percentage.[65] Where section 100A applies, the application of the law to the fictitious set of facts will have the result that there is a decrease in the beneficiary's adjusted Division 6 percentage, and an increase in the trustee's adjusted Division 6 percentage, within the meaning of the streaming rules.

[61] See also sections 95AAB, 95AAC, 102UX and 102UY.

[62] While at the time when section 100A was enacted, the specific provisions that would make a person liable to tax on income derived by a trustee would have been Division 6, 'for the purposes of this Act' in section 100A, can be understood as having an ambulatory meaning not be limited to provisions of the Act which existed in 1978: See *Deputy Commissioner of Taxation v Clark* [2003] NSWCA 91 at [139–142], per Spigelman J. The continued operation of section 100A for income comprised of capital gains and franked distributions is supported by the terms of the law (section 95AAA) and in the extrinsic materials that accompanied the introduction of the streaming amendments (paragraph 2.151 of the Explanatory Memorandum to the Tax Laws Amendment (2011 Measures No. 5) Bill 2011).

[63] Sections 115-228 and 207-58 of the ITAA 1997.

[64] Paragraphs 2.44 and 2.45 of the Explanatory Memorandum to the Tax Laws Amendment (2011 Measures No. 5) Bill 2011.

[65] Paragraph 115-227(a) and subsection 207-55(4) of the ITAA 1997.

Status: **draft only – for comment**

# Appendix 2 – Examples

***This Appendix provides examples which illustrate the principles in the Ruling. Decisions on individual cases will depend on the overall circumstances of that case. Consequently, the conclusions reached in the following examples are not necessarily determinative of the Commissioner's views on cases with similar, but different, facts.***

### *Example 1 – trust established under a will*

107. *A trust established under a will provides that William, the grandson of the deceased, is entitled each year to all of the trust income, although it is not to be paid to him until he is 25 years of age (and thereafter) or, if he dies before attaining the age of 25, to his estate.*

108. *At the time the trust is created, William is 15 years of age. The income is used by the trustee to make further income-producing investments.*

109. *Section 100A does not apply in relation to the entitlement to income of a minor beneficiary.*[66] *Additionally, after William turns 18, and absent other facts, the retention of income until William attains 25 years of age and the reinvestment of that income on the terms of the trust would be an arrangement entered into in the course of ordinary dealing.*

### *Example 2 – distribution to spouses with mixed finances*

110. *The Rosegum Family Trust is controlled by spouses, Lisa and Matthew Rosegum, who are the primary beneficiaries of the trust. The trust has a widely-drawn objects clause which includes family members of Lisa and Matthew and their related entities.*

111. *Each year, the trust makes Lisa and Matthew presently entitled to the income of the trust in equal proportions.*

112. *Lisa and Matthew have shared financial responsibilities and fund their lifestyle from a common pool of assets.*

113. *Trust distributions to spouses who have shared financial responsibilities and who ultimately enjoy the shared benefits of the distribution would usually be capable of explanation as achieving ordinary familial objects without the need for further explanation. Absent any additional factors taking the arrangement beyond those ordinarily encountered in the organisation of financial affairs between spouses, the arrangement would likely be entered into in the course of ordinary dealing.*

### *Example 3 – gift from parents to a child*

114. *Assume the same facts as Example 2 of this Ruling. In one year, Lisa and Matthew's eldest child, Kate, purchases a property. Lisa and Matthew pay for the deposit with funds attributable to their distribution from the Rosegum Family Trust. The making of gifts between family members for ordinary familial purposes, such as parents contributing to the purchase of a house, without additional facts, would usually be ordinary dealing, as able to be explained as achieving ordinary familial objects without the need for further explanation.*

[66] Paragraphs 100A(1)(a) and (2)(a). Note: Division 6AA should be considered regarding accumulations of trust income in respect of minors.

115. *A different outcome might arise if, for example:*

- *parents gift money received from a trust to their children repeatedly and the parent has a lower marginal tax rate and lesser means than the adult child who is also capable of benefitting under that trust in their own right (such as retired parents repeatedly gifting trust entitlements to higher marginal tax rate children in lieu of the trustee distributing to the adult child directly), or*
- *the situation is reversed, so that Kate, who is less financially advanced, gifted money to Lisa and Matthew, particularly where the adult child has a lower marginal tax rate than the parent (see Example 4 of this Ruling).*

***Example 4 – trust entitlement gifted to trustee***

116. *The trustee of the Gallagher Family Trust makes Pauline, who is an adult full-time student, presently entitled to trust income for a particular year. Pauline's entitlement is determined so her taxable income will not exceed certain marginal tax rate thresholds. Pauline gifts her entitlement back to the trustee.*

117. *The creation of an entitlement and gifting back indicates there may be an agreement, arrangement or understanding between the parties which is connected to Pauline's present entitlement. An arrangement between family members where the overt acts achieve a particular favourable tax result but cannot otherwise be seen to result in the achievement of any regular familial object will not be entered into in the course of ordinary dealing simply because it is among family members. For these reasons, the gifting back of Pauline's entitlement calls for explanation.*

118. *In circumstances where Pauline gifts her entitlement back to the trustee every year, it may be reasonable to infer that the dealing is not made for the furtherance of any familial or commercial object and was instead made for the reduction of tax. The dealing appears artificial, contrived and to involve the trustee and beneficiary acting cooperatively to achieve a particular tax outcome.*

119. *The evidence may more closely exhibit tax avoidance where the arrangement is repeated in subsequent years. However, it would still be open depending on the facts to demonstrate that a reimbursement agreement existed at the time when Pauline's present entitlement arose in year one, or in the event that the arrangement did not continue after the first year.*

120. *Additional factors which may indicate the dealing more closely exhibits tax avoidance than ordinary dealing would include:*

- *the trustee loaned funds attributable to Pauline's entitlement to her parents on interest-free terms for an undefined period, or*
- *instead of gifting back to the trust, Pauline gifts her trust entitlements to her parents, or*
- *instead of gifting back to the trust, Pauline applies her trust entitlements to repay her parents for costs incurred by them on her maintenance, education and financial support while Pauline was a minor.*

***Example 5 – unpaid entitlements held on separate trust***

121. *From time to time, the trustee of the Davidson Family Trust makes John, who is a family member, presently entitled to a share of trust income. John's entitlement is determined so his taxable income will not exceed certain marginal tax rate thresholds.*

*John is a full-time student and does not have income from other sources. In a particular year, funds underlying the present entitlement are set aside to be held by the trustee upon a separate trust for the sole benefit of John, who has indicated he may be unlikely to call for his entitlements until such time as he purchases a home or makes a similar investment. Nonetheless, John is at liberty to call for his trust entitlements at any time.*

122. *John's tax-free threshold reduces the overall tax on the trust net income. However, in the absence of additional factors, the arrangement would likely be entered into in the course of ordinary dealing.*

123. *A different outcome may arise if, for example, instead of setting funds aside for John upon a separate trust, the trustee:*

- *loans the funds on interest-free terms for an undefined period to another person, or*
- *otherwise applies the trust's funds in a way inconsistent with an intention to satisfy John's entitlements, should the trustee be called upon by John to do so.*

***Example 6 – non-commercial loan between family members***

124. *The Jones Family Trust includes in its class of beneficiaries Mr and Mrs Jones and their three adult children Amy, Ben and Claire. Each year, the trustee resolves to make each of these beneficiaries presently entitled to 20% of the trust income.*

125. *In one year, Mr Jones lends Amy an amount which is similar to the amount of trust income he is presently entitled to. He does this to help Amy move out of home. The loan requires Amy to pay Mr Jones back the principal when her financial circumstances permit and without interest.*

126. *Although the terms of the loan are not commercial, in these circumstances, a genuine interest-free loan from parent to child because of their family relationship is explicable as an arrangement entered into in the course of ordinary dealing.*

127. *As also noted in Example 2 of this Ruling, a different outcome may arise if, for example:*

- *Mr Jones loaned money from trust entitlements to Amy repeatedly and the parent has a lower marginal tax rate than the adult child (for example, lower marginal tax rate parents repeatedly loan trust entitlements to higher marginal tax rate children in lieu of the trustee distributing to the child directly), or*
- *the situation is reversed, so that Amy, who is less financially advanced, loaned money to Mr Jones, particularly where the adult child has a lower marginal tax rate than the parent.*

***Example 7 – dealing at arm's length and loan on commercial terms***

128. *The MNO Investment Trust is a fixed trust with 20 unrelated unitholders. The trust deed prohibits company unitholders, except as a nominee or trustee. The trust was established to invest in a mix of income-producing real property.*

129. *In a particular year, the trustee undertakes to acquire an industrial property from an arm's length vendor.*

130. *To partly fund the property acquisition, each unitholder agrees to loan back to the trustee an amount equivalent to their pending income entitlements for the income year. The loan is on commercial terms requiring the payment of market rate interest, which is capitalised over a fixed term of five years. Interest and principal are repayable at the end of the five-year fixed term. Each loan is convertible to units, commensurate to the market value of the accumulated loan balance, at the end of the five-year loan term.*

131. *Absent evidence to the contrary, the arrangement between the trustee and unitholders and any arrangement including the third-party vendor would have been entered into in the course of ordinary dealing, as demonstrated by the parties advancing their respective commercial interests. Also, it is normal or regular in a commercial context to invest, loan and borrow money on commercial terms.*

132. *A different outcome might arise in relation to the loans if, for example:*

- *there were indications the trustee lacked intention and/or capacity to repay the loans*
- *the level of risk was otherwise commercially unacceptable for a person in the unitholder's position, and/or*
- *based on the circumstances it is open to infer there was an understanding between the trustee and unitholder's that the interest or principal was not genuinely intended to be repaid.*

***Example 8 – share buy-back arrangement***

133. *The trustee of the Green Family Trust owns all of the shares in Green Tree Pty Ltd (Green Tree), a private company. The directors of the trustee company and Green Tree are the same individuals.*

134. *Green Tree's balance sheet records:*

- *$2 paid-up share capital*
- *$70,000 retained earnings, and*
- *assets and liabilities at their current market value.*

135. *Green Tree maintains a sufficient franking credit balance to fully frank a distribution of all of its retained earnings.*

136. *The trustee and Green Tree agree for the company to purchase its shares for market value consideration of $70,002 (share buy-back).*

137. *The trustee is paid the $70,002 proceeds from the share buy-back, $70,000 of which is taken to be a fully franked dividend paid by Green Tree for income tax purposes.*[67] *The franking credit is $30,000.*

138. *The trustee also receives $10,000 interest income in the relevant income year.*

139. *The trustee subsequently varies the trust deed to amend the definition of trust income so the 'income of the trust estate' (trust law income) for the relevant income year will be determined according to ordinary concepts. As the buy-back proceeds are a capital receipt, these are excluded from trust income.*

[67] Section 159GZZZP and Subdivision 202-C of the ITAA 1997.

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140. *Accordingly, the income of the trust estate is limited to $10,000 (comprised of the interest income), while the section 95 net income of the trust estate is $110,000*[68] *comprised of the interest, the deemed dividend equal to the buy-back proceeds and the gross-up for franking credits.*[69]

141. *On 30 June, the trustee resolves to appoint 100% of its $10,000 trust law income to Green Frog Pty Ltd (Green Frog), which is controlled by the same individuals. Green Frog lodges a tax return and includes $110,000 in assessable income.*[70]

142. *As the dividend component is fully franked, Green Frog has $3,000 income tax payable*[71]*, effectively being the income tax payable on the $10,000 interest income.*[72]

143. *The $10,000 is paid to Green Frog satisfying its trust entitlements. In the subsequent year of income, the $70,002 capital proceeds from the share buy-back are paid to Mr and Mrs Green's personal bank account and accounted for as a tax-free distribution of trust capital.*

144. *An agreement, arrangement or understanding can be inferred from the concerted steps taken by the trustee, the two companies and the controlling individuals. Absent evidence to the contrary, the arrangement (in existence when the present entitlement of Green Frog is created) is designed to achieve a reduction in tax that would otherwise be payable had Green Tree simply paid a dividend to the trust, which would be distributed to Mr and Mrs Green who received the share buy-back funds.*

145. *The $10,000 present entitlement of Green Frog is to a share of the income of the trust for subsection 100A(1) purposes. Coupled with this, the payment of $70,002 to Mr and Mrs Green would satisfy subsection 100A(7). It is not a requirement of subsection 100A(7) that the payment of money, transfer of property, services provided or other benefits are, or are referrable to, income of the trust. Equally, it is not a requirement of subsection 100A(7) that Green Frog not be paid its entitlement.*

146. *The exception for ordinary family or commercial dealing in subsection 100A(13) is not satisfied. Taken as a whole, the arrangement is not entered into in the course of ordinary dealing.*

[68] $110,000 section 95 net (taxable) income of the trust = $10,000 interest income + $70,000 buy-back proceeds + $30,000 gross-up for franking credit.
[69] Subsection 207-35(1) of the ITAA 1997.
[70] Comprised of $10,000 interest (subsection 97(1) of the ITAA 1997), and $70,000 dividend and $30,000 franking credits (paragraph 207-35(4)(b) of the ITAA 1997), included on the basis that there is no beneficiary specifically entitled to a share of the dividend and the adjusted Division 6 percentage for Green Frog is 100%. Green Fron is also entitled to a tax offset of $30,000 under section 204-45 of the ITAA 1997.
[71] Paragraph 23(2)(b) of the *Income Tax Rates Act 1986*.
[72] The $30,000 income tax payable by Green Frog is worked out using the method statement in subsection 4-10(3) of the ITAA 1997 as $110,000 taxable income x 30% tax rate less $30,000 tax offset.

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147. *Diagrams 1 and 2 of this Ruling illustrate the circumstances in this example.*

***Diagram 1 – Step 1: share buy-back agreement***

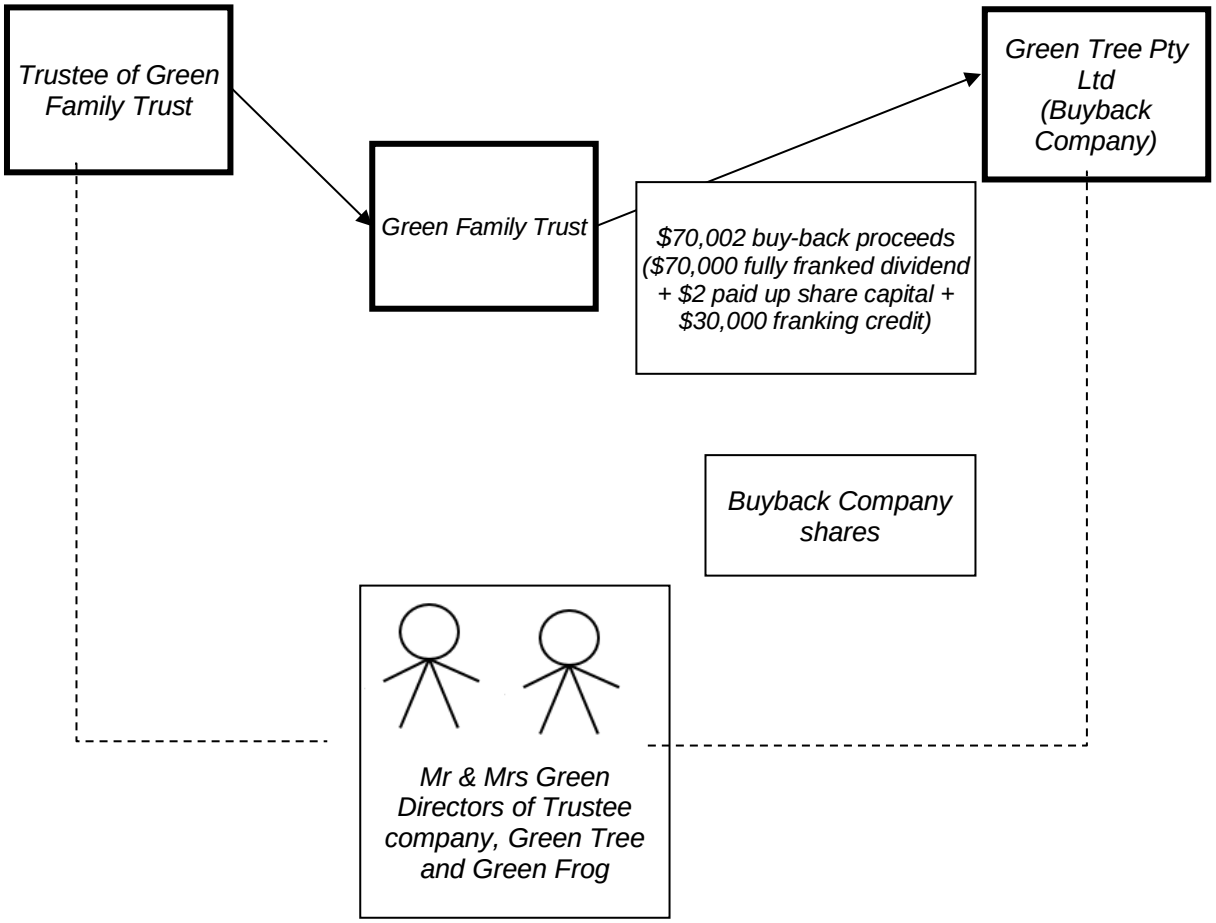
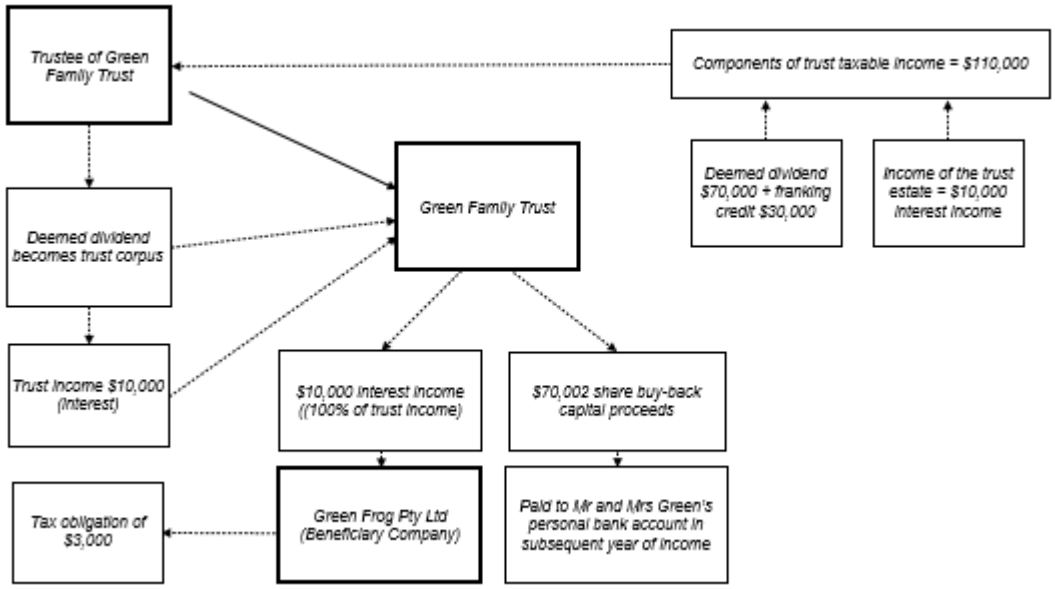


***Diagram 2 – Step 2: trust income definition variation and appointment of trust income***




***Example 9 – circular flow of funds***

148. *The trustee of a discretionary trust owns the shares in a private company. The company is also a beneficiary of the trust and it undertakes no substantial business activity. The directors of the trustee company and the beneficiary company are the same (or related) individuals.*

149. *The trustee makes the company beneficiary 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.*

150. *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.*

151. *The company pays a fully franked dividend to the trustee in year 2, sourced from the trust distribution, and the dividend forms part of the trust income and net income in year 2.*

152. *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.*

153. *There is a benefit to the trustee (in that capacity). The agreement provides for the payment of income from the trustee to the company on the understanding (inferred 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).*

154. *Absent evidence to the contrary, the concerted steps taken by the trustee and company indicate contrivance. The arrangement appears to be designed to achieve a reduction in tax that would otherwise be payable had the trustee simply accumulated the income. The arrangement is unlikely to be considered to have been entered into in the course of ordinary dealing. The ownership structure and, particularly, the perpetual circulation of funds, do not appear to serve ordinary commercial purposes.*

155. *Diagram 3 of this Ruling illustrates the circumstances in this example.*

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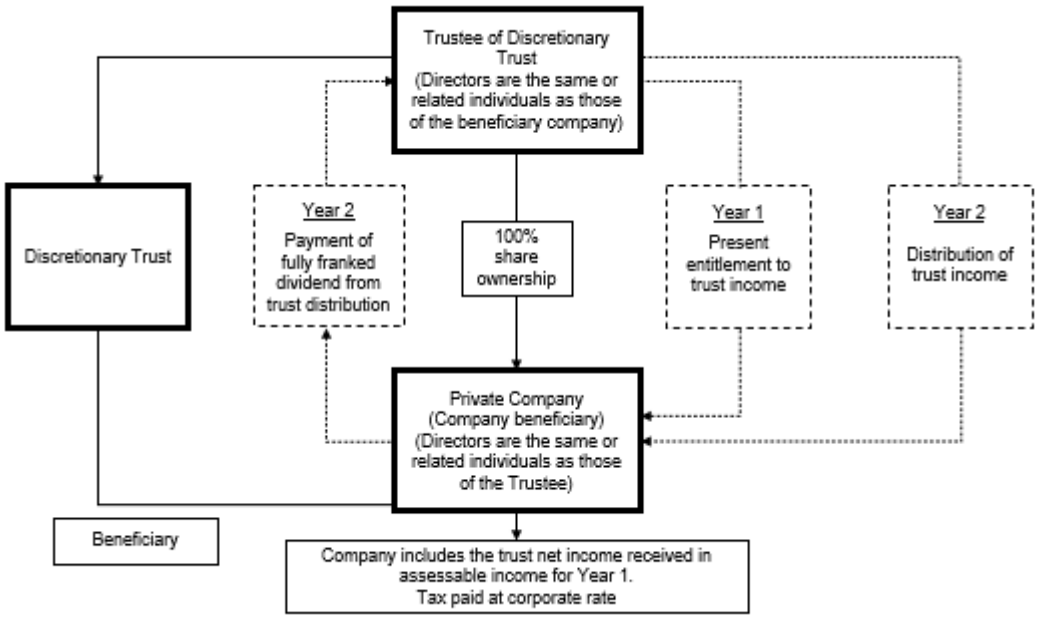
***Diagram 3 – circular flow of funds***



# Appendix 3 – Alternative views

***This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.***

### Tax reduction purpose requirement requires identification of income tax that would be payable apart from the scheme

156. The tax reduction purpose test in subsection 100A(8) sets out that:

> … a person who, if the agreement had not been entered into, would have been liable to pay income tax in respect of a year of income would not be liable to pay income tax in respect of that year of income or would be liable to pay less income tax in respect of that year of income than that person would have been liable to pay if the agreement had not been entered into.

157. It has been raised that for there to be a requisite purpose, some person must be found who would have paid more income tax if the agreement had not been entered into. However, because the legislative enquiry is limited to identifying what would the tax position have been if the transactions and actions under the agreement had not happened, proponents of this view argue that no assumptions can be made about any other transactions which would instead have happened. If no additional tax would have been payable absent the agreement, proponents of this view argue that no person can have had the relevant purpose.

158. This alternative view seeks to draw on a passage in the decision of Hill J in *East Finchley*, where His Honour observed:

> It will be recalled that s.100A(8) requires the purpose of entering into the relevant arrangement to be the reduction of a liability of some person to income tax. It requires the hypothesis to be formulated as to what income tax would become payable if the relevant agreement had not been entered into.

159. However, contrary to this alternative view, the language of the section can accommodate tax being payable on transactions which did not happen and transactions which would happen in any year of income including a future year of income. The observations of Hill J in *East Finchley* are consistent with this reading. The alternative view would also have the effect, contrary to legislative intent, that trust stripping arrangements would not be within the scope of section 100A as the third party who is intended to obtain a tax-free benefit under the arrangement would not in fact pay any more tax if the agreement were simply annihilated.

### *Tax avoidance not relevant to ordinary dealing exception*

160. It has been put to the Commissioner that the question whether the objective facts of the arrangement demonstrate tax avoidance does not affect the interpretation of 'ordinary family or commercial dealing' in subsection 100A(13).

161. The alternative view acknowledges that the words 'ordinary business or family dealing' are drawn from *Newton*, where it was pointed out by the Judicial Committee of the Privy Council that the categories of ordinary dealings and dealings for which there was a tax avoidance purpose were mutually exclusive for the purposes of section 260. However,

proponents of this alternative view draw attention to the following observation by Hill and Sackville JJ in *Prestige Motors*[73]:

> There is a danger that, when words used in a judgment are translated into the legislation, the change of context may alter the meaning of the words from that which they originally bore.

162. It is argued that the context of section 100A is different to section 260, with the effect that tax avoidance does not bear on the meaning of the words 'ordinary family or commercial dealing'. Within that context, the question of tax avoidance is reserved for subsection 100A(8).

163. We do not agree with the argument referred to in paragraph 162 of this Ruling. Section 100A is an income tax anti-avoidance provision and the composite phrase 'ordinary family or commercial dealing' derives from the judgment of Lord Denning in *Newton*. Section 260 was also an anti-avoidance provision and *Newton* reflected the contemporary meaning of ordinary family or commercial dealing as adopted by the Commonwealth Parliament in subsection 100A(13).

164. In *Newton*, the Privy Council had formulated a predication test to determine whether the conditions of section 260 were satisfied. For the Commissioner to establish that an arrangement had the purpose or effect of avoiding tax, that purpose had to appear on the face of the arrangement. It followed that if, having regard to the overt acts by which an arrangement was implemented, it was capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, section 260 would not apply. The primary meaning of the phrase 'ordinary business or family dealing' contained an element of not being a means to avoid tax.

165. This has been confirmed by later decisions of the High Court where arrangements that achieved considerable familial or commercial objectives were held not to be 'ordinary family or business dealing'. In *Peate v Commissioner of Taxation (Cth)*[74], the High Court upheld assessments raised under section 260 for an individual, who was a partner in a medical partnership that had been re-organised into a multi-tiered corporate structure, despite the apparent commercial and familial benefits achieved. In the leading majority judgment, Kitto J (with whom McTiernan and Owen JJ agreed) explained:

> The arrangement in the present case, considered objectively as is thus required, may well seem to be characterized by several purposes and effects, some of them unconnected with taxation, including the protection of individual members of the group against liability for negligence; the making of superannuation provision for employees, including doctors employed to assist the group; the better organization of the group's activities and particularly its methods of accounting; and the making of provision for the doctors' families. (All of these purposes … were actually contemplated in the formation of the plan.) But the question remains, whether the overt acts that were done under the plan are fairly explicable without an inference being drawn that tax-avoidance is a purpose of the arrangement as a whole. *Menzies* J. thought they were not, and with respect I agree.

166. Members of the Court in *Gulland* concluded that the meaning of 'ordinary business or family dealing' in section 260 was determined by the tax avoidance context in which it was used. Dawson J explained that the 'reference to ordinary business or family dealing is a reference by way of example to transactions capable of reasonable explanation by reference to considerations other than avoidance of tax'.[75] Gibbs CJ further observed that

[73] *Prestige Motors*, at [222].
[74] [1964] HCA 84.
[75] *Gulland*. See also Brennan J:
> A purpose of avoiding tax is not taken to exist when the means adopted to carrying the arrangement into effect are fairly referable to ordinary business or family dealing and the avoidance of tax is merely incidental.

the phrase adopted by the Privy Council was intended to 'refer to what was normal or regular, rather than to what had become common or prevalent' and was made 'by way of contrast to the words 'without necessarily being labelled as a means to avoid tax''.[76]

167. Regarding section 100A, in *Prestige Motors* the Court characterised the overt circumstances of the arrangement entered into by the parties to test whether there was ordinary commercial dealing. The Court observed that a straightforward agreement for the transfer of one entity in the group (Perron Investments) to another (LSP) 'might well be characterised as ordinary family or commercial dealing'. However, the Court also observed absence of any commercial motivation for the sale, the replacement of LSP as trustee, the issue of further units, making of distributions to the unitholder to be offset against tax losses and making interest payments to another entity that would act in the Perron group interests. In light of this evidence, the Court characterised the sale as '… one element of a larger one-off transaction designed to avoid tax, and … not an agreement entered into in the course of ordinary commercial dealing'.[77]

### *Section 100A has no application to streamed capital gains and franked distributions*

168. A further alternative view that has been expressed is that section 100A does not apply to capital gains or franked distributions that would be included in a beneficiary's assessable income under the streaming rules. It is argued that the deeming does not create a statutory fiction.[78] Rather, the deeming causes the relevant beneficiary to not satisfy the description of being 'presently entitled' for the purposes of Division 6. As the statutory concept of 'specifically entitled' is different from the statutory concept of 'presently entitled' the deeming is said to have no effect on whether a beneficiary is 'specifically entitled'.

169. Under this alternative view, Division 6E is also said to ensure capital gains and franked distributions are dealt with outside of Division 6. Therefore, where these amounts are effectively streamed under the streaming rules, they are beyond the scope of section 100A (as a provision within Division 6).

170. We do not agree with the view outlined in paragraphs 168 and 169 of this Ruling. Read together, subsections 100A(1) and (2) are not concerned with the mere characterisation of their subject matter. The better reading of those subsections is that the consequence of the deeming is to substitute a fictitious set of facts in place of the actual circumstances operating between the trustee and the beneficiary. The relevant deeming is expressed to be 'for the purposes of this Act' and its application is not limited to Division 6. This conclusion is reinforced, in our view, by the express statement in section 95AAA, enacted with the streaming rules, that 'Division 6E … does not modify the operation of [Division 6] ... for the purposes of applying section 100A ...'.

171. We further consider that Divisions 6 and 6E, and Subdivisions 115-C and 207-B of the ITAA 1997, operate as an integrated scheme for the taxation of the net income of the trust estate and consider that the Commissioner's interpretation of the deeming in section 100A is to be preferred as it ensures the harmonious interaction of the components of this integrated scheme.

[76] *Gulland*.
[77] *Prestige Motors* at [222], per Hill and Sackville JJ.
[78] That is, the subsections 100A(1) and (2) deeming and consequent fiction described at paragraphs 99 to 100 of this Ruling.

# Appendix 4 – Your comments

172. You are invited to comment on this draft Ruling, including the proposed date of effect . Please forward your comments to the contact officer by the due date.

173. A compendium of comments is prepared when finalising this Ruling, and an edited version (names and identifying information removed) is published to the Legal database on ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

**Due date:** **29 April 2022**

**Contact officer details have been removed following publication of the final ruling.**

Status: **draft only – for comment**

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10

*Legislative references:*

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