Submission to Australian Taxation Office

Section 100A Draft Tax Products

29 April 2022

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Australian Taxation Office
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Hello Chris and Justin

Submission on Section 100A Draft Tax Products

ChangeGPS welcomes the opportunity to provide submissions on the following draft tax products:

- TR 2022/D1 – Draft Tax Ruling – Income Tax: Section 100A Reimbursement Agreements (the "TR").
- PCG 2022/D1 – Draft Practical Compliance Guide – Section 100A Reimbursement Agreements – ATO Compliance Approach (the "PCG").

ChangeGPS provides software, content, and resources to over 550 accounting firms across Australia, with over 3,500 accountants using our software applications each day.

The two recent webinars we ran on 28 February 2022 and 21 March 2022 in relation to the ATO's draft tax products in relation to s100A attracted 9,890 registrations and had 7,792 live attendees.

The vast majority of our ChangeGPS member firms (accounting firms) and the attendees in our recent webinars work in or are advisors to small business and SME's.

This submission is made on behalf of our ChangeGPS members and associates, based on the over 500 chat comments during our webinars and hundreds of emails, discussions, and suggestions we have received from our members and associates.

The Common Feeling of Accountants

An online comment to an article about the ATO's Interpretation of s100A in *The Australian* on Wednesday 20 April 2022, whilst expressed emotively, is consistent with the frustrations expressed by many of the members and associates of ChangeGPS by way of feedback on the TR and the PCG:

> *"The ATO is behaving like a football referee, who, after the game is over and the players have gone home, changes the rules of the game, applies them retrospectively to the finished game, calls the other side as winner, and fines the previous winner and the linesmen for breaking the new rules. No matter which team one backs, no-one can call that fair."*

For the taxation systems to operate efficiently and appropriately, there needs to be a high level of trust between Accountants and the ATO, and between Accountants and their clients.

While we do not believe that the ATO have done this intentionally (from our interaction with the ATO, we believe that the ATO have vastly underestimated the impact that the approach reflected in these drafts will have), the TR

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and PCG in their present form have the potential to significantly undermine the trust (pun unintended) that taxpayers have for the tax system in general and their advisers more specifically. The draft framework outlined by the ATO is exceedingly complex and it is extremely difficult for taxpayers and their advisers to understand why this approach is being taken in relation to a provision that has been in force for over four decades. This is particularly so when the PCG affords little practical comfort for taxpayers and their advisers in relation to the retrospective application of this view with no time limits and references to the application of promoter penalties to advisers and referrals to the Tax Practitioners Board.

Our Submission

Our submission is made in 2 parts.

The first part is a “big picture” overview and general response to the TR and the PCG and a summary of our key concerns and recommendations prepared by the ChangeGPS executive team.

The second part is a detailed technical examination of the TR and the PCG prepared by associates of ChangeGPS and includes a number of specific observations and recommendations in relation to each key technical tax area.

You will note that instead of merely raising complaints about the proposed approach, we have sought to provide suggestions as to proposed solutions for your consideration in relation to many of the key issues.

ChangeGPS respectfully requests that the ATO carefully consider our submission and reconsider the widespread ramifications that the approach currently reflected in the TR and PCG would have on business owners across Australia and their accountants.

Please feel free to contact Timothy Munro (timothymunro@changeaccountants.com.au or on mobile 0400 162 253) if you require further information or have any additional questions.

Kind regards

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ChangeGPS

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PART 1
GENERAL RESPONSE TO TR 2022/D1 AND PCG 2022/D1

ChangeGPS has 5 key concerns about the TR and the PCG.

1. ATO "Stretching" the Interpretation of Tax Legislation

Goes Against Original Intention

We submit that the ATO's proposed use of s100A clearly goes well beyond the purpose for which it was originally introduced in 1978.

The Explanatory Memorandum for the enacting legislation focuses on arrangements involving a specifically introduced beneficiary, such as a tax-exempt body or organisation, being allocated a trust distribution and only retaining part of it while providing the majority of the funds tax free to another beneficiary. Hansard records from 1978 and 1979 dealing with the introduction of and Parliamentary debate surrounding s100A clearly confirm this.

Further reference to relevant background material relating to the introduction of s100A is provided in the more technical material in Section 1 of Part 2 of this submission, but in essence our submission is that the TR and PCG released by the ATO represent a major overreach as to the operation of s100A. That this is occurring over 40 years since the introduction of the provision, without the protection generally afforded to taxpayers under the normal statutory amendment limits is considered to be very unfair to the middle-class entrepreneurs and business owners who legitimately use family trusts in the operation and growth of their businesses.

"Ordinary Family or Commercial Dealing"

The "ordinary family or commercial dealing" exception was incorporated into the provision late in the debate in 1978 because of concerns by the that the use of s100A would be expanded beyond the target "trust stripping" arrangements.

It was included to ensure trust distributions to family members or usual commercial dealings would not be affected by s100A.

The explanation of this exception by the ATO in the TR paragraphs 20 to 30 is, in our view, an attempt to create a new (and much narrower) understanding of what this exception means. We respectfully submit that this is stark departure from has been commonly understood by accountants since s100A was introduced in 1979. Indeed, except for certain material which was released on the ATO's website in 2014 (on which further commentary is provided later in this submission), evidence suggests that these views represent a significant departure from the ATO's historical views as to what this exception actually means. In addition, there is no real case law support for the Commissioner's views on this exception.

Ordinary family dealings involve funds that are transferred, loaned, or gifted backwards and forwards between different family members as the need arises. Each family and each family's circumstances will be different – economically, culturally, and socially. We believe is up to the family to decide whether these transactions are appropriate, not the ATO, by reference to a provision that was not introduced for that purpose.

We view ordinary commercial dealings as just that – dealings between entities and individuals with the intent to create profit. We have great difficulty seeing that s100A has any role to play in relation to unpaid trust distributions owing from a family trust to family members or entities controlled by those family members when one considers the purpose of s100A and the ordinary family or commercial dealing exception in this context. Keeping an unpaid distribution in a trust to assist it to generate additional profits or making a distribution to another loss-making trust within the same family group to provide funding to it so it can continue to operate are obvious examples of ordinary family or commercial dealings.

Estate planning and personal asset protection strategies are both clearly also ordinary family dealings and commercial family dealings. An individual who decides to gift an unpaid trust distribution to a separate discretionary trust (eg. a trust which they control and use as a wealth “vault” with provisions to keep their wealth in their family “bloodline” protected from claims from creditors or matrimonial breakdown risks) is doing this to protect their wealth.

In a similar situation, an adult child who has an unpaid present entitlement to trust income that has built up over a number of years may want to protect this asset by gifting to one of their parents or to a discretionary trust they control (as discussed above) to ensure this asset is not caught up in a family law dispute if they enter into a relationship with another person or get married in the future. Again, ChangeGPS sees such arrangements as an ordinary family or commercial dealing.

In summary (and for further comment, we also refer you to Section 2.1 of Part 2 of this submission), we believe that the exceedingly narrow view of the ordinary family or commercial dealing exception proposed by the ATO is inappropriate and should be reconsidered, pending any future clarification by the Courts. To be clear, ChangeGPS is not suggesting that all of the scenarios flagged by the ATO as being high risk in the TR and PCG are not worthy of attention (the ATO has other provisions that could be applied in appropriate circumstances – e.g. Part IVA). However, our strong view is that s100A is not intended to apply in most or all of these circumstances.

Recommendations:

1. The proposed approach reflected in the TR and the PCG represent a significant change to the administration of tax laws relating to family trusts with widespread implications for small and medium businesses – arguably the most significant tax change relating to this business segment in the last 20 years. That change would be brought about by the ATO stretching the interpretation of laws that were introduced many decades ago for a different purpose is, in our view, quite inappropriate. For such a change to be introduced with such significant ramifications, this should be by way of legislation being debated and approved by Federal Parliament, and not by the ATO stretching its interpretation of tax laws that were introduced many decades ago.
2. We agree with the original intention of s100A to prevent trust-stripping arrangements and to prevent income derived by trusts to be passed on to external beneficiaries in a tax-free form. However, within a family group, a Trustee of a discretionary trust that has made a Family Trust Election (FTE) should be able to make distributions to parents and children of the primary beneficiary (assuming the primary beneficiary is an individual) and entities directly controlled by the primary beneficiary that have made an interposed entity election (IEE) without an adverse application of s100A. This includes the ability for a discretionary trust to make a distribution to provide funding to another trust (within the same family group) that has losses. Equally, it is submitted that commonplace arrangements between members of the same “family group” (including entities that have a common controller and which have made a FTE/IEE to form part of the family group), such as distributions (whether paid or not), loans etc. should be regarded as ordinary family or commercial dealings, in the same way that such arrangements are regarded as permissible without penalty under the trust loss provisions.

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3. Individuals aged over 18 who are allocated a distribution from a discretionary trust but have not yet received the payment of this distribution should be able to gift this amount to a parent or to another discretionary trust that they control for genuine personal asset protection, family law and estate planning purposes without an adverse application of s100A.

2. Retrospective Application of Tax Rulings

In whatever form the TR and PCG are concluded following the consultative process, ChangeGPS believes that it is imperative that the TR and the PCG **NOT** be made retrospective. The retrospectivity aspect of the TR and PCG, coupled with the unlimited amendment element of s100A is totally unfair to accountants and their clients. Accountants have advised clients according to common understanding of the laws for many years. *In what reality is it fair for a client to be judged on prior year decisions they made with advice from their accountants by new laws introduced now?*

Common Understanding and Interpretation

After the release of the TR and the PCG, it has been suggested by the ATO in recent media releases and comments made in conferences that their position on s100A has not changed since 2014 and its administrative provision reflected in ***Trust Taxation – Reimbursement Agreement*** which was published on the ATO website.

ChangeGPS both respectfully disagrees with:

- this suggestion; and
- the assumption that the date of the release of this earlier material should be regarded as being a date on which the Commissioner's new views on s100A were adopted.

Firstly, the recently released TR and PCG both go far beyond what was published by the ATO in 2014, especially in relation to distributions to adult children and the way in which adult children choose to use, loan, or gift their trust distributions.

While the ATO has stated that its position was also made clear at various taxation conferences and to specific members of the taxation community, in our opinion this does not reflect the common understanding of the accounting community in Australia as to how s100A was being administered by the ATO. Prior to the long-awaited public release of the TR and PCG, the status and practical implications of the material published on the ATO's website was not clear.

The absolute uproar by accountants across Australia after the release of the TR and the PCG is evidence of this.

Another factor to consider is that, as far as we are aware, the ATO has never referred to s100A having the potential to applying in relation to unpaid beneficiary entitlements of a trust in public ruling or practice statements (TR 2010/3 Division 7A Loans: Trust Entitlements and PS LA 2010/4 Division 7A: Trust Entitlements) that specifically apply to situations examined in the TR and the PCG.

It is apparent to us from strong member feedback that the overwhelming view of the accounting community is that the TR and the PCG represent new interpretations of existing law by the ATO.

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Recommendation:

For fairness to accountants and their clients, any final TR and PCG should not apply new rulings on a retrospective basis and should only have operation in relation to the income tax year in which the final TRG and the PCG have been released.

On the retrospectivity issue, we also refer you to Section 2.1.2 of Part 2 of this submission for further detail.

3. “Promoter” Penalties

We refer to the following tax product that was released at the same time as the TR and the PCG:

- TA 2022/1 - Taxpayer Alert – Parents benefiting from the trust entitlements of their children over 18 years of age

The ATO's reference to accountants as promoters of arrangements potentially subject to promoter penalties, coupled with reports to the Tax Practitioner’s Board is of the highest concern to accountants. Judging by feedback from our members, the accounting profession is stunned that the ATO is contemplating now the application of promoter penalties to arrangements involving a provision that is over 40 years old, based on a change in view (with little case law support) as to how the provision is supposed to operate.

Tax planning is not tax avoidance. While there are many anti-avoidance and integrity measures in tax legislation, the law does not require taxpayers arrange their affairs to pay the maximum amount of tax. Accountants helping their clients to make legal choices with commercial reasons that will minimise their tax liabilities is entirely proper.

Recommendation:

We urge the ATO to provide clarification as to the specific circumstances that would need to exist for the ATO to apply “promoter penalties” to an accountant who provides tax planning advice to their clients as a usual part of their annual advice. Since the release, some public commentary by senior ATO officials on this issue have been welcome, but this needs to be formalised. Accountants need to know that their usual tax planning advice is acceptable and would not be at risk of being subject to “promoter penalty” consequences or risk of disciplinary action from the Tax Practitioner’s Board.

4. Impact on Accountants and Tax Agents

ChangeGPS appreciates that the ATO’s responsibility is to interpret and ensure compliance with the law. However, as the body charged with the responsibility of administering tax law, it is important to recognise the key role played by accountants and tax agents in the efficient and appropriate function of this system.

One of our major concerns with the proposed change (and, as mentioned previously, we do consider it a significant change) and, in particular, its retrospective application is the impact that this change would have on the accounting profession. Our direct feedback from members and associates is that the ramifications of the current proposal would be very significant and should not be underestimated.

During a recent ChangeGPS webinar which dealt with the new draft pronouncements on s100A that had over 3,600 accountants online, there were literally hundreds of chat screen comments like "this is the last straw, I can't stay in this profession anymore".

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We are gravely concerned that were the ATO to proceed with the approach in its current form, this may well be a tipping point for major disruption to the tax system.

Accountants are especially concerned at the prospect of:

- having to explain to their clients that, based on the TR and the PCG, their advice in regard to trust distributions may be incorrect (potentially going back 40 years in many circumstances!) and everything revisited to make it acceptable to the ATO; and
- given that there has been no change in the law, clients losing confidence in their advisers and, given the ATO's references to promoter penalties, the possibility of legal action being taken by clients against them.

Both the above would clearly be unwelcome and unfortunate developments within the tax system. Coupled with the other issue raised above, this has the potential to cause a major disruption to the administration of the tax system. With respect, we doubt that the ATO has factored these issues into consideration prior to issuing the TR and the PCG.

Recommendation:

The above concerns, again, underline the importance of eliminating retrospectivity in relation to the proposed approach. To ensure fairness to accountants and their clients, any final TR and PCG should not apply new rulings on a retrospective basis and should only have operation commencing in the income tax year in which the TRG and the PCG have been released.

As a practical measure, we also recommend that for this and any other major changes in ATO policy and interpretation, the ATO publish a simple to understand "What has changed and Why?" flyer that accountants can send to their clients. This would significantly assist accountants to explain to their clients why the interpretation/administration of a tax law has changed and what the change practically means for taxpayers (in general). A change in interpretation may be based on a case decision or it may be based on a change in interpretation in relation to existing authorities. Where it is the latter, we would strongly encourage the ATO to be open as to this change in interpretation and to ensure that it applies prospectively only. This will help taxpayers and their advisers have a greater degree of confidence in the ATO and the tax system in general.

5. Engagement of Smaller Accounting Firms for Input to ATO

While we understand that the TR and the PCG are draft documents that the ATO has requested submissions to consider, it is obvious that a very large amount of time and resources has been put into the preparation of these tax products by the ATO.

We also understand that the ATO has already sought feedback from certain tax professionals in the initial stages of development of the TR and the PCG.

However, it is very evident to ChangeGPS that the ramifications of the release of these tax products for small business and SME clients and their accountants was not properly understood by the ATO.

Accountants have overwhelmingly expressed to us that their opinions appear to not be heard by the ATO or their professional accounting bodies – who give the continued appearance of just representing the "big end of town" and not wanting to "rock the boat" in case it has an adverse effect on their future career prospects or, where the relevant individual is in practice, on their own client base.

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Recommendations:

1. The ATO should include a wider selection of accountants within their feedback mechanisms when developing tax products – specifically accountants who look after small business and SME clients – to receive fairer and more balanced feedback and input.

2. Simple examples and scenarios should be included in the TR and the PCG and in future ATO tax products. While ChangeGPS understands the application of the TR and the PCG to the scenarios below, the vast number of requests by accountants in the chat during our two webinars asking these questions and questions we have received from accountants afterwards has highlighted to us the uncertainty in their minds and that many accountants need confirmation of the application of tax laws to simple examples. We recommend the ATO specifically address these examples in the final TR and PCG:

    - Use of a “bucket company” (company beneficiary) to receive a trust distribution
        - Where the trust distribution is immediately paid to the bucket company
        - Where the trust distribution is not immediately paid to the bucket company but is put onto a Div7A Loan Agreement so the trust can use the funds as working capital
    - A business owner has multiple trading and investment trusts. One or more have losses. Is it acceptable to distribute profits through the loss trusts on their way out to ultimate beneficiaries?

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PART 2
DETAILED RESPONSE TO TR 2022/D1 AND PCG 2022/D1

Thank you again for the opportunity to provide submissions on draft Taxation Ruling TR 2022/D1 - I*ncome tax: section 100A reimbursement agreements* (**the TR**) and draft Practical Compliance Guideline PCG 2022/D1 – Section 100A reimbursement agreements – ATO compliance approach (**the PCG**). For ease of reference, in Part 2 of this submission these two recent releases will be collectively referred to below as **"the draft pronouncements"**.

Set out below is detailed commentary relating to the historical backdrop of section 100A, which is considered to be pertinent context to the provision (section 1), followed by comments and submissions on the draft pronouncements (section 2).

1. Background

Section 100A has been in force for nearly 44 years, having been introduced effective from 12 June 1978.

It is somewhat self-evident that the tax landscape was vastly different in 1978 as compared to today. At the time that section 100A was introduced, the original 1997 Act was still 19 years away and the integrity of the revenue was yet to be protected by specific measures later introduced into the 1936 Act relating to trusts and private companies, such as the trust loss provisions in Schedule 2F and Division 7A. Even the general anti-avoidance rules contained within Part IVA of the 1936 Act were not on foot at that time, being introduced some three years later.

1.1 *Announcement to introduce section 100A*

The announcement of new rules to counter "trust stripping arrangements", which resulted in the enaction of section 100A took place on 11 June 1978, when the then Treasurer, the Hon. John Howard MP, issued a Press Release announcing the Government's intention to legislate to overturn schemes which had the "*broad purpose of allowing income derived by trusts to be passed on to beneficiaries in a tax-free form*".

The Press Release stated as follows:

"*A feature of several of the schemes is a very wide power given to the trustee under the terms of the trust instrument as to the distribution or application of trust income. In reliance on this power,* ***the trustee agrees with promoters of tax schemes and other compliant parties to distribute or apply the bulk of the trust income–either directly or through an interposed trust—for the apparent benefit of specially introduced beneficiaries who do not pay any, or any substantial, amount of tax on the amount distributed or applied****.*

In some cases, the nominal beneficiary selected is a tax-exempt body, such as a charitable institution or sporting association. In other cases, it is a company, set up for the purpose by the promoters of the scheme, that by one means or another escapes payment of tax on the income. One technique is to set artificially created paper 'losses' off against the income received from the trust. Another technique is to strip assets from the recipient company so that the tax assessed on the income cannot be collected. Yet again, the income may be distributed to non-resident individuals each of whom does not have enough Australian taxable income to be liable to tax, but who will account for the income to the Australian family concerned.

The ***essential element*** *common to the schemes* ***is that, while the income concerned is effectively freed from tax in the hands of the nominal beneficiary, the terms of the underlying arrangement ensure that the beneficiary does***

not enjoy anything like the full use or benefit of the income. Instead, the arrangement, requires a broadly equivalent capital sum—but reduced by the promoter's fee and a modest reward for the services of any participating exempt body—to be directed to persons intended all along as the real beneficiaries of the trust*.*

The ***arrangements are often very complex*** *and the party responsible for putting the real beneficiaries in funds may be an associate of the nominal beneficiary. The return of the funds may be achieved by a settlement on another trust established for the benefit of the real beneficiaries of the main trust or their families, by the making to them of what is known colloquially as a 'collapsible loan', ie a loan that effectively does not have to be repaid, or through the nominal beneficiary having acquired the right to the income by payment to the real beneficiaries of a broadly equivalent sum. …*

The ***legislation to counter tax avoidance through trust stripping schemes*** *will broadly be on the lines that any distribution or application of income by a trustee, pursuant to a relevant contract, arrangement or understanding, will be treated as not having been made. This means that the trustee will be liable to be assessed and pay tax at the rate of 60 per cent on the amount involved as if it had been accumulated in the trust. In broad terms, a relevant contract, arrangement, or understanding will be one the terms of which contemplate conferring on a particular beneficiary a 'present entitlement' to income of a trust, and under which the beneficiary or an associated party is to provide funds or benefits in money's worth for another person, company, or trust*." [Emphasis added.]

1.2 *Introduction of section 100A*

Section 100A was subsequently introduced into the Parliament as the *Income Tax Assessment Amendment Bill (No 5) 1978.*

Reflective of the seriousness of the arrangements that this provision was introduced to address, the provision was specifically made open ended, in that the Commissioner was empowered to amend assessments without any time limitation. When the general anti avoidance rules in Part IVA were introduced some 3 years hence, these empowered the Commissioner to amend assessments struck down by Part IVA for a period of six years only.[1] The unlimited amendment power associated with section 100A indicates that the legislature considered arrangements to which section 100A should apply as ranking in seriousness alongside circumstances involving fraud and evasion, which also involved an unlimited amendment period.

In relation to the stated purpose of the new provision, the Explanatory Memorandum to the enacting Bill stated as follows:

Page 5:

"Tax avoidance by trust-stripping arrangements Clause 18)

By this clause it is proposed to overcome certain ***tax avoidance arrangements designed to enable trading profits and other income derived by trusts to escape tax completely****. …*

The particular tax avoidance arrangements rely on a ***nominal "beneficiary" being introduced*** *into the trust and being made presently entitled to income of the trust, thus relieving the trustee of any tax liability in respect of the income. However,* ***it is a feature of the arrangements that the introduced beneficiary also escapes tax by one means or another, e.g., as a tax-exempt body or organisation.*** *This "beneficiary" retains only a minor portion of the trust income, while* ***the group in whose favour the trust in substance exists, effectively enjoys the major portion, but in a tax-free form****.*" [Emphasis added]

[1] Subsection 177G(1) of ITAA 1936, as originally introduced.

And at page 31 and following:

"*A **common feature** of the tax avoidance arrangements at which the proposed section is directed is for a **specially introduced beneficiary** to be made presently entitled to income of the trust estate, so that the trustee is relieved of any tax liability on the income. Under the arrangements, **the beneficiary also does not pay tax, eg, because of a peculiar tax status**. For example, the beneficiary may be **a body or organisation that qualifies for exemption of its income** under specific provisions, or it may be **another trust that has sufficient deductible losses to absorb its share of income** as a beneficiary of the first trust estate.*

Invariably, the arrangements require this introduced beneficiary to retain only a minor portion of the trust income and to ensure that some other person - the one actually intended to take the benefit - effectively secures enjoyment of the major portion of the trust income but in tax-free form (eg, by the settlement of a capital sum in another trust estate for the benefit of that person)."

1.3 *Amendments to section 100A in 1981*

Shortly after its introduction, amendments were made to strengthen the operation of section 100A, by the addition of new subsections 100A(3A), 100A(3B), 100A(3C) and 100A(6A) to counter variants of arrangements to which section 100A was directed. These amendments were made by the *Income Tax Laws Amendment Act 1981*. In relation to the purpose of section 100A, the accompanying Explanatory Memorandum to this legislation stated as follows:

*"This measure relates to amendments made in 1979 to overcome certain trust stripping arrangements that were designed to enable trading profits and other income derived by trusts to escape tax completely. **Those arrangements involved a specially introduced "nominal" beneficiary being made presently entitled to income of the trust, thus relieving the trustee of any tax liability in respect of the income. At the same time, the introduced beneficiary also escaped tax by one means or another, e.g., as a tax-exempt body or organisatio**n. The bulk of the income was then returned to the intended beneficiaries in a non-taxable form, e.g., by the receipt of a loan that was never intended to be repaid, or by the settlement of trust funds."* [Emphasis added]

The amendments to section 100A were broadly designed to ensure that section 100A applied in circumstances where the ultimate nominal/introduced beneficiary of the relevant income that was the subject of the relevant reimbursement agreement was a trust. The accompanying Explanatory Memorandum from which the above passage is taken, again reinforces the purpose of section 100A

1.4 *Initial observations*

Before proceeding to outline specific comments on the draft pronouncements, the following general observations are made, which represent relevant context to some of the specific submissions to follow:

(a) It is acknowledged that the broad wording of section 100A is such that, on its face, the provision is potentially capable of broader application than the specific arrangements referred to above. Whilst there is limited jurisprudence on section 100A, amongst the few cases that have been decided on the provision, this has been acknowledged by the Courts. For example, in the joint judgement of Hill J and Sackville J in *FCT v Prestige Motors Pty Ltd* it was said of the extrinsic materials to the enacting legislation "*the examples given were intended to be illustrative, and not an exhaustive statement of the transactions that were to be subject to the legislation*" and that "*considerable care should be exercised before relying on examples given in this way in order to read down the statutory language*". [2]

[2] (1998) 82 FCR 195, at 219-220.

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While it may not be appropriate to limit the application of section 100A to the particular scenarios highlighted in the above passages from the Press Release and Explanatory Memoranda, it would seem to be another matter entirely to completely disregard the stated purpose for which the provision was introduced. With respect, it is submitted that the draft pronouncements pay little if any heed to the purpose of section 100A as outlined in the passages above.

There is a vast distance between the description of the circumstances outlined in the above extracts that prompted the introduction of section 100A to a number of those which are now flagged by the Commissioner in the draft pronouncements as being potentially of concern. A common and constant theme in the background provided is the introduction of a special nominal tax exempt beneficiary outside the relevant family group, the involvement of scheme promoters and the like.

It is clear that the concerns that prompted the introduction of section 100A were arrangements involving artificial schemes and aggressive tax avoidance well beyond many of the arrangements that the Commissioner has identified as being within the “blue” or “red” zones referred to in the PCG that involve dealings between members of the same family and entities with the same family group with the same controlling mind.

Put plainly, it is difficult to read the above passages and not conclude that the Commissioner is seeking to apply section 100A to many circumstances to which it was not intended to have application.

To be clear, it is not suggested that all the arrangements outlined by the Commissioner as being of concern are not worthy of query and beyond challenge. Some of these examples may well give rise to concerns under other provisions – for example, the general anti avoidance rules Part IVA. However, it is submitted that it is not appropriate for many of these to be challenged under section 100A.

(b) Given that section 100A has been in force for nearly 44 years, it has clearly taken a very extended period for the Commissioner to formally issue his views on its application. In this regard, it is respectfully submitted that this is because the Commissioner’s views as to how section 100A should be administered have changed significantly only quite recently. This appears to be evident in a number of ways:

(i) The lack of jurisprudence in relation to section 100A generally and, perhaps even more significantly, the concept of an “ordinary family or commercial dealing”, which is a reflection of the ATO only historically seeking to apply section 100A to cases involving perceived serious tax avoidance which, it is noted, is actually consistent with the stated purpose of section 100A.

The major cases dealing with section 100A are *Prestige Motors* (complex circumstances involving the acquisition of a loss company by a group and utilisation of losses by distributions of trust income), *Raftland* (introduction of loss trust previously external to the group as a beneficiary to absorb trading profits of a building business, with a fee being paid to the previous controllers of that trust), *East Finchley* (artificial scheme involving distributions of income to non-resident beneficiaries who loaned monies back to the trust) and *Idlecroft* (scheme involving formation of a joint venture between two unrelated parties, with adding of new loss beneficiary and distribution of income to that beneficiary only partially cashed out). Notably, each of these cases involves circumstances very different to the sorts of related party dealings which are the main focus of the draft pronouncements.

It is readily apparent that if these were the views held by the ATO throughout any material portion of the last 44 years, it would be expected that that by now taxpayers and tax advisers would have a

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significant body of relevant case law on section 100A to provide guidance on whether the views expressed by the Commissioner in the draft pronouncements are valid.

(ii) Experience from practitioners suggests that many of the circumstances that the Commissioner has identified as falling within the "red zone" of the PCG have not been challenged, identified as of any concern, or even queried during numerous risk reviews for private client groups (including, notably, reviews completed since the material on section 100A was released on the ATO website in July 2014). In particular, reference is made to the Commissioner's views that section 100A can apply in circumstances where a beneficiary of a trust refrains from drawing down its entitlement to income. Within a typical family group of entities involving companies and trusts, such arrangements are omnipresent and will have been routinely observed in the field by ATO officers.

(iii) In past public rulings and pronouncements on related subjects, the Commissioner has not made these views apparent. Consider, for example, the important public ruling and practice statement issued in relation to unpaid present entitlements owing to company beneficiaries in 2010, being TR 2010/3 (*Division 7A loans: trust entitlements*) and PS LA 2010/4 (*Division 7A: trust entitlements*). For all the extensive detail that these pronouncements contain in relation to unpaid entitlements of company beneficiaries of trusts, neither TR 2010/3 nor PSLA 2010/4 (Division 7A: trust entitlements) make any reference to the possibility that section 100A might have some role to play in relation to unpaid beneficiary entitlements of a trust. For a provision that had been in force for three decades at the time that these pronouncements were released, the lack of any reference to this provision is notable.

2. Comments and submissions on draft pronouncements

Following on from the above background, set out below are submissions on the draft pronouncements.

General submissions on the draft pronouncements are outlined at 2.1 below, with more specific comments on different elements of the draft pronouncements at section 2.2.

2.1 *General*

The most serious concerns in relation to the draft pronouncements can essentially be distilled down to the following general issues:

(a) the view that the Commissioner has taken of the "ordinary family or commercial dealing" exception (for ease of reference this will be referred to below as the **"ordinary dealing exception"**). It is considered that the Commissioner's view of the ordinary dealing exception to be exceedingly narrow and inconsistent with the policy intent underpinning section 100A:

(b) perhaps more fundamentally, the Commissioner's stated intention to apply this view retrospectively given:

  (i) that the Commissioner appears to be seeking to apply section 100A for a purpose well beyond its original intended purpose some 44 years after its introduction, as outlined in the background material set out above;

  (ii) the scarcity of specific judicial guidance or support for the Commissioner's views at this stage, particularly his narrow interpretation of the critical ordinary dealing exception, which is reflective of the fact that the interpretation of section 100A set out in the draft pronouncements is new and untested;

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(iii) the views expressed by the Commissioner are quite different to those held by many taxpayers and tax advisers and, indeed (as noted in the background provided earlier), do not reflect historical or even recent practice by ATO personnel in taxpayer reviews; and

(c) the fact that section 100A has an unlimited amendment period, which adds considerably to the concerns about retrospectivity.

Further specific comments on the ordinary dealing exception are set out at section 2.1.1 below, with comments on the retrospectivity element immediately following at 2.1.2.

2.1.1 *Ordinary dealing exception*

Whilst there is little in the way of judicial guidance on section 100A in general, there is even less guidance as to the breadth of the ordinary dealing exception. This is primarily because, for the most part, existing case decisions relating to the operation of section 100A, in the main, have appropriately involved arrangements with considerable artificiality and the introduction of external parties in the relevant arrangement – the meaning of the term "ordinary family or commercial dealing" within the context of dealings between family members and family entities with a common controller has not been considered in any useful detail, with the possible exception of the recent decision in *Guardian.*[3]

The Commissioner has stated in the TR that the meaning of the component terms in the ordinary dealing test, such as the word "ordinary" cannot be determined by reference to a dictionary meaning and rejects the view that arrangements which are commonplace or lacking artificiality will necessarily be ordinary.[4]

The customary meaning of the term "ordinary" is much broader than the limited meaning that the Commissioner appears to be ascribing for the purposes of section 100A. As noted above, it is considered that the view expressed in the draft pronouncements as to the meaning of the ordinary dealing exception is far too narrow and contrary to the policy intent underpinning section 100A.

That being said (and noting that the Commissioner may be reluctant to materially alter his position unless and until there is judicial precedent to the contrary), the submissions below on the ordinary dealing exception are essentially confined to particular concerns with the views expressed and guidelines given in the draft pronouncements, including anything that is regarded as being a particular inconsistency or anomaly therein.

2.1.2 *Retrospectivity*

The guidance provided in PCG 2022/D1 indicates that the Commissioner proposes to not apply compliance resources to certain arrangements arising before 1 July 2014, subject to important conditions being met.[5] Such arrangements are regarded as "white zone" arrangements under the PCG. However, the PCG also indicates that the Commissioner intends to apply section 100A retrospectively, and without limitation, to arrangements that would fall outside the "green zone" specified in the PCG where such an arrangement "…. *continues before and after that date"* ("that date", being 1 July 2014).

The relevance of the 1 July 2014 date is that, as noted in the PCG[6], general material was included on the ATO website in July 2014 in relation to the operation of section 100A. For ease of reference, this will be referred to as

[3] *Guardian AIT Pty Ltd ATF Australian Investment Trust v Commissioner of Taxation* [2021] FCA 1619.
[4] Paragraphs 23 and 79 of the TR.
[5] Refer paragraph 13 of PCG 2022/D1.
[6] Paragraph 47.

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"the 2014 Material". The Commissioner's view appears to be that this date should represent something of a "red line" in relation to the administration of section 100A.

It is respectfully submitted that this approach is completely inappropriate, both in principle and in practice, for the reasons outlined below:

(a) The 2014 Material released on the ATO website in July 2014:

(i) lacks the status, formality, detail, and rigour associated with a public ruling or guidance statement (draft or otherwise). Regardless of whether taxpayers and tax advisers agree or disagree with the views expressed in a draft ruling/determination or PCG, once the Commissioner's views are formalised in a draft ruling/determination or PCG, the practical reality is that taxpayers and tax advisers are quite clear as to the importance of an issue in the mind of the Commissioner and the approach that the ATO intend to adopt. The same cannot be said for the 2014 Material.

Similarly, the much higher level of formality associated with a public ruling or PCG means that ATO officers are much more likely to enforce the Commissioner's interpretation of a provision where there is a formal ruling and PCG in existence, rather than general information available on the ATO's website. As noted in the background provided above, there is widespread anecdotal evidence of the ATO not seeking to query or challenge arrangements in reviews (including reviews conducted after 1 July 2014), notwithstanding that the Commissioner appears to have identified such arrangements as being potentially at risk under section 100A. This factor of itself has undermined the credibility of the information contained in the 2014 Materials;

(ii) deals with a contentious subject matter with (as noted above) very little in the way of judicial guidance, particularly in relation to the critical ordinary dealing exception. The views of the Commissioner remain largely untested by the Courts, notwithstanding the age of section 100A; and

(iii) is light on detail, ambiguous in certain respects and contains statements that differ from what is said in the draft pronouncements. By way of illustration:

- the 2014 Material has little to say in relation to dealings between family members, whereas this is a significant focus of the PCG and the sole focus of the Taxpayer Alert;
- the "use of funds" condition, as expressed in the 2014 Materials is considerably less stringent than that prescribed in PCG 2022/D1[7]; and
- there is ambiguity in the 2014 Materials as to the extent to which interest-free loans from a trust might be regarded by the Commissioner as giving rise to a section 100A risk; and

(b) Whilst there have been some recent reports that the ATO have given some assurances that they would only look to open up issues prior to 1 July 2014 in "*very exceptional circumstances*"[8], it is submitted that this is not at all evident from the PCG.

[7] Paragraph 21 of PCG 2022/D1 requires not only that the funds loaned to an associate of the lending trust be placed on terms that would satisfy section 109N, but that the **borrower** of the funds also use the funds in a way that satisfies the new use of funds test. The 2014 Materials make no reference to any requirements for use of funds by the borrower.

[8] Reported in Accountants Daily 22 March 2022 ATO defends stance on draft 100A | Accountants Daily

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To the contrary, the preconditions for "white zone" status as defined in the PCG appear very stringent. As noted above, any arrangement that falls outside the "green zone" and which is regarded as continuing after 1 July 2014 will not fall within the white zone.[9] Based on the PCG, a multitude of arrangements could fall outside the green zone – for example, any arrangement that is regarded by the Commissioner as "*having one or more features that* ***may*** *be explicable by a tax avoidance purpose*" (an exceedingly wide and ambiguous requirement – an issue in itself that will be referred to further later) or any arrangement where a strict "use of funds" condition is not met[10] (also to be referred to in more detail later), will fall outside the green zone[11] and therefore the white zone. If such an arrangement is regarded by the Commissioner as "continuing" beyond 1 July 2014, the PCG offers taxpayers no comfort that the arrangement would not be challenged regardless of how far back the arrangement was implemented.

Consider the following illustrative "retention of funds" example: Trust A with unpaid present entitlements owing to the controller of a trust (or an entity controlled by the controller of a trust) for many years, well before 1 July 2014, has loaned moneys (again, well prior to 1 July 2014) to Trust B (controlled by the same person) to fund the income earning activities of Trust B.

The conventional view would be that such a loan could be made interest free within the ordinary dealing exception. Based on the PCG, however, the Commissioner's view seems to be that if such a loan is or has been on anything "less" than section 109N terms at any time since 1 July 2014, it would:

(i) not satisfy the "use of funds" condition that the Commissioner has indicated would need to be satisfied to fall within the "green zone";

(ii) be regarded as being continuing past 1 July 2014; and

(iii) fall within the "red zone" and be potentially subject to ATO challenge.

Our major objection to the Commissioner seeking to use 1 July 2014 as a milestone date for arrangements such as this is that there was no suggestion made by the ATO in the 2014 Material or elsewhere that if pre-existing loan or unpaid beneficiary entitlements (**UPE**) arrangements (which may have been on foot for some years prior to 1 July 2014 on other terms less than what might have been regarded by the Commissioner as adequate) were made to conform to loan terms regarded as acceptable to the Commissioner prospectively from 1 July 2014, these arrangements would in practice be accepted by the ATO without challenge.

For taxpayers and their advisers to be now told that had they placed such longstanding arrangements on terms that the Commissioner regards as acceptable 8 years ago, these arrangements would fall within the safe "white zone", when this was not made at all clear at the time that the 2014 Materials were released is, with respect, extremely harsh and unfair.

<u>Submissions:</u>

Having regard to the above, if the Commissioner is to proceed to formalise an approach whereby an expansive view is taken of the operation of section 100A (subject, of course, to any subsequent judicial clarification) it is strongly submitted that:

[9] Paragraph 13 of PCG 2022/D1.
[10] Referred to in paragraph 21 of PCG 2022/D1.
[11] Paragraph 20 of the PCG.

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(a) the Commissioner should only apply this approach prospectively from the date of the draft pronouncements to arrangements entered into on or after that date, subject of course, to any subsequent judicial clarification; and

(b) if (contrary to the above submission and other submissions made elsewhere in this paper) the Commissioner does seek to apply his views in the draft pronouncements (or any subsequently modified version of them) retrospectively, to the extent that the arrangements involve existing loans or UPEs, he should provide taxpayers with an opportunity to restructure their affairs prospectively to fall within the "white zone".

In relation to the submissions that the draft pronouncements should be only applied prospectively, recent public reports of comments recently made by the ATO in relation to the draft pronouncements that the Commissioner is formally bound to apply his view of the law consistently (presumably this is the case even where that view has significantly changed over time) are noted.[12] However, it would certainly be open to the Commissioner to confirm that he would only seek to apply compliance resources to enforce these views prospectively from the date of release of the draft pronouncements. The PCG already reflects this approach, albeit with a much earlier (and significantly qualified) date of 1 July 2014, as noted above. It is suggested that this type of approach would give a sufficient degree of comfort to taxpayers.

2.2 *Comments and submissions on conditions for eligibility for green (and white) zone status*

Set out below are comments on the conditions set out for green zone status in the PCG which, it is submitted, are far too restrictive and reflective of some significant ambiguities and anomalies. This issue is also relevant for white zone categorisation (and the related retrospectivity issue) in that a past arrangement will be ineligible for white zone status without satisfying the green zone preconditions.

In the main, the comments, concerns and submissions below focus on the "retention of funds" scenario requirements set out in paragraph 20 (and, by extension, paragraphs 21 and 26) of the PCG.

2.2.1 *Use of funds condition and loans to associates*

Firstly, the point is made that if the Commissioner is to proceed to enforce his expansive approach to the application of section 100A, the retention of funds condition would be a useful basis to afford something of a safe harbour for taxpayers. In doing so, the Commissioner is effectively (and, it is submitted, appropriately) recognising that funds retained for generation of assessable income and investment purposes within a trust that may be funded in part or full by UPEs should fall outside the application of section 100A.

Whilst it is considered that the use of funds concept is a worthwhile approach, there are significant concerns with the way that this condition is currently reflected in the PCG as it stands. These concerns stem from the combined effect of:

(a) the apparent stringency of the conditions set out in the PCG in relation to loans to an associate; and

(b) the retrospectivity issue briefly discussed at section 2.1.1 above.

In relation to loans to associates, it would appear from the PCG that:

[12] Reported in Accountants Daily 22 March 2022 ATO defends stance on draft 100A | Accountants Daily.

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(a) the Commissioner regards terms under section 109N as something of a commerciality benchmark, the implication being that arrangements involving a trust with retained funds that loans monies to an associate on "lesser" terms than those prescribed by section 109N may be regarded by the Commissioner as other than an ordinary family or commercial dealing; and

(b) further, the Commissioner would impose the same use of funds test (including the section 109N condition referred to above) on the borrowing associate, in determining whether the use of funds test was satisfied for the lending trust.[13]

Submissions:

In relation to these requirements, the following submissions are made:

(a) Even on the narrowest application of the ordinary dealing exception, it is respectfully submitted that adopting section 109N terms as the standard for an ordinary family or commercial dealing is quite inappropriate. In context, a wide variety of loan terms may well be regarded as an ordinary family or commercial dealing – the most obvious example of a typical commercial loan is an interest only loan, but there are a range of circumstances where interest-free loans may also be regarded as an ordinary family or commercial dealing.

(b) The Commissioner appears to regard retained funds situations involving UPEs owing to a controller of a trust (and the controller's spouse) as more likely to fall within the ordinary dealing exception than arrangements involving UPEs to other persons independent of the controller. This is evident from the other conditions set out in paragraph 20 of the PCG. The Commissioner has also recognised in other ways the importance and relevance of entities with the same controlling mind - the most current example is the draft determination issued in relation to UPEs and Division 7A on the same day as the draft pronouncements.[14] Having regard to these factors, and consistent with the Commissioner's recognition that funds should be able to be retained in a trust for genuine income producing and investment purposes without the risk of section 100A applying, it is submitted that there is every reason to extend this condition to encompass funds retained in entities with the same controlling person. That is, where the funds retained relate to a UPE owing to the controller or their spouse (or any entity controlled by the controller/spouse) are loaned to an entity with the same control as the lending trust for genuine income earning or investment purposes, these arrangements should also fall within the green zone. There should be no requirement that such loans be on section 109N terms. In this regard, there seems no logical reason to distinguish between funds retained in a trust where those funds have been applied to genuine income producing pursuits and funds applied to genuine income producing activities in other trusts with the same controlling mind, in terms of satisfying the use of funds condition.

(c) If, however, contrary to the submission referred to above, the Commissioner proceeds with the existing proposal reflected in the PCG to impose the strict use of funds condition inclusive of the section 109N lending requirement, it is submitted that there is no reasonable basis for extending this requirement to the borrowing entity. With respect, it is submitted that the imposition of this additional condition is unnecessary, irrelevant, and excessive. In this regard, it is noted that if the borrowing entity with a debt owing under section 109N terms does not use these funds for income producing purposes, the interest charged on the loan will not be deductible

[13] Refer paragraph 21(b)(iii) of the PCG.
[14] *TD 2022/D1 Income tax: Division 7A: when will an unpaid entitlement or amount held on sub-trust become the provision of financial accommodation?*

2.2.2 *Exclusionary factors (paragraph 26 of PCG)*

Pursuant to paragraph 20 of the PCG, an arrangement will not be eligible for green zone status where any of the features referred to in paragraph 26 exists. There are a large number of factors listed, many of which are worthy of further comment:

(a) Gifting, disclaiming or waiving UPEs or related loans

It is presumed from the PCG that the Commissioner regards arrangements involving the gift, disclaimer, or waiver of UPEs or related loans as being of concern and likely to represent a risk under section 100A. It is difficult to see why the gifting of funds (whether UPEs or otherwise) to a family trust, of itself, should be regarded by the ATO as a significant risk factor in relation to section 100A. In this regard, it is noted that the ATO has previously issued a private ruling in the context of a family group that the release or waiver of a UPE would be regarded as an ordinary family or commercial dealing.[15] There may be particular reasons why the ATO did not regard this arrangement as of concern or perhaps this further exemplifies that the ATO's views regarding section 100A have significantly changed in recent years.

(b) Entitlements or related loans satisfied by payments sourced from the beneficiary – dividend scenario

One of the major practical concerns with the conditions set for green zone eligibility in the PCG is the apparent ATO view that arrangements involving the discharge by a company of a UPE (or related loan owing its existence to a former UPE) owing to the company via the payment a dividend will be disqualified from green zone status.

Whilst the Commissioner's concerns regarding contrived arrangements involving the circular flow of funds as illustrated in Example 9 in the TR are understood and acknowledged, it is submitted that the use of dividends by corporate beneficiaries to discharge UPEs and related loans for the most part is both legitimate and commonplace. Dividends from corporate beneficiaries are routinely paid and applied to ensure that Division 7A requirements of such companies are met. Indeed, the specific rule in paragraph 109R(3)(a) in Division 7A expressly contemplates the use of franked dividends to service Division 7A loans and ensures that such payments of such dividends will not be disregarded under the reborrowing rule in section 109R.

Consider the following common illustration:

(i) Trust A, Company B and Trust C are all controlled by the same person.

(ii) Trust A generates taxable income; Trust C holds all the shares in Company B.

(iii) Trust A has distributed income to Company B. The UPE is discharged and replaced with a loan complying with section 109N terms, which requires regular annual repayments.

(iv) To meet one of these repayments, Company B declares a franked dividend to Trust C, its shareholder. Trust C distributes that franked income to the controller of the group who is on the top personal rate of income tax. The funds from this dividend are then used by the controlling individual to lend to Trust A which has the section 109N loan obligations, and the funds are used to meet the required repayment.

It is submitted that the arrangements illustrated above:

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[15] PBR number 1012571177732.

(i) can be clearly differentiated from the circular fund flows illustrated in Example 9 of the TR. The clear differentiating feature is that the dividend is distributed by the receiving trust to an individual taxpayer who pays personal tax and then uses the funds to partly refinance the section 109N loan of Trust A; and

(ii) are infinitely more common than those set out in Example 9, which it is acknowledged are worthy of the Commissioner's attention.

(c) Entitlements or related loans satisfied by payments sourced from the beneficiary – unitisation scenario

The view expressed in paragraph 26 is that arrangements whereby distribution entitlements of unitholders are discharged by the application of the subscribed funds for units in a unit trust is a feature that would exclude an arrangement from the green zone. With respect, assuming that the subscription price for the relevant units is commercially appropriate, the view that such arrangements would fall outside the ordinary dealing exemption is puzzling. By way of illustration, is the Commissioner suggesting that distribution reinvestment plans in relation to a listed property trusts would fall into the red or blue zones for the purposes of section 100A? It is seriously doubted that this would be the case, but the scenario highlighted as of concern in paragraph 26 is little different to the risk factor that the Commissioner is highlighting. It is noted that in paragraph 37 of the PCG, the example provided as falling within the red zone is one where the subscription price of the units is greater than their market value. It is submitted that if this factor is retained in paragraph 26, it should be amended to state that the set off arrangement would only fall outside the green zone where the subscription price for the units exceeds their market value.

(d) Manipulation of trust income

The Commissioner's concerns regarding arrangements whereby specific steps are taken to deliberately manipulate an outcome to reduce the 'income' of a trust (for the purposes of Division 6) to reduce this below taxable income are noted and acknowledged. Whilst such arrangements may well be worthy of the Commissioner's attention, it is questioned whether section 100A is the relevant measure by which the Commissioner should be seeking to challenge such arrangements. For example, in Example 8 in the TR, which illustrates an arrangement under which steps are taken to reduce the income Green Family Trust, the reduced income is in fact paid out in full. If the income is paid out and retained by the beneficiary, it is unclear how section 100A would have any role to play. The general anti-avoidance provisions of Part IVA may well apply in the same circumstances, but there would seem to not be a reasonable basis on which section 100A would apply in these circumstances.

(e) Tax avoidance motive

The last exclusionary factor in terms of green zone status refers to circumstances where "*The arrangement involves one or more features that may be explicable by a tax avoidance motive*". This residual catch-all is so broad and ambiguous that it could mean almost anything – whether an arrangement "*may be explicable*" means that in practice it will be exceedingly difficult to know whether this condition is satisfied or not.

Submissions:

In relation to the various exclusionary factors, it is respectfully submitted as follows:

(a) It is questioned whether the gifting, release, or waiver of UPEs or related loans should disqualify an arrangement from green zone status. If this position is to be maintained by the Commissioner, it is

submitted that this underlines the need for only prospective application of the approach set out in the draft pronouncements.

(b) It is considered that the risk factor identified by the Commissioner in relation to the unitisation of UPEs into units in a unit trust is inappropriate and should be either deleted or amended to refer to circumstances where the issue price of the units exceeds market value.

(c) In relation to entitlements or related loans satisfied by dividends, it is submitted that it is of major importance to significantly amend this condition to ensure that the legitimate use of dividends to meet Division 7A obligations is not impeded. Again, this is by no means an endorsement of the scenario outlined in Example 9 of the TR, which warrants attention, but any exclusion from the green zone should be limited to similar arrangements, rather than circumstances where the franked dividends are ultimately distributed to family individuals who apply those entitlements to ensure that Division 7A obligations are met.

(d) In relation to the tax avoidance motive condition, it is strongly recommended that the meaning of this be clarified. In its current far reaching and ambiguous form, it is considered so ambiguous as to be practically unworkable.

2.2.3 *Other retention of funds conditions*

The remaining conditions referred to in paragraph 20 of the PCG in large part refer to the link between the beneficiary and the control of the trust. The main issue raised in this context, for clarity, is that the conditions specified only refer to circumstances where the beneficiary is either an individual or a company – there is no reference to situations where the beneficiary may be the trustee of a trust.

Does this mean that arrangements involving distributions of income to a trustee beneficiary can never fall within the green zone? Based on the PCG as currently worded, it is assumed that the answer to this question is yes.

In this regard, it is noted that section 100A has no application to arrangements involving trust distributions to other trusts in circumstances where the receiving trust distributes that income to another beneficiary – section 100A only applies to arrangements relating to the last distribution in a chain of trusts.[16] However, income distributions to trust beneficiaries remain within the scope of section 100A to the extent to which that income is not distributed further.

It is submitted that there is no logical or policy reason why an unpaid entitlement owing to a trust should be treated any differently to an unpaid entitlement owing to an individual or a company. It is therefore submitted that this condition should be amended so that where the relevant beneficiary is a trust, this will also satisfy the requirements of paragraph 20 where the trustee of that trust is controlled by the same person(s) as the trust from which the income distribution was made.

However, in any event, it is requested that the Commissioner's views on trust beneficiaries for the purposes of paragraph 20 of the PCG should be made clear, for the avoidance of any doubt.

2.3 *Red zone conditions*

Set out below are comments concerning factors relating to the "red zone" referred to in the PCG.

[16] Subsections 100A(3A) and (3B).

2.3.1 *General*

The PCG refers to two general criteria that would result in red zone categorisation of an arrangement[17]:

- *"beneficiaries' entitlements appear to be motivated by sheltering the trust's (taxable) net income from higher rates of tax*
- *arrangement involves contrived elements directed at enabling someone other than the presently entitled beneficiary to have use and enjoyment of the economic benefits referable to the trust net income*."

Submissions:

In relation to general conditions, it is submitted as follows:

(a) It is assumed that red zone categorisation would require both factors listed to be present. If so, it is recommended that this be made clear.

(b) The first of the two criteria is quite broad. perhaps not quite as broad as the "tax avoidance" exclusion from green zone status in paragraph 26, but very broad nonetheless. For example, any discretionary trust arrangements where distributions are determined with some regard to tax rates or thresholds would quite possibly satisfy this condition. Further clarification on what is meant by this condition would be desirable.

(c) In relation to the second condition, the observation is made that this condition at least requires the existence of contrivance but is still relatively broad and could well apply to simple scenarios where a family beneficiary does not typically demand payment from the family trust of their entitlement. It is considered that section 100A was never intended to apply in such circumstances, but leaving this aside, it is submitted that it should be made clear that green zone status would override red zone status in circumstances where green zone conditions are satisfied – for example, in green zone Scenario 3, the retention of funds example. Because of the breadth of the red zone, as expressed, arrangements that fall within Scenario 3 of the green zone could conceivably satisfy these two criteria and fall within the red zone. It is presumed that this is not intended; it is suggested that further clarification be provided on this potential overlap.

2.3.2 *Red zone scenarios*

There are various red zone scenarios set out in the PCG.

The main general comment to be on the red zone scenarios is that the PCG does not make it clear whether:

(a) these scenarios are merely examples of situations that might fall within the red zone based on the general principles set out in paragraph 30 of the PCG or whether these scenarios are intended to be exhaustive;

(b) the headings to each of these scenarios might indicate a broader scope of the red zone than the specific circumstance outlined. The examples outlined in these scenarios are quite specific and it is considered that by and large each of these contains a specific element of artificiality or contrivance that would make such arrangements at the high-risk end of the scale. As a result, it is considered that such circumstances would not be commonplace. On the other hand, the headings in relation these scenarios are quite broad and it is difficult to determine whether more common arrangements that differ from the more extreme circumstances outlined may still fall within the red zone. A similar comment can be made in relation to

[17] Paragraph 30.

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red zone examples provided in the PCG – these generally contain an extreme feature, which would place it at the higher risk end of the spectrum. The more relevant question for many taxpayers will be whether more common arrangements with less extreme features would still be regarded by the ATO as falling within the red zone.

As a final specific point in relation to red zone Scenario 1, it is noted that distributions to non-resident beneficiaries are singled out for special attention. It is unclear as to the policy reason why arrangements involving distributions to non-resident beneficiaries should in principle be ranked as any more high risk than arrangements involving distributions to resident beneficiaries. In this regard, it is noted that there would seem to be some potential overlap between this scenario and the retention of funds example in green zone Scenario 3. Would green zone status override red zone status in these circumstances?

Submission:

The Commissioner is requested to provide additional clarity in relation to the above matters in the final version released of the PCG.

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