ATO Guidance

Reimbursement Agreements

December 2022

On 8 December 2022, the ATO released its final guidance on "reimbursement agreements" under section 100A of the *Income Tax Assessment Act 1936 (ITAA 1936)*.

What is section 100A?

Section 100A is an integrity provision designed to stop arrangements where a distribution is made to one beneficiary (typically with a low tax rate) but the economic benefit of the distribution is effectively transferred or paid to a second beneficiary (usually on a higher rate of tax). Section 100A does this by deeming the first beneficiary who is presently entitled to the trust income, to not be presently entitled where that present entitlement arose out of a "reimbursement agreement". The Trustee is then assessed on that income at the top marginal tax rate.

On the face of it, this seems quite straightforward. However the scope of this provision, and in particular, the meaning of "reimbursement agreement" and "ordinary family or commercial dealing" have been subject to much debate over the years, resulting in the ATO's guidance on section 100A being in development for some time.

Key points

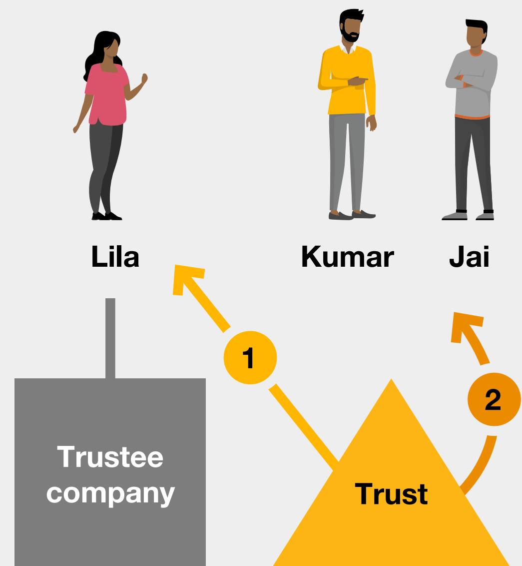
- The guidance released by the ATO on 8 December 2022 comprises 2 key items with respect to section 100A:
  - Taxation Ruling TR 2022/4; and
  - Practical Compliance Guideline PCG 2022/2.
- The release of the final guidance follows consultations on draft versions earlier this year, and a Taxpayer Alert (TA 2022/1, released in February 2022) which highlighted section 100A as one possible anti-avoidance rule that can apply where parents benefit from trust entitlements of their children over 18 years of age.
- The Taxation Ruling sets out the ATO's views on the four basic requirements for section 100A to apply, including the exception for "ordinary family and commercial dealings".
  - The scope of the "ordinary family and commercial dealings" exception is the focus of much of the discussion around section 100A. Whilst it appears that the ATO has somewhat walked back from its previous position that a dealing is not an ordinary family or commercial dealing merely because it is commonplace (this is no longer stated in the binding part of the ruling), a similar position is stated in the explanation part of the ruling. In particular, the explanation states that, *"[a]n arrangement that is commonplace, but which does not achieve family or commercial objectives, is not entered into in the course of ordinary family or commercial dealing."*
- The Practical Compliance Guideline provides a risk assessment framework that allows taxpayers and their advisers to assess the level of risk regarding their trust distribution arrangements. The Guideline outlines three "zones" into which arrangements may fall – a white, green and red zone - and the ATO's compliance approach to arrangements falling within each zone. Some of the key changes from the initial draft version include:
  - expanding the "green zone" scenarios which cover low-risk cases where the ATO does not intend to apply compliance resources
  - removing the blue zone to reduce complexity, and
  - including more practical examples to illustrate the operation of the green and red zone scenarios.
- The ATO has released a compendium of comments received during the consultation phase earlier this year. The quantity and nature of the comments received during the consultation highlights the complex nature of the issues dealt with in this guidance material.

Section 100A example

Below is an example (example 14) of an arrangement that, according to the Practical Compliance Guideline, falls within the red zone, and is likely to attract the ATO's attention. The Guideline states that when an arrangement is described in the red zone, it does not necessarily mean that section 100A applies to it, but the ATO will dedicate compliance resources to consider the application of section 100A as a matter of priority.

Lila is the sole shareholder and controller of the Trustee Company. Kumar and Jai are Lila's children, aged 21 and 19. They both live at home with Lila, study full time and derive no income during the year.

1. The Trust derives income during the year and makes regular payments to Lila during the year recorded as "beneficiary loans".
2. At the end of the year, Kumar and Jai are made presently entitled to all of the income of the Trust. The Trustee Company applies their entitlements against the beneficiary loan owed by Lila because they each purportedly have an outstanding debt owed to Lila in respect of education expenses and their share of the household expenses that Lila paid before they each turned 18.



What happens now?

- TR 2022/4 and PCG 2022/2 apply both prospectively and retrospectively. However, for entitlements conferred before 1 July 2022, the ATO will stand by any administrative position reflected in its prior website guidance to the extent it is more favourable to the taxpayer's circumstances than PCG 2022/2.
- In addition, the ATO has indicated that in most cases, it will only apply section 100A within 4 years of a trustee lodging their tax return, and it will not be reviewing arrangements prior to 1 July 2014, other than in exceptional circumstances as outlined in PCG 2022/2.
- Interestingly, the ATO has chosen to finalise its guidance now in the midst of appealing a case on this section to the Full Federal Court. In December 2021, a single judge of the Federal Court found in favour of the taxpayer in a case concerning the application of section 100A (read more about this decision here). This was the first case in more than a decade to consider the meaning of "reimbursement agreement". The Full Court appeal was heard in August 2022, with the judgement currently pending.
- With a continued focus on high wealth private groups via its Next 5000 compliance program, it is expected that potential historical exposure to section 100A will be on the ATO's agenda. Given there is no time limit for the Commissioner to amend assessments to affect an adjustment under section 100A, it is recommended that all private groups which operate with a discretionary trust review their past transactions and arrangements in line with the framework set out in PCG 2022/2, if they have not already done so.
- The importance of contemporaneous documentation and governance over trust distribution arrangements for private groups cannot be overstated. Where the ATO finds governance to be lacking, this will likely lead to further enquiries about the overall tax arrangements of the broader private group.

Find out more:

For a more detailed discussion on the implications this draft guidance may impact your current arrangements, please get in touch with your PwC advisor or contact:

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