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Trusts – 100A reimbursement agreements; identifying and reducing taxpayer risks

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1 Overview

Section 100A of the *Income Tax Assessment Act 1936* (Cth), a provision that is now celebrating its 43rd birthday (from its earliest effective date of 12 June 1978), has roared back into prominence within the last five years, with multiple public announcements, a promised public ruling, and numerous audits placing section 100A on centre stage.

Given the relatively recent refocussing by the Australian Taxation Office (**ATO**) on section 100A, it is necessary for practitioners to also focus their minds on the section to ensure their clients' (and likely, also their own) affairs are managed so as not to give rise to risks under the section.

This article does not seek to engage comprehensively with the history of Section 100A – instead, the authors would refer readers to Michael Butler's excellent 2019 paper "*Section 100A: When is a dealing between members of a family not in the course of ordinary family dealing?*" presented at the 2019 Tax Institute National convention, which provided a comprehensive review of the history of the provisions.

This paper also does not seek to engage in detail with the ATO's public statements (including its examples) to date on section 100A, as those statements have *not* (in the authors' opinion) been anchored (by way of explicit reference or endorsement) in law – or, if they have, the legal basis on which they stand has not been communicated publicly in sufficient detail.

This paper *is* directed to consideration of the strictly legal effect of section 100A– how the words of section 100A can be expected to be interpreted by a court.

There is particular emphasis on the meaning of the "ordinary family dealing" exclusion (as explained below), as that is an area where there is *no* direct prior case law but which is the area of current ATO focus.

Given the ATO focus, this emphasis on family dealings is appropriate. As will be argued, application of the key principles underlying section 100A to family (versus commercial) situations must come to grips with behaviour and relationships which are entirely usual in those family settings but which would be unusual between commercial (non-family) parties. From the authors' recent audit experiences, the ATO appears not to wish to recognise these differences.

Accordingly, the authors respectfully submit that this task (of considering the strictly legal effect) is of particular value at the present time because the lack of sustained, detailed and disciplined analysis of *the law* – versus what the ATO and/or taxpayers may seek the law to be and/or what they regard as the policy behind the section - has, to date, not provided meaningful and (very much desired) certainty for taxpayers (or the ATO).

The authors have benefited from prior analyses of section 100A, to which they have added their own experiences and thinking in dealing, in detail, with section 100A issues in a number of ongoing ATO audits.

With a task of a detailed and disciplined analysis of *the law* in mind, the paper seeks to demonstrate the correct way of interpreting section 100A based on the *words of the section* and the *existing case*

law, including both the relevant limited case law on section 100A itself and case law relating to the rules of statutory interpretation.

Based on the interpretation so identified, suggestions are made for what taxpayers should be doing to mitigate section 100A risks.

Even if others take different views of the correct interpretation of section 100A, the paper will have served a purpose if it contributes to a more detailed and disciplined analysis of *the law* relating to section 100A. Only on that basis will taxpayers and the ATO achieve greater certainty of the effect, and practical implications, of section 100A.

References to legislation in this paper are to the *Income Tax Assessment Act 1936* (Cth) unless otherwise indicated.

2 Words and structure of section 100A

We must start with the text of the section itself.

The key "operative" provision is **section 100A(1)**, which deems a beneficiary to **not** be presently entitled to income of a trust estate where that entitlement arises out of a "reimbursement agreement". That section is quoted below (our emphasis):

> "(1) Where:
>
> (a) apart from this section, a beneficiary of a trust estate who is not under any legal disability is presently entitled to a share of the income of the trust estate; and
>
> (b) the present entitlement of the beneficiary to that share or to a part of that share of the income of the trust estate (which share or part, as the case may be, is in this subsection referred to as the relevant trust income) **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**."

If section 100A applies, the amount of income to which the beneficiary is deemed not to be entitled to is taxed to the trustee at the trustee taxation rates. There is no amendment period restriction on section 100A.[1]

The nexus between the present entitlement subject to potential adjusted treatment (from taxation to the beneficiary to the trustee) and a "reimbursement agreement" is provided by way of the words "arose out of" or "arose by reason of".

From the start, it can therefore be noted, section 100A does not test the act of distributing to the beneficiary, including for some tax avoidance purpose. Section 100A asks:

- whether there is a "reimbursement agreement", as defined; and then
- whether the present entitlement "arose out of' or "arose by reason of" that agreement (or any act, transaction or circumstance that occurred in connection with, or as a result of the agreement).

Section 100A(2) applies the same treatment as section 100A(1) to beneficiaries who have actually been paid amounts, or had amounts applied to their benefit from, the income of a trust estate. It is otherwise identical to section 100A(1) and we will not discuss it separately.

Section 100A(3) to (6B) are specific mechanical provisions that are not directly relevant to the positions put forward in this paper – but we will refer to them where relevant.

Section 100A(7) is the first of the key "interpretative" provisions in section 100A. That section is quoted below (our emphasis).

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[1] Section 170(10)

> "(7) 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 other persons."

A "reimbursement agreement" therefore requires a payment of money, transfer of property, provision of services or other benefit to pass to a person other than the beneficiary that is presently entitled.

This is a very wide scope. Beneficiaries will *always* do these things – we refer to them as actions or outcomes in this paper - in the normal course of consuming or otherwise directing the use of their trust entitlement. For example, even if a beneficiary receives their trust entitlement fully in cash, the beneficiary will make payments and transfers to other people as they spend that entitlement.

The key points from sections 100A(1) and (7) are whether there is an "agreement", as defined:

- that provides for these things – the actions or outcomes; and
- out of which or by reason of which, the subject trust entitlement "arose".

Section 100A(8) modifies subsection (7) to exclude agreements without a tax purpose. The section is quoted below (our emphasis)

> "(8) 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."

That section 100A(8) must be read with **section 100A(9)**, quoted below (our emphasis).

> (9) For the purposes of subsection (8), an agreement shall be taken to have been entered into for a particular purpose, or for purposes that included a particular purpose**, if any of the parties to the agreement** entered into the agreement for that purpose, or for purposes that included that purpose, as the case may be.

Therefore, a "reimbursement agreement" will **not** exist where the agreement was **not** entered into for the purpose (either sole or with other purposes) of reducing the income tax payable of a person.

The "person" does not have to be the beneficiary presently entitled, the person receiving benefits under section 100A(7) or any other specific person.

The exclusion will **not** apply if **any** of the *parties to the agreement* had a tax avoidance purpose.

This can only mean a **subjective** purpose because it relates to each individual, not the overall objective purpose or effect of the agreement or a scheme.

It may be arguable that it is one or more of *the parties to the agreement* which must have the requisite purpose (rather than another person, such as a controller) but, due to the wide definition of agreement, this distinction may only be academic.

In summary, there is stated in section 100A a "non-tax purpose" exclusion, but it is a very narrow exclusion – narrower than a lack of an objective tax related purpose.

But note the sole mention of tax purpose in section 100A is in **exclusion** based on **lack** of tax purpose. On the words of section 100A, tax purpose does **not cause inclusion** of any "agreements', as defined.

Section 100A(10) to (12) are further interpretative provisions that note that loans and the releases of debts are benefits or payments, and that references to person include references to the person as trustee.

Section 100A(13) is, in the authors' view, the critical section to consider in detail, because it:

- sets out a very wide meaning of an "agreement' – which causes the concept of "reimbursement agreement" to be very wide; and then
- contains what are the substantive exclusions from that resulting very wide scope of "reimbursement agreement".

Section 100A(13) defines agreement to be (our emphasis):

> "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**."

This subsection gives the basis of what is commonly referred to as the "ordinary family dealing" or "ordinary commercial dealing" exceptions to section 100A.

There is some case law about the ordinary commercial dealing exclusion but there is **no** case law about the ordinary family dealing exclusion.

There is fundamental disagreement between taxpayers and the ATO about the interpretation of the ordinary family dealing exclusion, partly over how much of the meaning of the term "ordinary family dealing" in section 100A can properly be drawn from *Newton's* case[2] from which the wording appears to have been derived[3]. This is discussed below.

Key observations from wording

Based on the wording of section 100A, we make the following broad observations on how we see certain critical parts of the section working – with a view to testing our thinking against the (admittedly limited) case law, to the extent possible.

We should note that, in applying section 100A, the ATO must (and taxpayers should insist it does) move through all the specific elements of the section, which includes *fully* specifying the relevant reimbursement agreement.

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[2] (1958) 98 CLR 1

[3] Prestige Motors Pty Ltd as trustee of the Prestige Toyota Trust 98 ATC 4241 at 4262, where reference is made by Hill and Sackville JJ to the "ordinary commercial dealing" exclusion wording being derived from Lord Denning in *Newton's* case.

That the subject present entitlement "arose out of' or "arose by reason of" the reimbursement agreement is one of the critical steps in section 100A applying to that entitlement.

It may be that the act of distributing value in a particular way from a family trust (including to reduce overall tax within a family group) will, in some cases, have a sufficient connection to how that value is **understood or agreed** to be consumed/used by the family - so as to satisfy the "arose out of' or "arose by reason of" (a potential reimbursement agreement) wording.

It may be that the act of distributing in a particular way (to reduce tax) can, itself, be part of the potential reimbursement agreement.

But focus of the section is still not purpose – tax or otherwise – and the exclusions from what is a reimbursement agreement must be given effect.

The the focus of the section is whether there is a reimbursement agreement, as objectively defined, and whether the stated exclusions from that concept apply – **not** whether the act of distributing the trust income a particular way has a tax purpose.

The concept of "reimbursement agreement" relates to objectively stated **actions** that will be taken by any beneficiary in the ordinary course of consuming or directing the use of their entitlement.

Tax purpose – or more correctly the lack of it - arises in connection with section 100A **only** as a **very limited exclusion** from such a reimbursement agreement.

The exclusions that substantively prevent section 100A from applying to all those circumstances in which a beneficiary ordinarily consumes or directs the use of their entitlement are the ordinary family or commercial dealing exclusions from the meaning of "agreement".

Tax purpose is not a part of those exclusions. There is no reason why:

- a *presence* of tax purpose should limit the scope of these ordinary family or commercial dealing exclusions – thereby expanding the scope of section 100A; or
- an *absence* of tax purpose should expand the scope of these "ordinary family or commercial dealing exclusions – thereby reducing the scope of section 100A.

Those ordinary family or commercial dealing exclusions operate to limit an agreement, arrangement or understanding "that provides for" the objectively stated **actions** which would otherwise be included within the meaning of a "reimbursement agreement". Accordingly, in applying the concept of ordinary family or commercial dealings in section 100A, we submit the context requires the exclusion of an agreement, arrangement or understanding that has the **objective characteristics** of being entered into in the course of ordinary family or commercial dealings.

Such an excluded agreement, arrangement or understanding will be one with the objective characteristics of providing for actions that are "ordinary dealings" in the sense of being either:

- ordinary interactions within a family; or
- ordinary transactions between commercial parties.

We next seek to test these key observations against the case law, followed by a more detailed statement of how we submit section 100A should be applied.

3 The cases considering section 100A

There is unfortunately limited case law regarding section 100A generally, and no case law has addressed critical issues such as "ordinary family dealing" head on.

That being said, we think important details are dealt with in the section 100A cases that have been decided.

Because we will refer to details from these cases to support our detailed outline of how section 100A should be interpreted and applied, it is worthwhile first summarising and making relevant observations on these main cases here.

3.1 The section 260 cases

Discussions of section 100A invariably include discussions of section 260, being the precursor to Part IVA and the major anti avoidance provision of its time.

The relevance of the section 260 cases stems from *Newton v FCT*[4] (***Newton***) in which Lord Denning considered that section 260 would not apply to arrangements capable of explanation as ordinary business or family dealings. This has been referred to as the "predication" issue – that if the arrangements could be predicated on ordinary family or business dealings, they would not be arrangements for the purpose of tax avoidance.

It is worth restating the wording of section 260 (as it was - our emphasis) in full:

> Contracts to evade tax void
>
> (1) Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly:
>
> (a) altering the incidence of any income tax;
>
> (b) relieving any person from liability to pay any income tax or make any return;
>
> (c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or
>
> (d) preventing the operation of this Act in any respect;
>
> be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose.
>
> (2) This section does not apply to any contract, agreement or arrangement made or entered into after 27 May 1981.

[4] (1958) 98 CLR 1

In the context of this wording of section 260, it can be observed:

- the contract, agreement, or arrangement, the subject of consideration for section 260, was one that (directly or directly) altered tax outcomes (e.g. moving assets so that income would flow differently); and
- Lord Denning's comments on an "ordinary business or family dealing" are specific to the section 260 context of excluding a tax related "purpose and effect", where the transactions were capable of explanation by reference to such ordinary business or family dealing,

If the relevant test being applied is **not** that of a tax related purpose and effect – as we submit is the case in the section 100A context – there is **no** basis to import such a "tax related purpose and effect" meaning into the use of wording similar to "ordinary business or family dealing" in that other, different context (i.e. such as the use of the wording "ordinary family or commercial dealing" in section 100A(13)).

Lord Denning's comments in *Newton* were endorsed repeatedly in subsequent section 260 cases. Those cases determined what would be ordinary family or business dealings **for the purpose of section 260.**

By way of two examples:

- *Peacock v FCT*[5] confirmed that a husband bringing his wife (who did not have the relevant professional skills) into partnership to conduct his surveying business was ordinary family dealings.
- *Jones v FCT*[6] confirmed that the redistribution of family assets, including business assets, was an ordinary family dealing.

The cases above are often referred to in interpretative attempts of "ordinary family dealing" in section 100A, however in our view they provide only limited assistance – because the context of section 100A is very different to that of section 260.

While these cases may demonstrate what is ordinary family dealings when distinguishing such transactions from those **with a tax related purpose or effect under section 260**, they do not bear directly on what are ordinary family dealings as an exclusion from reimbursement agreements under section 100A.

In dealings with the ATO in section 100A audits, we have had put to us such comments as the following, with reference made to *Jones v FCT*:

> Ultimately, in this particular matter, the question falls on whether the Arrangement had the purpose of redistributing family assets within the family group or a purpose of gaining a tax advantage for [Taxpayer] by utilising his parents and children's lower marginal tax rates.

[5] 76 ATC 4375
[6] 77 ATC 4058

This line of reasoning seeks to incorrectly import the purpose-based context of the meaning of "ordinary family dealing" as used in applying section 260, into the interpretation of that wording in the fundamentally different context of section 100A.

As we have identified above in our key observations on the wording of section 100A, in section 100A, the ordinary family and commercial dealing exclusion operates to limit a concept of agreement (reimbursement agreement) that relates to certain objectively stated **actions** taken (the consumption use of the beneficiaries entitlement) – **not** to limit a concept of agreement defined by the agreement's tax purpose or effect.

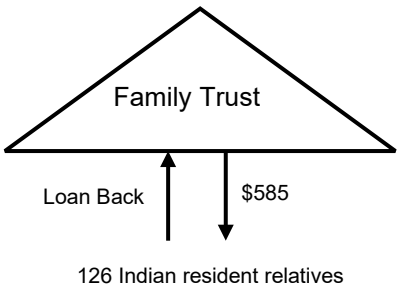
3.2 East Finchley

This brings us to the first true section 100A case, *East Finchley Pty Ltd v Commissioner of Taxation*[7] (***East Finchley***) – although we note that even this case was decided on other grounds.

East Finchley was a decision by Justice Hill. Much of the reasoning in the case has subsequently been overruled by later cases. It is, however, relevant to review this case since it plays an important role in the history of how the courts have interpreted section 100A.

East Finchley concerned a scheme devised by the accountants of a discretionary family trust. East Finchley Pty Ltd was the trustee of the trust. In June 1983, East Finchley resolved to allocate a substantial portion of the income derived by the trust in the 1983 income year to 126 relatives of the husband and wife principals behind the trust. These relatives resided overseas in India and were allocated $585 each – which was the tax free threshold for non-residents in the 1983 income year.

In July 1983, the husband travelled to India where the beneficiary overseas relatives lived and gave each of those relatives a pro forma letter notifying of their entitlement to a $585 income allocation and arranged for them to sign another pro forma letter, authorising East Finchley to credit the allocation to a loan account in the relative's name in the trust's accounts. All but 15 beneficiaries signed the letters. No money changed hands and the trust kept the money in its bank account. The pro forma letters were devised by East Finchley's accountants who devised similar schemes for other clients.



In August 1988, the trust decided to distribute to the non-resident beneficiaries the monies purportedly loaned to it. In the meantime, the Commissioner assessed East Finchley on the basis

[7] [1989] FCA720

that section 100A applied to the 1983 income distributions, such that East Finchley was assessable on that income under section 99A.

Justice Hill did **not** rule on whether section 100A applied to assess East Finchley on the 1983 trust income because there was a factual issue as to whether East Finchley's trustee resolution was legally effective. If it was not legally effective then the default beneficiaries of the trust would have been presently entitled to that trust income, rather than the non-resident beneficiaries. Justice Hill remitted the case back to the Administrative Appeals Tribunal (**AAT**) to consider these factual issues.

East Finchley (being the taxpayer in this case) attempted to argue that the arrangements involved no 'payment' of money and as such no 'reimbursement agreement'. Justice Hill rejected this argument holding that the consequence of the non-resident beneficiaries signing the pro forma letter was that there was an offset between East Finchley's obligation to pay the beneficiaries their entitlements and their agreement to lend the funds back to East Finchley. That offset was a 'payment' of money on which could form part of a reimbursement agreement.[8]

This part of the *East Finchley* decision has not been challenged in later cases. It is relevant to how the flow of funds should be recognised, where beneficiaries direct consumption/use of their entitlements, in lieu of receiving that entitlement in cash, for the benefit of other family members, as contributions resolved to be made to trust corpus or for use in other ways.

In the context of this case where the reimbursement agreement involved the loan back of funds by the beneficiaries to the trust, Justice Hill suggested that for a reimbursement agreement to exist the beneficiaries needed to be a party to the arrangement.[9] At page 5294 of his judgment Justice Hill made the following comments:

> 'While I have no difficulty in accepting that a reimbursement agreement can be a non-legally binding arrangement, for sec. 100A(13) so says, I have some difficulty in accepting the possibility that there could be a reimbursement arrangement in the relevant sense where present entitlement arose in circumstances where the trustee hoped that he might be able to enter into an arrangement in the future with the beneficiary, that the beneficiary pay money to the trustee. In such a case it would be difficult to see how the necessary purpose in sec. 100A(8) would be present.
>
> It will be recalled that sec. 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. Since the relevant agreement requires the payment of moneys to be made by some person, generally the beneficiary (in this case the payment clearly relied upon was a payment by the beneficiary to the trustee) it seems to me to be a matter of necessity that the relevant reimbursement agreement could only have been entered into where the beneficiary is in fact a party.'

Whilst there was evidence in this case that there was an arrangement between East Finchley and the principals of the trust, it was not clear whether the arrangement extended to the non-resident beneficiaries.

When this case came back before the AAT in *Case X40* 90 ATC 342, the AAT suggested that the arrangement whereby the non-resident beneficiaries were made presently entitled to the tax-free

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[8] *East Finchley Pty Ltd v FCT* 89 ATC 5280 at 5291.

[9] *East Finchley Pty Ltd v FCT* 89 ATC 5280 at 5295.

threshold amount on the basis that each non-resident beneficiary would be asked to, and expected to, lend such moneys back to East Finchley was a 'reimbursement agreement'.

This was so notwithstanding that the beneficiaries were not parties to the arrangement.

Ultimately it was not necessary for the AAT to decide whether section 100A applied to the arrangement, because it already decided that East Finchley should be assessed on the trust income under section 98 ITAA 36 on the basis that there was no evidence to prove that East Finchley's trustee resolution to distribute to the non-resident beneficiaries was made prior to 1 July 1983 and the default income beneficiaries were two infant beneficiaries. Since these beneficiaries were under a legal disability, section 100A did not apply to their present entitlements.

The AAT did, however, suggest that, in the alternative, it would have considered that section 100A applied to assess East Finchley since the present entitlements of the non-resident beneficiaries arose by reason of transactions and circumstances that occurred in connection with the reimbursement agreement. In this respect the AAT's reasoning foreshadowed the later case of Idlecroft which overruled East Finchley and held that there was no need for a beneficiary to be a party to an agreement before it is classed as a reimbursement agreement.

3.3 Prestige motors

Prestige Motors concerned two separate reimbursement agreement arrangements.

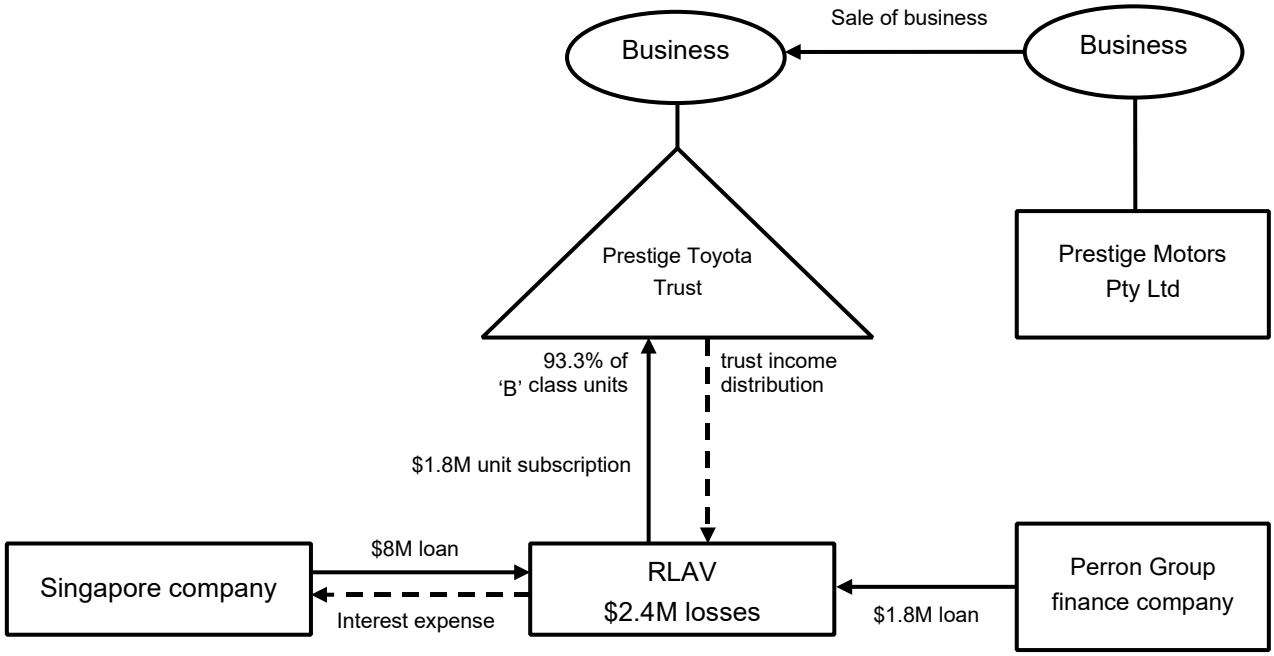
The taxpayer, Prestige Motors Pty Ltd, carried on a profitable business in its own right as a wholesaler and retailer of cars. The principal of the taxpayer, Mr Perron, wanted to reduce the tax paid by the taxpayer on its profits and so two sets of transactions were entered into for this purpose, namely:

a. transactions with Ronald Lyons Australia (Vic) Pty Ltd (**RLAV**) which was an unrelated loss company (**RLAV transactions**); and

b. transactions with National Mutual Life Association (**NMLA**) which was a tax exempt entity (**NMLA transactions**).

RLAV transactions

The RLAV transactions are summarised in the following diagram:



RLAV was an insolvent company with $2.4 million in tax losses and $8 million in debts. So that the taxpayer's profitable business could take advantage of these attributes the following steps were implemented:

a. a Singapore company was established and RLAV's creditors assigned $8 million of debts owed to them by RLAV to the Singapore company for nominal consideration. Whilst the directors of the Singapore company were not legally controlled by directors of the Perron group of companies, it was hoped that they would act in accordance with the wishes of the directors of the Perron group of companies;

b. the Perron group finance company then lent $1.8 million to RLAV to subscribe for 93.3% of the 'B' class units in a newly established trust, being the Prestige Toyota Trust;

c. the Prestige Toyota Trust then used the subscribed funds to acquire Prestige Motors Pty Ltd's business;

d. after the purchase of the business, the trustee of the Prestige Toyota Trust was changed to Prestige Motors Pty Ltd; and

e. the interest payable on the $8 million debt owed by RLAV to the Singapore company was then increased to 13.5% per annum. The judge at first instance found that there was an understanding with the directors of the Singapore company that the $7 million funds paid as interest would remain with the Perron group of companies save for the payment of interest withholding tax.

The Commissioner argued that section 100A applied to tax Prestige Motors Pty Ltd as trustee of the Prestige Toyota Trust on the trust income to which RLAV was presently entitled since the above arrangements comprised a reimbursement agreement. In particular the Commissioner argued that the above transactions:

a. provided for the payment of money to a person other than a beneficiary in the following ways:

   i. the payment of money to the trustee of the Prestige Toyota Trust by RLAV in return for its 'B' class units;

   ii. the payment of money by the trustee of the Prestige Toyota Trust to Prestige Motors Pty Ltd as the vendor of the business;

   iii. the payment of money to the Singapore company comprising the interest expense payments;

b. the transactions were entered into with a tax avoidance purpose as they were aimed at reducing the tax payable on the business profits by diverting to RLAV (being a loss company) and in part to the Singapore company where only a 10% interest withholding tax would be paid on the profits.

The Commissioner alleged that the parties to this reimbursement agreement comprised Prestige Motors Pty Ltd, RLAV, the Perron group finance company, the Singapore company, Mr Perron, Mr Gadsdon (who was a director of Prestige Motors Pty Ltd and was primarily responsible for implementing the transactions) and Mr Fieldhouse who was the solicitor for the Perron group of companies.

The Full Federal Court agreed with the Commissioner and ruled that the RLAV transactions comprised a reimbursement agreement. In particular, the payment of interest by RLAV to the Singapore company was sufficient to meet the requirement that there be a payment of money to a person other than the beneficiary.

In this respect, the Full Federal Court noted that there is no requirement that an 'agreement' must be legally enforceable for there to be a 'reimbursement agreement'. If there was an understanding that the directors of the Singapore company would act in accordance with the wishes of the Perron group and that interest paid to it would remain available to the Perron group, that understanding would be an 'agreement' for these purposes[10].

Significantly the Full Federal Court rejected the taxpayer's argument that the trust in which the beneficiary had a present entitlement (such present entitlement being affected by section 100A) must be existence at the time the reimbursement agreement was entered into. The relevant trust in the case was the Prestige Toyota Trust and it was created as a part of the reimbursement agreement. The Full Federal Court held that it was not necessary for the trust to be in existence at the time of the reimbursement agreement is entered into, for there to be a reimbursement agreement.[11] Accordingly, the creation of the relevant trust can be part of the reimbursement agreement.

The Full Federal Court also rejected the taxpayer's argument that for the reimbursement agreement to have a tax avoidance purpose, the beneficiary of the trust (being RLAV) needed to be a party to the agreement. The taxpayer had argued that there was no reimbursement agreement because RLAV was not a party to the overall transactions identified by the Commissioner because it was not

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[10] *FCT v Prestige Motors Pty Ltd as trustee of the Prestige Toyota Trust* 98 ATC 4241 at 4257.

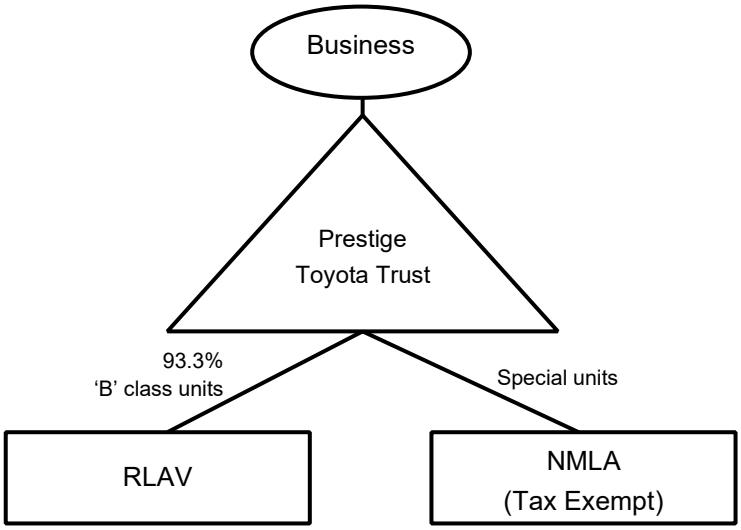
[11] *FCT v Prestige Motors Pty Ltd as trustee of the Prestige Toyota Trust* 98 ATC 4241 at 4259 to 4260.

involved in the assignment of its debts to the Singapore company or in the establishment of the Prestige Toyota Trust.

The Full Federal Court rejected this argument and ruled that there was no requirement to restrict section 100A(8) to a beneficiary or trustee of the trust concerned.[12] This is because section 100A(9) makes it clear that the requirement of a tax avoidance purpose can be met by any of the parties who entered into the reimbursement agreement. Here each of Mr Gadsdon, Mr Fielding and Mr Perron had the relevant tax avoidance purpose since the RLAV transactions were formulated by the former two parties with the assent of Mr Perron, with the intention of reducing tax on the business profits.

NMLA transactions

The NMLA transactions can be summarised diagrammatically as follows:



The NMLA transactions involved the issue of special units to NMLA which was an income tax exempt association. Broadly, the transactions involved Mr Perron making a written offer NMLA to subscribe for special units in the Prestige Toyota Trust which would provide NMLA with a guaranteed return of 18%. The terms of the special units issued entitled NMLA to set income distributions over seven and half years, after which the units would become worthless and would not be entitled to participate in any assets, capital or future profits of the Prestige Toyota Trust. There were two issues of special units to NMLA on these terms. To facilitate the issue of the special units, the trust deed for the Prestige Toyota Trust had to be amended.

The Prestige Toyota Trust used the unit subscription funds to acquire land from Prestige Motors Pty Ltd used in the business carried on by the Prestige Toyota Trust and to make interest free unsecured loans to entities associated with the Prestige Toyota Trust.

[12] *FCT v Prestige Motors Pty Ltd as trustee of the Prestige Toyota Trust* 98 ATC 4241 at 4261.

At first instance the primary judge found that there was a reimbursement agreement in the NMLA transactions because it involved NMLA paying the Prestige Toyota Trust money for the special class units. The fact that NMLA effectively received interest on the investment (being the 18% rate of return) did not alter this fact. The primary judge also found that parties to the NMLA transactions had the relevant tax avoidance purpose of implementing the transactions so that RLAV who would have otherwise been liable to pay tax on the income distributed on the special class units, was not so assessed. Those parties included Mr Perron who made the written offers to NMLA, Prestige Motors Pty Ltd as trustee of the Prestige Toyota Trust and Mr Gadsdon.

Not ordinary commercial dealings

The Full Federal Court found, against the taxpayer, that both the RLAV and NMLA transactions were **not** ordinary commercial dealings.

But, importantly, in doing so, it stated[13]:

> The wording of the exclusion in s 100A(13) derives from the judgment of Lord Denning, on behalf of the Privy Council, in Newton & Ors v FC of T (1958) 11 ATD 442 at 445; (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".
>
> 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. It is clear from both the judgment of the Privy Council and from the language of the High Court on the same case (FC of T v Newton (1957) 96 CLR 578) that s 260 was regarded as involving a dichotomy. A transaction was either stamped as one entered into to avoid tax or as one about which it could be predicted that it was entered into in the course of ordinary family or commercial dealing. In the former case the transaction was caught by s 260; in the latter case it was outside the section. We do not need to decide in the present case whether s 100A imports a similar dichotomy. In particular we do not need to decide whether if an agreement is shown to have been "entered into in the course of ordinary commercial dealing", the operation of s 100A is spent, regardless of whether the commercial purpose was subsidiary to the purpose of tax avoidance. In our view, none of the transactions was entered into in the course of ordinary commercial dealing.

By this statement, the court was expressly questioning whether tax purpose is relevant to limiting the meaning of an ordinary commercial dealing. The final two sentences of these comments indicate that Hill and Sackville JJ concluded the arrangements in *Prestige Motors* were not 'ordinary commercial dealings' *without* reliance on purpose.

They made following comments in their judgement that noted various features of the arrangements (both the RLVA and the NMLA transactions) and about how a tax may have relevance to those features. But the plain statement above is that they did **not** rely on balancing competing purposes.

They determined the status of "ordinary commercial dealings" on another basis.

From their following comments, that basis can be seen to be the objectively "non-ordinary" commercial characteristics of the whole of the arrangements.

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[13] *FCT v Prestige Motors Pty Ltd as trustee of the Prestige Toyota Trust* 98 ATC 4241 at 4262

The RLAV transactions were said to involve further steps that went beyond a straightforward business sale - this included Prestige Motors Pty Ltd replacing the old trustee of the Prestige Toyota Trust, the issue of 'B' class units to RLAV, distributions of income on those units to RLAV, RLAV utilising its losses and making interest payments to the Singapore company to reduce the tax payable on those income distributions and the factual finding that the directors of the Singapore company would act in the interests of the Perron group of companies.

It was observed that *"the sale could be seen as one element of a larger one-off transaction designed to avoid tax"*[14] but that observation (about design) does not alter that the conclusion (that the ordinary commercial dealing did not apply), was made on the objective "non-ordinary" characteristics that went beyond a straightforward business sale – and **not** by reference to tax purpose itself.

On the NMLA transactions, the Full Federal Court rejected the taxpayer's arguments and at pages 4262 to 4263 made the following comments:

> '*The NMLA transactions involved the companies and individuals within the Perron group, on the one hand, and NMLA, on the other. Whether the agreement was in the course of ordinary commercial dealing might be answered differently depending upon whether the issue is addressed from the perspective of Prestige or other entities within the Perron group, or from NMLA's perspective. Section 100A(13) does not make it explicit how the issue is to be determined when what is said to be a reimbursement agreement involves parties which have dealt at arm's length with those whose purpose is to avoid liability to pay income tax. In our view, the question is to be addressed, at least principally, from the point of view of those who have that purpose. If it were otherwise, s 100A could be rendered nugatory in its application to classic cases of trust stripping, since in such a case the introduced beneficiary may well enter the agreement in the course of* ***its*** *ordinary commercial dealings.*'

Despite the references to tax purpose in this explanation of the point of view from which the status of ordinary commercial dealings was to be determined, the concluding comments still make clear that the unusual objective characteristics of the NMLA transactions (including the sourcing of the funding outside the group, the collapsing nature of the units), not the tax purpose, decided the matter:

> But the mere fact that the moneys subscribed by NMLA were employed by Prestige (as trustee of the Trust) to acquire title to the land, does not establish that there was any commercial necessity or justification for the transaction. As Mr Slater pointed out, the Trust was a substantial creditor of other companies in the Perron group and could have funded the acquisition of the properties by an intra-group exchange of cheques. As with the 1981 NMLA transaction, Prestige did not discharge the onus of showing that there was a commercial reason to raise capital from outside the group. Having regard to the substantial completion of the 1981 NMLA transaction (by means of the final large distribution to NMLA in June 1984), the similarities in the form of the two transactions (including the ``collapsing'' nature of the units) and the obvious tax advantages to the Trust, the appropriate conclusion is that the agreement was entered into only for the purpose of enabling Perron Investments, as the holder of the ``A'' class units, to avoid liability to income tax on the Trust income that otherwise would have been distributed to it. The agreement was not entered into in the course of ordinary commercial dealing.

[14] *FCT v Prestige Motors Pty Ltd as trustee of the Prestige Toyota Trust* 98 ATC 4241 at 4262

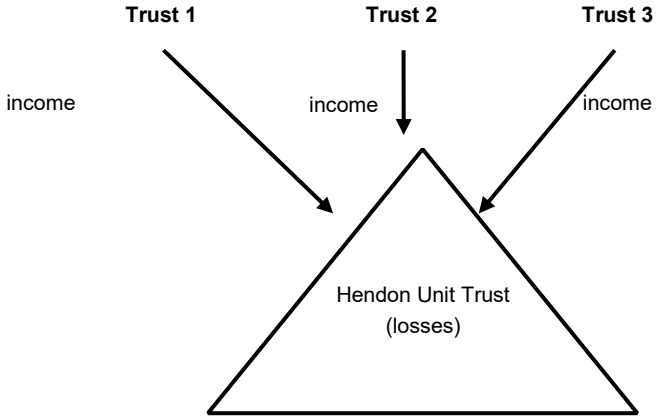
In our experience, the *Prestige Motors* case is the case most sought to be relied upon by the ATO in its push to expand the scope of application of section 100A.

But *Prestige Motors* is **not** authority for the importation of a concept of tax purpose into the meaning of ordinary commercial dealing, much less ordinary family dealing.

The express words of the Full Federal Court cited above, warning about the importation of dichotomy in commercial or family dealings between those that have a (dominant) tax purpose versus those being ordinary, are clear – and the court's decision is consistent with this expressly stated position.

3.4 Idlecroft

The taxpayers in this case comprised the trustees of three discretionary family trusts who entered into joint venture agreements with Westside Commerce Centre Pty Ltd as trustee of the Hendon Unit Trust (**HUT**) to develop a property. Under the joint venture agreements the taxpayers agreed to fund HUT's property development activities by adding HUT as a beneficiary of their respective trusts and then distributing trust income to HUT. HUT had accumulated losses to offset against such income. Save for the actual payment of 12% of the income distributions to the HUT, the three discretionary family trusts retained the remaining balance of their income distributions to use for other purposes.



Hendon Unit Trust added as a beneficiary of Trusts 1, 2 and 3

The taxpayers conceded that where the addition of HUT as a beneficiary of their respective trusts was legally effective then the joint venture agreements would be reimbursement agreements affected by section 100A ITAA 36.

The taxpayers argued, however, based on Justice Hill's comments in *East Finchley* that section 100A ITAA 36 could not apply in the case of two of the trusts because the addition of HUT as a beneficiary was not legally effective in those cases. The consequence of this was that the default income beneficiaries were presently entitled to the trust income and not HUT. The taxpayers argued that there was no reimbursement agreement because as Justice Hill as suggested in *East Finchley* for there to be a reimbursement agreement there had to be an agreement with the default beneficiaries and this agreement had to be made before the present entitlement arose.

The Full Federal Court rejected the taxpayers' argument, holding that the statutory definition of an 'agreement' in section 100A(13) ITAA 36 was broad and does not require the beneficiary who had the present entitlement to be a party to any arrangement or understanding. In this respect the Full Federal Court relied on the decision of *Prestige Motors* where a reimbursement agreement was found to be exist in relation to a trust that not yet been formed at the time of the reimbursement agreement, and in which case no beneficiary relationship had yet been created.

The fact that the present entitlement of the default beneficiaries did not exist at the time of the reimbursement agreement was also considered not to be relevant. Section 100A can apply where a present entitlement 'arose by reason of any act, transaction or circumstance that occurred in connection with, or as a result of, a reimbursement agreement'.[15] At page 4647 of its judgment the Full Federal Court held that this wording provides for a broad 'but for' test of causation:

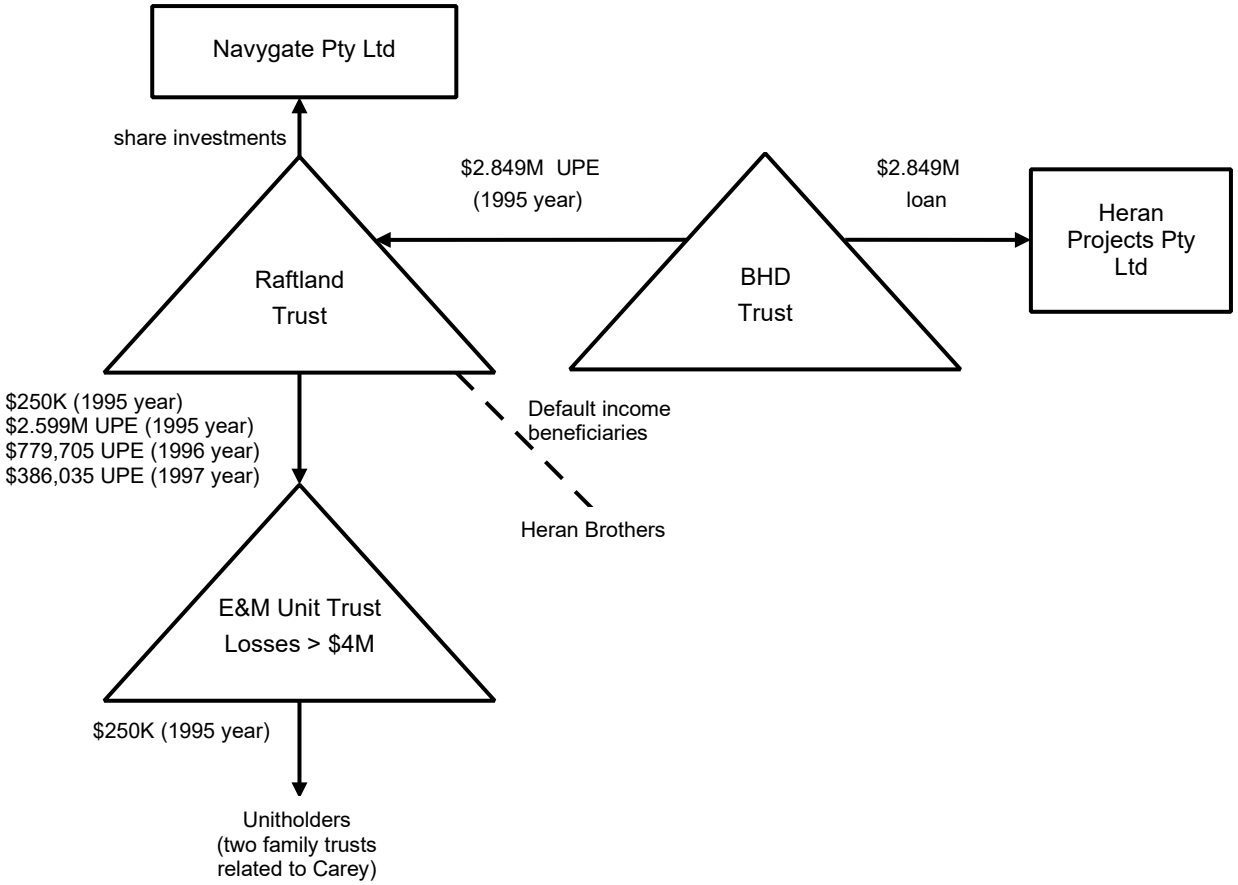
> 'That is to say, if one of the consequences of the act, transaction or circumstance were to result in any way from the designated criteria then it would be within the language of the section. Furthermore, it is not only the agreement that must be considered but also any circumstance or act that occurred "in connection with" or "as a result of" the reimbursement agreement.'

The Full Federal Court held that there was a connection between the default beneficiaries' present entitlement and the reimbursement agreement, since but for the invalid appointments of income to HUT which were connected with the reimbursement agreement, the default beneficiaries would not have gained their present entitlement. The fact that the default beneficiaries' present entitlements arose as a consequence of the terms of the trust deed, was not relevant because the required connection between the reimbursement agreement and the present entitlement was already met.

3.5 Raftland

Raftland involved a scheme to reduce tax via the 'purchase' of a loss trust. The principals behind the Raftland Trust were the Heran brothers who carried on a profitable building business. To reduce tax they in substance acquired an unrelated trust (the E & M Unit Trust) which had more than $4 million of accumulated revenue losses.

[15] Section 100A(1) ITAA 36.



Broadly the steps involved in the scheme that they undertook were as follows:

a. On 30 June 1995:

   i. Raftland Trust (a discretionary trust) was established with Raftland Pty Ltd as trustee. Raftland Pty Ltd was a company controlled by the Heran brothers;

   ii. the trustee of the Brian Heran Discretionary Trust (**BHD Trust**) then made the Raftland Trust presently entitled to $2.849 million trust income derived in the 1995 income year. This income distribution was not actually paid to the Raftland Trust and was instead left as an unpaid present entitlement. The BHD Trust then lent the $2.849 million funds to Heran Projects Pty Ltd; iii. Mr Carey who was the trustee of the E & M Unit Trust was replaced with Raftland Pty Ltd.

   The unit holders of the E & M Unit Trust were related family trusts of Mr Carey's parents. This unit holding was not altered by the scheme;

   iii. the Raftland Trust then made two income distributions of $250,000 and $2.599 million to the trustee of the E & M Unit Trust. Only the $250,000 distribution was actually paid out to the E & M Unit Trust which then on paid it to Mr Carey's related family trust (being a unit holder of the E & M Unit Trust). In effect this $250,000 was the purchase price paid to acquire the E &

   M Unit Trust and its accumulated losses ($30,000 of this purchase price was paid to Carey's accountants for facilitating the transaction). The $2.599 million income distribution was left

as an unpaid present entitlement and the Raftland Trust used those funds to make share investments in another company related to the Heran brothers (being Navygate Pty Ltd);

iv. the E & M Unit Trust then offset its accumulated losses against the $2.849 million income distributions it received from the Raftland Trust such that no tax was paid on those distributions.

b. In the 1996 and 1997 income years further trust income distributions were made to the Raftland Trust from the BDH Trust and another Heran controlled trust. The Raftland Trust on-distributed those income distributions to the E & M Unit Trust so that it could offset its accumulated revenue losses against those distributions as well. As in the 1995 income year, none of these income distributions were actually paid out to the E & M Unit Trust. Rather the funds were retained in the Raftland Trust and BDH Trust and used in the same way as outlined above for the 1995 income year.

The Commissioner sought to assess Raftland on the 1995, 1996 and 1997 income distributions it purported to distribute to the E & M Unit Trust under section 99A ITAA 36 on the basis that the distributions were shams. The Commissioner then argued that the consequence of the distributions being legally ineffective was that the Heran brothers became presently entitled to the income distributions as the default income beneficiaries and section 100A applied such that that present entitlement is disregarded with the result that Raftland was taxable on the trust income under section 99A ITAA 36.

The High Court agreed with the Commissioner's contention that the 1995, 1996 and 1997 income distributions were shams and accordingly had no legal effect. This was because the evidence showed that the intentions of the parties (being the Heran brothers and the principals behind the E & M Unit Trust) was that $250,000 was all that the beneficiaries of the E & M Unit Trust would ever receive from the Raftland Trust – that $250,000 being the purchase price for acquiring the E & M Unit Trust's trust losses. Since there was no intention on the part of the trustee of the Raftland Trust, the settlor of the Raftland Trust or the beneficiary (being the trustee of the E & M Unit Trust) that the 1995, 1996 and 1997 income distributions were actually have to legal effect, the income distributions were shams.

The effect of this ruling was that the Heran brothers then became presently entitled to the Raftland Trust's trust income for the 1995, 1996 and 1997 income years as they were default income beneficiaries under the Raftland Trust.

The High Court agreed with the reasoning of Justice Keifel at first instance in the Federal Court in relation to the application of section 100A. Justice Keifel found that there was a reimbursement agreement because a benefit was gained by the BDH Trust and Heran Projects Pty Ltd from the arrangement where the Raftland Trust did not pay out its income distributions to the E & M Unit Trust and left them as unpaid present entitlements. That benefit was that the BDH Trust did not have to pay out the Raftland Trust's unpaid present entitlement and so it did not have to call on Heran Projects Pty Ltd to repay its loan. At the same time the parties to the scheme enjoyed the tax benefits of offsetting the income distributions against the E & M Unit Trust's accumulated losses.

Applying the reasoning in *Idlecroft* Justice Kiefel found that there was the required connection between the Heran brothers' present entitlements as default income beneficiaries because but for the ineffective income distributions (which were made pursuant to the reimbursement agreement), the Heran brothers' present entitlements would not have arisen. The fact that the Heran brother's default income entitlements arose out of the trust deed did not alter this connection.

Section 100A(3A) which is the provision that applies to chains of trusts did not operate to prevent section 100A applying in this case. This was because section 100A(3A) ITAA 36 only applies where the beneficiary that has the present entitlement is a trustee of another trust. The relevant beneficiaries in *Raftland* were the Heran brothers in their own personal capacities.

3.6 Case law – some summary observations

The above case law review indicates that the concept of a 'reimbursement agreement' is extremely broad in that:

a. a payment of money can include an offset (*East Finchley*). This can apply both against a taxpayer but also means that beneficiaries do not need to receive cash to have received their entitlement;

b. there is no requirement that the 'agreement' be legally enforceable, a non-binding understanding is enough (*Prestige Motors*);

c. there is no requirement that the trust exist at the time the reimbursement agreement is entered into (*Prestige Motors*);

d. the relevant tax avoidance purpose can be garnered from any party to the reimbursement agreement and it is not necessary that either the trustee of the relevant trust or the relevant beneficiary have that purpose (*Prestige Motors*). As lack of a tax purpose operates as an exclusion (only) from the scope of a reimbursement agreement, the effect of this wide approach to identifying tax purpose is that the exclusion is very narrow;

e. there is no need for the beneficiary with the relevant present entitlement to trust income, to be a party to the reimbursement agreement (*Idlecroft* and *Raftland*);

f. in determining whether a present entitlement arose out of a reimbursement agreement one uses a broad 'but for' test, i.e. but for the transactions which form part of the reimbursement agreement would the present entitlement have arisen? Additionally, such an approach is wide enough to capture present entitlements of default beneficiaries (*Idlecroft* and *Raftland*);

g. the concept of sham trust distributions can be used in conjunction with section 100A to impose tax on a trustee (*Raftland*): and

h. the ordinary commercial dealing exclusion from reimbursement agreement can be applied without importing a dichotomy between those dealings that have a (dominant) tax purpose versus those being ordinary (*Prestige Motors*).

4 Statutory interpretation case law

It is also relevant to highlight some of the case law on statutory interpretation, given there is disagreement between the ATO and taxpayers about how section 100A – particularly how the "ordinary family and commercial dealing" exclusion - should be interpreted.

4.1 General

The following passage from the judgment of French CJ and Hayne J in *Certain Lloyd's Underwriters Subscribing to Contract No IHOOAAQS v Cross*[16] is a typically accepted statement of the basic principles:

> [23] It is as well to begin consideration of this issue by re-stating some basic principles. It is convenient to do that by reference to the reasons of the plurality in Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue (2009) 239 CLR 27 ; 73 ATR 256 : 'This court has stated on many occasions that the task of statutory construction must begin with a consideration of the text itself. Historical considerations and extrinsic materials cannot be relied on to displace the clear meaning of the text. The language which has actually been employed in the text of legislation is the surest guide to legislative intention. The meaning of the text may require consideration of the context, which includes the general purpose and policy of a provision, in particular the mischief it is seeking to remedy.
>
> [24] The context and purpose of a provision are important to its proper construction because, as the plurality said in Project Blue Sky Inc v Australian Broadcasting Authority : 'the primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of all the provisions of the statute.' That is, statutory construction requires deciding what is the legal meaning of the relevant provision 'by reference to the language of the instrument viewed as a whole,' and 'the context, the general purpose and policy of a provision and its consistency and fairness are surer guides to its meaning than the logic with which it is constructed.'

The following comments by French CJ (who was not part of the plurality cited above) from *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue*[17] also reflect that same accepted general approach to interpreting a statute:

> The starting point in consideration of the first question is the ordinary and grammatical sense of the statutory words to be interpreted having regard to their context and the legislative purpose. That proposition accords with the approach to construction characterised by Gaudron J in Corporate Affairs Commission (NSW) v Yuill [172 CLR 319 at 340] as:
>
> " … dictated by elementary considerations of fairness, for, after all, those who are subject to the law's commands are entitled to conduct themselves on the basis that those commands have meaning and effect according to ordinary grammar and usage."
>
> In so saying, it must be accepted that context and legislative purpose will cast light upon the sense in which the words of the statute are to be read. Context is here used in a wide sense referable, inter alia, to the existing state of the law

[16] [2015] HCA 52 at 23 and 24
[17] [2009] HCA 41 at 4

and the mischief which the statute was intended to remedy. [CIC Insurance Ltd v Bankstown Football Club Ltd (1997) 187 CLR 384 at 408 per Brennan CJ, Dawson, Toohey and Gummow JJ]

4.2 Interpreting a specific term – *Hunger Project Australia*

A case where the use of a specific term from one context was rejected when sought to be applied in another was *Commissioner of Taxation v Hunger Project Australia*[18]. In that case, the relevant term was "public benevolent institution". Relevant extracted comments follow:

> [38] Whilst past judicial statements concerning the ordinary meaning of a word or expression can often assist in divining the meaning of the word or expression, the common understanding of the meaning of an expression may change over time depending on the particular expression in question. When the question is whether a particular institution is a public benevolent institution, the answer depends on the common or ordinary understanding of the expression at the relevant time. The question is not to be approached as a legal question to be dealt with by the mechanical application of past authority, irrespective of the present current understanding of the expression in the currently spoken English language: Ambulance Service (NSW) v Deputy Commissioner of Taxation (2002) 50 ATR 496 at [40]-[42] (**Ambulance Service**).[19]
>
> …
>
> [41] As for the reliance on s 8(5) of the EDA Act, it is difficult to see how the terms of a different Act dealing with a different taxation regime can assist in divining the common or ordinary meaning of the expression public benevolent institution in the FBTA Act. The fact that in 1928 the legislature chose to separately exempt from estate duty, inter alia, a "public benevolent institution" and a "fund established and maintained for providing money for the use of such institutions" does not mean that the common understanding of a public benevolent institution over eighty years later cannot include an institution that is primarily involved in fund raising.[20]
>
> …
>
> [45] We should add that we do not consider that it is correct to approach the issue of the ordinary meaning or common understanding of an expression used in a statute as if the answer can necessarily be gleaned from the apparent intention of Parliament in the statute, or other statutes that may use the expression. As Allsop J, as his Honour then was, put it in Ambulance Service at [80], the inquiry is not "a legal question based on defined criteria or a question the answer to which is capable of being divined from the intention of Parliament in a statute, but, rather, to be part of an enquiry as to the meaning or usage of a phrase in the language, though one illuminated by legal authority."[21]

This approach adopted by the Full Federal Court in *Hunger Project* is entirely consistent with the doubts expressed in *Prestige Motors* - that the meaning of "ordinary family or commercial dealing" in section 100A today cannot be draw from *Newton's* case (decided 62 years ago), with its tax purpose orientation derived from the "purpose or effect' context in section 260 (a different section, which did not itself even include those words – they were only used in the judgement).

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[18] [2014] FCAFC 69
[19] [2014] FCAFC 69 at paragraph 38
[20] [2014] FCAFC 69 at paragraph 41
[21] [2014] FCAFC 69 at paragraph 45

The proper wording and context of section 100A and the "*present current understanding of the expression"* (from paragraph 40 as extracted above), must be taken into account when applying the exclusions from reimbursement agreements based on "ordinary family or commercial dealing".

5 Step by step guide to applying section 100A and observations

From the structure of Section 100A, and from the comments in the case law (particularly *Prestige Motors*), it is the authors' view that section 100A must be applied in a methodical, step by step process. To summarise that process by way of flow or step chart:

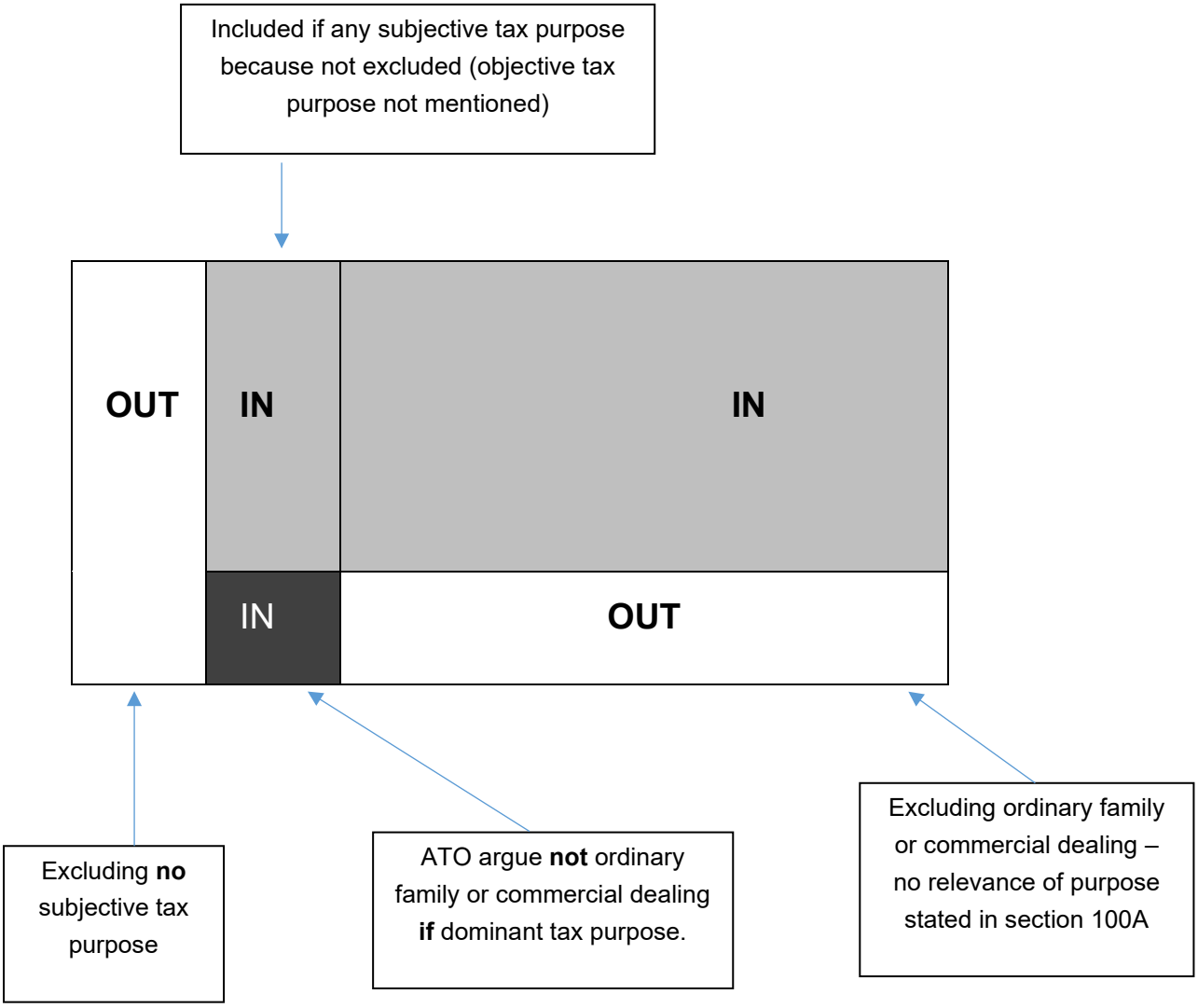
Step	Section reference	Description	If yes	If no
1	Section 100A(1)(a)	Is there a beneficiary under a trust estate, who is not under a legal disability, that is presently entitled to a share of the income of the trust estate?	Move to step 2	Section 100A does not apply
2	Section 100A(13) - definition of agreement	Is there an "agreement, arrangement or understanding"?	Move to step 3	Section 100A does not apply
3	Section 100A(7) - definition of reimbursement agreement	Did the agreement provide for a payment or transfer of property to another person other than the beneficiary?	Move to step 4	Section 100A does not apply
4	Section 100A(13) - definition of agreement	Is the agreement entered into in the course of ordinary family dealings or ordinary commercial dealings?	The arrangement is not an "agreement" and section 100A does not apply	Move to step 5
5	Section 100A(8) - tax purpose	Was the agreement **not** entered into for the purpose of reducing the income tax payable of "a person"?	The arrangement is not a "reimbursement agreement" and section 100A does not apply	Move to step 6
6	Section 100A(1)(b)	Did the beneficiaries entitlement **arise out of** the reimbursement agreement?	Section 100A applies	Section 100A does not apply

Put another way, the questions in respect of a trust entitlement (1 above) are:

- whether there is a "reimbursement agreement" (2 and 3 above) – but excluding (a) where ordinary family or commercial dealings (4 above) and (b) where no tax purpose (5 above) and; and then
- whether the present entitlement "arose out of' or "arose by reason of" that agreement (or any act, transaction or circumstance that occurred in connection with, or as a result of the agreement) (6 above).

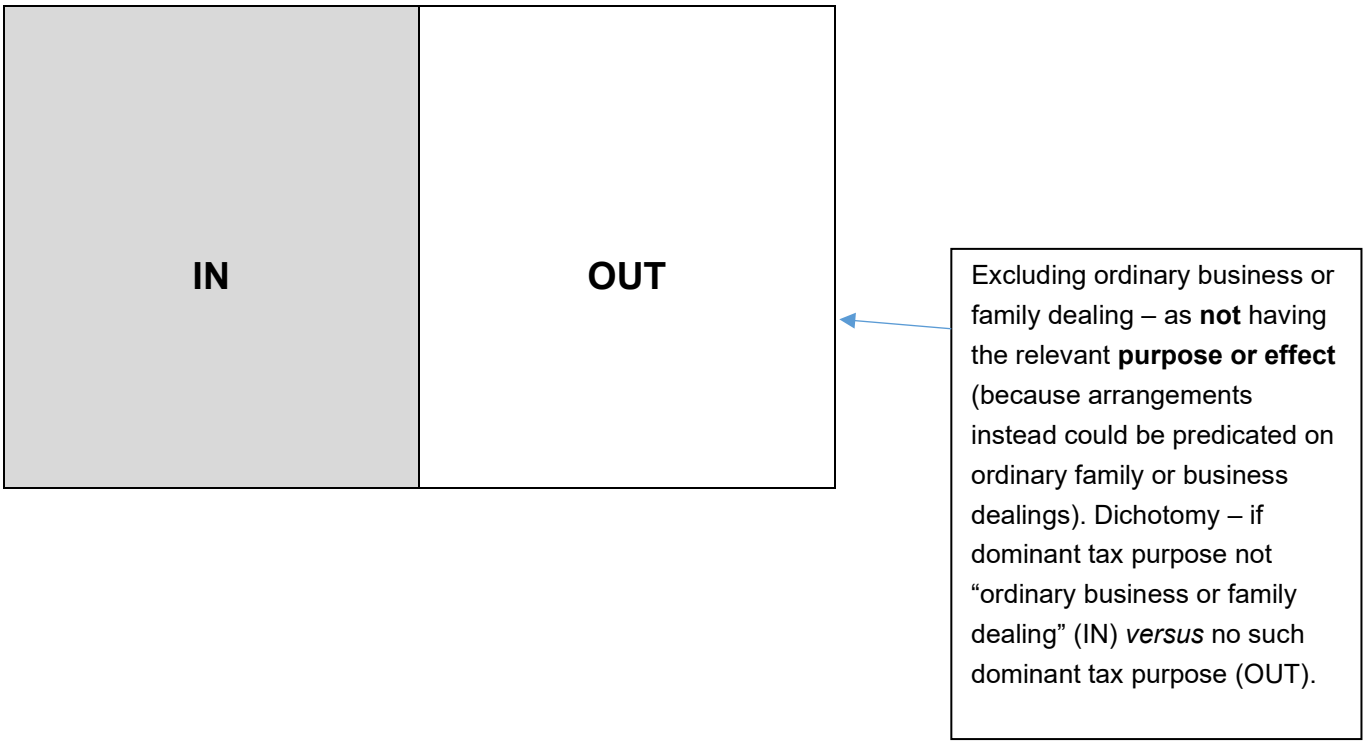
Diagrammatically, we suggest the section 100A concept of what agreements are included as reimbursement agreements can be represented as:

100A Reimbursement Agreement – starting point is an agreement ***that provides for certain specific actions*** *- 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 other persons.* ***Tax purpose or effect not relevant.***



In contrast, agreements, arrangements or schemes included for other anti-avoidance provisions, such as the previous section 260 and current Part IVA, can be represented as:

Section 260/Part IVA Arrangement/Scheme - starting point is an arrangement/scheme that has the **purpose or effect of altering tax.**



From the above, we submit the most common decision points in an application of section 100A will be:

- whether the actions in consuming/using the trust entitlement (which cause there to be a potential reimbursement agreement) are simply a unilateral act by the beneficiary – and so are not **provided for** as part of an **agreement** that can be a reimbursement agreement (2 and 3 above); and
- whether any agreement that did provide for those actions in consuming/using the trust entitlement is, in any case, excluded - because it was entered into in the course of **ordinary family or commercial dealings** (4 above); and

- whether the present entitlement **arose out of** or **arose by reason of** the reimbursement agreement (or any act, transaction or circumstance that occurred in connection with, or as a result of the agreement) (6 above).

6 Agreement and reimbursement agreement

The meaning of the complete phrase "reimbursement agreement" is drawn from two provisions within section 100A:

- section 100A(13), which provides a definition for "agreement"; and
- section 100A(7) which sets out when an agreement becomes a reimbursement agreement.

Those sections, when considered together, set out when a set of arrangements will be a reimbursement agreement.

6.1 What is an "agreement" in section 100A(13)?

Section 100A(13) defines "agreement as follows (our emphasis):

> "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**."

There are three features to note in the definition:

- "agreement, arrangement or understanding" is very broad drafting which is likely to capture most if not all arrangements;
- whether or not there is an enforceable arrangement is irrelevant – this means informal arrangements such as non-binding discussions between parties are potentially an agreement for the purposes of section 100A; and
- finally, an arrangement is *not* an agreement where it is entered into in the course of ordinary family or commercial dealings – which is considered under its own heading below.

The phrase "agreement, arrangement or understanding" is drafted very broadly and was likely intended to be drafted very broadly.

There is no case law which sets out what, if any, limits exist on this broad drafting.

The immediate comparison which comes to mind is the definition of "scheme" for the purposes of Part IVA. 'Scheme' is defined in section 177A as follows:

> '"scheme" means:
>
> (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
>
> (b) any scheme, plan, proposal, action, course of action or course of conduct.'

As readers will know, this definition is very broad – and its very broad application has been confirmed repeatedly by the courts. **Paragraph (b) of the definition in particular allows for unilateral actions to constitute a scheme**.[22] For example, you do not need another person involved to have a "plan".

A scheme even can include ordinary family or business dealings (this is obviously a very key distinction between Part IVA and section 100A).[23]

In our view, the definition of agreement within section 100A is narrower than "scheme" in Part IVA, even putting aside the express exclusion of ordinary family or commercial dealings for section 100A. In particular, the absence of an equivalent of section 177A(b) in section 100A potentially narrows the possible application of section 100A.

Unilateral schemes can be caught by Part IVA in part because of section 177A(b) including language such as "plan", "course of action" or "course of conduct". The absence of similar language in section 100A begs the question whether section 100A can apply where the claimed arrangement consists solely of unilateral acts.

For example:

- a trustee making distribution decisions without the input of other parties, an inherently unilateral act (as the beneficiary does not have to consent to having amounts of income or capital appointed to them); and
- a beneficiary deciding what they then do with their entitlement, as their genuinely unilateral decision.

Conversely, precedent exists to establish that an arrangement must involve two or more parties.[24] This principle was cited with approval in the context of section 100A in *East Finchley*. Even the widest term "understanding", listed as it is with "agreement" and "arrangement", would require an understanding between two or more people.

It is likely the ATO response to a taxpayer putting this argument forward would be to point towards a pattern of behaviour between trustees and beneficiaries within a family – such as repeated occurrences over years of distributions to beneficiaries who then allow the funds that the distribution represents to be used for the benefit of/controlled by other family members.

But if each of the trustee and the beneficiary truly act unilaterally in their decisions to distribute and to not call upon payment respectively, such a pattern of conduct still does not constitute an - *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.*

While the correspondence of such unilateral behaviour for the mutual benefit would not be creditable in non-family (commercial) situations, it is entirely to be expected in family situations.

This exclusion from the meaning of reimbursement agreement of unilateral actions, in reinforced by the use of "provides for", as discussed below.

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[22] *Howland-Rose v FCT* (2002) 49 ATR 206
[23] *Peabody v FCT* (1992) 24 ATR 58
[24] *FCT v Lutovi Investments Pty Ltd* (1978) 140 CLR 434

6.2 Reimbursement agreements are concerned with "providing for" consumption/use

We will return later to the concepts of ordinary family dealings and ordinary commercial dealings, critical as they are to the definition of agreement in section 100A(13), but we first wish to discuss the legal consequence of the drafting of section 100A(7) – the immediate definition of a "reimbursement agreement".

To repeat:

> *"(7) 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 other persons."*

A "reimbursement agreement" therefore involves an agreement that:

- **provides for** certain actions or outcomes;
- those actions or outcomes are - a payment of money, transfer of property, provision of services or other benefit to pass to a person other than the beneficiary that is presently entitled.

The "provides for" element, fits with the views we have expressed above that, despite the wide meaning given to an "agreement", there must be two or more parties to that agreement. The agreement must be more than the internal thinking of an individual. It must be directed towards causing – providing for - the payment of money, transfer of property, provision of services or other benefit to pass to a person other than the beneficiary that is presently entitled.

We submit that the internal thinking of individuals (about a unilateral act they may choose to take) does not cause/provide for anything. Only some co-operation with at least one other can actually "provide for" the outcomes listed.

As for the outcomes listed, it needs to be fully appreciated that they are simply the everyday ways a person will *always* consume or use their assets or choose to pass value to another person.

When a person:

- buys something in a shop - they "pay money" to another person.
- pays a bill for themselves or a relative – they "pay money' and/or "provide benefits' to another person.
- donate money - they "pay money" to another person.
- give a gift of property – they "transfer property".
- help in the family business – they "provide services".

The scope of these outcomes is vast. But they are "just' (plain) outcomes. They are not coloured by or added to, by any tax purpose. (The narrow "no subjective tax purpose' exclusion operates later and separately.)

The main limitations to this extraordinarily wide potential scope of section 100A "reimbursement agreements" come by:

- the need that these outcomes be **provided for** in *an agreement* (partly discussed above, and with the **ordinary family and commercial dealings exclusion** discussed below); and
- the need that the subject trust entitlement **arise out of** *that agreement* (discussed below).

These limitations narrow section 100A to its intended effect.

But the starting point of these **outcomes** - as the essence of what defines a "reimbursement agreement" - is very significant to how section 100A should be interpreted.

Any analysis of section 100A faithful to the words of the section, must start with these objectively stated outcomes uncoloured by any purpose – and then narrow the scope of the section's application only in accordance with the limitations/exclusions stated in the text of the section. There are no further inclusions based on tax purpose. The only mention of tax purpose is for the (narrow) subjective non-tax purpose exclusion.

7 Ordinary family or commercial dealings

An arrangement is not an agreement for section 100A purposes if it is entered into for the purposes of an ordinary family dealing or ordinary commercial dealing. These two (separate) exclusions for ordinary family dealings and ordinary commercial dealings are likely to be a key area of dispute in any section 100A matter involving a family and require detailed consideration.

The relative paucity of case law considering the meaning of ordinary family dealings or ordinary commercial dealings leaves taxpayers and their advisors with a number of unanswered questions as to what exactly are "ordinary family dealings" and "ordinary commercial dealings" and how those concepts are applied within the context of section 100A.

It is necessary to start with an understanding of where the expressions "ordinary family dealings" and "ordinary commercial dealings" originated from – however for the reasons we discuss further below, this historical understanding is in our view of limited assistance in interpreting the expressions "ordinary family dealings" and "ordinary commercial dealings" in the context of section 100A.

7.1 Irrelevance of the *Newton* meaning of ordinary family (or commercial) dealings

As already noted in respect of the section 260 cases above, discussion around ordinary family dealings and ordinary commercial dealings traditionally starts with *Newton's* case.

However, it is our view that *Newton's* case provides little *useful* guidance in how to interpret section 100A, despite arguably being the judicial origin of the expression "ordinary family dealings" or "ordinary commercial dealings".

Newton's case was based on section 260, which was concerned with voiding arrangements entered into to avoid taxation. As a starting point, it should be noted that the section involved in that case (section 260) made no reference to ordinary family or business dealings.

Instead, ordinary family or business dealings was considered by the Privy Council in *Newton* in the context of the concept of "predication" – a concept which is no longer the core of the anti-avoidance rules (including section 100A). In *Newton*, the Privy Council considered that for section 260 you must be able to predicate that the arrangement was for the purpose of avoiding tax, if it was "***capable of explanation by reference** to ordinary business or family dealings*" then the arrangement was **not** predicated on the avoidance of tax, meaning section 260 could no longer apply.

This was a relevant dichotomy, **when considering section 260**. If the arrangement could be explained as an ordinary family dealing, it was held not to be for the purpose of avoiding tax, where purpose or effect was the relevant issue in the Privy Council's consideration of section 260. The section included those "purpose or effect" (of reducing tax) words when identifying the *contract, agreement, or arrangement* to which it applied.

This context of the now somewhat mothballed idea of "predication", in our view, materially impacts the value of *Newton* in considering what "ordinary family dealings" and "ordinary commercial dealings" are in the different context of section 100A.

The comments already noted above by Hill and Sackville JJ in *Prestige Motors* are a strong basis for hesitancy in seeking to rely on *Newton*. Those comments are repeated below in full below (our emphasis):

> "**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**. It is clear from both the judgment of the Privy Council and from the language of the High Court on the same case (*FCT v Newton* (1957) 96 CLR 578) that **s 260 was regarded as involving a dichotomy**. A transaction was either stamped as one entered into to avoid tax or as one about which it could be predicted that it was entered into in the course of ordinary family or commercial dealing. In the former case the transaction was caught by s 260 ; in the latter case it was outside the section. **We do not need to decide in the present case whether s 100A imports a similar dichotomy.** In particular we do not need to decide whether if an agreement is shown to have been "entered into the course of ordinary commercial dealing" , the operation of s 100A is spent, regardless of whether the commercial purpose was subsidiary to the purpose of tax avoidance. In our view, none of the transactions was entered into in the course of ordinary commercial dealing."

This is a most important paragraph in *Prestige Motors*. It starts by striking a note of caution that seeking to import the meaning of words used in the context of *Newton's* case into section 100A may lead to a misinterpretation – a prescient warning, in our view, given the comments below.

The paragraph then goes on to query whether section 100A imports the same dichotomy as section 260 – i.e. the predication issue.

The justices in *Prestige Motors* **explicitly refrained from ruling whether such a dichotomy existed.** But the fact the justices felt that they could determine that the dealings were not ordinary commercial dealings *without* ruling on this dichotomy is itself informative.

At the very least, it means *Prestige Motors* is authority that finding a tax (avoidance) purpose is not necessary for section 100A to apply. The dealings under consideration can be found to not be "ordinary" on other bases.

Unfortunately, *Prestige Motors* left unanswered the question whether a tax (avoidance) purpose *can be* a relevant consideration in determining whether an arrangement is (not) an ordinary family or commercial dealing.

But, equally, *Prestige Motors* is certainty *not* authority that a tax (avoidance) purpose alone prevents dealings from being ordinary (family or) commercial dealings.

The irrelevancy of the *Newton* sourced meaning of "ordinary family or business dealings" (with its "purpose and effect' orientation) to an interpretation of that terms in section 100A is supported (and beyond the mere warning in *Prestige Motors*) by the statutory interpretation cases discussed earlier. Those cases require:

- *"that the task of statutory construction must begin with a consideration of the text itself"*- and the text of section 100A does not require *or allow* the introduction of a tax purpose element into the meaning of "ordinary family or commercial dealings". It does not allow it, because to introduce that purpose element restricts the scope of the "ordinary family or commercial dealings" exclusion, so as to impermissibly expand the scope of section 100A *on a basis not to be found in the text*.

- *Hunger Project Australia* (decided after *Prestige Motors*) is authority against the very thing warned against by Hill and Sackville JJ in *Prestige Motors* - the importation of the meaning of a term from a completely different statutory context (and time). For section 100A, that is the importation of the meaning of "ordinary family and commercial dealings" from the section 260 context with its purpose based dichotomy.

7.2 Characteristics, not purpose

Again, as discussed in our earlier consideration of *Prestige Motors*, from the comments in the judgement following the extract above, the bases on which the ordinary commercial dealings exclusion was held not to apply were the objectively "non-ordinary" commercial characteristics of the whole of the arrangements.

Our view is that this is the correct way to apply section 100A – that it is the **characteristics** of an arrangement, **not the purpose** of the arrangement that determines whether it is an ordinary family or commercial dealing. In this way, weighing ordinary family dealings could be considered to be similar to weighing the nature of a deduction. It is the "essential character" of an expense that determines its nexus as incurred to derive income or in the course of carrying on a business, not the intention.

We raise this analogy because, that principle makes the deduction provisions workable, *consistent with the legislative text*, without overstating the factual analysis needed to apply the tax law.

It is to be expected a similar workable approach, *consistent with the legislative text of section 100A*, would be sought and favoured by the courts.

The structure of the text in section 100A is relevant

Earlier this paper we discussed what we see as the structure of section 100A and how the provision should be applied.

Of relevance here is the separation of tax avoidance purpose matters into a separate subsection 100A(7). In our view, this is a strong indication that a consideration of purpose is not part of interpreting "agreement" as defined in section 100A(13).

In effect, our reading of section 100A is that a consideration of whether an agreement has a tax avoidance purpose only occurs once the reader is satisfied that there is an "agreement" at all (as defined in section 100A(13), which of course excludes arrangements that are ordinary family or commercial dealings). This means the consideration of *purpose* is a separate exercise to the consideration of ordinary family or commercial dealings.

This, in turn, supports that it is the *characteristics* of the arrangement that determine whether it is an ordinary family dealing or ordinary commercial dealing, not the *purpose* of those dealings.

The simplest example of this is a disposal of an asset for no consideration – the characteristics of that disposal (that is, the absence of consideration) could contribute to an objective conclusion that it is not an ordinary commercial dealing, because it is inherently uncommercial to dispose of an asset for no consideration. Inversely, the characteristic of "no consideration" may lead to the conclusion that an

arrangement is an ordinary family dealing, because it is an ordinary characteristic of family dealings not to require consideration.

Prestige Motors supports this conclusion. It is how that case was actually decided – per our earlier discussion of the case.

7.3 What characteristics are "ordinary" in family dealings?

The concept of ordinary family dealings then requires further detailed thought.

As opposed to ordinary commercial dealings, "ordinary family dealings" has had effectively no judicial consideration – any case where it could have been an issue was instead decided on other grounds.

In line with the comments in *Prestige Motors*, taxpayers seeking to rely on the ordinary family dealings exclusion should expect to have to convince the courts that the arrangements are in fact explainable as – have objective characteristics of – "ordinary" family dealings.

In attempting to discharge that onus, there are a number of unanswered questions when it comes to ordinary family dealings which have to be confronted – for example, whether "ordinary" suggests that it is an objective test on a "whole-community" basis, or whether "ordinary' refers to what is ordinary for a specific family (i.e. is it a subjective test).

In the context of other areas of law, in particularly succession law, the courts have been willing to consider what we would refer to as "natural law". For example, the development of family provision applications (by which a family member may seek a greater share of a deceased's estate) had its origin in a view that a parent had a natural obligation to make provision for their child or spouse. This "natural law" obligation was an obligation that the courts thought appropriate to enforce.

The authors of this paper query whether, in considering what constitutes ordinary family dealings in the context of section 100A, the courts would cast back to these "natural law" principles.

We would argue that it is an ordinary family dealing *in a modern context* for;

- for the "caretakers" of family wealth (typically parents) to be trusted to manage the family wealth for best possible return and use – conduct which is undertaken based on the very natural goal of seeking to maximise family wealth through prudent management to, among other things, ensure sufficient finances for future emergencies, care for family members who cannot finance their own care (due to age, illness or mental incapacity) or preserve value for successive generations of the family.
- for all family members to contribute to the family wealth – not just parents to children, also adult children to parents/wider family.
- for unexpended the family wealth to be returned to/concentrated in a family trust, including possibly the family trust from which the trust entitlements originally flowed – as that trust structure, by which no one family member owns that wealth, may best provide (non-tax based) protection against the risks of claims against any one family member.

Family members, including beneficiaries of family trusts, can naturally be expected to cooperate in these endeavours for the simple reason that families have long term emotional connections. If a more mercenary view is required, family members do so because, by participating in this management, the family member can expect benefits to return to them if they require them in the future, due to illness or incapacity, or through intergenerational wealth transfer. Either way, joint management and consumption of their assets and income it is what families do, in the ordinary course.

If a family cooperating to prudently preserve and deploy its wealth is ordinary, then the scenario where a trustee makes a beneficiary presently entitled to income, that beneficiary not calling on that entitlement to be paid, but instead allowing the value that entitlement represents to be used for family purposes, should (in the authors' view) be taken to be an ordinary family dealing.

It is also part of this family co-operation that family members often do not require a detailed accounting of their entitlements - as long as there is trust in the "caretakers" of the family wealth (typically parents).

Ideally, the authors hope the courts interpret "ordinary family dealings" in section 100A as an objective concept by reference to a typical family.

The alternative, a subjective basis or requiring evidence of what is ordinary for each individual family, would require families to detail and provide evidence of internal family dealings – which by their nature are intensely private matters (e.g. affected by illness, divorce, relationship issues, etc) – in the public domain of the courts.

Referring again back to the treatment of deductions where subjective purpose is sometimes considered where the objective nexus is not apparent, it may be that the courts will establish an objective concept by reference to a typical family but entertain specific and subjective evidence of what is ordinary in a particular family where the facts vary from that objective concept.

7.4 Examples

At this point, a couple examples might assist.

Example 1

Consider the following facts:

- Anna Bloggs is a partner of Bloggs and Associates, a professional partnership.
- Anna Bloggs is the trustee of her practice trust, Bloggs Practice Trust.
- Anna Bloggs' father (Jeff Bloggs) is elderly and infirm and requires frequent care but still has legal capacity.
- The Bloggs Practice Trust, is a source of funds that can pay for Jeff Bloggs' ongoing care requirements.
- Anna Bloggs, in her capacity as trustee for the Bloggs Practice Trust, resolves to distribute $180,000 of income to her father. Jeff Bloggs is informed of his right to demand payment of

the entitlement but chooses not to exercise it. Trusting his daughter completely, he instead confirms/directs that his entitlement is satisfied by its application within the family in the manner controlled by Anna Bloggs and that if there is any unapplied balance, that that balance be contributed as corpus to the Bloggs Practice Trust (for future use within the family). Jeff does not require a detailed accounting of the application of his entitlement**.**

- Jeff Bloggs and Anna Bloggs agree that the cost of paying Jeff Bloggs' ongoing care will be part of the application of the entitlement owed to Jeff Bloggs.
- The parties pay no heed to how these transactions should be accounted for during the year – which is not unusual for family dealings.

Applying section 100A:

- there is a present entitlement to a beneficiary (section 100A(1)(a) is satisfied).
- if the actions of Anna and Jeff are not unilateral actions, there may be an agreement between Anna Bloggs, Jeff Bloggs, and potentially the care provider (the first limb of the definition of agreement in section 100A(13) is satisfied).
- again, if the actions of Anna and Jeff are not unilateral actions, the agreement may also be taken to **provide for** the payment of money to a person other than the beneficiary Jeff Bloggs (Anna or the care provider).
- Anna Bloggs knew that distributing income to Jeff Bloggs would reduce the total income tax payable on the earnings of the Bloggs Practice Trust – hence the "no tax purpose" exclusion does not apply.
- To be discussed next - if Anna would have distributed to Jeff anyway, fully accepting he may demand his entitlement be fully paid in cash, then the trust entitlement may not **arise out of** the reimbursement agreement.
- Anna Bloggs knew that she could have distributed all the income to herself and paid her father's care expenses out of her own after tax income.

Assuming the "unilateral action" or "arose out of" points do not prevent section 100A applying, the question then is whether this arrangement is an ordinary family dealing.

If you accept the (*Newton* based) view that *a dealing driven by a tax purpose cannot be an ordinary family dealing*, the arrangement in this example would not be an ordinary family dealing – because the decision to offset the care expenditure against Jeff's entitlement was arguably driven by the lower tax cost.

This to our mind is an incorrect outcome. We would argue:

A taxpayer/family is not forced by section 100A to adopt an approach that results in the maximum amount of tax payable (i.e. that Anna receive the entitlement).

Any agreement about outcomes by which Jeff allows his entitlement to be applied to family purposes, including to his own care, has been entered into in the course of *objectively* ordinary family dealings. It is usual that families will share and collectively consume family resources, as part of supporting each other.

In such a family context, such sharing and the disinterest by Jeff in a detailed accounting of the application of his entitlement, is not an indicator of any artifice or sham or of “non-ordinary” family dealings. It merely reflects the trust within the family.

Example 2

Consider the following facts:

- David Blacksmith is a partner of Blacksmith and Associates, a professional partnership.
- David Blacksmith is the trustee of both his practice trust, Blacksmith Practice Trust and the Blacksmith Family Trust.
- David has a wife Mary who works part-time.
- David and Mary have two audit children studying full-time at university, one of whom is living at home and one of whom is in a serious relationship with and is living with their de facto partner. Both children work in casual jobs while studying.
- The family shares and consumes its resources collectively, so that the two children are supported by the family.
- In this context, the David, as trustee, typically distributes the income from the Blacksmith Practice Trust each year to each family member to bring their taxable income up to $180,000, with the excess shared between David and Mary.
- No family member receives any Centrelink support.
- The parties pay no heed to how these transactions should be accounted for during the year – which is not unusual for family dealings.
- However, the family is also concerned to accumulate, protect and manage the family assets generated from income not immediately used/consumed, against potential claims that may be made (including from relationship breakdown).
- Each family member is advised each year of their trust entitlement and their right to demand that entitlement in cash - but typically authorises how any monies have been used within the family during the year and directs any unexpended entitlement be contributed into the Blacksmith Family Trust for future family use.

Applying section 100A:

- there is a present entitlement to a beneficiary (section 100A(1)(a) is satisfied).
- if the actions of David and the other family beneficiaries are not unilateral actions, there may be an agreement between them (the first limb of the definition of agreement in section 100A(13) is satisfied).
- again, if the actions of David and the other family beneficiaries are not unilateral actions, the agreement may also be taken to **provide for** the payment of money to a person other than the beneficiary (the rest of the family or the Blacksmith Family Trust).
- David Blacksmith knew that distributing income across the family would reduce the total income tax payable on the earnings of the Blacksmith Practice Trust – hence the “no tax purpose” exclusion does not apply.

- To be discussed next - if David would have distributed across the family anyway, fully accepting they may each may demand their entitlements be fully paid in cash, then the trust entitlement may not **arise out of** the reimbursement agreement.

Again assuming the "unilateral action" or "arose out of" points do not prevent section 100A applying, the question then is whether this arrangement is an ordinary family dealing.

If you accept the (*Newton* based) view that *a dealing driven by a tax purpose cannot be an ordinary family dealing*, the arrangements in this example would likely not be ordinary family dealings – because the decision to decision to distribute across the family was driven by the lower tax cost.

This to our mind is an incorrect outcome. We would argue:

A taxpayer/family is not forced by section 100A to adopt an approach that results in the maximum amount of tax payable (i.e. that David, or David and Mary, only receive the entitlement).

Any agreement about outcomes by which the family – including the two adult children – allow their entitlements to be applied to general family purposes, including for their own individual support, has been entered into in the course of *objectively* ordinary family dealings. It is usual that families will share and collectively consume family resources, as part of supporting each other.

In such a family context, such sharing and the disinterest by the individual family members in a detailed accounting of the application of their entitlements, is not an indicator of any artifice or sham or of "non-ordinary" family dealings. It merely reflects the trust within the family.

8 Entitlement arose out of

8.1 Even if an agreement – does "arose out of" nexus exist?

The subject present entitlement must be one that "arose out of' or "arose by reason of" the reimbursement agreement (or any act, transaction or circumstance that occurred in connection with, or as a result of the agreement).

Even if a reimbursement agreement is held to exist and to include the distribution decision, it may be that the distribution to the beneficiary would have still been made, regardless of the way the beneficiary consumed or used their trust entitlement (that consumption/use being the essence of the reimbursement agreement).

This is a further reflection of the way that family members may act unilaterally, but co-operatively in their mutual interests, as discussed in respect of the meaning of "agreement".

Recall the comments above, based on *Idlecroft* and *Raftland*, that in determining whether a present entitlement arose out of a reimbursement agreement, one uses a broad "but for" test.

That is - but for the transactions which form part of the reimbursement agreement - would the present entitlement have arisen?

While it may have limited application in commercial situations, within a family, the controllers of a trust may often still be prepared to distribute to a family member:

- where there is an understanding or expectation of how the beneficiary would likely use their entitlement;
- but where it is still accepted the family member would be entirely free to use their entitlement at their sole discretion.

In those circumstances, can it correctly be said that the entitlement (the distribution decision) **arose out of** the reimbursement agreement?

If the trustee would have distributed the same way – for family reasons – regardless, we would submit not. In that case, the distribution would have been made and the entitlement would have arisen even if the reimbursement agreement had not existed.

Acceptance - for personal reasons of family affection, family obligation, etc – of the "risk" of the family member not complying with any understanding or expectation, breaks the "arose out of" nexus between any reimbursement agreement and the creation of the entitlement.

In such circumstances, it could **not** be said that - **but for** the transactions which form part of the reimbursement agreement - the present entitlement would not have arisen.

These are important issues that need addressing in family situations in determining whether a present entitlement is one that "arose out of' or "arose by reason of" any claimed reimbursement agreement.

Even though the meaning of "agreement" may be wide enough to extend as far as unenforceable and implied understandings of which a trustee may be party, the very loose nature of such an "agreement" is consistent with a trustee, who still chooses to make a distribution in family situations (based only on such an "understanding"), having made that distribution independently of any such "agreement" – and instead because of reasons of family affection, obligation, etc.

Tax purpose plays no part in these considerations. Even if a distribution has been calculated by reference to the tax position of a family member, that is irrelevant to establishing the nexus from the entitlement to the reimbursement agreement – that is, it is irrelevant to whether the entitlement "arose out of' the reimbursement agreement.

If the facts support that the trustee, in making the distribution, did so accepting that the family member was entirely free to use their entitlement at their sole discretion – accepting that any compliance with unenforceable implied understandings (the "agreement") would ultimately be the unilateral choice of the beneficiary (regardless of what the trustee may hope the beneficiary will do) - then we submit the "arose out of" nexus cannot exist.

8.2 Examples

A couple of final examples to illustrate this point:

Example 3

A trustee distributes to a family member in the full knowledge that the family member intends to make a $10,000 tax deductible donation to a charity. The distribution is specifically made to provide the family member with the funds to make that donation.

If there is a reimbursement agreement in respect of this intended use by the beneficiary of their $10,000 entitlement (which we would argue is not the case, because the donation is a unilateral act of the beneficiary and not part of an agreement), then it is difficult to see how gifting money away could be either an ordinary *family* or *commercial* dealing.

Making a donation may well be an ordinary dealing for some people but that action/outcome does not have features that make it ordinary as a *family* or as a *commercial* dealing.

Section 100A would then only be prevented from taxing the $10,000 to the trustee by there being no nexus by which the entitlement "arose out of'" the reimbursement agreement. That is, even though the trustee was aware of the intended donation – and has facilitated that donation by making the distribution – the decision to distribute has solely arisen to provide the beneficiary with the $10,000 **for their use as they choose**.

It does not follow that, because a trustee has certain understandings or expectations of how a beneficiary may use their entitlement, the distribution to that beneficiary has arisen out of (but for) any agreement around that understanding/expectation.

Example 4

A trustee distributes to a family company with a $100,000 tax loss. The trustee also controls the loss company with other family members.

The requirements of the trust loss provisions (e.g. the outsider rules) are satisfied to allow recoupment of the tax loss against the trust distribution.

The loss has been funded by loans made to the company by family members, so the ultimate flow of funds will be back to those family members by repayment of their loans.

The trustee knows both that (a) the funds are likely to flow to the family members to repay their loans; and (b) by distributing to the loss company, instead of directly to the family members who will have their loans repaid, those family members will not pay tax on the amount equal to the distribution.

The action/outcome elements of a reimbursement agreement seem to be made out, in that there are to be payments by the loss company beneficiary to other people - the family members owed the loans.

We would argue there is still not a reimbursement agreement, because the repayments are still a unilateral act of the company beneficiary and not part of an agreement.

But, if that view were wrong, then section 100A needs to be further considered.

If the ATO view – that tax purpose excludes agreements from being ordinary family or commercial dealings – is correct, then this would be a scenario in which there is a clear tax purpose in achieving the same ultimate outcome – that the family members receive amounts equal to their loans. This would seem to mean that, on the ATO view, the ordinary family or commercial dealing exclusion could not apply.

Aside from our disagreement with this ATO view, section 100A's (ir)relevance to this scenario can, in any case, be properly deal with by acknowledging that the distribution has still not arisen out of any reimbursement agreement. Instead, the distribution as arisen fully and only to provide the loss company beneficiary with its entitlement.

The trustee may have an understanding and expectation of what the loss company will do with its entitlement, but the distribution has been made fully accepting that the company may choose to take other actions at its sole discretion. Accordingly, the distribution has *not* arisen out of (but for) any agreement around that understanding/expectation of what the company would do with its entitlement.

9 Current section 100A climate - managing risk in that climate

The ATO has a number of audits running on section 100A issues in respect of distributions by family trusts to individuals and companies within a family group. In our experience, current targets are professionals – e.g. lawyers, accountants, engineers.

At least some of these audits have been running for over two years, flowing out of "reviews' started even earlier.

The ATO claims it has given guidance on section 100A by:

- an August 2015 factsheet that first floated the section 100A examples later transferred to (and still on) the ATO website (since 12 May 2016 per the website); and
- various presentations by senior ATO Tax Counsel Network (**TCN**) officers since June 2016.

But this supposed guidance has consistently failed to provide detailed technical analysis of the law supporting the concerns raised by the ATO.

Such a detailed technical basis was/is called for because:

- of the lack of relevant case law;
- the views expressed in the statements/examples are not apparent from the face of section 100A; and
- of the inconsistency of the ATO's more recent statements/examples with how the ATO has acted over the past 40 years.

The ATO has promised a ruling on section 100A since October 2018 (although we note the ATO website has now been updated to remove disclosing this starting date) but issue of a draft has been continually deferred. The current expected date is July 2021.

All taxpayers should expect the ATO will continue to threaten section 100A audits. The activity seems be part of a new drive by the ATO to alter the operation of trusts, even though there has been no legislative change.

The ATO is using what appears to be a standard template for these section 100A audits which typically, initially at least, includes a plan for formal recorded interviews of family members under oath by ATO counsel. The ATO has conducted numerous of these interviews in our experience.

The audit management plans extend over a year or so but, in our experience, have been constantly extended to longer periods – as the ATO continues to delay its public ruling on section 100A.

Based on our views, as expressed in this paper, we would advise;

- Taxpayers should now be much more rigorous in documenting how beneficiaries are aware of and direct the use of their trust entitlements (the "back end"), just as we have had to become more rigorous in respect of resolving trust distributions (the "front end") "post Bamford".

- Each year, each beneficiary should be advised in writing of their trust entitlement.
- Ideally, to support that any dealing with that entitlement is the beneficiary's **unilateral act** (and not part of some agreement providing for the outcomes of a reimbursement agreement), the beneficiary should acknowledge in writing their understanding that they can demand their entitlement in cash. (It would assist if there is also evidence the trust has the capacity to pay the entitlement in cash.)
- If a beneficiary has not received their entitlement fully in cash but has instead allowed it to be applied for the benefit of others (e.g. within the family) the beneficiary should expressly authorise that application in writing, as their **unilateral act**.
- Ideally, in support that the trust distribution did not **arise out of** any reimbursement agreement, the trustee should be prepared to confirm and support that they distributed to the beneficiary in the full expectation of paying the beneficiary their entitlement in cash, if called for by the beneficiary - accepting that any other outcome would be entirely a choice of the beneficiary.
- Also, a trustee should be prepared to confirm that their distribution decision is not related to any services the beneficiary may have provided/will provide to any party (e.g. to a family business) - but only flows from their status as a beneficiary.
- In case a court requires evidence of what is "ordinary family dealings" for the particular family - recording (at least in material terms) the pattern/history of sharing of the family resources within the family would be useful. But this does not mean families need to track all of their collective expenditure and/or (recall *East Finchley*) that beneficiaries need to have received all their entitlements in cash.

