INFORMATION EXCHANGE
Step Up to Advice

AUSTRALIAN TAX ADVISER

2301: JULY 2022

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IN THIS ISSUE

Continued

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IN THIS ISSUE

SECTION 1 – PROFESSIONAL DEVELOPMENTS

SECTION 100A OF THE INCOME TAX ASSESSMENT ACT 1936

In recent years, the Tax Office has been scrutinising trust distributions that are in possible contravention of s 100A of the ITAA36. Case law on the topic is frequently difficult to follow, since many of the trust arrangements scrutinised by the courts are complex and involve cross-border transactions.

The Tax Office and practitioners both agree that the rules regarding the taxation of trusts are antiquated and cumbersome, and in need of an urgent overhaul. Indeed, the rules regarding the taxation of trusts are still located in the 1936 Income Tax Assessment Act with its complex numbering and antiquated language.

To understand the issues surrounding s 100A, it is necessary to briefly look at the rules regarding trusts generally.

¶1.1 The rules regarding trusts

The first rule is that trusts do not pay tax; the net income of the trust estate is taxed either in the hands of the beneficiary receiving the distribution or the trustee in cases where no beneficiary is presently entitled to that income. In the latter case, the trustee is usually taxed under s 99A of the ITAA36 at the top marginal rate plus Medicare (i.e. 49%).

Trusts can either be discretionary, fixed or a mixture of the two (sometimes referred to as 'hybrid trusts). Since s 100A does not apply to fixed trusts, no further explanation of these trusts is required for the purposes of this article. Discretionary trusts may vary depending on the scope of the discretions afforded the trustee. It is, however, common to confer on the trustee the discretion to decide both the quantum and the destination(s) of the net income of the trust estate. This allows for the streaming of income to those beneficiaries with the lowest tax rates, thus lowering the overall tax liability in the structure.

In situations where the intended beneficiary already had a level of taxable income that results in that beneficiary paying a high rate of tax, trustees strove to overcome this in one of two ways:

1. resolve to pay the distribution to a beneficiary with a lower tax rate; or
2. introduce a beneficiary that did not pay tax (such as an endorsed charity).

The actual beneficiary would then enter into a reimbursement agreement under which some or all of the distribution would be returned to the trustee, who would then allocate those funds to the intended beneficiary by way of a loan.