How Section 100A operates and how it may affect your trust.

If you have a family trust, you may have heard of Section 100A of the 1936 Tax Act introduced in the late 1970s to prevent a specific type of anti-avoidance scheme.

Its purpose is to prevent trustees from distributing income to beneficiaries who are subject to a lower marginal tax rate rather than the beneficiaries who receive the funds - such as cash or assets - and are therefore intended to pay tax on them.

The ATO has provided a traffic light system: red, white and green zones to best describe the likelihood of your trust being reviewed.

To further help your understanding of Green and Red light risks, some examples of green and red light scenarios on how trust arrangements can impact tax compliance are shown below.

GREEN light

Scenario 1

A green light scenario for a trust is when the trust's distributions are made in accordance with the terms of the trust deed with the beneficiaries using the funds for their benefit, such as paying for education expenses or medical bills.

The trustee also keeps detailed records and documentation of the trust's operations and transactions and complies with all tax laws and regulations.

For instance, let's say that John sets up a trust to provide for his children's education expenses. The trust's deed specifies that the trustee may distribute funds for this purpose and John's children are the only beneficiaries of the trust.

Each year, the trustee distributes funds directly to the educational institution where the children are enrolled and keeps detailed records of these transactions.

In this scenario, the trust is operating in the green light zone because the trustee is complying with the terms of the trust deed and using the funds for the beneficiaries' benefit.

Additionally, the trustee is keeping detailed records and documentation of the trust's operations demonstrating compliance with tax laws and regulations if the trust is audited by the ATO.

Scenario 2

A family has set up a trust to manage their wealth and provide for their children and grandchildren. The trust is set up according to the terms of the trust deed and distributions are made to beneficiaries in a manner consistent with the deed.

The beneficiaries use the funds for their education, housing and other needs with clear documentation of all transactions.

The ATO considers this trust to be in the green zone as it is compliant with the law and low risk.

RED light

Scenario 1

An example of a red light scenario could be a trust arrangement where the trustee distributes income or assets to a beneficiary in a manner that is not consistent with the terms of the trust deed or where the funds are used for non-beneficial purposes.

For instance, if a trustee distributes income or assets to a beneficiary for their personal use, such as purchasing a car or paying for a vacation, instead of using it for its intended purpose, such as investing in the trust's assets or funding a business, it could be considered a red light scenario.

The ATO may investigate such arrangements to determine whether they comply with tax laws and regulations.

Scenario 2

A wealthy individual sets up a trust in an offshore tax haven to avoid paying tax on their income. The trust is not set up according to the terms of the trust deed and the beneficiaries use the funds for personal expenses such as luxury cars, jewellery or travel.

There is little documentation of the trust's transactions and the trustee fails to disclose information to the ATO. The ATO considers this trust to be in the red zone as it is non-compliant with the law and high risk.

Scenario 3

Another example of a red light scenario could be a trust that distributes income to beneficiaries who are not entitled under the trust deed, or where the beneficiaries use the funds for personal expenses that are not for their benefit such as repaying personal debts or funding a lavish lifestyle.

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