Tel: (08) 9444 9711
Web: www.infocusaccounting.com.au

IN THIS ISSUE

CONTRACTS MATTER IN RELATED PARTY DEALINGS

It can be a rare thing to have all the assets of a business held by one entity. Often the business structure contains various entities that own different elements of the business such as the intellectual property or the business premises. The use of service entities has waned in recent years however many still exist.

Invariably one group entity will charge a fee to another group entity for the use of its assets. The controllers of those entities are generally the same people, so everyone understands what the deal is, right? Is that enough to claim a tax deduction for the fee though?

There were muted celebrations when a case last year found that the documentation requirements for related party dealings, particularly for small and medium enterprises, should not be as onerous as the requirements for large enterprises. The Federal Court recognised informal arrangements and accounting practices could be sufficient to underscore a genuine commercial arrangement, with some suggestion that the ATO should understand the commercial realities of SMEs.

The celebrations were muted due to the expectation that the ATO would appeal the decision, and the appeal findings have now been made in the Full Federal Court.

The case involved a group involved in real estate where intellectual property such as trademarks and the rent rolls were held by different trusts. These trusts would charge service fees to the operating real estate entities for the use of those assets. From 2005-2015 all parties had written licence agreements in place, however due to an apparent oversight, they were not renewed when the contracts ended, and instead an oral agreement was entered into.

Service fees continued to be charged, and the ATO disallowed them as deductions in the 2016-2019 years. The Court does not provide any weightings, but of great interest is that the calculation of the service fees post-contract differed significantly from the expired contracts. The taxpayer argued that the new service fees, of "up to 8% of the value of the business", was based

on the advice of an external accountant. The actual amount of the service fees differed greatly from year to year without any coherent reasoning as to why.

The Court found there was not enough evidence that the entities had agreed to form a contract with terms outlining what a fair and reasonable fee for the services were.

The concept of a service fee being worth "up to 8% of the value of the business" being reasonable could not be backed up with any evidence.

The Court found no evidence of communication between the directors of the relevant entities that there would be a liability in relation to service fees, and the directors could not explain how the service fees were calculated. In addition, the service fees entered into the accounts of the entities appeared to not reflect an actual transaction that may occur under a contract, as there were no tax invoices issued in relation to the service fees as one might expect there to be.

The Court accepted the ATO's appeal and the service fee deductions were denied.

Where does this leave deductions from inter-entity arrangements? Well, right where they were. The best form of proof is a written contract, where the reasonableness of any service fees can be backed up with evidence, and the entities actually act in accordance with the contract. Removing any of these elements means replacing written evidence with oral evidence, which will have a lot less weight considering these are related party dealings.

Now would be a great time to review any inter-entity arrangements you have, ensure they are documented, are still part of a valid contract, and consider whether the terms are reasonable.

If you would like to discuss this matter further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

FORGIVING AN UNPAID PRESENT ENTITLEMENT (UPE) DUE FROM A TRUST

In dealing with Family Groups, there may be occasions where a beneficiary who is owed a UPE from a Trust decides to release or forgive the trustee from that obligation. We see this arise when parents are retiring from a business operated in a Trust and are handing over control of the Trust to their children. They don't want to burden with the business with this obligation, nor do they want the UPE to become an asset of their estate once they pass.

The parent, with assistance from their solicitor, execute a Deed of Release or Forgiveness, releasing the trustee of their obligations to pay over the UPE. However, what are the tax consequences of such an action?

Section 100A of the ITAA 1936 has attracted significant attention amongst tax professionals in recent years. The ATO's much heralded ruling of December 2022, gave rise to a Practical Guidance note (PCG 2022/2) that provided a traffic signal approach to various actions undertaken by trustee with respect to distributions.

Section 100A of the ITAA 1936 provides that where a beneficiary of a trust estate, who is not under a legal disability, is presently entitled to trust income, and that present entitlement is linked either directly or indirectly to a reimbursement agreement, the beneficiary is deemed not to be presently entitled to the income. Trust distributions which fall within section 100A of the ITAA 1936 are assessed to the trustee under section 99A of the ITAA 1936.

Subsection 100A(7) of the ITAA 1936 defines a reimbursement agreement to include:

> *...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 persons.*

Section 100A (8) to (13) contains other provisions that are of relevance in the interpretation of the term reimbursement agreement. These provisions are to the following effect:

> *For the purpose of the definition of reimbursement agreement, the payment of money includes:*
>
> *a) the payment of money by way of loan (s100A (10)), and;*
>
> *b) the release, abandonment, failure to demand payment, or the postponement of payment, of a debt (s100A (12)).*

Based on the above, the release or forgiveness of a UPE could be within the scope of section 100A and could potentially result in the trustee being assessable on the amount forgiven/released.

However, a key part of the term Reimbursement Agreement is its timing, in that the agreement must be present when the trustee resolves to make the initial distribution and not at a later time.

As a result, whilst the forgiveness of a UPE carries a risk of the application of section 100A, evidence of a reimbursement agreement must exist at the time the entitlement was created. That is, when the trustee resolves to make the distribution to the beneficiary, at that time, there must exist a reimbursement agreement that is undertaken for a purpose, not necessarily the sole purpose, of generating a tax benefit.

Whilst the later forgiveness or release of a UPE will require consideration of section 100A, it is not the act of release or forgiveness on its own that is important, but whether it can be seen to part of the agreement entered into at the time of the original distribution.

In our view where a parent later chooses to forgive or release a UPE from many years ago, and one that may have been partially paid down, it would be very unlikely that it would be considered to be part of a reimbursement agreement, entered into when that distribution was initially resolved. This would especially the case where the forgiveness was undertaken as part of their will.

As always, the tax implications of a forgiveness of a UPE will depend upon its own factual circumstances and whether section 100A could apply must be considered at that point. It is interesting to note that the ATO in PCG 2022/2 state that a forgiveness or a release of a UPE will not fall within their low risk, Green Zone, regardless of its factual circumstances. Importantly though, it is not, on its own, a high-risk Red Zone action.

If you would like to discuss this matter further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

FBT – No Longer an Afterthought

Recent ATO crackdowns on nil and non-lodgers, together with expanded data matching and review activities, indicate that fringe benefits tax (FBT) obligations can no longer be treated as an afterthought. Increased ATO scrutiny of common compliance errors, alongside two landmark case decisions, is materially shaping the FBT landscape for the 2026 FBT year.

Expect additional scrutiny from the ATO in the areas of applying the "minor and infrequent" exemption, entertainment, dual cab utes, business travel, benefits to business owners, and journalised employee contributions to name a few. Additionally, the ATO's recent wins on appeals at the Federal Court confirm that benefits provided to business owners risk potential FBT liability.

The first case, FCT v SEPL Pty Ltd ATF the SFT Trust [2025] FCA 581 (SFT Case), re-examined two issues and sets an important legal precedent for family businesses that provide benefits to family members who are owners or controllers of the business. The two issues identified were whether the brothers (beneficiaries of the trust) were (1) employees of the trust; and if so, whether (2) the luxury cars were provided to them in respect of employment. It was earlier held in BQKD v FCT [2024] AATA 1796 (BQKD Case) that the brothers were not employees and that even if they were, that the cars were not provided in respect of employment.

However, the AAT's decision in the BQKD Case was overturned by the Federal Court in the SFT Case which held that under the extended definition of employee under section 137 of the FBT Act, anyone who receives a non-cash benefit that, if paid in cash, would be treated as 'salary or wages' would be an employee. This confirms that that scope of s 137 is not limited to common law employees but can also apply to directors as was the case in the SFT Case.

The common practice of journalising employee contributions made in relation to fringe benefits is also under more scrutiny. These journals will only be effective for FBT purposes where it is in the form of a journal entry "set-off" arrangement. According to ATO guidelines in MT 2025, the employee must have an obligation to make an employee contribution towards the fringe benefit, e.g. a company policy exists, or the employee has entered into a salary sacrifice arrangement. It is the employer's responsibility to prove that such an obligation exists, so documented evidence of this arrangement would support this. Furthermore, the employer must also have an obligation to pay a debt to the employee.

Where a journalised contribution creates or increases a debit loan balance to the employee, for the offset journal to be effective for FBT purposes, both parties **must explicitly agree in**

advance that the employer would grant a loan through the employee's loan account. We note that a debit balance loan in itself could create other issues such as a Division 7A deemed dividend, or it may constitute a loan fringe benefit. Importantly, the time the set off agreement is entered into is the time the employee contribution is made.

The minor and infrequent FBT exemption allows small, occasional benefits under $300 to be exempt from FBT if they are provided irregularly and it would be unreasonable to treat them as fringe benefits. Common benefits that may qualify for the minor benefits exemption include off premises meal entertainment (such as meals at cafés or restaurants) where the cost is less than $300 per person (incl. GST) and provided infrequently, occasional small gifts or vouchers under $300 that are not provided on a regular basis, and light refreshments supplied in the workplace that satisfy the value and infrequency requirements. Each benefit must be assessed on its own facts, having regard to frequency, total value, and whether any associated benefits are provided.

These benefits risk being ineligible for the exemption where they are less than $300 but are not infrequent. Examples include instances where employees are regularly given gift cards as part of a direct reward for the employee's services, or where a manager or director is frequently incurring meal entertainment as part of their role to promote their organisation. In these instances, the "infrequency" criteria will not be met and applying the minor benefit exemption could expose employers to unexpected FBT liabilities.

Another common myth is that dual cab utes are automatically exempt from FBT. However, this is not always the case. To qualify for FBT exemption, two conditions must be met. The dual cab ute must be:

1. An eligible vehicle, which means it is designed to carry: (a) a load of one tonne or more; (b) more than eight passengers (including the driver); or (c) a load under one tonne and not be primarily designed for carrying passengers.

2. Private use must be limited (i.e., minor, infrequent and irregular), such as the occasional trip to the tip or helping a mate move house.

Therefore, if a work dual cab ute "doubles as the family taxi or is used for weekend personal trips", **it is not exempt from FBT**. Where an employee's personal use of the dual cab ute does not meet **both** of the above exemption conditions, then the employer will be liable for FBT. [1]

These developments highlight the need for increased vigilance by both employers and advisers in identifying and managing FBT obligations. This requires a focus not only on meeting reporting and payment requirements, but also on ensuring that FBT exposures are accurately assessed, all relevant benefits are identified, and tax is not overpaid as a result of overly conservative or outdated assumptions.

If you would like to discuss these matters further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

[1] Employers and tax agents can refer to 'Exempt use of eligible vehicles' (QC 71130) on the ATO's website for further information in this regard.