

Discretionary trusts and 'foreigners'

Or why you should care about the terms of your
discretionary trust

Overview

- Discretionary trusts and 'foreign' beneficiaries
- What does it mean to be a foreigner
- Impact in excluding a foreigner as a beneficiary
- Read the deed

With a rise in surcharges for 'foreigners' holding land in Australia, it is important to appreciate the broadness of the definition in applying to discretionary trusts

Discretionary trusts and foreign beneficiaries

Foreigners pay more

As of January 2019, foreigners pay more if buying or holding land in certain States/Territories in Australia. Examples include:

- Additional 8% in stamp duty in New South Wales
- Additional 7% in stamp duty in Queensland, Victoria, South Australia and Western Australia
- Additional 2% in land tax in New South Wales
- Additional 1.5% in land tax in Victoria and Queensland by an '*absentee*'
- Additional 0.75% in land tax in Australian Capital Territory

The rates changes depending on the tax and State/Territory.

Type of land

Whether a surcharge applies also depends on the land being acquired. For example, in relation to stamp duty, the surcharge applies:

- To 'residential property' in Queensland
- To 'residential related property' in New South Wales
- To 'residential property' in Victoria
- To 'residential land' in South Australia
- To 'residential property' in Western Australia
- To 'residential land' in Australian Capital Territory
- To 'residential property' in Tasmania

You need to look at the State/Territory, the relevant tax and then determine if the tax relates to the type of land being acquired.

Who is a 'foreigner' – comparing
some definitions

NSW – Stamp duty

Duties Act 1997 (NSW)

- Section 104G - Operation
- Section 104J – Definition
- *Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA)* modified
- Section 5 FATA – Ordinarily resident
- Section 4(d) FATA – Definition of ‘foreign person’
- Section 18(3) FATA – Discretionary trusts

- <https://www.revenue.nsw.gov.au/help-centre/resources-library/g010v2> - NSW treatment of discretionary trusts

VIC – Stamp duty

Duties Act 2000 (VIC)

- Section 18A - Operation
- Section 3 – Definition of 'foreign purchaser', 'foreign natural person' and 'foreign trust'
- Section 3B – 'Substantial interest'
- Section 3D – When Commissioner determines person has substantial interest
- <https://www.sro.vic.gov.au/foreignpurchaser> - VIC treatment of discretionary trusts

QLD – Stamp duty

Duties Act 2001 (QLD)

- Sections 231 and 240 - Operation
- Sections 234, 235 and 237 – Definitions
- Section 57 - Trust interest
- Section 237(2)(d) – Foreign interest
- Sections 238 and 61 – Related persons

SA – Stamp duty

Duties Act 1923 (SA)

- Section 72 - Operation
- Section 2 – Definitions
- Section 2(14) – Foreign meaning

Practical impact of excluding
'foreigners' in discretionary trusts?

Why pay more?

Solution to the 'foreign' issue was to exclude 'foreigners' as beneficiaries:

- Partial exclusion

22. Distribution Restrictions

22.1. The Trustee shall not make a distribution or do any other act which would:

- (1) cause the Trust to become a "foreign trust" for the purpose of the *Duties Act 2000* (Vic) or the *Duties Act 2001* (Qld); or
- (2) cause the Trustee to be a "foreign person" for the purpose of the *Duties Act 1997* (NSW) or the *Land Tax Management Act 1956* (NSW); or
- (3) cause the Trustee to be a "foreign person" for the purpose of the *Foreign Acquisitions and Takeovers Act 1975* (Cth).

22.2. Clause 22.1 shall not be varied while the Trust Property includes an interest in real estate (including without limitation as purchaser under a contract for sale) in New South Wales, Queensland or Victoria or for a period of three years following the sale or disposal of the last such interest in real estate.

Why pay more?

- 13.14 Despite a contrary term of the Deed, if a Beneficiary is a **Foreign** Person, then the share of an amount of Income of the Trust in an Income Year or Capital at any time which the Trustee may distribute to such Beneficiary, must not exceed the maximum percentage the Trustee can distribute without breaching the *Foreign Acquisitions and Takeovers Act 1975 (Cth)*.

Why pay more?

- Full exclusion

Beneficiaries means and includes, the Primary Beneficiaries, the Secondary Beneficiaries, the Tertiary Beneficiaries and the Default Beneficiaries, whether named or described in this Deed or appointed or becoming a Beneficiary after the Deed Date, even if:

- (a) any of them may not be in existence or do not come within the meaning of any of those expressions at the Deed Date; and
- (b) in the case of the trustee of any trust or settlement, the trust or settlement has not been formed or is not in existence or does not come within the relevant category of Beneficiary at the Deed Date,

and **Beneficiary** means any of them. The expression excludes all Excluded Persons;

Why pay more?

- Full exclusion (cont.)

Excluded Person means the following (even if any of them is named or would otherwise be or be included in a class of Beneficiary):

- (a) each person named or described in Item 14 in the Schedule or nominated by the Trustee to be an Excluded Person;
- (b) the Settlor and any Child of the Settlor who is at the relevant time under the age of 18 years;
- (c) any corporation in which a person in (a) or (b) above is a director or member or in which any of them has a beneficial interest in any share;
- (d) any trust in which a person in (a) or (b) above has a beneficial interest whether vested, contingent or otherwise; and/or
- (e) any Foreign Person;

Why pay more?

- Full exclusion (cont.)

Foreign Person means:

- (a) a foreign person for the purposes of Chapter 4 of the Duties Act 2001 (Qld);
- (b) a foreign person or a foreign trust for the purposes of Chapter 2A of the Duties Act 1997 (NSW);
- (c) a foreign natural person, a foreign corporation or a foreign trust as defined in section 3 of the Duties Act 2000 (Vic);
- (d) a person holding a controlling interest in a foreign corporation or a substantial interest in a foreign trust for the purposes of sections 3A and 3B of the Duties Act 2000 (Vic) respectively;
- (e) an absentee person as defined in section 3 of the Land Tax Act 2005 (Vic);
- (f) an absentee person holding an absentee controlling interest in a corporation for the purposes of section 3A of the Land Tax Act 2005 (Vic) (unless an exemption under section 3B of that Act applies);

3

- (g) any potential Beneficiary of this Trust who would or might cause this Trust to be or become a foreign person or a foreign trust for the purposes of any of the above provisions;
- (h) any potential Beneficiary of this Trust who would or might cause this Trust to be or become a foreign person or a foreign trust for the purposes of any other statute,

and who, by being a Beneficiary, would or might cause this Trust to be assessed to additional or increased duty or land tax (in excess of any amount which the Trust would be required to pay had the person, corporation or trust not been so classified) in respect of the acquisition or holding of any real property to which any of the provisions above apply, but only while:

- (i) the foreign person, corporation or trust continues to be so classified under the relevant provision; and/or
- (j) the Trust acquires or holds real property to which any of the provisions above apply;

Practical considerations

Things to consider

- What is being bought? Do 'foreigners' need to be excluded?
- Partial exclusion or full blanket exclusion?
- What happens if a beneficiary becomes a foreigner in the future?
- Does excluding foreigners exclude other group structures?
- Existing structures v structures to be established.
- Care must be taken to ensure group entities align!
- Which way are distributions to be made?
- Can some group structures be able to distribute to 'foreigners' while others can't?

Discretionary trusts can no longer be a set and forget mechanism. Care and thought must be made to their structure and distribution (especially as distributions can vary based on client's whereabouts)

Read the deed

What are you distributing?

(f) "the income" means "the net income of the trust estate" of this trust within the meaning of that term as used in the Income Tax Assessment Act, 1936 (as amended from time to time) unless the Trustee shall on or before the last day of the year of income declare in writing that the foregoing provision shall not apply in relation to that year and in the event of any such declaration being made "the income" means the income in the said year produced from the investment of the Trust Fund and/or from the property thereof.

'Limiting' beneficiaries

- (b) No distribution of capital or Income of the Trust of or derived from Australian urban land shall be made in favour of any Beneficiary or class of Beneficiary excluded from acquiring an interest in Australian urban land under the *Foreign Acquisitions and Takeovers Act 1975* and *Foreign Acquisitions and Takeovers Regulation 1989* without the prior approval of the Foreign Investment Review Board. The Beneficiaries and classes of Beneficiaries excluded in this clause are specifically excluded from any subsequent nomination or appointment or assignment. Despite anything contained in clauses 9, 10 and 11 of this Trust Deed the Trustee or Appointor shall not have the power to amend the intention of this clause 3(b) that the Trustee at all times comply with the *Foreign Acquisitions and Takeovers Act 1975* and *Foreign Acquisitions and Takeovers Regulation 1989* as amended from time to time.

'Limiting' beneficiaries

PROVIDED THAT THE FOLLOWING SHALL NOT BE GENERAL BENEFICIARIES NOTWITHSTANDING THAT THEY FALL WITHIN ONE OR MORE OF THE ABOVE CATEGORIES.

1.9.6.7 The Settlor.

1.9.6.8 Any trust under which the Settlor has a beneficial interest.

1.9.6.9 Any person or class of persons or any trust or corporation which the Trustee has declared in writing at any time (as it is empowered to do) to be incapable of being or to cease to be a General Beneficiary permanently or temporarily. The Trustee is also empowered to declare in writing that any person or class of persons or any trust or corporation shall be incapable of being or cease to be a General Beneficiary in relation to any distribution exceeding thirty-nine percent (39%) (or whatever other percentage the Trustee may from time to time determine) in relation to income and capital (or either of them) of the Trust.

'Limiting' beneficiaries

15. EXCLUSION OF BENEFICIARIES

15.1 A person is an Excluded Person if:

- (a)** an election made by the Trustee for the Trust to be treated as a family trust for the purposes of the Tax Act is in force;
- (b)** the person is not a member of the relevant family group for the purposes of the election; and
- (c)** a distribution of income or capital from the Trust to the person would give rise to a liability to pay family trust distribution tax for the purposes of the Tax Act.

15.2 Any person being a Beneficiary may by oral or written declaration recorded in the minutes of the Trustee at any time exclude himself from any class of Beneficiaries and no further income or capital sums shall be distributed to such Beneficiary provided that such notice shall not affect the beneficial entitlement to any amount to which such Beneficiary is entitled at the date of such notice.

15.3 Any income or capital of the Trust Fund paid to, applied or set aside for the benefit of, any Excluded Person shall be returned to the Trustee.

'Limiting' beneficiaries

23. EXCLUSION OF CERTAIN PERSONS

Notwithstanding anything in this Deed:

- (a) the Trust Fund and the income thereof shall be held to the entire exclusion of and of any benefit to any person who is at that time a recipient of a means-tested Centrelink and/or Veterans' Affairs income support payment and their Associate (as the term "Associate" is defined under the Corporations Act) whether by contract or otherwise howsoever;
- (b) no part of the capital or income of the Trust Fund shall be paid or lent to or applied whether by way of remuneration or otherwise for the benefit either directly or indirectly of any person who is at that time a

recipient of a means-tested Centrelink and/or Veterans' Affairs income support payment or their Associate in any manner or in any circumstances whatsoever; and

- (c) no power vested in the Trustee by this Deed or by reason of anything done pursuant to this Deed or by law shall be capable of being exercised and no provision contained in the Deed shall operate in such manner that any person who is at that time a recipient of a means-tested Centrelink and/or Veterans' Affairs income support payment or their Associate will or may become entitled either directly or indirectly to any benefit in any manner or under any circumstance.

'Limiting' beneficiaries

(b) Subject as hereinafter provided "beneficiaries"

means -

- (i) The Class A beneficiaries as hereinafter defined;
- (ii) The Class B beneficiaries as hereinafter defined;
- (iii) the beneficiaries of any trust under which any Class A or any Class B beneficiary has any interest whether vested or contingent or as beneficiary under a discretionary trust;
- (iv) any person or persons declared by the Trustee to be additional beneficiaries of the trusts of this Deed in pursuance of a declaration made under the provisions of Clause 7 of this Deed (hereinafter referred to as additional beneficiaries); and -
- (v) any charitable institution in Queensland being an institution the income of which is exempt from income tax under any income tax law for the time being in force;

PROVIDED:

(a) no person who is trustee of the trusts of this Deed may be a beneficiary under this Deed during the time which he is trustee of it; and -

- 3 -

(b) the Settlor shall not be a beneficiary under this Deed.

(c) Subject as aforesaid "the Class A beneficiaries" means those persons named in the Fourth Schedule hereto.

(d) Subject as aforesaid "the Class B beneficiaries" means -

- (i) the children of Class A beneficiaries and their children; and
- (ii) other the issue of any Class A beneficiary; and -

(e) "children" and "issue" includes illegitimate children if they are wholly maintained as members of the family of the mother or of the putative father, and adopted children.

Obscure clauses

Trustee must not exercise certain powers until Appointor has been given notice

- 5.12 The Trustee may exercise any of the following powers where it has given the Appointor at least three day's written notice of the exercise of the power, including specific details of how the power is to be exercised:
- 5.12.1 The power to Distribute capital.
 - 5.12.2 The power to resolve in writing how capital is to be Distributed on the Vesting Day.
 - 5.12.3 The power to Distribute Income or accumulate it.
 - 5.12.4 The power to resolve in writing how Income is to be Distributed.
 - 5.12.5 The power to choose a person to whom capital or Income is to be Distributed.
 - 5.12.6 The power to create a sub-trust.

Conclusion

- The introduction of surcharges on stamp duty and land tax for 'foreigners' have complicated the use of discretionary trusts in family groups
 - Online providers have moved to deal with this surcharge
 - As a result, understanding at a minimum who the beneficiaries are of each trust in the group is critical for intra-group distributions
-
- Read the legislation
 - Read the deed

Question?

Contact details

Darius Hii

Director, Chat Legal Pty Ltd

0403923374

darius@chatlegal.com.au

chatlegal.com.au