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Let's chat

Trusts and international issues – September 2023

With:

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Information provided is general in nature; precise application depends on specific circumstances



Things to note

- Content is complicated, more specialised advice may be required
- Can apply to 'less rich' families
- Raised with clients past few years, ATO have caught on in recent times
- Intended to raise awareness of issues to reduce your risk



Trusts and residency – the basics

- Australian resident trust - worldwide
- Non-Australian resident trust – Australian source*
- Double tax agreements

- Residency rules (to determine if Australian resident trust or not)
- Source rules (to determine if Australian income tax on non-resident trust)

- *Noting exceptions such as the transferor trust rules



Resident trust (non unit trusts)

- Section 995-1 1997 Tax Act
 - trust that is not a unit trust to be a resident trust for CGT purposes for an income year,
 - if at any time during the income year
 - a trustee is an Australian resident; or
 - the central management and control of the trust is in Australia
- NB similar to section 95(2) 1936 Tax Act
- Note it is an 'or' test
 - One Australian resident trustee will suffice
 - Alternatively, consider if all trustees are non-residents but the management and control is in Australia (i.e. if an appointor/guardian 'controls' trustee via Australia or if control and management made in Australia)
 - Note broader definition of term 'trustee' under tax law which can include the founder, settlor, protector etc



Residency cases

- *Harding*
 - Focus on domicile test
 - Meaning of 'permanent place of abode'
 - Taxpayer resided in 'temporary serviced apartment' in Bahrain
- *Bywater*
 - Acknowledging *Fundy Settlement v Canada (Garron)* where:
 - the control and management was in Canada with the trust's settlor
 - Corporate trustee deferred to the recommendations of Canadian resident beneficiaries in the substantive decisions made regarding the trusts

What about residency of unit trusts?



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- For CGT purposes, a unit trust is an Australian tax resident for CGT purposes for an income year if at any time:
 - any property (not just real property) of the trust is situated in Australia or the trust carries on a business in Australia; and
 - the central control and management of the trust is in Australia or
 - Australian residents held more than 50% of the beneficial interests in the income or property of the trust.



Residency considerations

- Don't forget about the DTAs and tiebreakers
 - Looking for 'non-natural persons' where relevant
- Tax effect of ceasing to be a resident trust:
 - CGT event I2
 - Triggered when trust stops being a resident trust for CGT purposes
 - Assess capital gains on all trust assets other than following exceptions:
 - TARP
 - An asset used in carrying on a business through a permanent establishment in Australia; or
 - An option or right to acquire either of the above
 - No more capital gains following the trust no longer being a resident trust for CGT purposes other than for TARP transactions



Residency considerations

- Tax effect of being a resident trust:
 - Trustee taken to acquire CGT assets it owns at market value at the time the trust became a resident trust for CGT purposes other than:
 - TARP
 - Pre-CGT assets
 - No change if trust was a transferor trust
 - NB no capital gains or losses made from start of income year until trust becomes resident trust for CGT purposes except for TARP transactions
 - Tax considerations for foreign country trust ceasing to be a resident of?
 - Section 99B considerations relating to the 'uplift' in cost base upon becoming an Australian resident? (TBD further)



Residency issues

- Clients move overseas (whether planned or not)
 - COVID issues with clients stuck overseas
 - 'Forgetting' about tax residency having a flow-on effect where taxpayer trustee of trust
- Clients moving to Australia – need to consider overseas entities/structures (and not the concept of trust differs)
 - Are there similar 'taxing events' overseas?
- Deceased estates where no Australian based trustee
 - Non-resident trust
 - Non-resident tax rates for LPR
 - Potential loss of CGT discount for LPR



Section 99B - background

- Inserted in 1979 following a High Court decision.
- Explanatory memorandum extract:
 - *“A second set of provisions is designed to overcome a High Court decision that the existing trust provisions in Division 6 of the Income Tax Assessment Act (the "Principal Act") only have application to Australian source income of trusts. As the law now stands, Australian residents can defer, or escape completely, the payment of tax on foreign source income accumulated in trusts for their benefit.”*
- Remember residency rule – Australian taxed on worldwide sources
 - Old rules left a gap where taxation of Australian trust only considered sources from Australia
 - Enabled an Australian trust to therefore accumulate foreign source income in the trust as it would not be captured in the definition of income



Section 99B - background

- Section 99B was introduced to capture amounts to be included in assessable income.
 - *“(1) Where, at any time during a year of income, an amount, being property of a trust estate, is paid to, or applied for the benefit of, a beneficiary of the trust estate who was a resident at any time during the year of income, the assessable income of the beneficiary of the year of income shall, subject to subsection (2), include that amount.”*
- Note subsection 2 exceptions:
 - corpus of the trust estate (except to the extent to which it is attributable to amounts derived by the trust estate that, if they had been derived by a taxpayer being a resident, would have been included in the assessable income of that taxpayer of a year of income)
 - amounts that would not have been included in assessable income if derived by resident taxpayer;
 - NANE income



Section 99B - corpus

- 'Principal or capital sum'
- 99B captures corpus which is attributable to amounts derived by the trust estate that, if they had been derived by 'a taxpayer being a resident', would have been included in the assessable income of that taxpayer
- Examples:
 - Shares transferred into a Foreign Trust where original cost base is nominal but would be of value when transferring into Foreign Trust.
 - Untaxed earnings on funds which are only taxed on distribution. In the context of deceased estates, the corpus forming part of initial estate is not assessable but the untaxed earnings (although corpus) will be assessable had it been in the hands of the taxpayer
 - Overseas retirement funds/Accumulated foreign-source income/Distributions from foreign discretionary trust



Section 99B – interest chargeable

- Intended to make up for deferral of Australian tax not taxed on previous year of income of the non-resident trust
- Interest only charged on certain distributions and impacted if profit from 'listed country' or not or is 'eligible designated concession income'



Section 99B – why care?

- Australian resident trust client
- Receives money from overseas?
- Do you know where the money is coming from?

- The ATO may know
 - AUSTRAC
 - Other information sharing arrangements with countries



Section 99B – why care?

- Difficulty to track where money come from if via multiple entities
 - Commonly seen Australian trust receiving money from overseas who then lends to other Australian trusts to acquire property
 - Contemporaneous evidence
 - Possible to even obtain given inability to access some trust documents
- Difficulty to prove if comes from corpus?
 - Trust loans money to beneficiary, can prove it comes from corpus or does it comprise of taxable income?
 - Resolution confirming loan out of corpus of the trust estate?



Section 99C – a bridge too far?

- Extends 99B to also include amounts applied for the benefit of a beneficiary (but not paid)
- Potentially includes non-arm's length loans or forgiveness of loans?



TA2021/2

- Regarding the disguising of undeclared foreign income as gifts or loans from related overseas entities
- Noting a genuine gift or loan is one where:
 - the characterisation of the transaction as a gift or loan is supported by appropriate documentation;
 - the parties' behaviour is consistent with that characterisation; and
 - the monies provided are sourced from funds genuinely independent of the taxpayer.
- Consider the relationship and size of the transaction
 - Financial records should align



Transferor trusts

- Div 6AAA 1936 Tax Act
- Where Australian resident moves money to a non-resident trust for nominal/no consideration
- Attributes income of a trust to the Australian resident
 - Division required as others could otherwise allow income to accumulate in the overseas trust before gifting or lending back to Australia
- Considered a transferor if:
 - have at any time transferred property or services to a non-resident discretionary trust estate; or
 - transferred property or services after 7.30pm on 12 April 1989 to a non-resident trust estate that is non-discretionary for either no consideration or for consideration less than an arm's length amount
- Easy to be considered a transferor due to the broad nature that it can include any person who has transferred value to that trust



Transferor trusts

- Exemptions exist and depend on the type of trust:
 - Public unit trusts, deceased estates, post-marital family trust and family relief trusts
- Exemptions also depend on where trust estate located – ‘listed countries’
 - Care should be had as to whether a trust is a trust of a listed country
 - Need to consider more than just where management located
 - May need to ensure all income or profit subject to tax in the listed country – section 102AAE
 - Type of income also relevant



Other 'foreign' structuring issues

- FIRB
 - 'Person not ordinarily resident'
 - Citizens may not ordinarily be resident and technically a 'foreigner' under the definition
 - Regulation provides for exemption for Australian citizens
 - Thresholds and types of properties
 - Residential, vacant commercial land - \$0 threshold
 - Fees start from \$14,100
- Annual vacancy fee
- Stamp duty and land tax surcharges
 - Every State/Territory differs
- Above impacts the beneficiary class of trust deeds
 - Amendments required? What about changes to the law?



Miscellaneous note

- Australian Accounting Standards
- Does your trust deed require financial statements in accordance with the AAS?
- Why matters?
 - General purpose v special purpose financial statements



Example 1

9.1 Preparation of accounts

The Trustee:

- (a) may appoint an Auditor of the accounts in respect of the Trust; and
- (b) must keep proper accounts in respect of the Trust or cause them to be kept in accordance with any applicable Accounting Standards or otherwise as approved by the Trustee.

AASB means the Australian Accounting Standards Board or successor body.

Accounting Standards means the accounting standards applying with respect to the Trust as determined by the Trustee but, if no determination is made by the Trustee, will be:

- (a) the accounting standards required under the Corporations Act 2001 (Cth); and
- (b) if no accounting standard applies under the Corporations Act 2001 (Cth) in relation to an accounting practice, the standards acceptable to the AASB including:
 - (i) Australian equivalents to IFRS (International Financial Reporting Standards);
 - (ii) other authoritative pronouncements of the AASB;
 - (iii) abstracts and interpretations issued by the AASB; and
 - (iv) to the extent not inconsistent with any of these, any other accounting principles, standards, practices and methods of valuation generally accepted in Australia.

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