

Foreign surcharges and discretionary trusts

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Practice note history

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Purpose

This practice note outlines how surcharge purchaser duty and surcharge land tax will be applied in situations where land is held by a discretionary trust. The note also explains what you need to do in order to be exempt from foreign surcharge.

Note: Failure by a trustee to advise the Chief Commissioner that the trust is a discretionary trust could result in interest and penalties.

Note: Chapter 11A (Tax avoidance schemes) of the *Duties Act 1997* potentially applies to the avoidance of both surcharge purchaser duty and surcharge land tax^[1].

Background

Surcharge purchaser duty applies to acquisitions of NSW residential land by foreign persons, and surcharge land tax applies to foreign persons who are owners of residential land in NSW. Surcharge purchaser duty and surcharge land tax (together, the foreign surcharges) are payable in addition to any other duty or land tax payable.

Where an interest in a property is acquired directly or indirectly by or held through a discretionary trust, the trustee of the trust may be liable for foreign surcharges if any one of the potential beneficiaries is a foreign person.

Each beneficiary in a discretionary trust is deemed to have the maximum percentage interest in the income or property over which the trustee may exercise a discretion to distribute^[2].

This Commissioner's Practice Note clarifies the workings of section 104JA of the *Duties Act 1997* and section 5D of the *Land Tax Act 1956*.

Commissioner's practice note

Potential beneficiaries are not limited to persons named in the trust instrument. The term extends to the members of any class of persons to whom or for whose benefit trust property can be distributed or applied pursuant to the exercise of the discretions of the trustee under the trust.

Potential beneficiaries are often nominated by class rather than name for a number of reasons, including change of circumstances or they do not exist at the time the trust deed is executed. They could be foreign persons for the purposes of surcharge purchaser duty and surcharge land tax. In such circumstances, it follows that the trustee of a discretionary trust will be a foreign person.

A person is a 'potential beneficiary' of a discretionary trust if the exercise or failure to exercise a discretion under the terms of the trust can result in any property of the trust being distributed to or applied for the benefit of the person.

To avoid being a foreign trustee, the discretionary trust must meet both of the following requirements:

1. no potential beneficiary of the trust is a foreign person (the "no foreign beneficiary requirement"); and
2. the terms of the trust must not be capable of amendment in a manner that would result in a foreign person being a potential beneficiary (the "no amendment requirement").^[3]

Note: The “no foreign beneficiary requirement” can (and will usually) be satisfied in respect of a person if the terms of the trust prevent any property of the trust from being distributed to or applied for the benefit of the person.

Example 1

Mr and Mrs Jones (both Australian citizens) are primary beneficiaries of the Jones Family Trust. Other primary beneficiaries include their two children Mark and Peter who are under the age of 10. The trust has potential beneficiaries who include future spouses and children of Mark and Peter and no other potential beneficiaries.

The trust has no existing foreign beneficiaries, but future spouses and children of Mark and Peter could be foreign persons. The trustee is taken to be a foreign person. To be exempt from foreign surcharges, the trust must be amended to exclude any foreign beneficiaries and the amendment must be irrevocable.

Example 2

Mr and Mrs Jones (both Australian citizens) are primary beneficiaries of the Jones Family Trust. Potential beneficiaries include their children, their spouses, grandchildren, aunts and uncles (all Australian citizens), and an Australian charity operating in Australia for the benefit of residents in Australia.

Although the trust has no existing foreign beneficiaries and no potential foreign beneficiaries, the trust must still be amended to exclude any future foreign potential beneficiaries and the amendment must be irrevocable.

Note: As the charity is operating in Australia, the exclusion of foreign beneficiaries does not exclude the charity. See Australian Charities and Not-for-profit Commission (ACNC) register. A charity will also not be considered to operate overseas if its activity overseas is directly related to its purposes in Australia, and the activity is incidental to its operations in Australia^[4].

Example 3

Mr and Mrs Jones (both Australian citizens) are primary beneficiaries of the Jones Family Trust. Potential beneficiaries include their children, their spouses, grandchildren, aunts and uncles (all Australian citizens), the lineal descendants of the specified beneficiaries and any entities in which Mr and Mrs Jones holds an interest whether formed in Australia or elsewhere such as corporations, charities etc.

The trust had no land in New South Wales and therefore the terms of the trust did not need to contain a prohibition on foreign persons being beneficiaries.

In June 2020 the trust purchased residential property in NSW. The trust will be liable for surcharge purchaser duty. The trust will also be liable to surcharge land tax for the 2021 tax year. In order for the trustee not to be liable for foreign surcharges, the trust will need to be amended to exclude any foreign potential beneficiaries and the amendment must be irrevocable.

Example 4

Mr and Mrs Jones (both Australian Citizens) are beneficiaries of the Jones Family Trust. Potential beneficiaries include their children, their spouses, grandchildren, aunts and uncles (all Australian citizens), the lineal descendants of the specified beneficiaries and any entities whether formed in Australia or elsewhere such as eligible corporations, charities etc. The trust also has an excluded class of beneficiaries and this class includes any beneficiary who is a foreign person.

As all foreign persons, entities and charities are excluded and the terms of the trust are incapable of amendment, the trustee will not be liable for foreign surcharges.

Example 5

ABC Pty Ltd, an Australian Corporation, enters into a contract for the purchase of residential property in NSW. All the shares in ABC Pty Ltd are owned by a discretionary trust. ABC Pty Ltd will be liable to surcharge purchaser duty if the trust does not contain a provision to exclude foreign beneficiaries.

Corporations are foreign persons if a shareholder who is a foreign person has a substantial interest in the corporation. For a discretionary trust, each beneficiary that the trustee has discretion to distribute the income or property to is deemed to have the maximum percentage interest in the income or property that the trustee may exercise a discretion to distribute to them. It follows that as the discretionary trust is the shareholder of the company then the company is a foreign person. However, if the trust is amended to exclude foreign beneficiaries and the terms of the trust is incapable of being amended to allow a foreign person to become a potential beneficiary, then no surcharge purchaser duty is payable.

Similar rules apply to a unit trust where the units held in the trust are held by a trustee of a discretionary trust.

Example 6

Mr Jones is the principal beneficiary of the Jones Trust. This trust is set up as the result of injury claims in the Supreme Court. The general beneficiaries include the trustee, the parents, spouse and children of the principal beneficiary. The date of determination is the death of the principal beneficiary or 80 years after the date of the deed. Any payment made to the general beneficiaries is made for the benefit of the principal beneficiary.

The principal beneficiary is the only person who benefits from the trust. The general beneficiaries will only benefit after the death of the principal beneficiary either as a beneficiary under the will or arising on an intestacy. Therefore, the trust does not need to be amended and will not be liable to foreign surcharges as the status of the general beneficiaries does not matter.

Note: *Generally, superannuation trusts and special disability trusts do not need to contain a prohibition on foreign persons becoming beneficiaries.*

A superannuation trust will generally not qualify as a discretionary trust.

A special disability trust is a concessional trust where the primary purpose is for the reasonable care and accommodation of the principal beneficiary and is not discretionary in nature. This is because the trustee does not have the discretion to benefit anyone else other than the principal beneficiary.

Some trusts, such as the special disability trust and the trust set up in example 6, cannot be amended and therefore will comply with the 'no amendment requirement'. Other trusts that cannot be amended and are not covered in this practice note will be dealt with on a case by case basis. A request for a private ruling should be lodged. The factors that Revenue NSW will consider in determining such a ruling include:

- nature of the trustees' power to amend the trust;
- nature of the trust;
- the rights of the beneficiaries.

Named beneficiaries

Should the trust contain named or specified beneficiaries that are foreign persons, the Chief Commissioner will usually require that such beneficiaries are removed from the trust as beneficiaries. If the named foreign beneficiaries are not removed, the trustee will generally be liable for foreign surcharges.

Note: It is generally not sufficient that named beneficiaries are merely prevented from receiving distributions, e.g. through a general clause

excluding foreign persons from receiving distributions. This is because the named beneficiaries might have the power to appoint a new Appointer or appoint or remove trustees and the trust may still be capable of amendment in a manner that would result in a foreign person being a potential beneficiary^[5].

Transitional Provisions

No Foreign Beneficiary Requirement

If the trustee of a discretionary trust is liable for surcharge purchaser duty on a transfer of dutiable property that occurred before 24 June 2020 or after that date but before midnight on 31 December 2020, the trustee will still not be liable if the terms of the trust have been amended before midnight on 31 December 2020. If surcharge purchaser duty was paid, the trustee is entitled to a refund if the amendment is made before midnight on 31 December 2020.

If the trustee of a discretionary trust is liable to pay surcharge land tax in respect of the 2017, 2018, 2019 and/or 2020 land tax year, the trustee will still not be liable if the terms of the trust have been amended before due date for the payment of land tax or after the due date but before midnight on 31 December 2020. If surcharge land tax was paid, the trustee is entitled to a refund if the amendment is made before midnight on 31 December 2020.

Example 7

Mr and Mrs Jones (both Australian citizens) are beneficiaries of the Jones Family Trust. Potential beneficiaries include their children, their spouses, grandchildren, aunts and uncles, the lineal descendants of the specified beneficiaries, corporations in Australia and elsewhere.

The trust was liable for surcharge land tax and surcharge land tax was paid for 2017, 2018 and 2019 tax years.

If the trust is not amended by midnight on 31 December 2020 to exclude foreign persons from being beneficiaries and the terms of the trust are not amended to make the exclusion irrevocable, the trustee will still be liable for surcharge land tax for the 2020 tax year.

However, if the trust is amended before midnight on 31 December 2020 and as surcharge land tax was paid, then the trustee is entitled to a refund for the 2017, 2018 and 2019 tax years.

No Amendment Requirement

If, before 24 June 2020, a trust satisfied the no foreign beneficiary requirement under section 104JA of the *Duties Act* 1997 or section 5D of the *Land Tax Act* 1956, the trustee will be exempt from surcharge purchaser duty and surcharge land tax without having to satisfy the no amendment requirement.

Example 8

Mr and Mrs Jones (both Australian citizens) are primary beneficiaries of the Jones Family Trust. Potential beneficiaries include their children, their spouses, grandchildren, aunts and uncles (all Australian citizens), the lineal descendants of the specified beneficiaries and a company whose shareholders and directors are Mr and Mrs Jones.

The trust has no existing foreign beneficiaries, but potential future descendants could be foreign persons. The trustee is taken to be a foreign person. The trust was amended in March 2020 to exclude any future potential foreign beneficiaries, but the terms of the trust were not amended to satisfy the no amendment requirement. As the trust was amended prior to 24 June 2020, the trustee will be exempt from surcharge purchaser duty and surcharge land tax without having to satisfy the no amendment requirement.

Testamentary trust

An Australian testamentary trust is a discretionary trust arising from a will or codicil or the administration of an intestate estate where the deceased was not a foreign person immediately before death.

The trustee of an Australian testamentary trust is not a foreign trustee even if the trust does not prevent a foreign person from being a beneficiary of the trust if:

- a. the will or codicil was executed on or before 31 December 2020, or
- b. the deceased died intestate before, or within two years after 24 June 2020, or
- c. an order of a court varying the application of the provisions of a will or codicil or of the rules governing the distribution of an intestate estate was made on or before 31 December 2020.

Footnotes

1. Section 5D(7) of the *Land Tax Act* 1956
2. Section 18(3) of the *Foreign Acquisitions and Takeover Act* 1975 (Cth) (**FATA**)
3. See transitional provisions in the ruling.

4. <https://www.acnc.gov.au/for-charities/manage-your-charity/governance-hub/acnc-external-conduct-standards/when-do-external>
5. △ If in doubt request for a private ruling