

FACT SHEET: FOREIGN PERSON SURCHARGES IN NSW AND DISCRETIONARY TRUSTS

From 21 June 2016, where a foreign person acquires residential land in New South Wales, they are liable to extra stamp duty (currently 8%) on the acquisition. Similarly, a foreign person that holds residential land in NSW on any 31 December after 21 June 2016 will pay a land tax surcharge (currently 2%) on the land.

The application of the foreign person surcharges has been an area of considerable confusion, particularly for discretionary trusts.

This fact sheet has been designed to assist understanding where the surcharges can apply where land is directly or indirectly owned by discretionary trusts, and what action can be taken to prevent the surcharges from applying. This is a general overview to assist in understanding the issues that should be considered for the foreign person surcharges and should not be used as substitution for obtaining advice.

This fact sheet makes observations based on a Bill to amend the *Duties Act 1997* (NSW) and the *Land Tax Act 1956* (NSW) that is currently before NSW Parliament. The Bill is not yet law and, accordingly, advice should be obtained before relying on the content of this fact sheet.

This fact sheet only outlines the foreign person surcharge rules that apply where a discretionary trust owns residential land in NSW. There are different rules that apply in other States. Further, where a trust owns land in other States, as well as in NSW, expert advice should be obtained on the duties and land tax rules in the other States before amending the trust deed as there may be tax consequences in the other States in making the amendments.

WHO IS A FOREIGN PERSON?

'Foreign persons' include the following:

1. an individual who is not:
 - (a) a citizen of Australia,
 - (b) a permanent resident of Australia who has been in Australia during 200 or more days of the preceding 12-month period;
 - (c) a citizen of New Zealand who has a special category of visa under section 32 of the *Migration Act 1948* (Cth) and who has been in Australia during 200 or more days of the preceding 12-month period; or
2. a foreign corporation or a foreign government investor; or
3. any trust in which:
 - (a) in the case of a unit trust, a foreign person has an interest of 20% or more; or
 - (b) in the case of a discretionary trust, a foreign person is within the class of eligible beneficiaries; or
4. an Australian corporation in which a foreign person has an interest of 20% or more.

Importantly, the meaning of *foreign person* is different from the meaning of *foreign resident* for income tax purposes. An Australian citizen may be a foreign resident for income tax, but they will not be foreign person for the purpose of the duty and land tax surcharges.

DISCRETIONARY AND HYBRID TRUSTS

Where the trust is a discretionary trust or a hybrid trust in which a trustee has discretion to appoint income to a wide class of beneficiaries, any person who is capable of benefiting under the trust is deemed to have the maximum percentage interest in the income or property that the trustee may exercise discretion to distribute to them. Therefore, if under the terms of a trust, the trustee could potentially distribute all of the income or capital of the trust to a foreign person, whether or not they actually do so, the foreign person is treated as having a 100% interest in the trust and the trustee is treated as a foreign person.

The problem is that typically, discretionary trusts and certain hybrid trusts provide for a broad class of beneficiaries who are defined by reference to their relationship to a principal beneficiary. These beneficiaries may be relatives of the principal beneficiary, or related companies and trusts. These beneficiaries may also be persons who are never intended to benefit under the trust and may include foreign persons.

COMPANY OR A UNIT TRUST DIRECTLY OWNS RESIDENTIAL LAND

This can also impact on indirect interests in residential land of a discretionary trust or hybrid trust. For example, if the trustee of a discretionary trust holds 30% of the shares in a company that owns residential land in NSW or 30% of the units in a unit trust that owns residential land in NSW, and the trustee of the discretionary trust is a foreign person because of the rules mentioned above, the company or unit trust will also be a foreign person. Accordingly, in such circumstances, it will be necessary to amend the trust deed for the discretionary trust to prevent foreign persons from benefiting, to ensure that the company or unit trust is not a foreign person.

UNIT TRUSTS AND LAND TAX

There is a special rule for land tax surcharge where the unit trust is a fixed trust for land tax. In that case, the unit trust can never be a foreign person. This is because with land tax fixed trusts, both the unit trust and the unitholders receive land tax assessments.

The rules effectively provide that the foreign person assessment is done at the unitholder level. Practically this means that, with a land tax fixed trust, land tax surcharge can be imposed even where the foreign person has units in the unit trust of less than 20% (although effectively only on the foreign person's proportionate interest in the land) and, where the foreign person has an interest of 20% or more, the land tax surcharge will still only be imposed on the foreign person's proportionate interest in the land.

It should be noted that not all unit trusts are fixed trusts for land tax. In the case of a unit trust that is not a fixed trust, no surcharge is imposed if the foreign person's interest is below 20% and, where the foreign person's interest is at least 20%, the surcharge is imposed on the total value of the land.

HOW DO I EXCLUDE FOREIGN PERSONS?

Under the current law and administrative practice of Revenue NSW, it is sufficient that foreign persons are incapable of benefiting from the trust, unless the trustee is seeking to rely on the Commissioner's concessional approach in *Revenue Ruling G010* to obtain retrospective exemption from the surcharge.

Where *Revenue Ruling G010* is being relied upon, it is necessary that the terms of the trust are not capable of amendment in a manner that would result in there being a potential beneficiary of the trust who is a foreign person. That is, the exclusion of foreign persons from benefiting under the trust must be *irrevocable*.

The Bill currently before NSW Parliament proposes to amend the law so that for trusts that exclude foreign persons from benefiting prior to 31 December 2019 (whether or not the exclusion is irrevocable), the trustee will not be a foreign person. Unless such an exclusion is made, the trustee will be a foreign person for the 2017, 2018 and 2019 land tax years and for any dutiable transactions prior to 31 December 2019.

Where a trust deed does not exclude foreign persons as beneficiaries prior to 31 December 2019, the amendments proposed by the Bill require that in order to ensure that the trustee is not a foreign person for duty and land tax from December 2019, there must be no ability under the trust deed to use the amendment power to include foreign persons as beneficiaries. That is, the exclusion of foreign persons must be irrevocable.

It is not clear how the amendments proposed by the Bill interact with *Revenue Ruling G010*. As the Bill is not currently and likely will not be law before 31 December 2019, we recommend that trustees act in accordance with the requirements of *Revenue Ruling G010* and exclude foreign persons irrevocably to ensure that the trustee is not a foreign person for the 2017, 2018 and 2019 land tax years and for any dutiable transactions prior to 31 December 2019.

WHAT IS RESIDENTIAL LAND?

Residential land includes:

1. land on which there is at least one dwelling, or on which there is a building or buildings under construction that, when completed, will constitute at least one dwelling; and
2. vacant land that is zoned for residential purposes.

Land that is land use for primary production (i.e. is exempt from land tax under the primary production exemption) is not residential land.

The above is a non-exhaustive summary of the meaning of residential land.

Where land is residential land, there will be a reduction in the surcharges where the land is being used for non-residential purposes to reflect the non-residential use of the land. For example, if a house is being used as premises for a doctor's surgery only, the duty and land tax surcharge should be reduced to nil.

HOW ARE HYBRID TRUSTS TREATED?

It depends upon the nature of the hybrid trust. If the hybrid trust deed provides the trustee with power to distribute to a class of beneficiaries and not simply the unitholders, then the hybrid trust will be treated the same as a discretionary trust and it will be necessary to ensure foreign persons are excluded from benefiting from the trust, to ensure that the foreign person surcharges are not imposed on the trustee.

DOES LAND TAX SURCHARGE APPLY WHERE THE LAND IS EXEMPT FROM LAND TAX?

Yes, except where the land tax exemption is the primary production exemption.

DO I ONLY NEED TO AMEND TRUST DEEDS FOR TRUSTS THAT DIRECTLY OR INDIRECTLY OWN RESIDENTIAL LAND?

Yes. To prevent the law from treating the trustee of a discretionary trust or hybrid trust as a foreign person for the purposes of the surcharges, it is only necessary that a trust deeds for discretionary trusts or hybrid trusts that directly or indirectly own residential land exclude foreign persons.

However, if there is an intention to distribute from trusts that directly or indirectly own residential land (a **land owning trust**) to another trust (a **receiving trust**) and foreign persons have been excluded from benefiting from the land owning trust, then it will also be necessary to exclude foreign persons from benefiting under the receiving trust, as otherwise, the receiving trust would not be entitled to the distribution from the land owning trust.

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