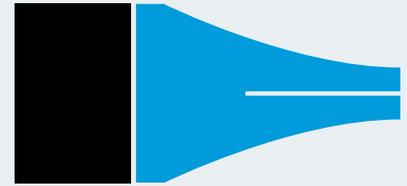


Are foreign trusts the new black?

by Phil Broderick, CTA, Sladen Legal



As more jurisdictions create special rules for “foreign trusts”, it is important to understand what makes a foreign trust under each measure.

Introduction

It seems everyone is introducing regimes for foreign trusts. The Commonwealth has had a foreign trust regime for many years. But in recent times, the Victorian, New South Wales and Queensland governments have all brought in duty surcharges that apply to foreign persons, including the trustees of foreign trusts. Unhelpfully, each jurisdiction has a different test for what constitutes a foreign trust and each test catches what most people would consider to be a non-foreign trust.

This article has limited its consideration of foreign trusts to the new duty surcharges for each regime and the Foreign Investment Review Board (FIRB) regime. There are other situations where foreign trusts will attract special rules (for example, the new foreign resident capital gains withholding regime and the new FIRB taxation conditions).

It should be noted that this article contains a high-level review of each of the regimes. The relevant provisions for each measure are complicated and contain their own individual nuances which should be reviewed in detail to confirm whether that regime will apply to any particular situation.

The Commonwealth

Legislation

The Commonwealth has a foreign trust regime in the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (FATA).

What is the purpose of the regime?

The purpose of the FATA regime is (among other things) to ensure that foreign persons, including the trustees of foreign trusts, seek the permission of the FIRB before acquiring certain assets. This

includes all residential property (other than new residential property).

What is the definition of “foreign trusts” under the FATA?

Section 4 FATA provides that a foreign person includes (among others):

- the trustee of a trust in which an individual not ordinarily resident in Australia, a foreign corporation or a foreign government holds a substantial interest; or
- the trustee of a trust in which two or more persons, each of whom is an individual not ordinarily resident in Australia, a foreign corporation or a foreign government, hold an aggregate substantial interest.

Therefore, the key to the definition is, what is a substantial interest, and an aggregate substantial interest, in a trust? These are also defined in s 4 FATA as follows:

“**substantial interest**”: a person holds a **substantial interest** in an entity or trust if:

- (a) for an entity — the person holds an interest of at least 20% in the entity; or
- (b) for a trust (including a unit trust) — the person, together with any one or more associates, holds a beneficial interest in at least 20% of the income or property of the trust.”

“**aggregate substantial interest**”: 2 or more persons hold an **aggregate substantial interest** in an entity or trust if:

- (a) for an entity — the persons hold an aggregate interest of at least 40% in the entity; or
- (b) for a trust (including a unit trust) — the persons, together with any one or more associates of any of them hold, in the aggregate, beneficial interests in at least 40% of the income or property of the trust.”

For discretionary trusts, interests are worked out by the following test:¹

“... under the terms of a trust, a trustee has a power or discretion to distribute the income or property of the trust to one or more beneficiaries, each beneficiary is taken to hold a beneficial interest in the maximum percentage of income or property of the trust that the trustee may distribute to that beneficiary.”

Therefore, for a discretionary trust, if one of the beneficiaries is a foreign person and the trustee has the power to distribute all of the income or capital² of the trust, the trustee of that trust will be a foreign person. This would include most “normal” discretionary trusts where the primary beneficiaries, or one of their relatives, are a foreign person.

Victoria

Legislation

Victoria has a foreign trust regime in the *Duties Act 2000* (Vic) (DA Vic) and the *Land Tax Act 2005* (Vic).

What is the purpose of the regime?

The purpose of the foreign trust regime in Victoria is to apply a duty surcharge of 7% on acquisitions by a foreign purchaser of residential land³ and a land tax surcharge of 1.5% on the trustee of an absentee trust. “Residential land” is widely defined.⁴ The regime also applies to land on which a foreigner intends to construct a residential building, at the time they form that intention.⁵

What is the definition of “foreign trust” under the DA Vic?

Section 3 DA Vic defines a “foreign trust” as a trust in which one of the following persons has a substantial interest in the trust estate:

- (1) a foreign corporation;
- (2) a foreign natural person; or
- (3) another person that holds the substantial interest as trustee of another foreign trust.

A substantial interest in a trust estate is if the foreign person, alone or together with an associated person,⁶ has a beneficial interest of more than 50% of the capital of the estate of the trust or if the Commissioner makes a determination under s 3D DA Vic.⁷

For discretionary trusts, significant interest is determined under the following test:⁸

“... under the terms of a foreign trust, a trustee has a power or discretion as to the distribution of the capital of the trust estate to a person or a member of a class of person, any such person is taken to have a beneficial interest in the maximum percentage of the capital of the foreign trust estate that the trustee is empowered to distribute to that person.”

Again, this would mean that for most “normal” discretionary trusts where the primary beneficiaries, or one of their relatives, are a foreign person, that foreign person would have a 100% interest and therefore the trust would be a foreign trust.

New South Wales

Legislation

New South Wales has a foreign trust regime in the *Duties Act 1997* (NSW) (DA NSW) and the *Land Tax Act 1956* (NSW).

What is the purpose of the regime?

The purpose of the foreign trust regime in New South Wales is to apply a duty surcharge of 4% on acquisitions by a foreign purchaser of residential related property⁹ and a land tax surcharge of 0.75% on a foreign trustee. “Residential land” is widely defined.¹⁰ The regime also applies to an option to purchase such land.¹¹

What is the definition of “foreign trust” under the DA NSW?

The DA NSW adopts the FATA definition of “foreign person” and “foreign trustee”, with some modifications.¹²

Queensland

Legislation

Queensland has a foreign trust regime in the *Duties Act 2001* (Qld) (DA Qld).

What is the purpose of the regime?

The purpose of the foreign trust regime in Queensland is to apply a duty surcharge of 3% on acquisitions by a foreign person of additional foreign acquirer duty residential land or “AFAD residential land”.¹³ “AFAD residential land” is widely defined.¹⁴

What is the definition of “foreign trust” under the DA Qld?

Under s 234 DA Qld, a foreign person includes the trustee of a foreign trust. Section 237 DA Qld defines a “foreign trust” as a trust in which at least 50% of the trust interests in the trust are foreign interests. Foreign interests are defined as follows:¹⁵

- (a) a trust interest of a foreign individual; or
- (b) a trust interest of a foreign corporation; or
- (c) a trust interest of a foreign trustee; or
- (d) a trust interest held by a related person of a person mentioned in paragraph (a) to (c).¹⁶

For discretionary trusts, takers in default of income or capital have a trust interest.¹⁶ That interest is measured by the greatest percentage of capital or income they would receive in default of an appointment by the trustee.¹⁷

Therefore, unlike the other jurisdictions, the Queensland regime does not capture trusts simply because they have a foreign person as a mere object. However, if the foreign person is a related person of a taker in default and that taker in default holds a 50% or more trust interest, the trust will be a foreign trust.

Summary

Table 1 summarises the regimes discussed above.

Converting a trust into a non-foreign trust

As can be seen above, it is easy for a widely drafted discretionary trust to be deemed to be a foreign trust and be subject to FIRB approval or the duty or land tax surcharges. If the trustee of such a trust wishes to avoid the application of such regimes, consideration should be given to varying the trust deed of the trust to ensure that foreign persons and their associates do not have the necessary entitlement to capital and/or income.

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Acknowledgment

The author would like to thank Callum Wood for his research on this topic.

References

- 1 S 18 FATA.
- 2 S 11 FATA.
- 3 The regime also applies to acquisitions in a landholder that has an interest in residential land: see s 70(2) DA Vic.
- 4 S 3G DA Vic.
- 5 S 18A DA Vic.
- 6 S 3B(3) DA Vic.
- 7 S 3B(1) DA Vic.
- 8 S 3B(2) DA Vic.
- 9 The regime also applies to acquisitions in a landholder that has an interest in residential land: see Pt 2B DA NSW.
- 10 Ss 104I and 104K DA NSW.
- 11 S 104K DA NSW.
- 12 S 104J DA NSW.
- 13 The regime also applies to acquisitions in a landholder that has an interest in residential land: see s 245 DA Qld.
- 14 S 232 DA Qld.
- 15 S 237(2) DA Qld.
- 16 S 57 DA Qld.
- 17 S 60 DA Qld.

Table 1: Summary of foreign trust tests

Jurisdiction	Income and/or capital	Percentage	Aggregate percentage	Duty surcharge	Land tax surcharge
Commonwealth	Income and capital	20% or more	40% or more	n/a	n/a
Victoria	Capital	More than 50%	More than 50%	7%	1.5%
NSW	Income and capital	20% or more	40% or more	4%	0.75%
Queensland	Income and capital	50% or more of the takers in default	50% or more of the takers in default	3%	Nil