



## TAX ALERT – PROPOSED NSW CHANGES IMPACTING DISCRETIONARY TRUSTS

### PROPOSED CHANGES TO SURCHARGE PURCHASER DUTY AND SURCHARGE LAND TAX LAW FOR DISCRETIONARY TRUSTS OWNING RESIDENTIAL LAND IN NSW

The NSW government recently introduced a Bill relevant to trustees of discretionary trusts that either own or will own residential land in NSW. It deals with when the surcharge purchaser duty and surcharge land tax that are aimed at foreign persons will apply to discretionary trusts. The surcharge purchaser duty is currently 8% (in addition to the duty otherwise payable) and the surcharge land tax is currently 2% (in addition to the land tax otherwise payable).

#### SUMMARY OF THE PROPOSAL

*State Revenue Legislation Further Amendment Bill 2019* introduced into the NSW parliament on 22 October 2019 contains various proposed changes to the duty and land tax law in NSW. One lot of those changes relates to discretionary trusts. Very broadly, for the purposes of both the surcharge purchaser duty and surcharge land tax, it is proposed that trustees of **all** discretionary trusts be treated as foreign trustees/foreign persons, **unless** the terms of the trust prevent a foreign person from being a beneficiary or becoming a beneficiary.

The Bill provides for trust deeds to be amended on or before 31 December 2019 to not be caught by these proposed changes, subject to satisfying certain conditions. The Bill has significant retrospective effect.

#### REASON FOR PROPOSED CHANGES

Presently, a trustee of a discretionary trust of which any potential beneficiary is a foreign person is a foreign trust subject to surcharge purchaser duty on the acquisition of residential land (including residential related property) and surcharge land tax on residential land in NSW.

Discretionary trusts (often testamentary trusts) with a limited class of beneficiaries that do not include any foreign persons (eg a trust for the deceased's children all of whom are Australian citizens) satisfy the requirements and are not foreign trustees/persons. However, many discretionary trusts are unwittingly foreign trustees/persons subject to surcharge purchaser duty and surcharge land tax.

The Bill builds upon the current law and Revenue NSW's practice in relation to discretionary trusts, and contains the precise rules that will need to be satisfied for the surcharges not to apply to discretionary trusts.

#### PROPOSED DUTY CHANGES

The Bill proposes to introduce a new section (s104JA) into the *Duties Act 1997* (NSW) (**Duties Act**) to contain special provisions for discretionary trusts. The trustee of a discretionary trust will be taken to be a foreign trustee (and so potentially subject to the surcharge purchaser duty) unless the trust prevents a foreign person from being a beneficiary. There are two requirements, as follows:

1. A '**no foreign beneficiary requirement**'. Broadly, this requires that under the terms of the trust no property is able to be distributed to, or applied for the benefit of, a foreign person.
2. A '**no amendment requirement**'. This requires that the terms of the trust are not capable of being amended in a manner that would result in there being a potential beneficiary of the trust who is a foreign person.

'Discretionary trust' is currently defined in a fairly broad way, and this definition will apply to the proposed changes. Hybrid trusts would generally be discretionary trusts.

Purchaser surcharge duty applies to 'residential-related property' and not just 'residential land' in NSW, and the dutiable transactions that can trigger surcharge purchaser duty are not limited to agreements to acquire residential land or transfers of residential land. However, this is not discussed in this article.

## TRANSITIONAL RULES FOR DUTY CHANGES

The transitional rules are very significant and far reaching. While the new law does not commence until the Bill receives assent, the proposed changes for discretionary trusts are to apply before the commencement, ie as far back as the surcharge duty applies, on and from 21 June 2016. That is, they will apply to acquisitions of residential land, or any contract entered into to acquire residential land, on or after 21 June 2016.

Such a retrospective change would clearly have significant ramifications. To address these, there are two specific transitional rules, as follows:

1. A trustee is exempt from the surcharge purchaser duty if the terms of the trust are amended prior to midnight on 31 December 2019 so that the trust prevents a foreign person from being a beneficiary. However, except where the surcharge duty has been paid (where refund provisions apply) the amendment must also be before the due date of payment of duty (ie 3 months after the liability for duty arises).
2. If the trust satisfies the no foreign beneficiary requirement immediately before the commencement of s104JA, it does not have to satisfy the no amendment requirement.

## PROPOSED LAND TAX CHANGES

The Bill proposes to introduce similar changes for the land tax surcharge. In particular, it proposes to introduce a new section (s5D) into the *Land Tax Act 1956* (NSW) (**Land Tax Act**) to treat the trustee of a discretionary trust as a foreign person in similar circumstances, so potentially liable to the surcharge land tax on residential land. Interestingly, there is an additional proposed change for the land tax provisions which is to also apply the anti-avoidance provisions contained in the Duties Act to avoidance of surcharge land tax in connection with the operation of proposed s5D.

There are also similar transitional rules to the proposed surcharge purchaser duty changes, meaning that the proposed changes apply in respect of the 2017, 2018 and 2019 land tax years (ie land held at 31 December 2016, 2017 and 2018).

## TESTAMENTARY TRUSTS

Special rules are proposed for testamentary trusts which are not discussed in this article.

## UNIT TRUSTS AND COMPANIES

Unit trusts and companies that have trustees of discretionary trusts as unitholders/shareholders and own residential land in NSW should also consider the impact of these proposed changes.

## OUR COMMENTS

As the class of beneficiaries of a discretionary trust is usually very wide, there will often be foreign persons that are beneficiaries, even if no distributions are made to them or intended to be made to them. We therefore appreciate the NSW government wanting to codify and clarify the rules that apply to discretionary trusts.

We also appreciate the no amendment requirement. We understand that it has been Revenue NSW's concern for some time that trust deeds could be amended to exclude foreign persons before a taxing point (eg before the trustee of the trust enters into a contract to acquire residential property), and then after the taxing point the deed is amended again to include foreign persons. This concern was expressed in the second reading speech introducing the Bill. We also understand that Revenue NSW considers that the anti-avoidance provisions in the Duties Act could be used to counter this for duty. This could be the reason why the proposed land tax amendments also include the proposed general anti-avoidance provisions.

However, there are some aspects of the proposed changes that could be particularly harsh. Following are some of these:

- In a way the application of the surcharges to discretionary trusts is a 'gotcha tax'. That is, while there may never be any distributions to foreign persons, or any intention to make such distributions, the proposed changes will still apply. So even if there is no attempt to avoid the surcharges, there will need to be the right paperwork. Problems with this include:
  - The trustee and advisers not being aware of the proposed changes and it only being discovered on an audit.
  - The trustee and advisers not appreciating the definition of 'residential land' and assuming that the trustee of the trust does not and will not own residential land, so thinking that foreign persons do not need to be excluded as beneficiaries.
  - The trustee and advisers not appreciating the meaning of 'foreign person'.
  - Trust deeds that do not have an amendment power (not common but still do occur, particularly for some older trusts) so requiring a court order to amend the deed.

- Trust deeds with an amendment power, but the power does not extend to excluding beneficiaries.
- Trust deeds that have relevant exclusion clauses, or are amended to include them, but Revenue NSW does not accept that they are effective or wide enough.
- Trust deeds that have been amended in good faith, but for some reason the amendment is not valid. There are often procedural aspects that need to be followed, and if not followed may render the amendment invalid (eg the trustee failing to obtain the consent of an appointor or guardian if required, or the trustee failing to give notice to the appointor or guardian if required). Also, beneficiaries of discretionary trusts have the right to see that the trust is being administered lawfully. The exercise of the trustee's discretion to amend the deed to exclude beneficiaries is potentially challengeable by persons who are excluded by the amendment.
- Trustees of discretionary trusts that also own land outside of NSW, and the amendment would give rise to duty in a jurisdiction outside of NSW (South Australia and Victoria, for example, can be problematic).

There is only until 31 December 2019 to amend trust deeds, if required. That is not far away. Also, it seems to us that it would be appropriate for the proposed new law to expressly provide that the Chief Commissioner be able to extend this date, which is not uncommon in the income tax context. How, for example, is a trustee going to obtain a court order by 31 December 2019, if required? We appreciate as pointed out in the second reading speech that Revenue NSW has publicised the potential liability to the surcharges for discretionary trusts under the current law (ie by simply having one foreign person as a beneficiary under the current law the trustee would be treated as a foreign trustee/foreign person) (eg ruling number G010 and note number CPN 004). However, people make innocent mistakes and those mistakes may not be realised until after 31 December 2019. It seems to us that the proposed law should allow amendments after 31 December (eg if they are done within a reasonable time requested by the Chief Commissioner and there have not in fact been distributions to foreign persons after 31 December 2019).

If an amendment is required, the transitional rule does not only require an amendment before midnight on 31 December - the amendment also needs to be before the due date for payment of duty (for the surcharge purchaser duty) or before the due date for payment of land tax (for the surcharge land tax). This additional requirement that the amendment needs to be before the due date for payment seems to us to be potentially problematic and could restrict in practice the utility of this concession.

If foreign persons are excluded in a separate deed of exclusion entered into pursuant to a power in the trust deed, will this be adequate? We understand that the practice of Revenue NSW has been to accept this, provided that both the power in the trust deed to exclude beneficiaries and the deed of exclusion are expressed to be irrevocable.

The amendments to the trust deed may be relatively extensive to expressly and irrevocably exclude foreign persons as beneficiaries, and prohibit the nomination or amendment to include a foreign person as a beneficiary.

## RECOMMENDED ACTION

If the Bill becomes law in its current form, we recommend that any new discretionary trusts established after the Bill receives assent contain provisions that comply with both the no foreign beneficiary requirement and the no amendment requirement, if it is proposed that the trustee of the trust will own residential land in NSW and it is desired that the surcharges not apply. Of course, this involves not having foreign persons as beneficiaries, which sometimes will not reflect the actual commercial goals.

In relation to discretionary trusts established prior to the Bill receiving assent, we recommend that the deeds and any amendments be reviewed to determine whether any further amendments are required if the trustee of the trust acquired any residential land in NSW on and from 21 June 2016 (contract or transfer entered into on or after then) or owned any residential land in NSW on and from 31 December 2016.

## FOR FURTHER INFORMATION PLEASE CONTACT



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