

Property Law Update

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Additional duty for foreign purchasers of residential property in Victoria: **a potential trap for discretionary trusts**

Earlier this year the Victorian government made changes to the Duties Act 2000 (Vic) (**Act**) to impose an additional 3% of duty on foreign purchasers of Victorian land used or intended to be used as residential property. These changes, which apply to contracts, transactions, agreements and arrangements (which may also include nominations of foreign purchasers) entered into and settled on or after 1 July 2015, have significant reach, particularly when it comes to discretionary trusts (including family trusts).

Hunt & Hunt recommends advice be sought prior to acquiring land in a trust to ensure that:

- (a) if it is an existing trust – it is not a foreign trust or is amended so that it will not be a foreign trust (subject to resettlement considerations); or
- (b) if you are establishing a new trust – it will not be a foreign trust.

These amendments also apply the additional 3% duty in circumstances where a foreign purchaser purchases land for a non-residential purpose and subsequently forms an intention to construct a residential building on that land.

WHY IS THE ADDITIONAL DUTY A CONCERN FOR DISCRETIONARY TRUSTS?

The changes create a potential trap for discretionary trusts because of the new definitions and interpretation sections that have been inserted into the Act. Further, the Commissioner is given the power to make a determination about a beneficiary's interest in a trust (which can result in a trust being deemed a foreign trust and consequently a foreign purchaser). The relevant excerpts from the Act are:

foreign purchaser means a transferee (for the purposes of Chapter 2) or a person who makes a relevant acquisition (for the purposes of Chapter 3), and that transferee or person is—

- (a) a foreign natural person; or
- (b) a foreign corporation; or
- (c) the trustee of a foreign trust.

foreign trust means a trust in which one of the following persons has a substantial interest in the trust estate—

- (a) a foreign corporation;
- (b) a foreign natural person;
- (c) another person that holds the substantial interest as trustee of another foreign trust.

foreign natural person means a natural person who is not any of the following—

- (a) an Australian citizen within the meaning of the Australian Citizenship Act 2007 of the Commonwealth;
- (b) the holder of a permanent visa within the meaning of section 30(1) of the Migration Act 1958 of the Commonwealth (i.e. a permanent resident);
- (c) a New Zealand citizen who is the holder of a special category visa within the meaning of section 32(1) of the Migration Act 1958 of the Commonwealth.

Section 3B – What is a substantial interest in a trust estate?

1. For the purposes of the definition of foreign trust in section 3(1), a person has a **substantial interest** in the trust estate if—
 - (a) the person has a beneficial interest of more than 50% of the capital of the estate of the foreign trust; or
 - (b) the Commissioner has made a determination under section 3D in respect of the person.
2. If, 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.
3. Subsection (1) applies whether or not the person has the substantial interest alone or together with an associated person.

Section 3D – Commissioner may determine person has a substantial interest in a trust

1. For the purposes of section 3B(1)(b), the Commissioner may determine that a person has a substantial interest in a trust estate if, in the Commissioner's opinion, the person has the capacity to determine or influence the outcome of decisions about the administration and conduct of the trust, taking into account—
 - (a) the practical influence the person can exert in addition to any rights the person can enforce; and
 - (b) any practice or behaviour affecting the trustee's administration and conduct of the trust (even if that practice or pattern of behaviour involves the breach of an agreement or a breach of trust).

2. This section applies regardless of any interests that any other person has in the trust estate.

What the above definitions mean is that a trust will be considered a foreign trust, and therefore a foreign purchaser liable to additional duty, where **any** beneficiary of the trust is a foreign natural person and could by the exercise of the discretion of the trustee receive more than 50% of the capital of the trust (which would be a common position for beneficiaries in most discretionary trusts). The fact that most discretionary trusts also contain a very broad class of beneficiaries also increases the scope for these provisions to apply.

By way of example, Hunt & Hunt's standard discretionary trust deed provides that the following persons are included in the class of beneficiaries:

grandparents, parents, brothers, sisters, spouses, widows, widowers, children and remoter issue and next of kin of the persons named in the Schedule and the spouses, widows, widowers, children and grandchildren of such parents, brothers and sisters, spouses, children and remoter issue and next of kin.

This definition, together with the trustee's broad discretion to distribute capital, means that if any one of the persons in this class is a foreign natural person then the trust will be a foreign purchaser and subject to 3% additional duty. This could be the case even if the beneficiary in question is a remote relative of the particular beneficiaries named in the Schedule who the trust was mainly intended to benefit and is a beneficiary who is unlikely to ever receive anything from the trust.

This is an issue for Australian trusts which already have one or more beneficiaries living overseas. It is likely to arise more frequently as Australians leave Australia to return to their roots, retire or relocate for work in a world that is becoming increasingly global.

WHAT SHOULD I DO?

Seek legal advice before purchasing a new property in a trust and in particular in a discretionary trust. Hunt & Hunt can advise you whether your existing trust is a foreign trust or whether it can be amended to make sure it will not meet the definition of a foreign trust. Hunt & Hunt can also provide you with a trust deed for a new trust that is drafted so that it will not ever meet the current definition of foreign trust.

Please contact us if you would like more information.

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