Family Discretionary Trusts & Foreign Purchaser Additional Duty
Is it time to vary your family trust deed?

Introduction

The State Revenue Office of Victoria ("SRO") has adopted a strict approach in determining whether a family discretionary trust is a foreign trust and thus subject to the foreign purchaser additional duty ("FPAD") on the acquisition of residential property.

The FPAD is currently 8% of the property's dutiable value and is in addition to normal duty rates. For example, buying a 1-million-dollar house would see you paying normal duty of $55,000 plus FPAD of $80,000 – that is a lot of extra duty to pay!

The SRO's new approach will result in an increase in family discretionary trusts being deemed foreign trusts and consequently liable for FPAD. There are, however, ways in which you can protect your trust, such as by varying your trust deed. McKean Park is of course available to provide advice and assist you with your particular circumstances.

The SRO's new approach and how it affects your family trust

The SRO previously applied a "practical approach" to determine whether a family discretionary trust was a foreign trust. It would assess the trust's previous distributions and its actual situation to determine whether a foreign beneficiary would be likely or unlikely to receive any future distribution from the trust. The SRO has removed the practical approach in favour of the "strict approach".

Under the SRO's strict approach, if a family trust has any potential foreign beneficiaries, the trust will generally be deemed a foreign trust. The *Duties Act* 2000 (VIC) ("the Act") defines a foreign trust as, "a trust in which a foreign corporation, a trustee of another foreign trust, or a natural person holds a substantial interest in trust estate". Special rules apply for discretionary trusts in determining whether the substantial interest threshold is satisfied. As the trustee of a discretionary trust has the discretion to distribute the capital of the trust estate to a person or a member of a class of persons, any such person is deemed to have a beneficial interest in the maximum percentage of the capital of the trust estate that the trustee is able to distribute to that person.

In light of the Act, the SRO views the acquisition of residential property by a family discretionary trust as follows:

- A discretionary trust typically, if not always, has a wide class of beneficiaries that could potentially include a foreign beneficiary; and
- The trustee of a discretionary trust has the power to distribute the capital of the trust to that foreign beneficiary; and
- The special rules for discretionary trusts deem that any such distribution to a foreign beneficiary could be at the maximum percentage; and
- Therefore, the substantial interest threshold in the definition of foreign trust is satisfied.

Accordingly, the SRO will deem virtually all discretionary trusts as foreign trusts under the strict approach. Proving otherwise to the SRO would take considerable time and expense. A family trust buying residential property in Victoria is therefore at risk of having to pay FPAD in addition to normal duty.

How to protect your trust from FPAD?

The most effective way to protect your family trust from paying FPAD is to vary the trust deed to expressly exclude foreign beneficiaries from receiving capital of the trust. The trust would not be deemed a foreign trust in circumstances where an exclusion clause prevents foreign beneficiaries from receiving capital of the trust. Normal duty rates would of course continue to apply.

Variation must occur prior to settlement

Importantly, the SRO makes it clear that any variation to the trust deed to exclude foreign beneficiaries must occur prior to the completion of the acquisition of the property. It is too late to amend the trust deed post-settlement to avoid FPAD.

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If you fail to vary your trust deed prior to settlement and the SRO conducts an audit post-settlement, there is a real risk that your trust may be deemed a foreign trust if there is no foreign beneficiary exclusion clause. If you cannot then prove that there are no foreign person beneficiaries, the trust will be responsible for the following:

- the unpaid FAPD;
- penalties and interest on the overdue monies; and
- potential additional legal costs to respond to the SRO's audit;

together with the time + stress involved.

Conclusion

Varying your existing trust deed can however have significant adverse consequences if not done correctly. For example, you could potentially cause a re-settlement of the trust resulting in duty being imposed on all dutiable property that the trust holds, as well as other tax implications. It is therefore paramount that you seek expert advice before proceeding with any variation to your family trust deed.

On the other hand, varying the trust deed to exclude foreign beneficiaries may not be appropriate in your particular circumstances. Perhaps the trustee wishes to distribute to a foreign beneficiary in the future. In this instance, an alternative solution may be to choose another investment vehicle to purchase the property. Again, this would need to be dealt with prior to settlement (and preferably before the purchase of the property) to avoid payment of FPAD if possible.

McKean Park would be pleased to advise you on your next property purchase and discuss the options available to you.

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