

Episode 41 - Transcript

Surcharge Traps

Intro

If you have clients who are not Australian citizens, it is important to understand when they will be liable to pay Surcharge Purchaser Duty or Surcharge Land Tax. Host Julian Morrow chats with barrister Andrew Rider about some of the trickier aspects of surcharge duty and land tax and tips for avoiding traps and giving the right advice at the right time.

Julian: Welcome to Risk on Air. I'm Julian Morrow and today we're talking about SPD and SLT traps with barrister Andrew Rider. Listed by Doyle's Guide as a leading tax barrister in Australia, Andrew also edits Australian Stamp Duties Law and writes the National Stamp Duty section of the online service Practical Guidance Property Law.

Andrew, thanks very much for joining us on Risk on Air.

Andrew: Thanks for having me, Julian.

Julian: Now let's get down to the basics, Andrew. SPD and SLT, before we talk about the traps, what do the acronyms mean?

Andrew: Surcharge Purchaser Duty and Surcharge Land Tax.

Julian: And why is this a subject that we're discussing on Risk on Air Lawcover's Podcast?

Andrew: Well, since both taxes were introduced in 2016, they've been the cause of, from what I understand, unprecedented numbers of claims and also the quantum of the claims where solicitors have been found to have incorrectly advised their clients on their liability or otherwise to the two surcharge taxes.

Julian: So it does sound like that word traps in the title is well placed. Could you just run us through what the two pieces of legislation did, what the Surcharge Purchaser Duty is and what the Surcharge Land Tax is, and I imagine stepping through some of that detail will perhaps map out the minefield for us.

Andrew: Yeah, absolutely. In 2016, the NSW government introduced the Surcharge Purchaser Duty. So for the first time in NSW, we had a special additional tax. It's like a Stamp Duty but it's an additional Stamp Duty. It's for foreign persons and it's only for residential land in NSW. When the tax first came in, it was sort of seen as a bit of a novelty. I don't think people had really drilled into the detail and understood the traps there were in trying to work out whether somebody was foreign. So essentially, the test of foreignness is either you're not an Australian citizen or you're not a permanent resident, or you are a permanent resident, but you haven't satisfied the 200 days in the last year test. So just to flesh that out a bit,

permanent residents - to escape the surcharge when they're purchasing residential land in NSW - before exchange and also before completion, which is when the transfer happens, they have to have been in Australia for 200 days. Not continuously, but 200 days in the year before exchange and also before completion. That's obviously just talking about natural persons, individuals. Foreign person is a very wide concept. It includes companies and it includes trusts, specifically discretionary trusts, although it does include all trusts. The trap with discretionary trusts was that, because a lot of the definitions come from the FIRB - the Foreign Investment Review Board - legislation, which nobody reads and, in fact, nobody can understand, then you find that people don't appreciate that it only takes one potential beneficiary of a discretionary trust to actually make the trustee a foreign person. But, in any event, the legislation was amended in 2020 retrospectively too so that now the position is that every trustee of every discretionary trust that holds residential land in NSW is considered to be a foreign person, unless there's an irrevocable prohibition in the Trust Deed on any foreign person being a beneficiary, whether taker in default, or whether a discretionary object or both. So it was the foreignness of people that was not, I think, being picked up either by the purchasers themselves or their solicitors.

There's been a lot of confusion about when a visa type makes someone a permanent resident. Generally speaking, a permanent resident has got no time limit on when they can stay in Australia. Bridging visas, I think, were one of the big areas that has been and will continue to be an issue because it's a little bit strange the wording of the conditions to do with a visa. It doesn't jump out at you that someone's time limited, but in fact they are because they're here, I think, until the minister exercises discretion. So it's not in fact an unlimited time period.

So this is where the problems have arisen. So the problems all come from these forms that people fill in. They're called Purchaser Declarations and for individuals, if they're not an Australian citizen, then there's a question 'are you a permanent resident?' And I think people have been confused, either because of their visa type or because they're confusing it with a federal tax concept, which is a tax resident, which is a different test altogether, or they haven't read the test, that not only do they have to be a permanent resident, they have to satisfy the 200 days in the year before exchange or completion of the purchase of the residential land.

Julian: And just on the year there, is that calendar year or financial year.

Andrew: Calendar year. Calendar year. So that's where it started off really with individuals, but now Revenue through this Surcharge Purchaser Duty compliance campaign, and this is a well-funded campaign. There was a line item in the NSW budget a few years ago, allocating I think, specific funds to the audits, where they expected that, as a result of undisclosed liabilities in their audits, they were going to be collecting an additional \$200 million over four years. And the thing about it is a lot of these properties are high value properties and where the surcharge liability is missed, sometimes it's in the millions of dollars plus there's always at least 25% penalty tax and a very high rate of interest, typically north of, I think, about 12% to 14% per annum.

Julian: So it's a high stakes game of very technical definitions. Very important to be cautious and clear on advising clients.

Andrew: Yeah, absolutely. And the problem is I think clients aren't either giving the right instructions to their lawyers or the lawyers aren't asking the right questions about particularly the visa type that they have, or just taking it at face value. I mean, it's pretty easy to tell when someone's an Australian citizen, you ask for their passport, and it will say whether they are or aren't an Australian citizen. With permanent residents, if the lawyers are just asking, are you one?, are you a permanent resident?, they're not going behind what their visa type is. Now, a few years back, Revenue did amend or augment the explanatory notes they have to their Surcharge Purchaser Declarations, and I think from memory there's a table right at the front of those explanatory notes where it talks about common visa types and whether they do or don't make somebody a permanent resident. But I've got to tell you one thing that's a bit bizarre with one of the visa types and it's a pretty common one, it's to do with New Zealanders and their subclass 444 visas. So get this, while they hold that type of visa, the 444, and they're in Australia, they're considered to be a permanent resident. As soon as they pass through immigration to go overseas and leave Australia, they become a foreign person. But when they return to Australia, they again become a permanent resident. So is it a common trap? Well, I've seen it enough that, yes, it is. The first time I became aware of it, a New Zealand lady with one of these visas was about to exchange on some residential property in NSW. She must have given authority for someone to sign on her behalf. Well, she left the country before exchange. She was a foreign person at the time of exchange, so she was absolutely toast, and I think she stayed out of the country until completion, so she was a foreign person at completion, because you actually test Surcharge Purchaser Duty at exchange and completion.

Julian: Give us that point again. So you test it at...

Julian (and Andrew): ... at exchange and completion.

Andrew: Yes

Julian: So you need to be very alive to the possibility

Andrew: Yes

Julian: that different practices could change your status within that time.

Andrew: Yeah, but there's an interesting twist. So if you're foreign at exchange but you're not foreign at completion, provided you pay the Surcharge Duty, your liability that arose because you were foreign in exchange, if you pay it, you can actually get it back if you're not foreign at completion. But the problem is, number one, if you weren't expecting a foreign surcharge liability and I mean it's a lot of money, currently it's 8%, it's going up to 9% from the 1st of January 2025. And that's on top of normal stamp duty. But the thing about it is, if you weren't expecting to have to pay 9% on top of the normal stamp duty. well, where are you going to get the money from?

Now, sometimes it's not an issue because a lot of these liabilities are very high sort of value properties, so the individuals are relatively well off. But if they're not, there becomes the issue. Well, how do you fund an unexpected liability of hundreds of thousands of dollars? Often, or sometimes it's low millions and, yes, you will eventually get it back, but with refunds of a certain size, it's going to take a couple of weeks at least to get the money back from Revenue NSW.

Now let's look at the obverse of that. You're not foreign at exchange but you're foreign at completion. Now this is where a lot of traps have arisen, because you're filling your Purchaser Declaration off the back of the exchange and you're not a foreign person and then by the time completion comes around, you've forgotten that you've become foreign again. In the case, for example, if you're New Zealander with a 444 subclass visa, that they're out of the country at completion, so they're actually liable for the surcharge on the transaction because they were foreign at completion. So, as I say, it bites at two points. So you've got to be non-foreign at both points. Or at least, if you were foreign at the first point, you've got to be non-foreign at completion so you can pay and get your money back.

Julian: Wow. Well, I certainly think that any listeners who have New Zealand clients are certainly paying very, very careful attention now, and I think the general take home from this is that in any category of visa, you need to be very, very particular about what the details of the visa are and to satisfy the 200-day requirement.

Andrew: Yeah, from what I understand, I think if you'd hop onto the Department of Home Affairs website, I'm pretty sure it's got a function or whatever that you can actually put in the visa type number, and it will tell you what the conditions are attached to the visa. But it also will probably pay you as well to have a look at the explanatory notes to the Purchaser Declaration to see what Revenue is saying about some of those visas, because, as I say, bridging visas from memory is one that kept coming up as a problem.

Julian: And it's not unknown in the area of immigration law for different categories of visa to pop up and disappear, and it's a constantly changing area.

Andrew: It is a constantly changing area and there are literally dozens, if not even low hundreds, of visa types, so you've got to be careful in each and every case.

Julian: And to recap the point that you made earlier, it serves a client's best interests not to assume that the client themselves is fully across the detail of their visa status, because let's face it, these things are complex and sometimes you have an understanding that can be a little bit wrong and it sounds like the financial consequences of it, in this instance, can be quite profound.

Andrew: That's right. And the other thing is a lot of the clients buying these high value properties - English isn't their first language. And if they're reading an English language form

Julian: English is my first language and I'm struggling with some of these concepts.

Andrew: Yeah, from memory I can't remember if they've got translations of the form on the Revenue NSW website, but even then, if, for example, you're not an English speaker and you're reading the term permanent resident, as I say, issues have come up because someone is, for example, a tax resident for federal tax purposes, but that's not the test for whether they're a foreign person or otherwise for your NSW surcharge duties.

Let's also talk about other types of foreign persons - companies. So what we're seeing now, particularly where people are lodging stuff through eDuties so not to get too technical all the lawyers will know what I'm talking about. So there's two ways you can lodge or stamp documents in NSW. There's a thing called EDR, which is where lawyers can register and do it themselves in-house, or you can use what's called a client service provider, and there's four well-known ones around town, or you have to do eDuties. So in other words, you lodge your documents electronically, but that goes to a live person at Revenue NSW. Now where your transactions are going through eDuties and it's a company that's a purchaser and

someone has ticked 'No the company is not a foreign person', Revenue themselves is now doing back checks in terms of their own ASIC searches as to who the shareholders are in the companies. Now, I'm not sure when it comes to individual shareholders when they're going to the next step, for example, in checking their citizenships.

So everyone should be aware, Revenue NSW has got information sharing protocols with the Commonwealth and from memory they are able to access details about people's citizenship but also their immigration records, about when they've come into Australia and when they've left Australia. And so that's how a lot of people have been caught. They've said on the form whatever, they've been in the country 200 days either before exchange or completion. Revenue's hopped onto the immigration records and found that's not true. So we all know that when we come back into Australia, we've got to fill out forms as to where we've been and how long we've been away, etc. So anyway, Revenue's got access to all of that.

But where Revenue is, for example, finding through an ASIC company search a non-beneficial shareholding, then they're sending out requisitions and they're saying, well, why is it non-beneficially held? Is it being held by a trustee, which most obviously it will be. And they're saying, well, if it is, is it the trustee of a discretionary trust? And bingo, nobody of course has had the presence of mind, a lot of lawyers haven't asked their clients, or their clients don't know themselves who the shareholders are in the company, or they forgot to tell the lawyer it's a discretionary trust.

Coming back to what I said before, with discretionary trusts it's a pretty low threshold for them to actually be foreign. If factually, there is one foreign person who is within the very wide class of objects the discretionary trust is a foreign person. So how does it happen? So with modern discretionary trusts, particularly with the natural persons, the class of beneficiaries is often a very wide family group. So if, for example, you've got you know a principal beneficiary but for example, their ancestors came from or are still overseas, you know, you've got Aunt Dora who's an Italian citizen, and suddenly she's a beneficiary of your discretionary trust, and so that makes the trustee a foreign person. Only takes one.

Julian: Or they're a New Zealander resident in Australia who's left the country briefly.

Andrew: Don't go there, Julian, but yes, that's right. So, anyway, Revenue in their requisitions they're saying, all right, well, you can say there's a non-beneficial shareholding. If it's a discretionary trust, show us the trustee. So there's an interesting issue here about this change of law that happened in 2020 that says now, by default, all trustees of discretionary trusts are foreign person unless there's this irrevocable prohibition.

Julian: Yeah, so let's just pause and dwell on that. As a result of this amendment, there's effectively a deeming or a presumption that everyone's foreign.

Andrew: Exactly

Julian: And that you've got to go through a very particular procedure.

Andrew: Absolutely

Julian: To establish that you're not foreign.

Andrew: Exactly. So Revenue did publicise at the time, I think pretty widely through their website and probably through seminars and that sort of thing. So they said, all right, well, listen everyone, there's a change of law coming and it's going to be retrospective unless you amend your Trust Deeds or if you're drafting a new one, you incorporate into it this irrevocable prohibition on foreign persons being beneficiaries and, from memory, you had to do that before 31 December 2020. So if you did it happy days and you did it properly, the Trustee was retrospectively treated as not being foreign back to the introduction of Surcharge Purchaser Duty, which was, I think, 21 June 2016. That in itself was a bit of a shocking thing, it was a retrospective tax or for the Surcharge Land Tax, which came in on 31 December 2016. We haven't talked about Surcharge Land Tax yet, but we will. So I think there was a mad rush to get the amendments on. Some people missed the deadline. Just a couple of things there. Even if people have made changes, Revenue has reviewed a lot of them and aren't satisfied with them. So that's a trap in itself. People tried to do the right thing, but they didn't do what Revenue wanted them to.

So what's the big message for all lawyers out there? If you know, for example, that your purchaser is a discretionary trust, or, for example, if it's a company and one of the shareholders is a discretionary trust, you've got to ask your clients to give you the discretionary trust deed and all deeds of variation, and then you've got to check yourself whether or not it meets the prescriptive requirements of the law. One of the issues that's come up is well, people say, well, gee, my client didn't meet the deadline of 31 December 2020. So, well, what do I do now? Is it a lost cause? Well, the answer is it's not a lost cause going forward. It is for the past, and that particularly manifests itself for Surcharge Land Tax, which we will talk about in a minute. But what it means is yes, before exchange, if the client says well, we're going to be buying this property in a discretionary trust, grab the trust deed, all variations. If at no stage, either in the deed itself or in the variation, they've tried to include the irrevocable prohibition on foreign beneficiaries, then you have to actually amend the trust deed, ideally before exchange. I would say always before exchange, the thorny issue arises if you've missed it, can you do it between exchange and completion? Well, that engages what we were talking about before, that if you're foreign at exchange but non-foreign at completion, so just say you do, and then your discretionary trustee, so you're not foreign then you've got to pay and get the money back.

But back to a company. So that's one of the things you've got to do as well. If a client comes in and says oh, we're going to be buying residential land in a company, as a lawyer it's incumbent upon you to trace all the way to the top of the ownership train to determine that there are no foreign persons, either foreign individuals or trusts, discretionary trusts, for example that have got at least one or more foreign persons as beneficiaries. Or, for example, if it's a unit trust, you don't have a unit holder that's a foreign person, it's a low threshold there. You only need a foreign person holding 20% of the units in the trust and they're foreign, and those sort of things.

Julian: And again, to remember that you need to do those tests, you need to drill down all the way at at least two points in time.

Andrew: Yeah, absolutely. But the idea is you save yourself the misery and you do it before exchange, so you ask all those questions.

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- Julian:** You were talking about the need to amend the Trust Deed to have this irrevocable prohibition.
- Andrew:** Yes
- Julian:** It was a statutory deadline for the time when that has to occur. So if you've missed the statutory deadline, is there any ability for that deadline to be extended somehow or for a deed variation to be made retrospective to sort of look like it complies with that statutory deadline?
- Andrew:** Yeah, so the statutory deadline, the purpose of meeting the statutory deadline was to protect yourself from the retrospective application of the tax.
- Julian:** right
- Andrew:** So, technically, what the law said is, if you're the trustee of a discretionary trust and you haven't got the irrevocable prohibition in there before as I said I think it was 31 December 2020, then we will tax you back to 2016 if you bought any residential land between 2016 and 31 December 2020, or if you held any residential land as trustee of that discretionary trust which engages the Surcharge Land Tax provisions. But just because you missed the deadline, okay, the past is gone and you don't have the retrospective protection, but you can always amend it now before exchange and you won't be deemed to be a foreign person going forward. It's just you don't get the retrospective protection looking backwards.
- Julian:** You mentioned that there was a degree of publicity about these changes, but it also does seem to be a very technical area and the sort of area where, even with the best of intentions, you might come a cropper.
- Andrew:** Yeah
- Julian:** What if you make a genuine mistake? Is that going to help at all in the process of trying to get these assessments challenged?
- Andrew:** Yeah, look, unfortunately, making a reasonable mistake or ignorance of the law has never helped anyone. Certainly, based on all the tribunal cases, which is where all the litigation has been in this area, I can't recall any Supreme Court cases and from memory I think every single taxpayer has lost their cases in the tribunal or NCAT. Now where the sort of best efforts, reasonable mistake, manifests itself is, for example, the ability to remit penalty tax or interest. So with all these surcharge, retrospective surcharge assessments which get picked up through audit, often years after something has happened, there's always, in addition to the primary liability with a Surcharge Purchaser Duty or Surcharge Land Tax, there's also penalty tax, which starts at 25%, but there's a discretion to remit if there's reasonable care taken, and then there's the interest as well. So it's a triple whammy. But interest is also the case law says if reasonable care was taken. So the question is, if a client goes to a lawyer and they were acting on the conveyance, is that enough to say, well, I was using a lawyer? Does that mean either the client, being the person who's actually primarily liable, did I take reasonable care because I engaged a lawyer? And I think the way the case law is developing is, no, that's not enough. The lawyer themselves has to have taken reasonable care, and that's always a tricky question. For example, did the lawyer ask all the questions that we've been talking about in terms of visa types and doing company searches to see what's at the top of the chain of ownership of the company? Or, for example, did they ask for the Trust Deed and deeds of variation to see whether or not the irrevocable prohibition from beneficiaries was in there? And even if they did, did they have the presence of mind to see whether it was even effectively drafted?

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- Julian:** Yes, and anyone looking for a bit of leniency or salvation certainly wouldn't be getting much comfort from the recent administrative tribunal decisions. One recent one is *Keddas Pty Ltd as the Trustee for the Kaluarachchi Family Discretionary Trust*. But again, all those things that you just identified, set out in very clear black and white, genuine mistake, doesn't make any difference. Appeals to notions of fairness, leniency or natural justice just not relevant when considering the validity of assessment under review.
- Andrew:** Yeah, and I think if the tribunal hasn't said that once, they probably said it over a hundred times. All those things you've mentioned which everyone, every dissatisfied taxpayer, chucks into the mix, they always go down in a screaming heap.
- Julian:** Yeah, I think there was an earlier case where there was a suggestion that the Commissioner should have made these changes more public and put the taxpayer on notice, but no dice there either.
- Andrew:** No, no, the other things as well, just sorry, just talking about foreignness as well, with clients sort of either having failing memories or misleading their lawyers and saying, if they were permanent residents, oh yeah, I was in the country for 200 days. So Revenue is back checking that because, as I say, they've got access to immigration records. But lawyers with authorisation can actually also verify whether their clients are telling them the truth. With authority, anyone can access again I think it's the Department of Home Affairs website. I might be wrong about that, but one of the Commonwealth agencies, you can actually go onto their website and, with authorisation from the client, you can actually access their immigration records to see whether they really were in the country 200 days in the year before exchange and completion.
- Julian:** Well, Andrew, you promised it so many times already that I feel I should ask you. We've been speaking so far about the SPD, the Surcharge Purchaser Duty. Now look, this is tax law. I assume that everything that you've said just applies equally and consistently and validly for the Surcharge Land Tax as well. Tell me it's so, Andrew.
- Andrew:** Yeah look it pretty much is Julian. So the definitions and concepts for Surcharge Land Tax, they're all borrowed from definitions that are in the Duties Act, albeit a lot of them are borrowed from the Foreign Acquisitions and Takeovers Act, which no one really can understand. But in any event, look, the difference is Surcharge Purchaser Duty, that's when you buy something that's residential. Foreign person buys residential land. Surcharge Land Tax is where a foreign person holds residential land in NSW at one of the annual taxing dates for Land Tax. which is always 31 December of every year. The concept of who's a foreign person is the same. The 200 days requirement is the same as it is for if it's a permanent resident.
- Julian:** At least in this case you don't have to do it at two dates. It will just be that end of year date.
- Andrew:** Yeah, although there's a tricky provision which actually can sometimes help, I think it's permanent residents when they're actually using and occupying land as their principal place of residence. I'm just going to pause here and say this is a massive trap. Again, is it incumbent upon lawyers to tell their clients about this liability? Probably. So, permanent residents, for example, I think they are able to buy land in Australia to live in as their home. Again, there's FIRB rules about that. Let's assume they are, because this happens all the time with a liability. So, interestingly, foreign persons, if they do own residential land in NSW and they do use and occupy it as their principal place of residence, they get an exemption from normal Land Tax. but they don't automatically get an exemption from Surcharge

Land Tax. That depends upon whether they satisfy the special conditions which only from memory, apply to permanent residents. This is really weird the way it works. So the way that Land Tax works is, you look at land you own at 31 December in a year and then that determines your liability or otherwise for the year starting on the 1st of January immediately after that. So from memory, the way this exemption works for permanent residents to get out of Surcharge Land Tax on their principal place of residence in NSW is it's a prospective test from memory. So in other words, you have to satisfy the Commissioner. so you make a declaration and say I am telling you now that I will be using and occupying my principal place of residence in NSW for a continuous period of 200 days starting from 1 January 2025, to absolve me from my surcharge liability that sort of notionally rises at 31 December 2024.

So a lot of issues there have arisen about what does continuous mean? And I think they did amend the law to say it really means what it says, like it means physically in Australia, apart from, I think, very minor physical absences, and I can't recall whether or not it's even at the Commissioner's discretion, whether it's up to him whether he considers to be a minor absence to be a minor absence. So say, for example, you had a sick relative overseas, you're at 198 days and you had to go and see a sick relative in the United States for a couple of days or weeks. It's not clear whether or not that would be the type of circumstance where the Commissioner would let you off the hook. And the thing about it is it's a hard date If you fail the 200 days continuous; you're at 199 days and you don't get to the 200, the tribunal decisions on generally the 200-day test say it's binary, like you either do or don't make it.

Julian: So I think everyone listening will be very, very alert to the complexity and the needs for extreme caution and making sure instructions are clear, verified and potentially also getting additional expert advice where necessary. Let's talk now about some practical tips, then, Andrew, what tips would you suggest for solicitors when looking at establishing trusts by deed or will?

Andrew: Okay. So yeah, well, with deeds, discretionary trust deeds, you've got to make the client aware that unless they've got the irrevocable prohibition in the discretionary trust deed - so we're talking about inter vivos trusts (we'll talk about testamentary trust in a minute) - you've got to get their instructions, or at least you've got to tell them and say, look, if you're going to be buying land, residential land, in NSW, in this discretionary trust, if you tell me you don't want the irrevocable prohibition in there, then I'm telling you that each and every year you're going to be up for, in addition to any Land Tax. Surcharge Land Tax which I think, from memory, it's going up to 5% from 1 January 2025. So it's a big slug and there's no threshold either, it's flat, so it adds up very quickly. Sometimes you've got clients that will say, look, I take that on board, but look, I do actually want to be able to make distributions to people who are foreign persons. As to why they would want to do it, I've got no idea, but sometimes they do, or at least they want the flexibility because, for example, factually there are going to be foreign persons caught within the orbit of the discretionary objects, whatever the discretionary trust within the wide classes.

If that's the case, you file note that you told the client and you file note what the client told you. And probably make the client sign the file note as well, so that it's abundantly clear that they have voluntarily offered themselves up to be paying Surcharge Land Tax each and every year.

But if they say, oh, no, no, I don't want to be paying the Surcharge Land Tax. then you need to draft the irrevocable prohibition. You build it into the trust deed so that no foreign person could be a beneficiary. And the prudent thing to do is, if you have enough time for a taxing date before 31 December, upload the trust deed to the Land Tax portal of Revenue NSW which bizarrely you've actually got to register through Service NSW and then ask Revenue to sign off before the taxing date that they're happy that the terms of that trust deed, whether incorporated into it or incorporated by variation deed, satisfy them that foreign persons are irrevocably excluded. You need that so that their system isn't going to pick up that the land is owned by a Discretionary Trust, because if they do that automatically, by default, if you haven't shown them the trust deed and they haven't verified that it's okay, you'll get a default assessment for Surcharge Land Tax, and then you'll have to object or that sort of thing.

Julian: The wording of the irrevocable prohibition. Is that a set formula, a particular set of words?

Andrew: Not really. You've obviously got to pick up definitions that are in the Duties Act because they also apply for Surcharge, Land Tax. So you obviously have to exclude any person who's a foreign person under the Duties Act, which includes deemed foreign persons. There's actually two places you find the definitions, one's section 104J of the Duties Act, so it also applies for Land Tax purposes as well, but also 104J, which is the deeming provision that says any trustee of a discretionary trust is foreign unless there's the irrevocable prohibition on foreign beneficiaries. So you've got to exclude those types of foreign persons by definition.

Some people go wider and also talk about any person who may in the future be deemed under legislation that hasn't even arisen. So people try and anticipate what might happen or the Commissioner's administrative practices, Revenue rulings, that sort of thing. They try and cover the field as to how is it that someone could be foreign and if it's not just by legislation, they try and anticipate if the Commissioner might have a practice. Currently he doesn't, but I think people are just being prudent. But no, there is no set words, but there's certain things that you do need to build into it.

Julian: And going back to what you said before, whatever formulation you've chosen, prudent to actually upload it to the Commissioner and make sure that you've actually got the person who's going to be deciding and giving you a tick in advance.

Andrew: That's right. So for wills again, there was an interesting transitional provision there. So for wills, typically where this arises is where one or more of the beneficiaries are discretionary testamentary trusts, which is a very common estate planning technique. There was a grandfathering transitional provision. I think it said if your will (or codicil to your will, because codicils, of course, even if they don't touch the sort of provisions we're talking about in terms of irrevocable prohibitions, I think any change by codicil can actually republish the will) but the thing about it is the will or the codicil had to have been, I think, from memory, executed before the 31st of December 2020. And if it was, then if you've got a testamentary trust arising under that will or from the codicil from memory, you didn't need the irrevocable prohibition on foreign beneficiaries of the testamentary trust to protect it most typically from Surcharge Land Tax. Because if, for example, residential land is passing into a testamentary trust under a will from memory, I think there's a duty exemption. But when the land actually passes to the trustee thereafter, unless there's the prohibition and it's grandfathered, then you're going to be up for Surcharge Land Tax year after year, and I guess one of the traps is as well sometimes wills don't allow you to actually amend

the terms of the testamentary trusts. So that's another thing as well, when you're taking instructions from a client, because obviously we're now well past 31st of December 2020, so, if you're taking instructions from a client, either drafting a new will or a codicil, just be conscious that if there are beneficiaries who are testamentary trusts, you'll need to get their instructions on whether or not they do want the irrevocable prohibition on foreign beneficiaries, because if they don't, going forward, when the residential land passes under the will to those testamentary trusts, they'll be up for the Surcharge Land Tax. Again, it's a matter of instruction from the clients. You need to make them aware of it and sometimes they say, okay, I'm happy to, well no one's ever happy, but, all right, I understand the Surcharge Land Tax, yes, we'll incur it, because I do want that Testamentary Trust to be able to benefit a foreign beneficiary. Whatever the outcome is, you've got to tell them that you told them about the Surcharge Land Tax and you've got to file note what their response and instructions were.

Julian: And the same would apply to advising on any purchasing or holding a residential property?

Andrew: Yeah, absolutely. My first reaction, whenever I see somebody's talking about buying some land, my first question is, is it residential land? Yep, okay. Well, who's the purchaser? Right. Well, it's a person, right? Well, have you done all the relevant checks? Nope, go and do it before exchange. Is it a company? Yep, all right. Well, have you done all the ASIC searches? Have you seen any of the shareholders? And if there's any shareholders that are holding non-beneficially, are they trustees of a discretionary trust? Have you seen the trust deeds? Have you seen the variations? Have you seen whether the clauses are in there? Have you checked whether the clauses are even okay? If it's a discretionary trust, you ask the same amount of questions. Unit Trust is the same thing. Look at the unit register. Who are the unit holders? Etc, etc.

Julian: Great detail required. What about if you do find yourself getting either assessments or requests for information from Revenue NSW? Any practical tips for lawyers in that scenario, Andrew?

Andrew: Yeah, absolutely. So, number one, I mean it'll tell you you've got to respond, so do respond. If you don't, you can make things even worse. I should say that most investigations are carried out by Revenue for good cause, because they've back-checked things that don't match up with what they've been told. So you do need to respond. Obviously, you need to onboard your client immediately and you've got to get to the bottom of whatever it is that's upsetting Revenue. And if there's something that needs to be disclosed, you disclose it. When responding, if, for example, there has been a liability triggered and no one realised it, the Revenue will always say in their letters, listen, if we find you're foreign, there's going to be Surcharge Purchaser Duty or Land Tax, but also there's going to be interest and penalty tax. There's often not a lot you can do about the primary liability, but one of the first things that should come to mind is you've got to make submissions back to Revenue, in addition to providing information, asking for a remission in whole or part of the penalty tax or the interest. Will it be granted? In the early days they were more lenient, not so much now. But if you don't ask, then you're not going to get. But there are some things, a checklist if you like you can go through to see whether Revenue is on the right track. So Revenue might say, look, you're a permanent resident but you weren't in the country 200 days. Well, you can actually, as I said before, you can actually access someone's immigration records from this Commonwealth department. Look, 99 times out of 100, or probably 999 times out of 1,000, Revenue will have got it completely right. I only see one instance where I think someone had the identical name as someone who was a purchaser, but they got the wrong

person and in fact this person really had, by checking the right immigration details which they were able to access, they were in the country. Another one as well is verifying whether somebody who might've been foreign at exchange was actually non-foreign at completion, which would mean you'd say, all right, well, you got us, we're foreign exchange, okay, we're going to have to pay the liability, but in fact here's the evidence to prove they were non-foreign at completion. So we're paying the money and thanks, we'll have the money back.

There's an interesting quirk with discretionary trust deeds. There's a special grandfathering provision. No one seems to know about it and it's always the first thing I tell people about. If, factually, a discretionary trust deed had no foreign beneficiaries on the date of the amending legislation, and I'm reluctant to say the date because it slipped my mind, lawyers can verify it themselves if you look at the transitional provisions in the schedules to the Duties Act and the Land Tax Act, I think it is, as opposed to Land Tax Management Act (well, maybe it's in that as well). So, whatever this date is, if you can prove to Revenue's satisfaction that there were factually no foreign beneficiaries, then the trustee of that discretionary trust is protected from being deemed to be a foreign person until such time that, factually, someone does come a beneficiary. Now this has actually helped a lot of people that have come to me upset where Revenue has said, oh okay, well, hang on, we've detected that the land is held by the trustee of a discretionary trust and most typically this has manifested itself through, say, a Surcharge Land Tax investigation.

Now, with the cases where we've been able to satisfy Revenue in relation to the application of this transitional provision, a lot of the trust deeds have been really really old, and by that I mean they're from the late 60s or the 70s or the 80s when discretionary trusts weren't as sophisticated as they are now and they often had a very, very limited class of discretionary objects who are often just natural persons and there may not have actually been that much of them.

So one of the first ones I did for a client successfully I think the only discretionary objects were actually five natural persons at this particular date and we were able to get all their passports which showed at that date they were all Australian citizens and so we were able to get them out of the Surcharge Land Tax liability, notwithstanding that the trust deed actually couldn't be amended because it was so old, it didn't even have an amending clause. So it's worked for a couple of clients. With the more modern trust deeds, they've often got such wide classes of discretionary object it's virtually impossible to prove that in fact, like, all the natural persons are Australian citizens or non-foreign persons, because it includes some very remote relatives and it's very hard to identify who those relatives might be and what their status is as foreign persons or otherwise. Or, for example, there's companies and trusts who are beneficiaries. And again, trying to prove a discretionary trust is not a foreign person because there aren't factually any foreign beneficiaries, it almost becomes impossible. But anyway, as I say, some clients have been able to do it.

Julian: Well, Andrew, there definitely seem to be a lot of traps in both SPD and SLT. Thank you so much for running us through them on Risk on Air.

Andrew: Thanks for having me, Julian.

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Surcharge Traps

Outro

Thanks for listening to Risk on Air by Lawcover. Join us for the next episode on current risks in legal practice to stay up to date.

Resources:

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