



COMMISSIONER'S PRACTICE DA 41.0

LANDHOLDER DUTY – EXTENT OF INTEREST IN A DISCRETIONARY TRUST

This Commissioner's practice explains the factors the Commissioner will consider when determining the extent of a landholder's interest in a discretionary trust under section 158 of the *Duties Act 2008* ('Duties Act').

Background

Chapter 3 of the Duties Act imposes duty on the *relevant acquisition* of a *significant interest*¹ or a further interest in a *landholder*.

Under section 155 of the Duties Act, an entity is a *landholder* if, immediately before the acquisition, the entity or a linked entity is entitled to land in Western Australia valued at \$2 million or more.

In relation to an acquisition of an interest in an entity ('the main entity'), where it is necessary to determine if there is any other entity linked to the main entity, section 156 of the Duties Act relevantly provides that:

- an ownership chain exists if a series of entities starting with the main entity are successively linked to one another;² and
- an entity is linked to the trustee of a *discretionary trust* if it is a potential beneficiary under the trust.³

Section 3 of the Duties Act defines a *discretionary trust* as:

- a trust under which the vesting of the whole or any part of the capital of the trust property, or the whole or any part of the income from the capital, or both –
 - (a) is required to be determined by a person either in respect of the identity of the beneficiaries, or the quantum of interest to be taken, or both; or
 - (b) will occur in the event that a discretion conferred under the trust is not exercised;
- or
- a trust that is, by regulation, declared to be a discretionary trust for the purposes of this Act,

¹ A *significant interest* means a 90 per cent or greater interest in a listed landholder or a 50 per cent or greater interest in an unlisted landholder: Duties Act s 161.

² Duties Act s 156(3).

³ Duties Act s 156(5).

but does not include –

- a trust that is solely a charitable trust; or
- a trust that is, by regulation, declared not to be a discretionary trust for the purposes of this Act.

Under section 157 of the Duties Act, the value of the entitlement of a linked entity to land is an amount equal to the same percentage of the unencumbered value of the land as the percentage of the main entity's interest in the linked entity.

Section 157(3) of the Duties Act provides that, in the case of a linked entity other than one that is immediately below the main entity in the ownership chain, the percentage of the main entity's interest in the linked entity is determined by multiplying the percentage of each link in the ownership chain.

Section 158(a) of the Duties Act provides that a potential beneficiary under a trust is taken to have a 100 per cent interest in the trust if the trustee of the discretionary trust is a linked entity. However, under section 158(b) of that Act, the Commissioner may determine it is inequitable to regard a potential beneficiary's interest in the discretionary trust to be 100 per cent and may decide the beneficiary's interest is some other percentage, or no interest.

Commissioner's Practice

1. Section 158 of the Duties Act does not include any criteria about when it will be inequitable for an entity's interest in a discretionary trust to be 100 per cent. The Commissioner will consider all facts and circumstances in each case when deciding whether to exercise the discretion to reduce the entity's interest to less than 100 per cent.⁴
2. In determining whether an entity's interest in a discretionary trust should be less than 100 per cent, the Commissioner will consider the entity's entitlement to the capital of the trust and whether the entity or the main entity does, will or may control the trust.
3. An entity will be considered to control a discretionary trust if it is in a position to directly or indirectly influence the vesting of the whole or any part of the capital of the trust property or income from the trust property.
4. Factors the Commissioner will have regard to when deciding to exercise the discretion under section 158 include:
 - 4.1 whether the entity is expressly named as a beneficiary of the discretionary trust or is a beneficiary because it is within a class of beneficiaries described in the discretionary trust (for example, it is a corporation of which a named beneficiary is a member);
 - 4.2 the entity's entitlement to the capital (that is, the property) of the discretionary trust upon the vesting of the trust. This will be

4 *Milstern Nominees Pty Ltd v Chief Commissioner of State Revenue* [2015] NSWSC 68 [29].

considered on the assumption all circumstances entitling the entity to a distribution of the trust capital are satisfied;

- 4.3 whether the entity's position as a discretionary object of the trust is related to the relevant acquisition, for example, if the acquisition of the main entity occurred so the acquirer could gain control of the discretionary trust;
 - 4.4 whether the entity will remain a potential beneficiary of the discretionary trust after completion of the relevant acquisition;
 - 4.5 the nature of the relationship the main entity or any other linked entity has with the discretionary trust or its property, including:
 - 4.5.1 whether the trust property or any part of it has been used as security for the benefit of the main entity or any linked entity;
 - 4.5.2 whether the trust property or any part of it has been used in any commercial activity or business structure involving the main entity or any linked entity, for example, where the business of the main entity is conducted on the land of the discretionary trust for nil or nominal rent; and
 - 4.5.3 whether there are any loan arrangements between the discretionary trust and the main entity or any linked entity;
 - 4.6 the circumstances surrounding establishment of the discretionary trust, including whether the trust was established for the benefit of the entity and the relationship between the entity and the person(s) for whom the discretionary trust was established;
 - 4.7 whether the main entity or any other linked entity has benefitted from the trust, either through the distribution of trust property or income under a power of appointment or otherwise, including the extent and regularity of any distributions;
 - 4.8 where the trustee of the discretionary trust has limited discretion to distribute capital or income of the trust, for example, the distribution of income is discretionary but the distribution of capital is fixed, the extent of the limitation and the obligations of the trustee; and
 - 4.9 whether the acquirer of the main entity gains any economic benefits from the discretionary trust property without acquiring an interest in the property.
5. These factors are provided as a guide and are not an exhaustive list of the matters the Commissioner may consider. In each case the onus is on the taxpayer to provide the information required for the Commissioner to make a decision under section 158 of the Duties Act about the extent of an entity's interest in a discretionary trust.

When the Commissioner will Reduce an Interest

6. Where the linked entity provisions apply so that more than one beneficiary has a 100 per cent interest in the same discretionary trust, the Commissioner will exercise the discretion under section 158 to ensure the sum of interests in the trust does not exceed 100 per cent.
7. The Commissioner will not usually reduce the interest of an entity in a discretionary trust to an interest between 0 per cent and 100 per cent except where:
 - 7.1 the trustee has limited discretion to distribute property of the trust to potential beneficiaries. This may be the case where the trustee of a trust with multiple beneficiaries has full discretion to distribute the income of the trust, but must distribute the capital in set proportions. In this case the Commissioner is likely to determine that a beneficiary of the trust has an interest equal to its entitlement to the capital of the trust; or
 - 7.2 multiple beneficiaries of the trust are linked entities and the Commissioner is satisfied the acquirer has gained the ability to control the trust. In this case the Commissioner is likely to determine that each linked entity that is a beneficiary has an equal interest with the sum of interests being 100 per cent. For example, if there are four beneficiaries that are linked entities, the interest would be determined as 25 per cent for each entity.
8. In all other cases, the Commissioner will usually exercise the discretion to reduce an entity's interest in a discretionary trust if satisfied:
 - 8.1 the entity has not benefited and is unlikely to benefit from the trust;
 - 8.2 neither the main entity nor any linked entity controls the trust; and
 - 8.3 the acquisition of the interest in the landholder does not and will not result in a change in beneficial ownership or control of the discretionary trust property.

Example 1

Company A is a landholder in the business of property development. Mr Jones is a director of Company A and holds 100 per cent of the issued shares.

Mr Jones is also the trustee and a named beneficiary of the discretionary Jones Family Trust. Company A is not a named beneficiary. However, under the trust deed any corporation in which a named beneficiary is a shareholder is a potential beneficiary of the trust. Company A is a potential beneficiary of the trust on the basis Mr Jones is a shareholder of Company A.

The trust deed provides the named beneficiaries are entitled to the capital of the trust upon vesting in the absence of an appointment by the trustee.

The trust was established to hold land on which the Jones family carried on a farming business. Company A has never received a distribution of capital or income from the trust.

Mr Jones sells 50 per cent of the shares in Company A to Ms Smith, which results in Ms Smith making a relevant acquisition in Company A. The consideration paid is equal to 50 per cent of the net value of the company.

The Commissioner would usually exercise the discretion to reduce Company A's interest in the trust to nil for the following reasons:

- Company A does not own or control the land of the trust;
- the acquisition has not resulted in any change in the beneficial ownership or control of the property of the trust;
- the trust's land is not used for or connected or associated with Company A's business or other activities; and
- the trust was established for the benefit of the individual members of the Jones family.

Example 2

Mr Lee is a shareholder of Company B, a mining company listed on the ASX. Mr Lee is also the trustee of the Lee Family Trust, a discretionary trust of which he is a named beneficiary.

On 1 July 2015, there was a relevant acquisition of the shares in Company B.

Under the trust deed any companies in which Mr Lee is a shareholder may be beneficiaries of the trust, and Company B is therefore a potential beneficiary. However, the directors of Company B are not aware of the trust and Company B has never received any distributions from it.

In these circumstances the Commissioner would usually exercise the discretion to reduce Company B's interest in the trust to nil.

Example 3

The Z Unit Trust is a land development trust which holds a number of properties in Western Australia in various stages of development. The administration of the business is conducted on land owned by the Y Hybrid Trust.

The primary beneficiaries of the Y Hybrid Trust are the Z Unit Trust and the X Property Unit Trust (which has many of the same unit holders as the Z Unit Trust). The trustee of the Y Hybrid Trust has absolute discretion to distribute income received by the trust to any beneficiary, but may only distribute the capital of the trust (including the land owned

by the trust and any proceeds of the sale of that land) equally to the Z Unit Trust and the X Property Unit Trust.

The Z Unit Trust issues a number of additional units to an existing unit holder, which results in that unit holder obtaining a significant interest.

In these circumstances the Commissioner is likely to determine the Z Unit Trust has a 50 per cent interest in the Y Hybrid Trust, as it is guaranteed to receive 50 per cent of the capital of that trust.

When the Commissioner will not Reduce an Entitlement

9. The Commissioner will not usually reduce an entity's interest in a discretionary trust to less than 100 per cent if:
 - 9.1 the acquisition in the main entity does, will or may result in a change in the beneficial ownership or control of the discretionary trust property; and
 - 9.2 duty has not been assessed on the change in beneficial ownership or control of the discretionary trust property as a trust acquisition or surrender⁵ or a disposition of shares in a corporate trustee.⁶

Example 4

Company C operates a market garden business which is run on land owned by the C Discretionary Trust that is leased to Company C at market rates.

The trust was specifically set up to hold the land used by Company C, and the trustee of the trust is a company owned by Company C. Company C is one of a number of named beneficiaries of the trust.

Distributions of income from the trust have been made to a variety of individual beneficiaries, but not to Company C.

An investor buys 100 per cent of the issued shares in Company C.

In this case, the Commissioner would usually determine Company C has a 100 per cent interest in the trust as the investor is able to control the trust by changing the directors of the trustee company.

Example 5

Company D holds land in Western Australia valued at \$5 million in its own capacity, and also holds land in Western Australia valued at \$2 million as trustee of the Fletcher Family Trust. The primary beneficiary of the trust is Company D in its own capacity and other beneficiaries include a number of individual members of the Fletcher family.

⁵ See Duties Act ss 53 – 62.

⁶ See Duties Act ss 63 – 66.

Ms Roberts buys 100 per cent of the shares in Company D from an unrelated party. As part of the dealing the trust deed is amended to remove the existing beneficiaries (apart from Company D) and replace them with Ms Roberts and members of her family.

The acquisition of shares in the corporate trustee of the trust is assessed for transfer duty on the value of land held by the trust.

In this circumstance, the Commissioner would usually exercise the discretion to reduce Company D's interest in the trust to nil as it would be inequitable to assess duty twice on the same land under what is essentially two steps in the same transaction.

Date of Effect

This Commissioner's practice takes effect from 27 May 2016.

Nicki Suchenia
COMMISSIONER OF STATE REVENUE
27 May 2016

Commissioner's Practice History

Commissioner's Practice	Issued	Dates of Effect	
		From	To
DA 41.0	27 May 2016	27 May 2016	Current