LAND TAX AND UNIT TRUSTS

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Changes to NSW Land Tax

Following the High Court's decision in *CPT Custodians Pty Ltd v Commissioner of State Revenue; Commissioner of State Revenue v Karingal 2 Holdings Pty Ltd* [2005] HCA 53, the New South Wales (**'NSW'**) Office of State Revenue (**'OSR'**) began assessing unit trusts as 'special trusts' for land tax purposes. This resulted in unit trusts which hold land in NSW to lose the land tax-free threshold, and as a result a higher land tax bill.

The NSW Treasurer in the 2006/07 Budget Speech announced legislative changes to the land tax regime to provide certainty as to what types of trusts would qualify for the land tax-free threshold. However, those changes, found in the *State Revenue Legislation Amendment (Tax Concessions) Act 2006* (NSW) only received Royal assent on 2 November 2006.

Broadly, and amongst other things, the *State Revenue Legislation Amendment (Tax Concessions) Act 2006* (NSW) sought to:

- clarify when a trust would be considered a 'fixed trust' and be eligible for the land tax-free threshold;
- expanded the exclusion to the classification of 'special trusts' to 'family unit trusts', to grandfather their pre-2006 land tax year treatment as eligible for the land tax-free threshold; and
- introduced an amnesty period relating to NSW State taxes, to allow the restructuring of eligible trusts so that they may fall within the 'fixed trust' definition.

This paper does not provide an analysis of the terms of the NSW land tax provisions before the introduction of the *State Revenue Legislation Amendment (Tax Concessions) Act 2006* (NSW). For an analysis of the pre-existing NSW land tax provisions, readers should refer to the paper entitled *Assessing Unit Trusts as 'Special Trusts'* presented to the NSW Division of the Taxation Institute on 14 June 2006.

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1. Background – an overview of the legislation regarding New South Wales land tax

1.1 The New South Wales land tax regime is contained in the following Acts:

1.1.1 The *Land Tax Management Act 1956* (NSW) (**'LTM Act'**) – deals with liability to land tax and exemptions from land tax;

1.1.2 The *Land Tax Act 1956* (NSW) (**'LT Act'**) – includes in the Schedules the rates of land tax;

1.1.3 The *Taxation Administration Act 1996* (NSW) (**'Administration Act'**) – administration of all State revenue legislation, and deals with returns, assessments, objections and appeals;

1.1.4 *Valuation of Land Act 1916* (NSW) (**'VOL Act'**)– given that the Valuer-General determines the taxable value of land for land tax purposes, deals with objections against valuations.

1.2 Generally speaking, the liability to pay land tax is assessed under the LTM Act. Imposition and the applicable land tax rates is provided for in the LT Act.

1.3 The LTM Act was amended by the *State Revenue Legislation Amendment (Tax Concessions Act 2006* (NSW) (**'Amendment Act'**) which received Royal assent on 2 November 2006. The Explanatory Note to the Amendment Act provided that the objects of the Amendment Act were to (amongst other things):

> *... to clarify the circumstances in which a trust will be treated as a fixed trust or special trust under the Act and to grant land tax concessions in respect of certain family unit trusts and other unit trusts that are restructured to comply with the new provisions ...*
>
> *... to make further provision with respect to the determination of the average value of land under that Act and with respect to other 2006-2007 Budget measures that have already been passed by parliament ...*

...to make miscellaneous amendments to other Acts ... in connection with the changes to the Land Tax Management Act 1956 that provide for the use of an average value of land for land tax purposes.

1.4 The measures contained in the Amendment Act were first announced by the New South Wales Treasurer in the 2006/07 Budget Speech.[1]

2. Overview of the New South Wales land tax provisions - steps to ascertain a land tax liability

2.1 Ascertaining a taxpayer's land tax liability requires an analysis of the following:[2]

Step	Analysis
One	What was the land owned, or deemed to be owned, at midnight of the immediately proceeding 31 December?
Two	What land, if any, is exempt?
	if there is land subject to land tax (i.e. not exempt); then,
Three	What is the 'taxable value' of the land?
Four	What is the calculation of land tax – i.e. what rates apply to the taxpayer / land?

2.2 This paper is concerned with the question at **step one** above. That is, what is the land owned, and who qualifies as the 'owner' of land when it is subject to a unit trust relationship.

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[1] Budget Speech 2006/07 – Budget Paper No 1 - http://www.treasury.nsw.gov.au/bp06-07/bp1/pdf/bp1.pdf
[2] Brett Young 'Lodging Objections to Land Tax Valuations' – NSW Young Lawyers. pp 4-5.

3. Overview of the New South Wales land tax regime

3.1 The LTM Act deals with the liability to, and exemptions from, the New South Wales land tax regime.

3.2 Section 7 of the LTM Act is the central charging provision, under which land tax is to be levied and paid on the land value of all land situated in New South Wales which is owned by taxpayers. Section 7 of the LTM Act provides that:

> *Land tax at such rates as may be fixed by any Act is to be levied and paid on the taxable value of all land situated in New South Wales which is **owned** by taxpayers (other than land which is exempt from taxation under this Act).* [emphasis added]

3.3 The charge to land tax is in respect of lands owned at midnight on 31 December immediately preceding the year for which the land tax is levied. Section 8 of the LTM Act provides that:

> *Land tax shall be charged on land as **owned** at midnight on the thirty-first day of December immediately preceding the year for which the land tax is levied.*
>
> *In this section year means the period of twelve months commencing on the first day of January.* [emphasis added]

3.4 For example, land tax for the year commencing 1 January 2007 is leviable and payable in respect of land owned as at midnight on 31 December 2006.

3.5 As will be discussed below (see paragraph 4 below), essential to determining liability to land tax, as provided in both sections 7 and 8 of the LTM Act, is ascertaining the owner of the land.

3.6 In general, the principal place of residence and land used for primary production is exempt from land tax. Properties potentially liable for land tax therefore include:

3.6.1 vacant land, including vacant rural land;

3.6.2 a holiday home;

3.6.3 investment properties;

3.6.4 company title units; and

3.6.5 commercial, residential and industrial units.

Exemptions from land tax

3.7 The exemptions from land tax are provided by section 10 of the LTM Act. The two most commonly attracted exemptions are:

3.7.1 the exemption for a taxpayer's principal place of residence[3]; and

3.7.2 the exemption for land used for primary production[4].

3.8 It should be noted that the principal place of residence exemption cannot, by definition, be accessed by a unit trust.

4. Who is an 'Owner' for NSW land tax purposes

4.1 Essential in determining land tax liability is ascertaining the 'owner' of land. This is because it is the 'owner' of the land who is subject to land tax (section 7 of the LTM Act).

4.2 The term 'owner' is defined in subsection 3(1) of the LTM Act, as being, in relation to land, every person who jointly or severally, whether at law or in equity:

4.2.1 is entitled to the land for any estate of freehold in possession; or

4.2.2 is entitled to receive, or is in receipt of, or if the land were let to a tenant would be entitled to receive, the rents and profits thereof, whether as beneficial owner, trustee, mortgagee in possession, or otherwise;

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[3] Subsection 10(1)(r) of the LTM Act provides that: '*Except where otherwise expressly provided in this Act the following land shall ... be exempt from taxation under this Act ... land which is exempt from taxation under the principal place of residence exemption, as provided for by Schedule 1A*'. Schedule 1A of the LTM Act in turn discusses the principal place of residence requirements to be satisfied in order to obtain the exemption.

[4] For example, subsection 10AA(1) of the LTM Act provides that '*Land that is rural land is exempt from taxation if it is land used for primary production*'. Under subsection 10AA(2) of the LTM Act, some non-rural land, provided that it satisfies certain requirements, may be considered as being used for primary production.

4.2.3 in relation to any leasehold estate in land, whether legal or equitable,[5] a person, or a persons who is a member of a class or description of persons, prescribed for the purposes of the provisions; or

4.2.4 a person who, by virtue of the LTM Act, is deemed to be the owner.

4.3 Following the High Court's decision in *CPT Custodians Pty Ltd v Commissioner of State Revenue; Commissioner of State Revenue v Karingal 2 Holdings Pty Ltd* [2005] HCA 53 (***'CPT Custodians'***), and before the amendment to the LTM Act by the Amendment Act, the Office of State Revenue (**'OSR'**) decided to assess unit trusts as special trusts under the LTM Act on the basis that the unit holders are not (but rather the trustee is) '*... entitled to the land for any estate of freehold in possession...*'.[6] Similarly, in the Victorian Land Tax Act,[7] the relevant provision under which the trustee in *CPT Custodians* was assessed as the 'owner' of the land expressed as: '*... every person entitled to any land for any estate of freehold in possession...*'.

5. Specific treatment of trusts that hold land in New South Wales

5.1 Special rules may apply to the extent that the land is subject to a trust. The treatment of trusts that hold New South Wales situated land for land tax purposes depends on whether they are characterised as 'special trusts', 'fixed trusts' or a 'family unit trust'.

5.2 Land which is subject to a 'fixed trust' or a 'family unit trust' can access the land tax-free threshold, which is currently $352,000 of the 'taxable value'. However, if a trust is not a 'fixed trust' or a 'family unit trust', then it is a 'special trust' and the land tax-free threshold does not apply.

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[5] Except for lessees of land owned by the Crown or council (section 21C of the LTM Act) or lessees of leasehold strata lots (section 21D of the LTM Act).
[6] see paragraph (a)(i) in the definition of 'Owner' contained in subsection 3(1) of the LTM Act.
[7] See section 51 of the former *Land Tax Act 1958* (Vic)

6. Definition of 'special trusts'

6.1 A trust will be a 'special trust' if:

6.1.1 it is not a fixed trust (section 3A of the LTM Act);

6.1.2 the trust elects to be classified as a 'special trust' under section 25 of the LTM Act; or

6.1.3 the Commissioner classifies the trust as a 'special trust' under section 25A of the LTM Act.

6.2 Subsection 3A(1) of the LTM Act defines a 'special trust', by providing that '*... a trust is a **special trust** if...*':

6.2.1 the trust property includes land;

6.2.2 the trustee of the trust is the owner of the legal estate in the land; and

6.2.3 the trust is not a '**fixed trust**'.

6.3 Subsection 3A(2) of the LTM Act provides that for the purposes of section 3A of the LTM Act, a trust is a 'fixed trust':

> '*...if **the equitable estate in all of the land that is the subject of the trust is owned by a person or persons** who are owners of the land for land tax purposes* (disregarding section 25(3)[8])'. [emphasis added]

6.4 Subsection 3A(3) provides that for the purposes of determining whether a trust is a fixed trust, '*... any equitable interest of the trustee as trustee of the trust is to be disregarded...*'.

6.5 Subsection 25(1) of the LTM Act provides that:

> *The **owner of any equitable estate or interest in land** is liable in respect of land tax **as if he or she were the legal owner of the estate or interest** and land tax is to be assessed accordingly.* [emphasis added]

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[8] Subsection 25(3) of the LTM Act provides a carve out to the extent that the land is subject to a 'special trust'.

6.6 That is, in order for a unit trust to be considered a 'fixed trust', and therefore not caught by the definition of 'special trust' contained in section 3A of the LTM Act, the equitable estate in all of the land that is the subject of the trust needs to be 'owned' by the unit holders. That is, the land needs to be subject to a 'fixed trust' – which is one in which the unit holders have an indefeasible interest in the trust fund.

Trusts which are excluded from the definition of 'special trust'

6.7 Subsection 3A(4) of the LTM Act provides carve-outs for the following trusts from the definition of 'special trust':

6.7.1 charitable trusts;

6.7.2 a trust which includes a principal place of residence of a deceased;

6.7.3 'concessional trusts' – which include as their beneficiaries people under the age of 18 or those under a legal disability (subsection 3B of the LTM Act);

6.7.4 a trust established under a will '*... but only during the period ending on the expiration of 12 months after the date of death of the testator...*' or such further period as allowed by the Commissioner (subsection 3A(4)(e) of the LTM Act); and

6.7.5 '*. . . in relation to any land tax year in which*...[the trust]... *is a superannuation trust...*' (subsection 3A(4)(d) of the LTM Act); and

6.7.6 '*... in relation to any land tax year in which it is a family unit trust ...* ' (subsection 3A(4)(f) of the LTM Act).[9]

6.8 The carve-out from the definition of 'special trusts' for complying superannuation funds should be noted. As a result, a useful vehicle in which land may be acquired / held is via a superannuation fund.

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[9] Inserted by item 3 , Schedule 2 of the Amendment Act.

6.9 For current purposes, the definition of 'special trust' carves out both:

6.9.1 'fixed trusts' under subsection 3A(1)(c) from the LTM Act; and

6.9.2 'family unit trusts' under subsection 3A(4)(f) of the LTM Act.

7. Definition of 'Fixed Trusts'

7.1 As observed in paragraph [6.3] above, subsection 3A(2) of the LTM Act provides that a 'fixed trust' is one in which the '*... equitable estate in all of the land that is subject of the trust is owned by a person or persons who are owners of the land ...*'. Subsection 3A(3A) of the LTM Act[10] attempts to provide further clarification to the requirement in subsection 3A(2) of the LTM Act:

> *If a trust satisfies the **relevant criteria**, the persons who are beneficiaries of the trust under the trust deed are taken to be owners of an equitable estate in the land that is the subject of the trust and, accordingly, the trust is taken to be a fixed trust.* [emphasis added].

7.2 The term 'relevant criteria' for the purposes of subsection 3A(3A) of the LTM Act is in turn defined in subsection 3A(3B)(a)[11] of the LTM Act as being satisfied if:

(a) the trust deed specifically provides that the beneficiaries of the trust:

(i) are presently entitled to the income of the trust, subject only to payment of proper expenses by and of the trustee relating to the administration of the trust, and

(ii) are presently entitled to the capital of the trust, and may require the trustee to wind up the trust and distribute the trust property or the net proceeds of the trust property.

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[10] Inserted by item [2] of Schedule 2 of the Amendment Act.
[11] Inserted by item [2] of Schedule 2 of the Amendment Act.

7.3 Subsection 3A(3B)(b)[12] of the LTM Act provides a further requirement regarding the 'relevant criteria', being that it cannot:

> *... be removed, restricted or otherwise affected by the exercise of any discretion, or by a failure to exercise any discretion, conferred on a person by the trust deed.*

7.4 It seems that the purpose of subsection 3A(3B)(b) of the LTM Act is to ensure that certain 'hybrid trusts', which are structured as prima facie unit trusts, but give a discretion to (for example) a trustee to allocate income or capital from unit holders – will not fall within the scope of the 'relevant criteria'.

Examples of income allocation clauses of trust deeds – are the 'relevant criteria' satisfied?

7.5 For example, without more, the following income allocation clause contained in a trust deed may be considered to meet the 'relevant criteria':

> *Subject to any special rights or restrictions provided in the Second Schedule in relation to Units of any class the Trustees shall in each Accounting period until the Vesting Day or the date of termination of the Trust whichever shall first occur pay apply or set aside the net income of the Trust Fund of the Accounting Period to or for the benefit of the Unit Holders in proportion to the number of Units of which they are respectively registered as Holders at the end of the Accounting Period.*

7.6 However, on closer inspection of other terms of the trust deed, the trustee is given the power to issue units that have any special rights as determined by the trustee:

> *The Trustee ... may:*
>
> *(1) create whether in respect of issued or unissued Units such new class or classes of units with such preferred deferred or other special rights or subject to such rights of redemption whether at par*

[12] Inserted by item [2] of Schedule 2 of the Amendment Act.

or otherwise or subject to such restrictions or limitations in respect of any matter as the Trustee may determine;

(2) reclassify any Unit whether issued or unissued.

7.7 Arguably, the above clause allows the Trustee to issue units which, for example, gives the holders a 'first right' to discretionary allocations of net income of the trust. As a result, the 'relevant criteria' cannot be satisfied.

7.8 Another example where the 'relevant criteria' contained in subsection 3A(3B) of the LTM Act will not be satisfied is in the following income allocation clause contained in a trust deed:

> *The Trustee shall stand possessed of the net 'Income of the Trust Fund' for such one or more of the Income Units to the exclusion of the other or others of the Income Units and in such shares and proportions as the Trustee in its absolute discretion shall at any time during the Accounting period determine and to the extent that the Income Unit in whose favour such determination is made the particular Unit Holder shall be absolutely and presently entitled to the share of income allocated to the Income Unit pursuant to such determination ...*

7.9 Clearly in this example the trustee has the power / discretion to allocate income to particular 'Income Unit' holders.

7.10 However, it is submitted that the following income allocation clause[13] satisfies the 'relevant criteria', assuming that the trustee has no ability to distribute (for example) income to any other 'discretionary' class of unit holder:

> *If the Trustee determines to Pay[14] the Net Income, the Trustee must Pay the Net Income to the Members in accordance with their respective Member's Proportions[15] at the time of such Determination.*

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[13] This clause is subject to the following – which also satisfies the 'relevant criteria' – '*The Trustee will Pay out of the gross income of the Trust Fund all costs and disbursements and commissions, fees, taxes, management charges and other proper outgoings in respect of the investments and administration of the Trust Fund.*'

[14] Note discussion regarding 'accumulation' in the context of present entitlement at paragraph [13.16]

[15] 'Member's Proportion' defined as:

means with respect to the Units, or to each class of Units if the context requires, a fraction:

(a) where the numerator will be the number of issued Units of that class held by that Member; and

(b) where the denominator will be the total issued number of Units of that class;

7.11 Similarly, it is submitted that the following clause satisfies the 'relevant criteria':

> *Notwithstanding anything to the contrary ... and for the avoidance of doubt the Members:*
>
> (a) *are presently entitled to the income of the Trust, subject only to payment of proper expenses by and of the Trustee relating to the administration of the Trust; and*
>
> (b) *are presently entitled to the capital of the Trust, and may require the trustee to wind up the Trust and distribute the Trust Fund or the net proceeds of the Trust Fund.*

Ability of a trustee to recharacterise income or capital

7.12 An issue that has not been clarified by the OSR is the situation in which unit holders of a unit trust have a 'present entitlement' to income and / or capital of a unit trust, but where the trust deed gives a trustee a discretion to recharacterise income as capital or vice versa – usually for income tax purposes. An example is as follows:

> *If the Trustee so chooses at any time and from time to time, the Trustee may in its absolute discretion determine to ... treat any profit, gain (whether of an income or capital nature) or receipt which is assessable income for the purposes of the Income Tax Assessment Act 1936 as income of the Trust Fund or which enters into the calculation of a taxpayer's assessable income for the purposes of the same Act as net income of the Trust Fund ...*

7.13 On one view, such a clause may be used to take away one unit holder's right and give that entitlement to another unit holder - e.g. recharacterise a 'capital' payment to 'income', therefore depriving a 'capital unit holder's' entitlement to that recharacterised amount. [16]

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[16] for example, recharacterising an item of capital to income may take away a 'capital unit holder's' right and give the amount to a 'income unit holder'.

7.14 However, on another view (and the author's preferred view), without more, such a clause will not cause the 'relevant criteria' contained in subsection 3A(3B) of the LTM Act to be breached. As long as unit holders are 'presently entitled' to their respective entitlements – whether income or capital notwithstanding the characterisation by the trustee – then the requirement will be satisfied. This will especially be the case where there is only one 'class' of unit on issue. This is because what would have been (for example) income for the respective unit holders is merely recharacterised as capital. It will only be when the proportionate entitlement (and not the characterisation) of the respective unit holders is changed that the 'relevant criteria' will not be satisfied.

7.15 However, this conclusion may be different if there is, for example, separate income and capital units on issue.

Unit Trusts with separate income and capital units on issue

7.16 It is submitted that 'unit trusts' which have separate 'capital' and 'income' units on issue may fall within the scope of the 'relevant criteria' as long as they are 'presently entitled' to their respective entitlements, and that entitlement cannot be 'removed, restricted or otherwise affected'.

7.17 However, note discussion at paragraph [7.12] regarding ability to recharacterise income / capital.

8. Definition of 'Family Unit Trust'

8.1 As outlined in paragraph [6.9] above, subsection 3A(4)(f) of the LTM Act[17] provides that a '*... trust is not a special trust ... in relation to any land tax year in which it is a family unit trust, as provided for in Schedule 1AA*'. The term, 'family unit trust' is in turn defined in subsection 2(1) of Schedule 1AA of the LTM Act:

[17] Inserted by item [3] of Schedule 2 of the Amendment Act.

A unit trust is a family unit trust in relation to the land tax year commencing on 1 January 2006 if, at midnight on 31 December 2005:

(a) the trust property includes land (other than land that is exempt from taxation under this Act), and

(b) the taxable value of that land does not exceed $1,000,000, and

(c) the unit holders in the unit trust have fixed entitlements under the trust, and

(d) the units in the unit trust are family-owned.

8.2 Importantly, it should be noted that the concession **only applies to unit trusts that meet the definition of 'family unit trust' as at 1 January 2006.** This is in accordance with the New South Wales Treasurer's announcement in the 2006/07 Budget Speech.[18]

8.3 Subsection 2(2) of Schedule 1AA of the LTM Act provides that a trust that meets the requirement of subsection 2(1) of Schedule 1AA of the LTM Act will continue to be a family unit trust after 1 January 2006:

... in relation to each subsequent land tax year unless, before the commencement of the land tax year:

(a) the trust acquires additional land and, as a result of that acquisition, the taxable value of the land that is the subject of the trust (and is not exempt from taxation) exceeds $1,000,000 (with the taxable value of the land being the taxable value for the land tax year during which the acquisition was made), or

(b) the unit holders cease to have fixed entitlements under the trust, or

(c) the units in the unit trust cease to be family owned.

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[18] Budget Speech 2006/07 – Budget Paper No 1 - http://www.treasury.nsw.gov.au/bp06-07/bp1/pdf/bp1.pdf

8.4 That is, a unit trust that meets the definition of 'family unit trust' as at 1 January 2006 will continue to be treated as a 'family unit trust' after that time unless:

8.4.1 The trust acquires land, which is not exempt from land tax, and the acquisition causes the taxable value of the land held within the trust to exceed the $1,000,00 threshold. However, it seems that if no acquisition is made, but the taxable value of land held within a unit trust as at 1 January 2006 exceeds the $1,000,000 threshold, then the unit trust will continue to be considered a 'family unit trust';

8.4.2 The unit holders cease to have a 'fixed entitlement' – see discussion at paragraph [8.7] below; or

8.4.3 The units cease to be 'family owned' – see discussion at paragraph [8.10] below.

8.5 It should be noted that subsection 2(3) of Schedule 1AA of the LTM Act provides that if a unit trust ceases to be a 'family unit trust', then the unit trust cannot regain its 'family unit trust' status again.

8.6 **Attachment A** contains some common scenario's / queries regarding whether a 'family unit trust' is in existence.

Definition of 'fixed entitlement'

8.7 The terms 'unit trust' and 'fixed entitlement' are defined in sections 1 and subsection 2(4) of Schedule 1AA of the LTM Act respectively for the purposes of the definition of 'family unit trust'. 'Unit trust' is defined as meaning:

> *... a trust in respect of which the beneficiaries of the trust are owners of units in the trust and each unit holder, or each unit holder of a particular class:*
>
> > *(a) is entitled, as a beneficiary of the trust, to participate in any income or capital distributions (or both) of the trust, and*
> >
> > *(b) the amount or proportion of any income or capital distribution to which the unit holder is entitled is based on the number or class of units owned by the person (or both).*

8.8 'Fixed entitlement' is defined as:

> *Unit holders in a unit trust have fixed entitlements under the trust if:*
>
> > *(b) the unit holders are entitled to a fixed proportion of the income or capital distributions of the trust (if any are made) based on the number or class of units owned by them, and*
> >
> > *(b) the entitlements referred to in paragraph (1) cannot be removed, restricted or otherwise affected by the exercise of a discretion, or by a failure to exercise a discretion, conferred on any person under the trust.*

8.9 The legal definition of 'fixed entitlement' is further discussed at paragraph [12] below. However, it seems that a trust which has separate income and capital units will meet the requirement of a 'family unit trust'.

When are the units in the unit trust 'family owned'?

8.10 Essential for eligibility of the 'family unit trust' concession is ensuring that the units in the unit trust are 'family owned'. Subsection 2(5) of Schedule 1AA of the LTM Act provides that:

> *Units in a unit trust are family-owned if:*
>
> *(a) in the case of a unit trust where the units are owned by one person:*
>
> > *(i) the person is a non-trustee, or*
> >
> > *(ii) the person is a family trustee, or*
>
> *(b) in the case of a unit trust where the units are owned by 2 or more persons, not less than 95% of the units in the unit trust are owned by non-trustees or family trustees (or a combination of both) who are members of the same family.*

8.11 That is, the units in a unit trust will be considered to be 'family owned' if they are:

8.11.1 owned by one person;

8.11.2 owned by one person as a 'family trustee' – see paragraph 8.14; or

8.11.3 owned by two or more persons in their own right or as 'family trustees', with not less than 95% of the units owned by 'members of the same family' – see paragraph 8.12.

'Same family' criteria

8.12 Subsection 2(6) of Schedule 1AA of the LTMA outlines when a person is to be considered a member of the same family, being when:

8.12.1 the person is married, or in a de facto relationship[19] with the other person;

8.12.2 the person is a child of the other person – whether by birth, adoption or marriage; or

8.12.3 the Chief Commissioner is satisfied '*... on the basis of any other relationship between the persons, that they can be considered to be members of the same family.*'

8.13 Importantly, subsection 2(9) of Schedule 1AA of the LTM Act deems the members of a superannuation fund (the trustee of which owns units in the relevant unit trust) to be the beneficiaries of the trust.

'Family Trustee' criteria

8.14 Subsection 2(8) of Schedule 1AA of the LTM Act defines a 'family trustee' as a person who holds units in a unit trust as a trustee of another trust which has one natural person as a beneficiary, or 2 or more beneficiaries who are all natural persons and members of the same family. Subsection 2(7) of Schedule 1AA of the LTM Act deems a trustee of a trust which has beneficiaries that are all members of the 'same family' (see paragraph 8.12) as a member of that family.

8.15 The provisions recognise a chain of trusts, which ultimately benefit one family group.

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[19] see the *Property (Relationships) Act 1984* (NSW).

9. **Time period in which a trust deed must be varied in order to satisfy the 'relevant criteria'**

9.1 The Amending Act provided that in the event that the Trust Deed is varied so as to meet the 'fixed trust' requirements, then:

9.1.1 the land tax assessment referable to the 2006 land tax year (and thereafter) may be reassessed; and

9.1.2 stamp duty will not be chargeable under the *Duties Act 1997* (NSW) '... in respect of an instrument executed on or after 6 June 2006 and before 1 January 2008 that effects a variation to a trust deed for a unit trust...'.[20] Paragraph 10 discusses the 'resettlement' implications of proposed changes of trusts.

9.2 In order to avail itself of these concessions, the unit holders need to have 'fixed entitlements' under the relevant trust deed (see for example section 42 of Part 20 of the LTM Act) and the amendment to the trust deed to ensure that it satisfies the 'relevant criteria' (see discussion above) is made before 1 January 2008.

9.3 It should be stressed that the concession only applies if the unit holders have fixed entitlements[21] (i.e. something less than a 'present entitlement') under the trust before the restructure. That is, it seems that, for example, a discretionary trust cannot avail itself of the concession.

9.4 See the discussion at paragraph [12] regarding the difference between 'fixed entitlement' and 'present entitlement'.

10. **Variation to the terms of a trust deed – resettlement considerations**

10.1 Notwithstanding the amnesty for NSW stamp duty with respect to amendments of trust deeds (see paragraph [9] above), amending trust deeds so as to fall within the 'relevant criteria', with the expectation that the trust is

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[20] See section 284B of the *Duties Act 1997* (NSW).
[21] See definition of 'fixed entitlement' at paragraph [8.7] which is the same as that contained in subsection 42 of Part 20 of the LTM Act.

assessed as a fixed trust for land tax purposes, will require consideration of whether a 'resettlement' occurs from a capital gains tax ('CGT') perspective.[22]

10.2 Resettlements relate to changes to a trust relationship which have the effect that a new trust estate comes into existence. According to the High Court decision in *FC of T v Commercial Nominees of Australia Ltd* [2001] HCA 33 (***'Commercial Nominees'***), the issue to determine is whether '*... what occurred* ... [i.e. the variation] ... *was a fundamental alteration in the trust relationship established by the original deed, such that it destroyed the necessary continuity of the 'taxpayer'...*'.

10.3 Some of the implications of a resettlement include:

10.3.1 the trust property may be disposed of, potentially triggering both stamp duty and CGT liabilities;

10.3.2 carried forward tax benefits may be lost; and

10.3.3 beneficiaries may dispose of their interests in the original trust and acquire interest in a new trust.

10.4 Specifically in the context of CGT, a resettlement may cause either CGT event E1 (section 104-60 of the 1997 Act) or CGT event E2 (section 104-65 of the 1997 Act) to happen.

10.5 In August 2001 the Commissioner of Taxation ('**Commissioner**') issued a Statement of Principles entitled *Creation of a new trust* ('**the Statement**'). The Statement clarifies when, in the Commissioner's view, changes to a trust gives rise to a new trust. The Commissioner considers that a new trust estate arises where there is a 'fundamental change to a trust relationship' – ie, a change in the essential nature and character of the original trust relationship. Further, the Commissioner considers that a new trust (i.e. a resettlement) may arise in the following circumstances:

10.5.1 a change in beneficial interest in trust property;

10.5.2 a new class of beneficial interest (whether introduced or altered);

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[22] Or a stamp duty perspective to the extent that the trust is not a NSW trust, and therefore cannot avail itself of the NSW stamp duty concessions.

10.5.3 a redefinition of the beneficiary class;

10.5.4 changes in the terms of the trust or the rights or obligations of the trustee;

10.5.5 changes in the nature of the trust property;

10.5.6 additions of property which could amount to a new and separate settlement;

10.5.7 depletion of trust property;

10.5.8 a change in the termination date of the trust;

10.5.9 a change in the trust that is not contemplated by the terms of the original trust;

10.5.10 a change in the essential nature and purpose of the trust; and / or

10.5.11 a merger of two or more trusts or a splitting of the trust.

10.6 The Commissioner considers that depending on their nature and extent, the above changes may either amount to:

10.6.1 a variation of a continuing trust; or

10.6.2 a fundamental change in the essential nature and character of the trust relationship. In such a case, the original trust may be brought to an end and a new trust created. Whether a new trust is created depends on the terms of the original trust and on the powers of the trustee.

10.7 The High Court in *Commercial Nominees* held that significant changes to a superannuation fund trust deed did not create a new trust, even though the amending deed had:

10.7.1 changed the name of, and appointed a new trustee to the fund;

10.7.2 introduced a new category of beneficiaries;

10.7.3 changed the fund from a defined benefit fund to an accumulation fund;

10.7.4 appointed a professional management company as administrator; and

10.7.5 allowed membership to be promoted to the public.

10.8 The High Court in *Commercial Nominees* considered that there were three main indicators of the continuity of a trust relationship, being:

10.8.1 the constitution of the trust;

10.8.2 the trust property; and

10.8.3 the membership of the trust.

Substantial changes any of the above may cause a resettlement.

10.9 The High Court considered that, in order to destroy the necessary continuity, changes in one or more of the above indicators must be such as to terminate the existence of the entity, or to produce the result that the particular trust does not derive the income in question. It was held that the changes made to the trust deed in question were not sufficient to destroy the continuity, primarily because the fund was at all times governed by the same deed, the trust property did not change, and the members before the amendment to the trust deed remained members afterwards.

Amending Deed – creating a 'present entitlement'

10.10 It should be noted that the Commissioner in the Statement considered that where a fixed trust (unitised or otherwise) is amended to give the trustee a discretionary power of appointment over the trust income, there will be a creation of a new trust. The position is explained at example 5.5.2 of the Statement:

> *Although the new discretionary beneficiaries may not have a proprietary interest in the trust fund, the rights of the holders of previously fixed interests are radically changed. Previously, they would be presently entitled to, and accordingly had a right to demand, payment of all income. Now, assuming a mere power, any rights would not only be in respect of the unappointed residue, if any. In this situation the essential nature of the trust relationship changes and a new trust estate comes into being.*

10.11 However, as a general proposition (and subject always to the specific terms of a trust), it is submitted a resettlement would not occur in the event that a trust deed, which contains discretionary elements, is amended[23] such that the discretionary objects receive fixed entitlements, or indeed a present entitlement (see discussion at paragraph [12] below]. Arguably, the entitlements would be 'fixed' by the trustee exercising its discretion, being both a valid exercise of the trustee's rights, and consistent with the terms and nature of the deed.

11. Rights of amendment under a deed

11.1 Whenever a trust deed is being amended, consideration needs to be given to whether the proposed method is permitted under the terms of the trust deed. Further, the trust deed will outline the way in which a trust deed may be amended.

11.2 In the event that a trust deed does not allow for particular amendments to be made, then an application to the Court under the *Trustee Act 1925* (NSW) requesting that the trust deed be amended. Relevantly, subsection 81(1) of the Trustee Act provides that:

> *(1) Where in the management or administration of any property vested in the trustees, any sale, lease, mortgage, surrender, release, or disposition, or any purchase, investment, acquisition, expenditure, or transaction, is in the opinion of the Court expedient, but the same cannot be effected by reason of the absence of any power for that purpose vested in the trustees by the instrument, if any, creating the trust, or by law, the Court:*
>
> *(a) may by order upon the trustees, either generally or in any particular instance, the necessary power for the purpose, on such terms, and subject to such provisions and conditions, including adjustment of the respective rights of the beneficiaries, as the Court may think fit, and*
>
> *(b) may direct in what manner any money authorized to be expended and the costs of any transaction, are to be paid or borne as between capital and income.*

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[23] in particular, by the trustee

11.3 Consideration needs to be given to the principles surrounding such an application to the court. See for example *Stein v Sybmore Holdings* [2006] NSWSC 1004, *Bowmil Nominees Pty Ltd* [2004] NSWSC 161, *Perpetual Trustee Co Ltd v Godsell* [1979] 2 NSWLR 785, *Riddle v Riddle* (1952) 85 CLR 202 and *NM Superannuation Pty Ltd v Hughes and Ors* (Supreme Court of NSW, 5 March 1996, unreported, BC 9600423.

12. What is 'present entitlement' and 'fixed entitlement'

12.1 As outlined above, in order to be considered a 'fixed trust', the unit holders need a 'present entitlement' to the income and capital of the trust estate. Further, in order to be considered a 'family unit trust', or to become eligible for the restructuring concessions, the unit holders need a 'present entitlement' to the income and capital of the trust estate.

12.2 Therefore, for present purposes it is essential to determine the definition of 'present entitlement' and 'fixed entitlement'.

12.3 The term 'present entitlement' is foreign to trust law. It is a conglomeration of concepts contained in both the law of estates and the law of trusts.[24] The authorities indicate that a beneficiary is 'presently entitled' to the income of a trust if:

12.3.1 ***in accordance with the laws of estates*** - the beneficiary's interest is both:

(a) vested in interest; and

(b) vested in possession; and

12.3.2 ***in accordance with the laws of trusts*** – the beneficiary has a present right to demand payment of the income of the trust.

12.4 However, a beneficiary will be considered to have a 'fixed entitlement' if only the requirements of paragraph [12.3.1] are satisfied.

12.5 Whilst the OSR has released a 'fact sheet' dealing with the Act (**attached**), the OSR does not provide any clarification as to what 'present entitlement' or

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[24] see *FC of T v Whiting* (1943) 68 CLR 199.

'fixed entitlement' means. As a result, the meaning of the term may be taken from the decisions concerning use of the term in section 97 of the *Income Tax Assessment Act 1936* (Cth) (**'the 1936 Act'**).

12.6 Everett[25] relevantly observed that:

> *Ever since the 1930's, when income tax was referred to the Commonwealth by the States, the determination of a beneficiary's tax liability under a trust has been problematic. There have been continuing difficulties over the years in determining the nature of a beneficary's interest under a trust. The difficulties in determining one's tax liability as a beneficiary under a trust will continue, unless there is change in the legislation that deals with this issue.*

12.7 Subsection 97(1)(a) of the 1936 Act provides that:

> *Subject to Division 6D, where a beneficiary of a trust estate who is not under any legal disability is presently entitled to a share of the income of the trust estate –*
>
> *(a) the assessable income of the beneficiary shall include –*
>
> > *(i) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was a resident; and*
> >
> > *(ii) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was not a resident and is also attributable to sources in Australia ...*

12.8 Also, subsection 157(3) of the 1936 Act provides that:

> *Subject to subjection 3(A), for the purposes only of determining whether a person is carrying on a business of primary production, a beneficiary in a trust estate shall, to the extent to which he is presently entitled to the income or part of the income of that estate, be deemed*

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[25] Everett, Anna. 'An analysis of the concepts of 'present entitlement' (2003) Revenue LJ 147 at 148.

to be carrying on the business carried on by the trustee of the estate which produces that income.

12.9 The Commissioner of Taxation (**'the Commissioner'**) at paragraph 30 of Taxation Ruling TR 95/29 entitled *Division 16 – applicability of averaging provisions to beneficiaries of trust estates carrying on a business of primary production* concluded that:

> *'... a beneficiary will be presently entitled to the income of a trust estate if:*
>
> - *the beneficiary has an indefeasible, absolutely vested, beneficial interest in possession in trust law income; and*
> - *the beneficiary has a present legal right to demand and receive payment of the trust law income (or would but for a legal disability), whether or not the precise entitlement can be ascertained before the end of the year of income and whether or not the trustee has the funds available for immediate payment'.*

12.10 It should be noted that cases dealing with section 97 of the 1936 Act deal with the concept of whether a beneficiary is 'present entitlement to a share of net income of a trust estate', with the term 'net income' defined under section 95 of the 1936 Act. The LTM Act requires the present entitlement to relate to the income of the trust estate – presumably being trust law income. Kitto J in *Union Fidelity Trustee Co of Australia & Anor v FC of T* 69 ATC 4084 discussed when there would be a present entitlement to the income of a trust estate as follows:

> *At no time during the year was any beneficiary presently entitled to any part of the income of the estate (though a very small part of the income was in fact distributed to the beneficiaries). This is so because 'presently entitled to any part of the income of a trust estate'* ***refers not to the availability of any income for payment to him but to a present title in possession in respect of any income the estate may produce*** ... [emphasis added]

12.11 Arguably, the term '*... subject only to payment of proper expenses by and of the trustee relating to the administration of the trust...*' contained in subsection 3A(3B)(a)(i) of the LTM Act are superfluous, as the concept of 'present entitlement' takes into account such expenses. Bowen CJ, Deane and Fitzgerald JJ in *FC of T v Totledge Pty Ltd* 82 ATC 4168 at 4173 – 4174 observed that:

> *A beneficiary under a trust who is entitled to income will ordinarily only be entitled to receive actual payment of the appropriate share of surplus or distributable income: the trustee will be entitled and obliged to meet revenue outgoings from income before distributing to a life tenant or other beneficiary entitled to income. Indeed, circumstances may well exist in which a trustee is entitled and obliged to devote the whole of gross income in paying revenue expenses with the consequence that the beneficiary entitled to income may have no entitlement to receive any payment at all. This does not, however, mean that a life tenant or other beneficiary entitled to income in a trust estate has no beneficial interest in the gross income as it is derived. He is entitled to receive an account of it from the trustee and to be paid his share of what remains of it after payment of, or provision for, the trustee's proper costs, expenses and outgoings ...*

12.12 The Commissioner in TR 95/29 considered that:

> *... it is quite consistent with the authorities that, provided there is some gross trust law income, a beneficiary may be presently entitled to income of a trust estate even if the trust:*
>
> - *has incurred a loss for the year for trust law purposes; or*
> - *has incurred a loss for the year for tax law purposes; or*
> - *has no net income for tax law purposes.*

13. **Additional requirement for 'present entitlement' needed for funds that are merely 'vested and indefeasible'**

13.1 In order for a beneficiary to be 'presently entitled', the beneficiary needs more than a vested and indefeasible interest. For example, subsection 95A(2) of the 1936 Act provides that:

> *For the purposes of* ...[the 1936 Act] ... *where a beneficiary has a* ***vested and indefeasible interest in any of the income of a trust estate but is not presently entitled to that income****, the beneficiary shall be deemed to be presently entitled to that income of the trust estate.* [Emphasis added]

13.2 The High Court in *Harmer v FC of T* 91 ATC 5000 at 5004 considered that a beneficiary is presently entitled to a share in trust income where:

> *(a) the beneficiary has an interest in the income which is both vested in interest and vested in possession; and (b) the beneficiary has a present legal right to demand and receive payment of the income, whether or not the precise entitlement can be ascertained before the end of the relevant year of income and whether or not the trustee has the funds available for immediate payment.*

<u>When will a beneficiary have a 'vested and indefeasible interest'?</u>

13.3 Arguably, in order for a unit holder to have a 'fixed interest' for the purposes of obtaining the 'family unit trust concession, or the restructure concessions, the beneficiary needs a 'vested and indefeasible interest' in the capital and / or the income of the trust estate.

13.4 Hill J in *Dwight v FC of T* (1992) 37 FCR 178:

> *The words 'vested' and 'indefeasible' in the context of trust law are technical legal words of limitation, which have a well understood meaning to property conveyancers.*

13.5 With respect to whether an interest is 'vested', it was held that:

> *Estates may be vested in interest or vested in possession, the difference being between a present fixed right of future enjoyment*

where the estate is said to be vested in interest and a present right of present enjoyment of the right, where the estate is said to be vested in possession ... A person with an interest in remainder, subject to a pre-existing life interest, has an interest which is vested in interest, but being a future interest is not yet vested in possession. That person's interest will vest in possession on the death of the life interest.

13.6 With respect to whether an interest is 'indefeasible', it was held that:

An interest is said to be defeasible where it can be brought to an end and indefeasible where it cannot. Thus, a beneficiary with an interest which is not contingent but which interest may be brought to an end by the exercise of a power of appointment, would be said to have a vested but defeasible interest.

13.7 Paragraphs 13.3 to 13.9 of the Explanatory Memorandum to the *Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997* (Cth) provides the Commissioner's interpretation of the meaning of the terms 'vested' and 'indefeasible':

What is a fixed entitlement to income or capital of a trust?

13.3 A person (the beneficiary) will have a fixed entitlement to either income or capital of a trust (whichever is applicable) where the beneficiary has a vested and indefeasible interest in a share of the income of the trust that the trust derives from time to time (i.e. current and future income), or a share of capital of the trust [subsection 272-5(1)] . The share that the person has an interest in is expressed as a percentage of the total income or capital (whichever is applicable) of the trust.

What is a vested interest?

13.4 A person has a vested interest in something if the person has a present right relating to the thing. Stated simply, a vested interest is one that is bound to take effect in possession at some point in time. A vested interest is to be contrasted with a 'contingent' interest which may never fall into possession. If an interest of a beneficiary in income or capital is the subject of a condition precedent, so that an event must

occur before the interest becomes vested, the beneficiary does not have a vested interest to the income or capital since such an interest is instead 'contingent' upon the event occurring.

13.5 In traditional legal analysis, a person can be said to be either 'vested in possession' or 'vested in interest'. A present interest, i.e. one that is being enjoyed, is said to be 'vested in possession'; a future interest, i.e. one which gives its holder a present right to future enjoyment, is said to be 'vested in interest'. A person is vested in possession where the person has a right to immediate possession or enjoyment of the thing in question. In the definition of fixed entitlement, 'vested' includes both vested in possession and vested in interest.

13.6 Because vested interests include future interests, a person can have a vested interest in a thing even though the person's actual possession and enjoyment of the thing is delayed until some time in the future.

When is a vested interest indefeasible?

13.7 A vested interest is indefeasible where, in effect, it is not able to be lost. A vested interest is defeasible where it is subject to a condition subsequent that may lead to the entitlement being divested. A condition subsequent is an event that could occur after the interest is vested that would result in the entitlement being defeated, for example, on the occurrence of an event or the exercise of a power. For example, where a beneficiary's vested interest is able to be taken away by the exercise of a power by the trustee or any other person, the interest will not be a fixed entitlement.

13.8 Where the trustee exercises a power to accumulate income or capital of the trust in accordance with the trust deed, the accumulation does not result in a beneficiary's interest being taken away or defeased as long as the beneficiary nevertheless remains entitled at some future time to enjoy his or her share of the income or capital which has been accumulated.

Example

13.9 A unit trust has 100 units. All of the units carry equal rights to income and capital of the trust. The trustee has no discretion to allocate income or capital of the trust to unit holders other than in accordance with the share of income and capital represented by their units. The trustee has the power to accumulate income of the trust if the majority of the unit holders agree to such accumulation. However, each unit holder retains their interest in the share of accumulated income represented by their units. All of the income and capital of the unit trust is subject to fixed entitlements. The mere fact that the income of the trust is accumulated in the trust in accordance with the terms of the trust deed does not prevent the beneficiaries of the trust from being treated as having a vested and indefeasible interest in the income or capital of the trust.

The mere fact that units can be issued or redeemed at market value does not mean an interest is defeasible.

Present entitlement requires an 'additional element' over and above 'vested and indefeasible'

13.8 Where a beneficiary has a vested and indefeasible interest in a trust, an 'additional element' is required to convert that interest into a 'present entitlement'.[26]

13.9 Kitto J in Taylor v FC of T 70 ATC 4026 considered the 'additional element' as '*... an interest in possession in an amount of income that is legally ready for distribution so that the beneficiary would have a right to obtain payment of it ...*'. Further, it was observed at 4176 that present entitlement to trust income is to:

> *'... income that was available for distribution regardless of whether the accounts necessary to enable its precise ascertainment had been completed at the end of the income year or whether it was actually held in a form ready for immediate payment ...'.*

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[26] See paragraph 26-135, Marks, B. 'Trusts & Estates: Taxation & Practice'. *Law Institute of Victoria Practitioner Text.*

13.10 In *FC of T v Whiting & Ors* (1942 – 1943) 68 CLR 199 at 215, the High Court observed that:

> *... when the Act speaks of a beneficiary being presently entitled to a share in income,* ***it refers to the right of a beneficiary to obtain immediate payment****, rather than to the fact that a beneficiary has a vested interest ...* [emphasis added]

13.11 It was held in *Taylor & Anor v FC of T* 70 ATC 4,026 at 4,030 that:

> *... 'presently entitled' refers to an interest in possession in an amount of income that is* ***legally ready for distribution*** *so that the beneficiary would have a right to obtain payment of it if he were not under a disability.* [emphasis added]

13.12 Similarly, in *Totledge Pty Ltd v FC of T* 82 ATC 4168 the Court considered that income to which beneficiaries are 'presently entitled' is '*... income that was available for distribution*'.

13.13 In *Pearson v Commissioner of Taxation* [2006] FCAFC 111, it was observed by the Full Federal Court that:

> *A beneficiary is 'presently entitled' to a share of the income of the trust estate if, but only if: (a) the beneficiary has an interest in the income which is both vested in interest and vested in possession; and (b) the beneficiary has a present legal right to demand and receive payment of the income, whether or not the precise entitlement can be ascertained before the end of the relevant year of income and whether or not the trustee has the funds available for immediate payment ...*

13.14 That is, whilst a unit holder in a unit trust will typically have a proportionate vested and indefeasible interest in a trust's income / capital, to the extent that a trustee has the power to accumulate (income for example), then there will be no 'present entitlement' of that income – even though the unit holder may have a proportionate interest in that income (which may become corpus). In Trustees of the *Estate Mortgage Fighting Trust v FC of T* 2000 ATC 4,525 at 4,538, Hill J observed that:

> *No doubt where there is a trust to accumulate income during the year of income it will ordinary be true that where there could be no present entitlement, and thus an assessment for tax of the trustee under s 95A(4) is required. One exception which was relied upon by the trustee would be where, notwithstanding a trust to accumulate income, the trustees are empowered to apply income to or for the benefit of the beneficiaries and do so. In such a case the beneficiaries would be presently entitled to that income whether because of operation of s 101 or 95A(1) ...*

13.15 However, the beneficiary will be 'presently entitled' if the entitlement is not directly paid to the beneficiary, but applied for the beneficiary's benefit. It was considered in *Sacks & Ors v Gridiger & Ors* 90 ATC 4,299 at 4,305 that:

> *It would be wrong to treat these formulations as excluding from the operation of the expression 'presently entitled' a case where the relevant entitlement under the trust was to have a payment made not directly to the beneficiary but otherwise for his benefit. The provision of sec. 101 corroborate the view that it is immaterial for the purposes of considering whether a beneficiary is 'presently entitled' to a share of income, to distinguish between the beneficiary's right to have a payment made to himself on the one hand and his right to have a payment made for his benefit, on the other.*

13.16 As a result, even if a beneficiary has a 'vested' and 'indefeasible' interest, without a deeming provision such as section 95A of the 1936 Act, the beneficiary will not be 'presently entitled'. Therefore, arguably in order to fall within the requirements of subsection 3A(3B)(a)(i) of the LTM Act (for example), the trust deed in question should not provide for the accumulate of trust income, as this would cause the unit holders not to be 'presently entitled' to the trust income. Again, this will probably only affect trusts which have different capital and income unit holders.

13.17 It is submitted that if this is an oversight, a provision similar to section 95A of the 1936 Act should be introduced into the LTM Act to rectify this position.

13.18 As a result, arguably if a trust deed contains (for example) an income accumulation clause, then 'income unit holders' will not be considered '*... presently entitled to the income of the trust ...* ' as is required by subsection 3A(3B)(a)(i) of the LTM Act. An example of such an clause is as follows:

> *Until the Vesting Date the Trustee may at any time before the expiration of each Accounting Period determine to Pay or accumulate all or any part of the Net Income for each Accounting Period. The Net Income may be Paid by an interim or final distribution.*

13.19 However, assuming that there is only one class of unit on issue under the trust deed, if the accumulated income is considered as adding to the corpus of the trust, then the unit holders may be considered to be'*... presently entitled to the capital of the trust ...*' as is required by subsection 3A(3B)(a)(ii) of the LTM Act. An example of such an clause is as follows:

> *The amount of any accumulation pursuant to ...* [the precedent clause contained in paragraph [13.18] above] *... will be dealt with as an accretion to the Trust Fund, however, the Trustee may at any time Pay the whole or any part of any accumulation as if it was Net Income.*

13.20 Interestingly, the Full Federal Court in *Pearson v Commissioner of Taxation* [2006] FCAFC 111 observed that:

> *Nothing was said in CPT Custodians to cast doubt on the principle ...* [regarding 'present entitlement'] *.... That is not surprising because CPT Custodians was not concerned with the question of whether the beneficiary unitholder was 'presently entitled' to income of a trust estate for the purpose of Div 6 of Pt III of the ITAA.*

Present entitlement - knowledge of the beneficiary is irrelevant[27]

13.21 Knowledge on the beneficiary's behalf is irrelevant in determining whether a beneficiary is presently entitled.

13.22 The Full Federal Court in *Vengers v FC of T* 91 ATC 4213 held that '*... an entitlement under a trust is valid notwithstanding that the beneficiary has had*

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[27] See also paragraph 26-140 of Marks, B. 'Trusts & Estates: Taxation & Practice'. *Law Institute of Victoria Practitioner Text.*

no knowledge of it ...'. Further, in *Ramsden v FC of T* 2004 ATC 4659, it was held that:

> *'... a beneficiary has an entitlement to income under a trust for the purposes of s 97 of the Assessment Act from the moment it arises, notwithstanding that the beneficiary has no knowledge of it and might be able later to disclaim the entitlement'.*

Reinvestment plans – whether the unit holders may be 'presently entitled'?

13.23 A trust deed may provide that trust distributions of net income of the estate are to be automatically re-invested into additional units for the unit holders. In these cases, it is considered that the unit holders are 'presently entitled' to the income of the trust estate as the income (via the re-investment) is applied or dealt with at the unit holders direction.

13.24 In answering the question of whether a '*... taxpayer derived assessable income ... in respect of a unit trust distribution that was automatically reinvested on the taxpayer's instructions into additional units in the unit trust ...*' the Commissioner in ATO Interpretative Decision ATO ID 2001/647 entitled *Reinvestment of Unit Trust Distributions* considered that '*... the taxpayer ...* [had] *... derived assessable income' as the '... income was applied or dealt with as the taxpayer directed.*'

13.25 Similarly, in *Edited Version of Notice of Private Ruling – Authorisation Number: 6269*, the Commissioner when considering whether '*... trust distributions you received from an Income and Growth Fund assessable income at the time they are reinvested back into the fund...*' made the following observation with respect to 'present entitlement':

> *A beneficiary will be presently entitled to the assets which are held in trust for them if they could take legal action to recover their share of income from the trust at any time. There are a couple of extensions to this rule, such as if the beneficiary is under a legal disability, or they have a vested interest in the trust, they are still deemed to be presently entitled to the asset. These extensions or conditions will be stipulate din the trust deed. In basic terms though, if the beneficiary is able to*

demand their share of the asset from the trustee, they will be presently entitled to the asset.

13.26 The Commissioner concluded that:

Therefore, you are required to declare the net distribution you received from the Income and Growth Fund, despite the fact that you have not actually received the cash payment. This is because you are presently entitled to this income, which is specifically included as part of your assessable income by subsection 97(1) of the ITAA 1936. In essence, you have received the distribution, you have chosen to put that money back into the fund to purchase more units. This decision to reinvest the distribution in the form of more units rather than taking a cash payment does not alter the fact that you were still entitled to the income this financial year.

Default distribution clause – may create a 'present entitlement'

13.27 Default distribution clauses may cause a beneficiary to be 'presently entitled' (Ramsden v FC of T 2005 ATC 4,136).

Power to terminate trust does not amount to a 'present entitlement'

13.28 Although not free from doubt, it seems that the power of beneficiaries to cause the termination of a trust does not give rise to a 'present entitlement': *Walsh Bay Developments Pty Ltd v FC of T* 95 ATC 4,378.

14. Has the issue raised in *CPT Custodian* been addressed by the LTM Act?

14.1 The Commissioner has relied on the authority of the High Court decision in *CPT Custodian* to assess unit trusts as special trusts for NSW land tax purposes. Therefore, essential in understanding the OSR's position is analysing the decision of *CPT Custodian*.

14.2 It is submitted that both the 'relevant criteria' contained in the 'fixed trust' definition, and the 'fixed entitlement' criteria contained in the 'family unit trust' definition have not addressed the issue contained in the High Court's decision in *CPT Custodian*. The essential issue in CPT Custodian was that under the terms of the relevant (Victorian) land tax legislation, because of a trustee's

right of indemnity, a unit holder could not be considered to be an 'owner' of land subject to such a trust. It is submitted that the issue that arose in CPT Custodian did not apply to the LTM Act even before the commencement of the Amendment Act due to the carve-out of a trustee's interest in a trust contained in subsection 3A(3) of the LTM Act, which provides that:

> *For the purpose of determining whether a trust is a fixed trust under this section, any equitable interest of the trustee as trustee of the trust is to be disregarded.*

14.3 Indeed, it is submitted that the Amendment Act does not deal with the issues contained in CPT Custodian, as for example, the conditions contained in the 'relevant criteria' were not points at issue in that case.

Finding in CPT Custodian

14.4 The High Court in *CPT Custodian* held that for the purposes of the Victorian *Land Tax Act 1958* (Vic), unit holders of a unit trust own an interest in the assets of a unit trust as a whole, rather than an ownership interest in any particular asset of the unit trust. As a result, the unit holders are not considered to own the land held by a unit trust. This is on the basis that the trustee's (and manager's) entitlement to the assets of the trust effectively dilutes, or defeases the underlying unit holder's entitlements to the assets, income and capital of the trust.

14.5 In determining whether the unit holders were the 'owners' subject to the trust, the High Court observed that a two step approach to statutory construction should be undertaken (paragraph 14):

14.5.1 the ***first step*** was to ascertain the terms of the trust upon which the relevant land was held; and

14.5.2 the ***second step*** was to construe the statutory definition to ascertain whether the rights of the taxpayers under those trusts fell within that definition.

14.6 The Trust Deeds subject to litigation in *CPT Custodian* were typical of those types of trusts in which property is held. The High Court outlined the basic items of the trust deeds in question, and found that they has the following characteristics:

14.6.1 '*the Fund was vested in the Trustee upon trust for the Unit Holders*' (paragraph 19);

14.6.2 '*the beneficial interest in the Fund was divided into units, each said to confer an equal interest in all property for the time being held by the Trustee upon the trusts of the Deed'* (paragraph 20);

14.6.3 no unit conferred '... *any interest in any particular part of the Trust Fund or any investment' and each unit had 'only such interests in the Trust Fund as a whole as ...* [was] *... conferred on a Unit under the provisions contained in ...* [the Deed]' (paragraph 20);

14.6.4 '*Unit Holders were not entitled to require the transfer of any property comprised in the Fund, save as provided by the Deed but, by agreement with the Manager, distributions in specie might be made upon determination of the Fund*' (paragraph 20);

14.6.5 there was provision '*. . . for the distribution to Unit Holders of periodic income entitlements . . .*' (paragraph 21);

14.6.6 there was provision '*. . . for the realisation of the Fund upon its determination and distribution of the proceeds among Unit Holders...*' (paragraph 21);

14.6.7 the Trustee had the power to issue, repurchase or cancel units (paragraph 21);

14.6.8 '*... the parties to the Deed were . . .* [the Trustee] *. . . and a party defined as 'the Manager' in which the management of the Fund was vested exclusively . . .*' (paragraph 19);

14.6.9 '*... both the Trustee . . . and the Manager . . . were entitled to fees in significant amounts to be paid out of the Fund, and also to monthly*

reimbursement from the Fund of their costs, charges and expenses . . .' (paragraph 19).

14.7 It was noted that the central issue in the case was whether the terms of the trust upon which each parcel of land was held created an interest which met the statutory definition of 'owner'.

14.8 In quoting Nettle J, the Court observed at paragraph 37 that the unit holders did not have a specific entitlement to receive specific income, but rather:

> *... in a case of a complex unit trust of the kind with which I am concerned, the entitlement of the trustee to apply receipts in defined ways informs the nature of the income that the unit holders have a right to receive: not a total of all of the receipts derived from each asset the subject of the fund but rather such if any income as may be derived from the product of the application of gross receipts in various ways.*

14.9 It is submitted that the crux of the decision in CPT Custodian is contained in the Court's observations that the rights of the unit holders is secondary to the discharge of liabilities that may arise – the only entitlement of the unit holder is a proportionate share of the trust's income (paragraph 37):

> *It may well be that the income of the fund as finally constituted and distributed will include all of the rents and profits generated by a particular parcel of land within the fund. But it is distinctively possible that it will not. Each of the deeds gives power to the trustee to provide out of receipts of any property or business; to invest receipts in authorised investments and to deal with and transpose such investments; and* ***the only right of the unit holder is to a proportionate share of income of the fund for the year.*** [emphasis added].

14.10 The High Court essentially concluded that the trusts were not '*... exclusively for the benefit of the ...' unit holders* (paragraph 48). This was seen as particularly the case given the Trustee and Manager's right to indemnity out of the trust fund (paragraph 49):

> *In the Deed, the Manager covenanted with the Trustee ... to ensure that there were at all times sufficiently readily realisable assets of the*

Trust available for the Trustee to raise the fees to which the Manager and the Trustee were entitled … . These stipulations made the Trustee and the Manager interested in due administration of the trusts of the Deed … . Put somewhat differently, the unit holders were not persons in whose favour alone the trust property might be applied by the trustee of the Deed.

14.11 With respect to the trustee's right of indemnity being an interest which trumps a unit holders entitlement to the trust fund, the Court at paragraph 51 held that:

In the present case, the unsatisfied trustees' right of indemnity was … an actual liability …. Until satisfaction of rights of reimbursement or exoneration, it was impossible to say what the trust fund in question was.

14.12 As a result the High Court looked at the terms of the relevant trust deeds without giving any significance to the label 'unit trust'. The Court held that the terms of the trust were framed such that the unit holder could not be considered the 'owner' of the trust land. This was particularly so given the provisions with respect to:

14.12.1 the application proceeds of selling trust assets;

14.12.2 reinvesting proceeds and paying or providing for trust expenses; and

14.12.3 the provisions dealing with the fees payable to the trustee and manager and their right to be indemnified out of the trust assets for their expenses.

14.13 Arguably, the decision of the High Court in *CPT Custodian* regarding a beneficiary of a trust only having a residuary entitlement to the assets of a trust was already authority recognised by past decisions of the High Court.

14.14 Under the general law, as the legal owner of trust property, the trustee is considered to be personally liable for debts incurred in the course of carrying out the activities of the trust. However, under the general law, the various

trustee legislations[28], and also as typically provided for in the particular trust deeds, with respect to the debts that a trustee may become personally liable for, a trustee might seek to:

14.14.1 reimburse itself – i.e. a trustee has a ***right of indemnity***; and / or

14.14.2 pay or discharge out of the trust property (i.e. a ***right of exoneration***) all expenses properly incurred or expended in or about execution of the trustee's trusts or powers.

14.15 It is submitted that the decision in CPT Custodian did not create new law. Indeed, in *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 (***'Octavo's case'***), the High Court expressed the view, which had been confirmed in *Chief Commissioner of Stamp Duties v Buckle* (1998) 151 ALR 1 (***'Buckle's case'***), that a trustee's right of indemnity is property – that is, a right for the benefit of the trustee in the trust fund.

15. Decisions since CPT Custodian

15.1 The High Court's decision in *CPT Custodian*, and in particular the observations regarding the nature of a trustee's right of indemnity and the effect on a beneficiaries interest in the trust fund has recently been applied in a number of decisions.

15.2 In *Warren Halloran & Ors v Minister Administering National Parks and Wildlife Act 1974* [2006] HCA 3 (**'Halloran's Case'**), land was 'transferred' by a scheme involving a complex series of steps, the result of which was that the original owner became the owner of units in a unit trust owning the land. The scheme relied on the 'transfer' to the trusts not giving rise to a change in beneficial ownership. It was thought that as the original owner held all the units in the unit trust that it was still the beneficial owner of the land. This view was rejected by the High Court. In referring to the decision of *CPT Custodian*, the High Court considered that the unit holder in a unit trust has no interest in any particular asset of the unit trust (refer paragraph 75).

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[28] See for example section 59(4) of the *Trustee Act 1925* (NSW).

15.3 Gzell J referred to the decision of *CPT Custodian* in *CSR Ltd v The Chief Commissioner of State Revenue* [2006] NSWSC 1380 in finding that no members of a superannuation fund '*... had any beneficial ownership of any of the underlying investments ...*' held within the superannuation fund.

15.4 Further, the importance of a trustee's right to reimbursement or exoneration under the terms of a trust was also noted in *Koompahtoo Aborigional Land Council v Klalc Property & Investment Pty Ltd & Anor* [2006] NSWSC 856:

> *Whether the Council as sole unit holder of those units having the entire right to income and corpus invoked the rule in Saunders v Vautier ...* ***will depend upon the terms of the trust deed granting rights of reimbursement or exoneration upon the Trustee*** *(CPT Custodian ...) .... See, also, Halloran...* [emphasis added]

15.5 Further, *Shop, Distributive and Allied Employees Association v Commissioner of State Revenue* [2005] VSC 484 was concerned with the exemption from stamp duty contained in section 36 of the *Duties Act 2000* (Vic), which at the time of the transfer provided that:

> *No duty is chargeable under this Chapter in respect of a transfer of dutiable property that is subject to a trust ('the principal trust') to a beneficiary of the principal trust if –*
>
> (a) *the beneficiary was a beneficiary when the property ... was first vested in the trustee of the principal trust; and*
>
> (b) *the transfer is –*
>
> (i) *to the beneficiary absolutely; or*
>
> (ii) *to the beneficiary as trustee of another trust ('the second trust') of which all the beneficiaries are natural persons who were beneficiaries of the second trust when the property was first vested in a trustee of the principal trust; and*

(c) *the duty (if any) charged by this Act in respect of the first vesting of the property ... in a trustee of the principal trust has been paid.*

15.6 In finding that the exception from duty did not apply, the Court Hollingworth J in *Shop, Distributive and Allied Employees Assn* considered that:

> *As the High Court has recently commented in CPT Custodian ..., 'the classic nineteenth century formulation by English courts of the rule in Saunders v Vautier did not give consideration to the significance of the right of the trustee under the general law to reimbursement or exoneration for the discharge of liabilities incurred in the administration of the trust'. In that case, having regard to the terms of the particular trust deed, the High Court held that* ***until satisfaction of the trustee's right of reimbursement under the trust deed, it was impossible to say what the trust fund in question was****.* [emphasis added]

15.7 As an interesting aside, the Court in *Shop, Distributive and Allied Employees Assn* considered that whilst the trustee of the trust in question *'... had trustees' powers to sell, transfer and convey property, those powers had to be exercised for the purposes of the trust. Such provisions would not have authorised it to simply transfer the property to a beneficiary prior to the vesting day without consideration.*'

15.8 Further, in *Hillig v Darkinjung Aboriginal Land Council* [2006] NSWSC 1371, it was observed that:

> *The third point goes to the matter raised by DPL concerning preservation of the trustee's indemnity. Particularly where a winding up application is pending and seems most likely to produce an administration in insolvency, I am not satisfied that it is sufficient to look at that matter simply in terms of set-off. A trustee's right to be indemnified out of trust assets is given effect to by means of an equitable interest in the whole of the assets of the trust. Until the right to be indemnified is exercised, the trustee has a right to possession superior to the rights of the beneficiaries. ... and a 'preferred beneficial interest in the trust fund' .... .* ***Until satisfaction of the trustee's right***

> ***of indemnity, it is not possible to say what the trust fund is: CPT Custodian*** ... [emphasis added]

15.9 Further, to restate the observation made in paragraph [13.13] above, the Full Federal Court in *Pearson*, being a decision which concerned (amongst other things) the concept of 'present entitlement', observed that:

> *Nothing was said in CPT Custodian to cast doubt on the principle as expressed* ... [in paragraph 15.1] *supra. That is not surprising because CPT Custodian was not concerned with the question of whether the beneficiary unitholder was 'presently entitled' to income of a trust estate for the purpose of Div 6 of Pt III of the ITAA.*

16. Establishing new unit trusts to hold NSW land

16.1 As discussed at paragraph [8] above, a unit trust established after 1 January 2006 cannot obtain the 'family unit trust' concession (see subsection 2(1) of Schedule 1 of the LTM Act).

16.2 As a result, in order to obtain the land tax-free threshold, unit trusts established after 1 January 2006 will need to satisfy the 'fixed trust' test.

17. Going forward with existing clients - restructuring

17.1 It is difficult to give a general approach regarding unit trusts that hold land in NSW. Indeed, the High Court's observations in CPT Custodian regarding statutory interpretation should be noted, being that one needs to undertake a two step approach, being (paragraph 14):

17.1.1 the ***first step*** - to ascertain the terms of the trust upon which the relevant land was held; and

17.1.2 the ***second step*** - to construe the statutory definition to ascertain whether the rights of the taxpayers under those trusts fell within that definition

17.2 However, with respect to existing clients, one may:

17.2.1 consider whether the 'family unit trust' conditions were met as at 1 January 2006. If the 'family unit trust' conditions have been satisfied, then in order to grandfather the concession, it should be ensured that no further NSW property is acquired in the trust.

17.2.2 even if the trust satisfies the 'family unit trust' definition, then in order to obtain the 'fixed trust' land tax concession within the NSW State tax amnesty period (i.e. 1 January 2008) should the 'family unit trust' conditions not be satisfied in the future, then it should be determined whether the trust deed meets the 'fixed trust' criteria.

17.2.3 when analysing the terms of a trust deed, in order to either be characterised as a 'family unit trust' or a 'fixed trust', it should be ensured that there are no discretionary elements regarding income or capital in the trust deed.

17.2.4 if a trust deed needs to be amended so that it falls within the scope of the 'fixed trust' definition, then resettlement for CGT purposes (stamp duty in other State if not a NSW trust or holds non-NSW property) will need to be considered.

17.2.5 in the event that the trust has different capital and income unit holders, then consideration needs to be given as to whether the 'present entitlement' issue with respect to both income and capital gains is satisfied if:

(a) the trustee (or another entity) has the discretion to recharacterise income or capital of the trust (or vice versa); and

(b) the trustee (or another entity) has a discretion / ability to accumulate income.

18. **Attachment A**

When is a trust a 'family unit trust' – some common scenario's

18.1 Individual sole unit holder holding unit beneficially.

An individual sole unit holder who holds the units 'beneficially' will satisfy the 'family-owned' criteria contained in subsection 2(1)(d) and subsection 2(2)(c) within Schedule 1AA of the LTM Act.

Subsection 2(5)(a)(i) of Schedule 1AA of the LTM Act provides that '*. . . units in a unit trust are family-owned if . . . in the case of a unit trust where the units are owned by one person . . . the person is a non-trustee . . .*'. The term 'non-trustee' is defined in subsection 2(8) within Schedule 1AA of the LTM Act as meaning '*. . . a natural person who owns units in a unit trust otherwise than as trustee of another trust.*'

18.2 Multiple individual unit holders all members of a family.

Multiple individual unit holders all members of the same family will satisfy the 'family-owned' criteria contained in subsection 2(1)(d) and subsection 2(2)(c) within Schedule 1AA of the LTM Act.

Subsection 2(5)(b) of Schedule 1AA of the LTM Act provides that units '*. . . in a unit trust are family-owned if . . . in the case of a unit trust where the units are owned by 2 or more persons, not less than 95% of the units in the unit trust are owned by non-trustees or family trustees (or a combination of both) who are members of the same family.*'

That is, only 95% of the unit holders need to be members of the same family.

The term 'family trustee' is defined in subsection 2(8) within Schedule 1AA of the LTM Act as meaning '*. . . a person who owns a unit in a unit trust as trustee of another trust which . . . has only one beneficiary, who is a natural person, or . . . has 2 or more beneficiaries, who are all natural persons and members of the same family.*'

It should be ensured that the 'same family' criteria (see discussion at paragraph [8.10]) is satisfied.

18.3 Individual unit holder holding unit as trustee of a family trust:

An individual unit holder holding units in a unit trust as trustee of a family trust will satisfy the 'family-owned' criteria contained in subsection 2(1)(d) and subsection 2(2)(c) within Schedule 1AA of the LTM Act provided that the beneficiaries and the trustee of the sub-trust are all members of the same family.

Subsection 2(5)(a)(ii) within Schedule 1AA of the LTM provides that units '*. . . in a unit trust are family-owned if . . . in the case of a unit trust where the units are owned by one person . . . the person is a family trustee.*'

As noted above, the term 'family trustee' is defined in subsection 2(8) within Schedule 1AA of the LTM Act as meaning '*. . . a person who owns a unit in a unit trust as trustee of another trust which . . . has only one beneficiary, who is a natural person, or . . . has 2 or more beneficiaries, who are all natural persons and members of the same family.*' Further, subsection 5(7) of Schedule 1AA of the LTM Act provides that:

> *If a person owns a unit in a unit trust as a family trustee, the person is treated as a member of the same family as another person only if the beneficiaries of the trust of which the person is family trustee:*
>
> *(a) are members of the same family as the other person, or*
>
> *(b) if the other person is also a family trustee, are members of the same family as the beneficiaries of the trust of which the other person is family trustee.*

It should be ensured that the 'same family' criteria (see discussion below) is satisfied.

18.4 Company as sole unit holder holding unit beneficially:

A company sole unit holder who holds the units 'beneficially' will not satisfy the 'family-owned' criteria contained in subsection 2(1)(d) and subsection 2(2)(c) within Schedule 1AA of the LTM Act.

As observed above, subsection 2(5)(a)(i) of Schedule 1AA of the LTM Act provides that '*. . . units in a unit trust are family-owned if . . . in the case of a unit trust where the units are owned by one person . . . the person is a non-trustee . . .*'. The term 'non-trustee' is defined in subsection 2(8) within Schedule 1AA of the LTM Act as meaning '*. . . a* ***natural person*** *who owns units in a unit trust otherwise than as trustee of another trust.*' [emphasis added]

This is notwithstanding that:

- the term 'person' is defined in section 3 of the LTM Act as including a corporation; and
- subsection 8(d) of the *Acts Interpretation Act 1987* (NSW) provides that when interpreting NSW legislation '*. . . a reference to a person does not exclude a reference to a corporation merely because elsewhere in the Act or instrument there is a particular reference to a corporation (in whatever terms expressed) . . .*'.

18.5 Company as sole unit holder holding a unit as trustee of a family trust

It seems that a company sole unit holder who holds units in a unit trust as trustee of another family trust will satisfy the 'family-owned' criteria contained in subsection 2(1)(d) and subsection 2(2)(c) within Schedule 1AA of the LTM Act.

Subsection 2(5)(a)(ii) within Schedule 1AA of the LTM provides that units '*. . . in a unit trust are family-owned if . . . in the case of a unit trust where the units are owned by one person . . . the person is a family trustee*'. As noted above, the term 'family trustee' is defined in subsection 2(8) within Schedule 1AA of the LTM Act as meaning '*. . . a person who owns a unit in a unit trust as trustee of another trust which . . . has only one beneficiary, who is a natural person, or . . . has 2 or more beneficiaries who are all natural persons and members of the same family*'. Further, the term 'person' is defined in section 3 of the LTM Act as including a corporation.

However, this reasoning seems inconsistent with subsection 2(7) of the LTM Act, which provides that:

> *If a person owns a unit in a unit trust as a family trustee, the person is treated as a member of the same family as another person only if the beneficiaries of the trust of which the person is family trustee:*
>
> *(a) are members of the same family as the other person, or*
>
> *(b) if the other person is also a family trustee, are members of the same family as the beneficiaries of the trust of which the other person is family trustee.*

Obviously, a company cannot be of the same family as the beneficiaries.

18.6 Individual unit holders holding units as joint trustees of super fund where individuals are not members of the one family.

Individual unit holders holdings units as joint trustees of a superannuation fund where the members of the superannuation fund are not members of the one family will not satisfy the 'family-owned' criteria contained in subsection 2(1)(d) and subsection 2(2)(c) within Schedule 1AA of the LTM Act.

Subsection 2(9) of Schedule 1AA of the LTM Act provides that:

> *For the purposes of this clause, if a person owns a unit trust as trustee of a trust that is a superannuation trust in relation to the land tax year . . . the members of that superannuation trust are taken to be beneficiaries of the trust.*

That is, subsection 2(5)(b) of Schedule 1AA of the LTM Act will not be satisfied as the trustees of the superannuation funds will not be 'family trustees'.

18.7 Individual unit holders holding units as joint trustee of super fund where individuals are members of the one family.

Individual unit holders holding units as joint trustees of a superannuation fund where the members of the superannuation fund are not members of the one family will satisfy the 'family-owned' criteria contained in subsection 2(1)(d) and subsection 2(2)(c) within Schedule 1AA of the LTM Act.

Refer to subsection 2(9) of Schedule 1AA of the LTM Act.

18.8 Company as sole unit holder holding units as trustee of a super fund where all members of the fund are members of the one family.

Company unit holders holding units as joint trustees of a superannuation fund where the members of the superannuation fund are not members of the one family will satisfy the 'family-owned' criteria contained in subsection 2(1)(d) and subsection 2(2)(c) within Schedule 1AA of the LTM Act.

Refer to subsection 2(9) of Schedule 1AA of the LTM Act, and the definition of 'person' in section 3 of the LTM Act extending to corporations.

18.9 In the event that examples (a) and (b) are not FUT because of the corporate trustee, what are the implications of change in the trustee to an individual(s)?

We assume that you are referring to examples (e) and (h) above. As discussed above, a corporate trustee will not cause the family unit trust provisions to be satisfied.

However, whenever a change in trustee is being contemplated, it needs to be ensured that subsection 54(3) of the Duties Act 1997 (NSW) is satisfied in order to obtain the nominal $10 duty on transfer of dutiable property.

18.10 If land value to under $1M at 31/12/05 and trust qualifies as a FUT, will it lose its FUT status if land value increases to be over $1M without any addition to land holding?

No. The family unit trust status will be lost only if the taxable value of the land subject to the trust exceeds the $1,000,000 threshold as a result of the trust acquiring additional land.

Subsection 2(1)(b) contained in Schedule 1AA of the LTM Act provides that, for amongst other reasons:

> '*A unit trust is a family unit trust in relation to the land tax year commencing on 1 January 2006, if, at midnight on 31 December 2005 . . . the taxable value of that land does not exceed $1,000,000.*'

Subsection 2(2)(a) contained in Schedule 1AA of the LTM Act provides that:

> *The unit trust continues to be a family unit trust in relation to each subsequent land tax year unless, before the commencement of that land tax year . . .* ***the trust acquires additional land and, as a result of that acquisition****, the taxable value of the land that is the subject of the trust (and that is not exempt from taxation) exceeds $1,000,000 (with the taxable value of the land being the taxable value for the land tax year during which the acquisition was made)* . . . [emphasis added]

18.11 In respect of the 'grandfathering' of treatment, can a unit trust that was set up after 6 June 2006 or a unit trust that first acquires land after 6 June be treated as an FUT?

No. A unit trust that was set up after 6 June 2006, or a unit trust that first acquires land after 6 June 2006, cannot avail itself of the family unit trust grandfathering concession.

Subsection 2(1)(a) contained in Schedule 1AA of the LTM Act provides that:

> *A unit trust is a family unit trust in relation to the land tax year commencing on 1 January 2006* ***if, at midnight on 31 December 2005 . . . the trust property includes land*** . . . [emphasis added]

The provisions do not seem to exclude a situation in which a property is held subject to a trust as at midnight 31 December 2005, the property is sold after midnight 31 December 2004 and acquires another property after that time (assuming that at all times the taxable value of the property is under the $1,000,000 threshold).

18.12 Is there a definition of 'same family' – who does it extend to?

The term 'same family' is defined in subsection 2(5) contained in Schedule 1AA of the LTM Act:

> *A person is a member of the same family as another person if:*
>
> *(a) the person is married to the other person or in a de facto relationship (within the meaning of the Property (Relationships) Act 1984) with the other person, or*

(b) the person is the child of the other person (whether by birth, adoption or marriage), or

(c) the Chief Commissioner is satisfied, on the basis of any other relationship between the persons, that they can be considered to be members of the same family.

Presumably, the Chief Commissioner's satisfaction regarding family membership under subsection 2(5)(c) of Schedule 1AA of the LTM Act may be obtained via a ruling request.

18.13 Can a unit trust set up after 6 June 2006 be restructured to qualify as a fixed trust?

A trust established after 6 June 2006 cannot be restructured to qualify as a 'family unit trust', but can be restructured in order to meet the 'relevant criteria' test relevant for 'fixed trusts'.

The only requirement is that the instrument that gives effect to the restructure needs to be executed before 1 January 2008. There is no limitation on accessibility to the restructuring concessions for a unit trust established after 6 June 2006.

Subsection 42(1) contained in Part 20 of the LTM Act provides for the restructuring of unit trusts so that they may be assessed (or reassessed) an non-special trusts:

This clause applies in respect of a unit trust (within the meaning of Schedule 1AA) if:

(a) an instrument is executed on or after 6 June 2006 and before 1 January 2008 that effects a variation to a trust deed for a unit trust, and

(b) before the instrument is executed, unit holders in the unit trust have fixed entitlements under the trust, and

(c) the purpose of the variation is to enable the unit trust to satisfy the relevant criteria (within the meaning of section 3A) and, accordingly, to be treated as a fixed trust under that section, and

(d) *the variation does not directly or indirectly result in a change in the proportion of any income or capital to which a unit holder is entitled under the trust.*

Similarly, the Bill inserted a new section 284B of the *Duties Act 1997* (NSW), which provides that:

> *Duty under this Act is not chargeable in respect of an instrument executed on or after 6 June 2006 and before 1 January 2008 that effects a variation to a trust deed for a unit trust (within the meaning of Schedule 1AA to the Land Tax Management Act 1956) if:*
>
> (a) *before the instrument is executed, unit holders in the unit trust have fixed entitlements under the trust, and*
>
> (b) *the purpose of the variation is to enable the unit trust to satisfy the relevant criteria . . . and, accordingly, to be treated as a fixed trust under that section, and*
>
> (c) *the variation does not directly or indirectly result in a change in the proportion of any income or capital to which a unit holder is entitled under the trust.*

Subsection 42(4) contained in Part 20 of the LTM Act

> *Anything done or omitted to be done on or after 6 June 2006 and before the date of assent to the State Revenue Legislation Amendment (Tax Concessions) Act 2006 that would have been validly done or omitted to be done if this clause had been in force at that time that it was done or omitted to be done is taken to have been validly done or omitted to be done.*

18.14 Do you have any feel as to whether the changes required to obtain fixed trust status will create a deemed disposal of underlying assets for CGT purposes?

You are correct to say that the answer to the query depends on the terms of the particular trust.

Whenever the terms of a trust are varied, an issue to consider is whether the variation amounts to a 'resettlement'. Resettlements relate to changes in a trust relationship which have the effect that a new estate comes into existence. Accordingly to the

High Courts decision in *FC of T v Commercial Nominees of Australia Ltd* [2001] HCA 33, the issue to determine is whether '. . . *what occurred* . . . [ie the variation] . . . *was a fundamental alteration in the trust relationship established by the original deed, such that it destroyed the necessary continuity of the 'taxpayer'* . . .'. However, for the likelihood of amendments to the trust deed causing a resettlement may be low.

18.15 Am I correct in understanding that unless the unit trust had fixed entitlements to income and capital, then in can not qualify as a FUT and it can not be restructured to meet the definition of a fixed trust accessing stamp duty exemptions to such variation?

You are correct. The unit holders of both the family unit trusts and the restructured unit trusts need to have had 'fixed entitlements'.

Family Unit Trusts

In order to qualify for the family unit trust grandfathering concession, subsection 2(1)(c) of Schedule 1AA of the LTM Act provides that the:

> . . . *unit trust is a family unit trust . . . if . . . the unit holders in the unit trust have fixed entitlements under the trust . . .*

Further, subsection 2(2)(b) of Schedule 1AA of the LTM Act provides that a: '. . . *unit trust continues to be a family unit trust . . . unless . . . the unit holders cease to have fixed entitlements under the trust . . .*'.

Restructured fixed trusts

Subsection 284(1) of the Duties Act which provides the exemption on restructuring unit trusts so that they satisfy the 'relevant criteria':

> *Duty under this Act is not chargeable in respect of an instrument . . . that effects a variation to a trust deed for a unit trust . . . if . . .* ***before the instrument is executed****, unit holders in the unit trust have* ***fixed entitlements*** *under the trust . . .*

18.16 Hybrid Trusts

As a general proposition (subject to reviewing the terms of the deeds) hybrid trusts – to the extent that they contain discretionary elements – will not satisfy the 'fixed trust' definition.

In relation to asserting that they hybrid trusts have always been, and indeed were intended to be unit trusts, this may be effected via a Deed of Rectification as between all parties involved. However, the resettlement (ie CGT and stamp duty) consequences would need to be considered.

If there is an actual change in intention regarding the characterisation of the hybrid trust deeds, then (again subject to the resettlement considerations), the two alternative approaches could be that:

- the hybrid trust deeds may be varied under their respective amendment clause so that there is no ability for the trustee to distribute income to discretionary objects; or

- the trustee may enter into a Deed under which it undertakes either not to make distributions to the discretionary objects, or determine a formula under which their beneficial entitlements would be satisfied. This would ensure that any existing beneficiaries, of any class, would have 'fixed entitlements' to their respective interests in the trust.

However, the resettlement implications will need to be considered in respect of each trust deed, and considering the factors surrounding the establishment of the particular trust.

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