Landholder Duty – Extent of Interest in a Discretionary Trust

This Commissioner's practice explains the factors the Commissioner will consider when determining the extent of an entity's interest in a discretionary trust for landholder duty purposes.

Background

Landholder

Chapter 3 of the *Duties Act 2008* ('Duties Act') imposes duty on the *relevant acquisition* of a *significant interest*[1] or a *further interest*[2] in a *landholder*.

Under section 155 of the Duties Act, an entity[3] is a *landholder* if immediately before the acquisition:

(a) it or a linked entity is entitled to land assets[4] in Western Australia valued at $2 million or more; or

(b) it is not a landholder as described in (a) and it or a linked entity is entitled to land assets, chattels or land assets and chattels in Western Australia and the acquisition is part of a relevant arrangement under section 155(4).

Linked entity

To determine if an entity is linked to the entity in which an interest is acquired ('the main entity'), section 156 of the Duties Act relevantly provides that:

(a) each entity (a linked entity) below the main entity in a linkage chain that exists immediately before the acquisition is linked to the main entity; and

(b) a linkage chain exists if a series of entities starting with the main entity are successively linked to one another.[5]

An entity is linked to another entity if:

- where the other entity is listed – it has an interest in the other entity of at least 90 per cent; or
- in any other case – it has a total direct or indirect interest in the other entity, calculated under section 154A, of at least 50 per cent.

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1 A *significant interest* means an interest of at least 90 per cent in a listed landholder or otherwise an interest of at least 50 per cent: Duties Act s 161.

2 A *further interest* means an interest in a landholder acquired by a relevant acquisition to which section 163(1)(c) or (d) applies: Duties Act s 148(1).

3 An *entity* means a corporation or a unit trust scheme: Duties Act s 152(1).

4 A *land asset* means land, a fixed infrastructure control right, a derivative mining right and, subject to section 204A, a fixed infrastructure access right: Duties Act s 148(1).

5 Duties Act s 156(3).

Direct or indirect interest in an entity

Section 154A of the Duties Act sets out how to calculate the total direct or indirect interest that one entity has in an unlisted entity.

Section 154A(2) provides that a higher entity has a 'direct or indirect interest' in a lower entity if there are one or more ownership chains between the entities. An ownership chain exists if:

(a) the higher entity has an interest in the lower entity defined in sections 153,[6] 153A[7] or 153B[8] (a direct interest); or

(b) there is a series of at least three entities, starting with the higher entity and ending with the lower entity, each of which successively has a direct interest in the next (an indirect interest).

Section 154A(4) of the Duties Act provides that the interest the higher entity has in a lower entity through a particular ownership chain is:

(a) if the higher entity has a direct interest in the lower entity – the percentage interest calculated under section 153A, 153B or 154; or

(b) if the higher entity has an indirect interest in the lower entity – the percentage calculated by multiplying the percentage interest of each link in the ownership chain.

Discretionary trusts

The trustee of a discretionary trust may be an entity in an ownership chain referred to in section 154A (other than the main entity) or a linked entity under section 156.[9] A *discretionary trust* means:[10]

(a) a trust under which the vesting of the whole or any part of the capital of the trust property, or the whole or any part of the income from the capital, or both –

  (i) is required to be determined by a person either in respect of the identity of the beneficiaries, or the quantum of interest to be taken, or both; or

  (ii) will occur in the event that a discretion conferred under the trust is not exercised;

  or

(b) a trust that is, by regulation, declared to be a discretionary trust for the purposes of this Act,

but does not include –

(c) a trust that is solely a charitable trust; or

(d) a unit trust scheme: or

(e) a trust that is, by regulation, declared not to be a discretionary trust for the purposes of this Act.

6 Interest in landholder or other entity.

7 Interest in, or held by, trustee of discretionary trust.

8 Interest in, or held by, partnership.

9 Duties Act s 152(3).

10 Duties Act s 3.

Under section 153A of the Duties Act, if a trustee of a discretionary trust is an entity in an ownership chain referred to in section 154A:

(a) an entity has an interest in the trustee of a discretionary trust if it is a potential beneficiary under the trust; and

(b) the trustee of a discretionary trust has an interest in an entity if the trust property includes the interest; and

(c) the percentage interest that the entity immediately above the discretionary trustee in the ownership chain has in the trustee of the discretionary trust is taken to be 100 per cent, or if the Commissioner decides this would be inequitable, some other (or no) interest as determined by the Commissioner.

If the Commissioner determines that an entity has an interest in a discretionary trust of less than 50 per cent, the entity and the discretionary trustee will not be linked. However, the entity and discretionary trustee may still form part of an ownership chain that results in the discretionary trustee, or entity in which the trust holds an interest, being linked to another entity.

Commissioner's Practice

1. Section 153A of the Duties Act does not include any criteria about when it will be inequitable for an entity's interest in a discretionary trust to be 100 per cent. The Commissioner will consider all facts and circumstances in each case when deciding whether to exercise the discretion to reduce the entity's interest to less than 100 per cent.[11]

2. In determining whether an entity's interest in a discretionary trust should be less than 100 per cent, the Commissioner will consider the entity's entitlement to the capital of the trust and whether the entity or the main entity does, will or may control the trust.

3. An entity will be considered to control a discretionary trust if it is in a position to directly or indirectly influence the vesting of the whole or any part of the capital of the trust property or income from the trust property.

4. Factors the Commissioner will have regard to when deciding to exercise the discretion under section 153A(c)(ii) include:

   4.1 whether the entity is expressly named as a beneficiary of the discretionary trust or is a beneficiary because it is within a class of beneficiaries described in the discretionary trust (for example, it is a corporation of which a named beneficiary is a member);

   4.2 the entity's entitlement to the discretionary trust property when the trust vests. For this purpose, it will be assumed that all circumstances entitling the entity to a distribution of property are satisfied;

   4.3 whether the entity's position as a discretionary object of the trust is related to the relevant acquisition, for example, if the acquisition of the main entity occurred so the acquirer could gain control of the discretionary trust;

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

4.4 whether the entity will remain a potential beneficiary of the discretionary trust after the relevant acquisition;

4.5 the nature of the relationship the main entity or any other linked entity has with the discretionary trust or its property, including:

4.5.1 whether the trust property or any part of it has been used as security for the benefit of the main entity or any linked entity;

4.5.2 whether the trust property or any part of it has been used in any commercial activity or business structure involving the main entity or any linked entity, for example, where the business of the main entity is conducted on the land of the discretionary trust for nil or nominal rent; and

4.5.3 whether there are any loan arrangements between the discretionary trust and the main entity or any linked entity;

4.6 the circumstances surrounding settlement of the discretionary trust, including whether the trust was established for the benefit of the entity and the relationship between the entity and the person(s) for whom the discretionary trust was established;

4.7 whether the main entity or any other linked entity has benefitted from the trust, either through the distribution of trust property or income under a power of appointment or otherwise, including the extent and regularity of any distributions;

4.8 if the trustee of the discretionary trust has limited discretion to distribute capital or income of the trust, for example, the distribution of income is discretionary but the distribution of capital is fixed, the extent of the limitation and the obligations of the trustee; and

4.9 whether the acquirer of the main entity gains any economic benefits from the discretionary trust property without acquiring an interest in the property.

5. These factors are provided as a guide and are not an exhaustive list of the matters the Commissioner may consider. In each case the onus is on the taxpayer to provide the information required for the Commissioner to make a decision under section 153A of the Duties Act about the extent of an entity's interest in a discretionary trust.

When the Commissioner will reduce an interest

6. When the linked entity provisions apply so that more than one beneficiary has a 100 per cent interest in the same discretionary trust, the Commissioner will exercise the discretion under section 153A so that the sum of interests in the trust does not exceed 100 per cent.

7. The Commissioner will not usually reduce the interest of an entity in a discretionary trust to an interest less than 100 per cent except where:

7.1 the trustee has limited discretion to distribute property of the trust to potential beneficiaries. For example, the trustee of a trust with multiple beneficiaries may have full discretion about distributing the trust's income, but must distribute the capital in set proportions. In this case, the Commissioner is likely to determine that a beneficiary of the trust has an interest equal to its entitlement to the capital of the trust; or

7.2 the main entity has a direct or indirect interest in multiple beneficiaries of the trust and the Commissioner is satisfied the acquirer has gained the ability to control the trust. In this case, the Commissioner is likely to determine that each of the beneficiaries has an equal interest with the sum of interests being 100 per cent. For example, if there are four beneficiaries the interest would be determined as 25 per cent for each entity.

8. In all other cases, the Commissioner will usually exercise the discretion to reduce an entity's interest in a discretionary trust if satisfied:

8.1 the entity has not benefited and is unlikely to benefit from the trust;

8.2 neither the main entity nor any linked entity controls the trust; and

8.3 the acquisition of the interest in the landholder does not and will not result in a change in beneficial ownership or control of the discretionary trust property.

Example 1

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

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

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

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

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

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

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

Example 2

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

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

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

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

Example 3

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

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

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

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

When the Commissioner will not reduce an interest

9. The Commissioner will not usually reduce an entity's interest in a discretionary trust to less than 100 per cent if:

    9.1 the acquisition in the main entity does, will or may result in a change in the beneficial ownership or control of the discretionary trust property; and

    9.2 duty has not been assessed on the change in beneficial ownership or control of the discretionary trust property as a trust acquisition or surrender[12] or a disposition of shares in a corporate trustee.[13]

[12] See Duties Act ss 53 – 62.

[13] See Duties Act ss 63 – 66.

Example 4

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

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

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

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

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

Example 5

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

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

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

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

Date of Effect

This Commissioner’s practice takes effect from 12 December 2019.

Nicki Godecke
COMMISSIONER OF STATE REVENUE
12 December 2019

Commissioner’s Practice History

Commissioner’s Practice	Issued	Dates of Effect	
		From	To
DA 41.0	27 May 2016	27 May 2016	11 December 2019
DA 41.1	12 December 2019	12 December 2019	26 October 2021