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Greetings from the Tax Team

Dear Readers,

Welcome to our first edition of Tax Update for 2006.

In this edition, Senior Consultant Graham Candy provides a detailed analysis of the controversial imposition of further land tax on land held in trust. This move affects every single trust relationship including those involving executors, administrators, guardians, liquidators and nominees.

If you need further information about this tax or wish to discuss another tax-related matter, please contact our Tax Team.

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New land tax on trusts

More land tax!

As from this year, any land held by a trustee (whether a person or company) will, with very few exceptions, be subject to extra land tax.

The new tax (0.375% of the taxable value) will apply on any portfolio of taxable land and buildings that has a total municipal value greater than \$20,000 and less than \$2.7 million. Where land is already taxable, the new tax will apply on top of the normal land tax rate.

Mandatory disclosure by 31 March 2006

All trustees must notify the State Revenue Office ("SRO") of all land that they hold which is "subject to a trust" by 31 March 2006. Penalties will apply if the SRO does not receive that notice. This applies to every single trust relationship, not just discretionary trusts and unit trusts created by

New land tax on trusts *cont*

deed. Executors, administrators, guardians, liquidators and nominees must all look to their obligations as trustees to see if the SRO should be notified. Penalties will apply to those who fail to do so. If the failure creates a land tax shortfall, the penalties can be up to three times the shortfall!

Calculating the surcharge

All land held by a trustee for a particular trust will be aggregated to calculate the total land tax payable by the trustee, including the additional tax. However, land held by different trusts will NOT be aggregated, even if the trusts have the same beneficiaries.

Escaping the tax – unit trusts and fixed trusts

Trustees of unit trusts and “fixed” trust can escape the surcharge by telling the SRO who their beneficiaries are and how many units or what share each beneficiary has in the trust. The trustee will still have to pay land tax on the land held for the beneficiaries (but without the surcharge) and so will the beneficiaries (on their share of the land as if they were part owners), but each beneficiary will be entitled to a credit for the land tax paid by the trustee on that beneficiary’s share.

Example

A trustee holds land worth \$540,000 for three beneficiaries in equal shares. Ordinary land tax is \$880. If the trustee notifies the SRO that the trust has three beneficiaries, each entitled to 33% of the trusts, the trust will pay \$880 in land tax and each beneficiary will add one third of the land value to his or her own land tax portfolio. If a beneficiary has no other land, the beneficiary will not pay any land tax. If the beneficiary has land, his or her 33% “share” of the trust’s land will be added to that portfolio as if the beneficiary owned it outright and the beneficiary’s own land tax will be assessed on that basis, less a credit for \$293, being 33% of the tax paid by the trustee.

If the trustee does not give any notification to the SRO, the trustee will pay land tax of \$2705 but the beneficiaries will not have to pay any land tax on their interest in that property.

Escaping the tax – discretionary trusts

A trustee of a discretionary trust has to pay the surcharge on any property acquired **after** 31 December 2005 – there is no escape. The value of all land held by the trustee for that trust will be aggregated and land tax will be assessed (with the surcharge) on that basis. However, as at present, no beneficiary will have to include any “interest” in the land in his or her own land portfolio.

The trustee can escape the surcharge on land acquired **before** 1 January 2006 if the trustee nominates **one** beneficiary to be treated (for land tax purposes) as the owner of **all** of the land in the trust. The nominated beneficiary must be an individual, over 18, who agrees to the nomination. Both the trustee and the nominated beneficiary will then be assessed for land tax (for the nominated beneficiary, on that land and his or her other land). The nominated beneficiary will get a credit for any land tax paid by the trustee.

Choosing the “nomination” option for a discretionary trust can reduce the total land tax bill (sometimes by a few thousand dollars) but be careful about doing so – it is a lifetime nomination which can be revoked by the nominee but a nominee who is still alive can only be replaced by another with the approval of the SRO. If that approval is refused, the trustee will be stuck with the extra tax as long as the original nominee lives.

If the nominee has no land at the time but acquires a taxable portfolio later, he or she may not be happy about being liable for tax on the entire real estate portfolio of the trust, particularly if the trustee is allocating the income and capital profits to other discretionary beneficiaries!

Principle Private Residence

A trustee will have to pay land tax and the surcharge on a property used by a beneficiary as a principle private residence unless the trustee nominates the occupier, in which case the property will be assessed on a single holding basis to the trustee without the surcharge and will be treated as exempt land for the nominated occupier. The surcharge will reapply and the exemption will cease if the nominee moves out.

The Current Year

If a trustee wants to escape the surcharge for the current year, the trustee must:

- (if a discretionary trust) nominate the beneficiary; or
- (if a unit trust or fixed trust) notify all beneficiaries

to the SRO by 30 June this year.

Exemptions

There are some exemptions – trustees will need to determine if these are available.

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Further Consequences

The information that trustees provide to the SRO this month will presumably open up a whole range of other enquiries, dating back at least to the commencement of the *Duties Act* on 1 July 2000. Trustees and beneficiaries could be assessed for aggregated land tax or for unpaid stamp duty (for example, on re-settlements, land rich holdings). The Australian Taxation Office will also be very interested in the information the SRO collects. In some cases, substantial capital gains tax issues may arise, once all the collected data is analysed.

Trustees also need to look at what arrangements they make (if any) for reimbursing nominated beneficiaries for additional land tax they have to pay as a result of being nominated **and** the income tax treatment of any such reimbursements. It could be a minefield for both trustees and beneficiaries.

Excluded Trusts

Public and wholesale unit trusts, charitable trusts, deceased estates less than three years old, trusts for disabled persons, trusts for clubs and associations and superannuation funds are in most instances exempt for the surcharge and genuine child maintenance trusts established as a result form a family breakdown generally do not have to pay the surcharge.

Exempt Land

Land currently exempt from land tax (e.g. sporting or primary production use) also escapes the surcharge, but many exemptions are now subject to the Commissioner's discretion, whereas previously they were automatic.

Where only part of the land is used for an exempt purpose, the rest will still be assessed for land tax. Expert advice should be obtained by any of these entities on the likely impact.

Aged care facilities, nursing homes, rooming houses, supported residential services, caravan parks and

primary production land that is not close to Melbourne will remain exempt from both land tax and the trust surcharge

Land close to Melbourne can only claim the primary production exemption if it is used solely or primarily for the business of primary production and is directly or indirectly owned and operated by individuals. However this exemption is **not** available to primary production land held by a trustee that is a company.

Things to be done:

- notify the SRO by 31 March 2006 of any land held by the registered owner as a trustee,
- decide what category your trust belongs in;
- if the trust is discretionary, look at when the land was acquired (to see whether nomination is possible or not) and decide which beneficiary (if any) should be nominated
- if the trust is fixed or is a unit trust, decide whether to make a notification;
- consider the impact of any nomination or notification on the relevant beneficiary (is he or she currently exempt, is any of the trust's property someone's principal private residence, what is its municipal value?);
- compare the cost and benefit of each scenario.
- submit any nominations for discretionary trusts by 30 June 2006
- submit any notifications for other trusts by 30 June 2006
- submit any subsequent notifications or nominations within **one month** after the trust acquires any land.

For further information, contact Graham Candy at Rigby Cooke on grahamcandy@rigbycooke.com.au or (tel) 03 9321 7890