The road to Oz

MATTHEW MARCARIAN AND **BOON TAN** OUTLINE THE LOCAL TAXATION LAWS THAT APPLY TO TRUST BENEFICIARIES RELOCATING TO AUSTRALIA

KEY POINTS

WHAT IS THE ISSUE?
Australia has complicated tax laws that apply to any income or dividends deriving from foreign trusts and controlled foreign companies that are paid to permanent residents or held for their benefit. However, generous concessions are available for 'temporary residents'.

WHAT DOES IT MEAN FOR ME?
Any STEP members who advise global families should be aware that careful tax planning should be undertaken when a family member is considering a move to Australia.

WHAT CAN I TAKE AWAY?
An understanding of the importance of residency status for Australian tax purposes, and some examples of common circumstances in which tax will be applied.

AS AUSTRALIA GROWS in popularity as a destination, many global families will need to contend with the Australian tax system. This could be when the heads of the family decide to emigrate to Australia, or if a child or grandchild moves to the country to study, work or start a business. This article highlights some circumstances that give rise to important Australian tax issues that often affect such families.

CONCESSIONS FOR TEMPORARY RESIDENTS

Global families that utilise trusts and companies to manage their wealth need to be aware that the tax position of a family member moving to Australia will be determined by that person's residence status, specifically whether they can be considered a 'temporary resident' for Australian tax purposes.

Australia's 'temporary resident' concessions under the *Income Tax Assessment Act 1997* (the 1997 Act)[1] are similar to the concessions under the UK's non-domicile rules, in that foreign-sourced income is not taxable in Australia. However, the Australian approach goes further, because the concessions remain available even if the foreign-sourced income is brought into Australia.

This means that a person who has moved to Australia and who qualifies as a temporary resident can remit to Australia foreign-sourced investment income to cover living expenses, or purchase real estate or other Australian-*situs* assets, and be exempt from Australian income tax, including capital gains tax (CGT). There is also no requirement under these concessions to segregate foreign income and foreign capital.

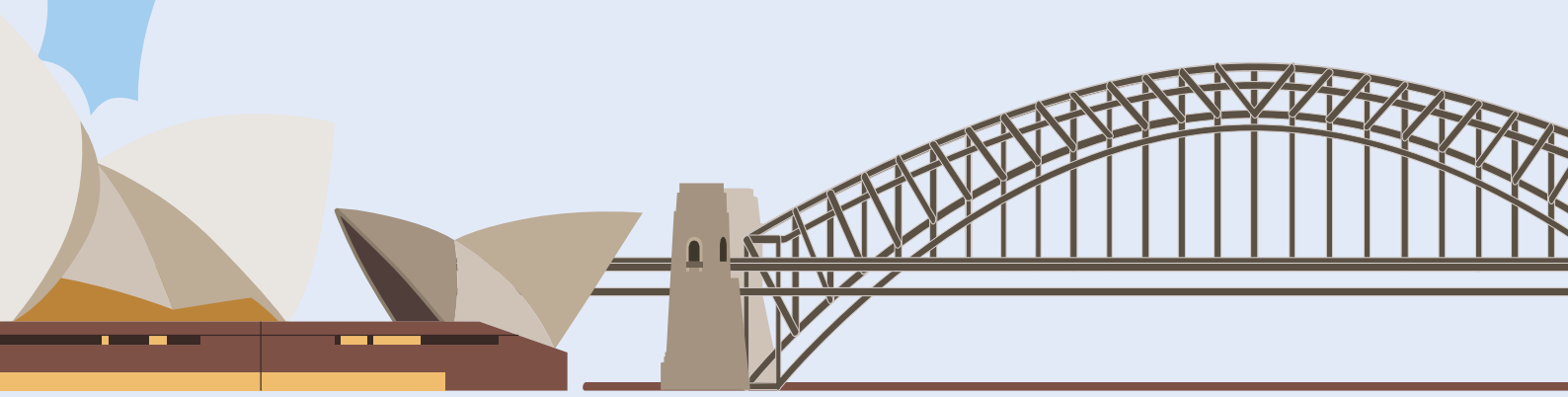
Most importantly, the exemption also extends to trusts. Any of a family's trusts that are located outside Australia are able to allocate or pay trust income or capital to family members who are temporary residents in Australia without any local tax issues, provided the distribution comes from non-Australian sources.

Whether the income in question has a source outside Australia will depend on familiar common-law principles and on certain exemptions in the 1997 Act in relation to capital gains. Under Australia's CGT rules, gains from most types of asset will not be considered to have an Australian source.

DETERMINING TEMPORARY RESIDENCY STATUS

To be deemed a temporary resident for tax purposes, the individual must hold a temporary immigration visa. However, it is not possible to claim temporary resident status if the individual has a spouse who is either an Australian citizen or a permanent resident. Complicating this is the fact that, under the terms of the 1997 Act, a spouse includes a person 'who, although not legally married to the individual, lives with the individual on a genuine domestic basis in a relationship as a couple'.

Determining the correct tax residency status of the individual or family member is important because, if they are treated as tax resident (without the benefit of temporary resident tax concessions), then they would be assessable on their worldwide income, and the tax consequences, pertaining to Australia's controlled foreign company (CFC) and foreign trust rules, could be significant.



TAXATION OF PERMANENT RESIDENTS

If a family member moves to Australia and is not considered a temporary resident for tax purposes, a number of provisions require consideration and, depending on the circumstances, might result in tax being applied to the income or capital gains derived by a foreign trust. Most of these provisions are found in the *Income Tax Assessment Act 1936* (the 1936 Act), which was significantly amended in the 1990s to include complicated anti-deferral regimes to tax the income of CFCs and trusts in the hands of Australian residents.

A full discussion of the scope of the CFC rules is beyond this article, but advisors should note that many foreign trust structures include underlying investment companies that could be caught by the Australian CFC rules, depending on the situation of their client.

For present purposes, we address the situation where an Australian resident is a beneficiary of a foreign trust, whether that trust was set up by their parents, grandparents or themselves, prior to their arrival in Australia.

PRESENT ENTITLEMENT

The first set of rules pertaining to foreign trusts is contained in the 1936 Act,[2] and relates to the case where an Australian resident becomes or is 'presently entitled' to the income of a trust. Under these rules, it does not matter whether the trust is an Australian trust or a foreign trust, simply that there is income to which an Australian resident beneficiary is presently entitled.

The concept of present entitlement under Australian tax law means that a beneficiary has an absolutely vested and indefeasible interest as against the trustee to call for the payment of the income. If an Australian resident becomes entitled in this way to a share of the income of a foreign trust, then they become liable to tax in Australia on the net income of that share. Whether the income is paid to them in Australia by the trustee is irrelevant.

PREVIOUSLY UNTAXED INCOME

Complex rules also apply under s.99B of the 1936 Act, for situations where an amount is paid to, or applied for the benefit of, an Australian resident at any time during a year. Unless it can be shown that the payment is from trust capital (and not previously accumulated trust income), the payment is likely to be taxable.

Trustees and advisors must be especially mindful of this because it has the effect of bringing to tax trust income that may have been derived by the foreign trust years before the family member ever moved to Australia. A deemed interest charge also applies that is designed to compensate the Australian Tax Office (the Office) for the deferral benefit achieved for the resident beneficiary.

TRANSFEROR TRUST RULES

The last set of rules applies where an Australian tax resident either has or is deemed to have transferred property or services to a non-resident trust at any time. This would include a time prior to the commencement of Australian residency. Under these transferor trust rules,[3] the net income of the foreign trust is attributed to the family member, meaning they are liable to tax on that income (including capital gains) regardless of whether they are entitled to the income under trust law.

The rules are similar in certain ways to the US grantor trust rules, and there are exemptions to the transferor trust rules for trust estates located (and resident) in certain countries that Australia regards as comparatively taxed, such as the UK and the US.

TRUST RESIDENCY

Finally, advisors should note that Australia's tax laws may treat a foreign trust as a resident of Australia for tax purposes even if the trustee is not a resident in Australia. This situation will arise if the central management and control of the trust is exercised in Australia.

Determining this can often be complicated, and it should not necessarily be assumed that the Office would accept that control of the trust is exercised by the trustee if the facts show otherwise. The recent Australian Federal Court case of *Re Bywater*[4] is an example of where the courts will look at the underlying substance of arrangements when deciding the question of where central management and control of an entity is located.

CONCLUSION

Australia's temporary resident rules will allow members of global families to temporarily move to Australia and receive foreign trust distributions (and other foreign-sourced income) without suffering Australian tax. However, if or when the move becomes permanent, a complex range of income tax laws will apply in relation to foreign trust income that would need to be understood and planned for.

1 www.legislation.gov.au/details/C2017C00336 **2** Div 6, Part III 1936 Act **3** Div 6AAA of the above **4** *Bywater Investments Ltd & Ors v Commissioner of Taxation; Hua Wang Bank Berhad v Commissioner of Taxation* [2016] HCA 45

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