

Changes to Land Tax on Trusts - Part 2

13 February 2006

Since our first article dealing with Changes to Land Tax on Trusts in November 2005, the Victorian Government has since passed the *Land Tax Regulations 2005* ("the Regulations"). The Regulations come into force as law on 1 January 2006.

As foreshadowed in the previous article, the key element of the special land tax on trusts feature an introduction of a tax surcharge of 0.375 per cent for trusts with aggregate property holdings above \$20,000 with higher initial thresholds for each bracket of assessed land value. It is to be noted that the SRO has not applied the surcharge to land holdings for values greater than \$2,700,000.

Depending on the particular trust structure, being either discretionary, fixed or unit trust, there are special provisions that apply. These special provisions allow the trustee to nominate a beneficiary, in respect to that land, in order to have the beneficiary pay land tax at "normal" land tax rates compared to the trust paying land tax at the "special" surcharge rate.

The State Revenue Office (SRO) requires any person who owns land in Victoria, as a trustee of a trust, for land acquired before 1 January 2006, to lodge Notification of lands held in trust providing details of all land holdings. This notification for submission to the SRO of lands held on trust must be made no later than 31 March 2006.

Discretionary Trusts

A trustee of a discretionary trust may nominate a beneficiary of the trust. The beneficiary of the trust must be a natural person, a beneficiary of the trust, be aged 18 or more as at 31 December 2005 and confirm in writing their acceptance of the nomination. This nomination must be lodged before 30 June 2006 or 3 months after the day on which the tax liability arises on the land. It should be noted that in nominating a beneficiary, the beneficiary will also be assessed on the pre 1 January 2006 land held by the trust in aggregate with any other land owned by the beneficiary (excluding the principal place of residence), under the ordinary tax scales. It is important therefore that careful consideration be given to the beneficiary to be nominated as where the beneficiary owns land on his/her own, the net result may be that the tax liability may be higher than if land holding is assessed leaving the land within the trust. A trust is allowed to nominate only one individual for all properties held by the trust.

It is important for the trustee to carefully consider the nomination of the beneficiary carefully. Once the initial nomination is made, there is no automatic right to change the nomination except where the existing nominated beneficiary dies. In any other case, the Commissioner of SRO has discretion to accept a change of nominated beneficiary and will consider each application on a case by case basis. Further the nominated beneficiary has the right to revoke their nomination at any time, with the result being that the trustee will become liable for land tax at the trust surcharge rates for future years.

It is important to note that the legislation contains very specific definitions of what is a discretionary trust and what would be traditionally considered a discretionary trust, may fall outside the definition for Land Tax purposes.

Fixed and Unit Trusts

Similar to the rules for discretionary trusts, a trustee of a fixed or unit trust may elect to notify the SRO of the beneficiaries and their respective interests or unitholdings in the trust. The trustee has until 30 June 2006 to do so and may at the same time they lodge their notification of lands held on trust if they wish. If such nomination is made, the trustee will be assessed at the ordinary tax rates. The result will be that the nominated beneficiaries (viz unitholders) will be deemed to be the owners of their respective portions of the land and will be assessed at the ordinary land tax rates (refer Table 1).

Each unitholder will be treated as if they own a proportion of the trust land which is equal to the number of units they hold as a percentage of total units. But where the beneficiaries or unitholders are trustees of other trusts, they are deemed to be the owners of their respective proportion of the land held by the fixed or unit trust and will be liable for tax at the special surcharge rates (refer Table 1).

The notification of the beneficiary remains in place until withdrawn by the individual. At such time the trustee may nominate an alternate beneficiary for the purpose of informing the SRO of their interests or unitholdings in the trust.

Examples of where the Surcharge does not apply

A surcharge rate based on the Table 1 will apply to all Victorian landholdings trusts, subject to various exceptions as outlined below:

- **Excluded Trusts**
 - A charitable trusts;
 - A concessional trusts;
 - A public unit trusts & wholesale unit trusts;
 - A wholesale unit trust;
 - A trust the sole beneficiary of which is a club or the members of a club;
 - A trusts established under a will;
- Land acquired by a **discretionary trust** on or before 31 December 2005, if the trustee nominates a beneficiary of the trust, where the standard land tax rate will apply. The trust surcharge rates will apply to land acquired by a discretionary trust after 31 December 2005.
- Land acquired by a **discretionary trust** which is used as the principle place of residence (PPR) of a nominated beneficiary, will also be liable for the standard land tax rate;
- A **fixed trust** if the trustee notifies the SRO of the beneficiaries of the trust; and
- A **unit trust** if the trustee notifies the SRO of the unitholders of the trust

Current exemptions for land which is held in a trust will not be affected by the new provisions.

All trustees holding Victorian land in trust will be required to submit a one-off return prior to 31 December 2005. Note there will also be various ongoing reporting requirements for trustees in certain circumstances. To establish whether your trust fits into one of the above categories, you should contact this office for advice.

New Special Surcharge Land Tax Scale

The special surcharge land tax scale compared to the normal land tax rate for the 2006 assessment year in the new legislation is as follows:

Table 1.

Total Unimproved Value	Normal 2006 Land Tax Rate	Special Surcharge Land Tax Rate
\$0 - \$19,999	Nil	Nil
\$20,000 - \$199,999	Nil	\$75 + 0.375% value over \$20,000
\$200,000 - \$539,999	\$200 + 0.2% value over \$200,000	\$750 + 0.575% value over \$200,000
\$540,000 - \$899,999	\$880 + 0.5% value over \$540,000	\$2,705 + 0.875% value over \$540,000
\$900,000 - \$1,189,999	\$2,680 + 1.0% value over \$900,000	\$5,855 + 1.375% value over \$900,000
\$1,190,000 - \$1,619,999	\$5,580 + 1.5% value over \$1,190,000	\$9,843 + 1.875% value over \$1,190,000
\$1,620,000 - \$2,699,999	\$12,030 + 2.25% value over \$1,620,000	\$17,905 + 1.706% value over \$1,620,000
\$2,700,000 and over	\$36,330 + 3.5% value over \$2,700,000	\$36,330 + 3.5% value over \$2,700,000

Examples¹

Following are some examples of how the new provisions will apply to the various trust categories.

Discretionary Trusts²

Scenario 1	Scenario 2	Scenario 3
<p>Mr Brown as trustee for the Brown Family Trust (a discretionary trust) owns land with an unimproved value of \$300,000. The land was acquired by the trust in 1995. Mr Brown, Mrs Brown and their thirteen year-old son are potential beneficiaries of the trust.</p> <p>Mr Brown is permitted to nominate himself or Mrs Brown to be the nominated beneficiary for the trust. He cannot nominate his son, who is under the age of 18. Mr Brown decides to nominate Mrs Brown, who accepts the nomination. Assume that Mrs Brown does not own any other land. The Land Tax payable is calculated as follows:</p> <ul style="list-style-type: none"> Mr Brown as trustee will be assessed on an unimproved value of \$300,000 at the ordinary Land Tax rates. This yields a 2006 Land Tax liability of \$400. As Mrs Brown does not own any other land, she will not receive a Land Tax assessment in 2006. 	<p>Assume instead that Mrs Brown owns an investment property with an unimproved value of \$250,000. The Land Tax payable is calculated as follows:</p> <ul style="list-style-type: none"> As in Scenario One, Mr Brown as trustee will be assessed on an unimproved value of \$300,000 at the ordinary Land Tax rates, and will have a 2006 Land Tax liability of \$400. Mrs Brown will be assessed on the aggregate unimproved value of the two properties, ie. \$550,000, at the ordinary Land Tax rates, yielding a Land Tax liability of \$930. However, she is entitled to a deduction for the \$400 Land Tax payable by Mr Brown as trustee, meaning that she will have a 2006 Land Tax liability of \$530. 	<p>Mr Smith creates the Smith Family Trust on 30 September 2006, and then acquires land with an unimproved value of \$300,000 in his capacity as trustee.</p> <p>Mr Smith is not permitted to nominate a beneficiary for the trust. In 2007, the Land Tax payable will be calculated as follows:</p> <ul style="list-style-type: none"> Mr Smith as trustee will be assessed on an unimproved value of \$300,000 at the trust surcharge rates. He will have a 2007 Land Tax liability of \$1,325.

¹ SRO Dec 05 LTX Trust Provisions - Practitioners Guide

² The examples for discretionary trusts do not take into account the cap on 2006 Land Tax liability increases

Fixed Trusts³

Scenario 1	Scenario 2
<p>Mr Brown holds land with an unimproved value of \$300,000 in a fixed trust for his two daughters, Amy Brown and Barbara Brown, in equal shares. Amy Brown owns a property with an unimproved value of \$400,000, which she uses as her principal place of residence.</p> <p>Barbara Brown owns an investment property with an unimproved value of \$200,000.</p> <p>Mr Brown elects to pay the trust surcharge rates instead of notifying the SRO of the beneficial interests in the trust property. The Land Tax payable by Mr Brown, Amy and Barbara is calculated as follows:</p> <ul style="list-style-type: none"> • Mr Brown as trustee will be assessed on an unimproved value of \$300,000 at the trust surcharge rates. He will have a 2006 Land Tax liability of \$1,325. • Amy's principal place of residence is exempt, and she will not be assessed for Land Tax on the trust property. <p>Therefore, Amy will not have to pay any Land Tax in 2006.</p> <ul style="list-style-type: none"> • Barbara will pay Land Tax on her investment property, but not on the trust property. Her 2006 Land Tax liability will be \$200. 	<p>Assume instead that Mr Brown notifies the State Revenue Office that he holds the land in trust for Amy and Barbara Brown in equal shares. The Land Tax payable is calculated as follows:</p> <ul style="list-style-type: none"> • Mr Brown as trustee will be assessed on an unimproved value of \$300,000 at the ordinary Land Tax rates. This yields a 2006 Land Tax liability of \$400. • Amy Brown does not own any other taxable land, as her principal place of residence is exempt from Land Tax. Therefore, Amy will not receive a Land Tax assessment in 2006. • Barbara Brown will be assessed on the aggregated unimproved value of her proportionate share of the trust property (50% of \$300,000 = \$150,000) and her investment property (\$200,000), ie. \$350,000, at the ordinary Land Tax rates. This yields a liability of \$500. <p>However, Barbara is entitled to a deduction for the Land Tax payable by Mr Brown as trustee on her proportionate share of the trust property, calculated according to a statutory formula. Applying this formula in Barbara's case yields a deduction of \$200, meaning that she will have a 2006 Land Tax liability of \$300.</p>

Unit Trusts

Scenario 1	Scenario 2
<p>ABC Investments P/L acts as trustee of a unit trust, which owns one property with an unimproved value of \$250,000, and a second property with an unimproved value of \$350,000. There are four unitholders, each holding one of the four units in the trust. One of the unitholders, Mr Brown, owns an investment property with an unimproved value of \$1,000,000.</p> <p>ABC Investments P/L elects to pay the trust surcharge rates instead of notifying the SRO of the unitholders in the trust. The Land Tax payable by ABC Investments P/L and the four unitholders is calculated as follows:</p> <ul style="list-style-type: none"> • ABC Investments P/L as trustee will be assessed on an unimproved value of \$600,000 at the trust surcharge rates. It will have a 2006 Land Tax liability of \$3,230. • The three unitholders which do not own other property will not be assessed for Land Tax on the trust property, and will not have to pay Land Tax in 2006. • Mr Brown (the fourth unitholder) will pay Land Tax on his investment property, but not on the trust property. His 2006 Land Tax liability will be \$3,680. 	<p>Assume instead that ABC Investments P/L notifies the SRO of the unitholders in the trust. The Land Tax payable by ABC Investments P/L and the four unitholders is calculated as follows:</p> <ul style="list-style-type: none"> • ABC Investments P/L as trustee will be assessed on an unimproved value of \$600,000 at the ordinary Land Tax rates. This yields a 2006 Land Tax liability of \$1,180. • The three unitholders which do not own other property will not receive a Land Tax assessment in 2006. • Mr Brown's Land Tax assessment for his investment property will also include a proportion of the value of the trust property which is equal to the number of units he holds as a fraction of the total number of units in the trust. In other words, Mr Brown will be assessed at the ordinary Land Tax rates on \$1,000,000 + $\frac{1}{4}$ of \$600,000 = \$1,150,000. This yields a liability of \$5,180. <p>However, Mr Brown is entitled to a deduction for the Land Tax payable by ABC Investments P/L on his proportionate share of the trust property, calculated according to a statutory formula. Applying this formula yields a deduction of \$295, meaning that Mr Brown will have a 2006 Land Tax liability of \$4,885.</p>

³ The examples for fixed & unit trusts do not take into account the cap on 2006 Land Tax liability increases

Conclusion

The State Revenue Office (SRO) requires any person who owns land in Victoria as a trustee of a trust, for land acquired before 1 January 2006, to lodge Notification of lands held in trust providing details of all land holdings. This notification for submission to the SRO of lands held on trust must be made no later than 31 March 2006.

Before any decision to nominate a beneficiary is made, all trustees should carefully consider their current and future positions. Where a beneficiary is nominated by a trustee and although the result in doing so is to avoid paying the special surcharge rate, this will have the effect that the beneficiary will have his/her land holdings aggregated and may result in an overall higher rate of land tax to be paid. All nominations must be lodged with the SRO by no later than 30 June 2006. It is important as shown by the examples above, that any decision in respect to the nomination of beneficiaries by the trustee be considered in consultation with professional advice.

Further, to be granted an exception from paying the surcharge tax rate, the trust must be an excluded trust as defined by the legislation or be in a particular category of either discretionary or fixed/unit trust. To confirm whether your trust is eligible for an exemption for the surcharge rates you should contact this office.

Angelo Simonetto
Wainwright Ryan Eid Lawyers

<p>Although all care and skill has been used in the preparation of this article, it is intended only to provide a general summary of the legislative changes and should not be relied upon as a substitute for professional advice.</p>
