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1 Introduction

The increased global mobility of individuals and online transactions, together with the deregulation of financial markets and exchange controls since the 1980s, mean that Australian residents being entitled to foreign funds is, in many instances, “the new black”.[1]

This may be “baby boomers” who accumulated wealth in “tax friendly” jurisdictions or migrants to Australia leaving behind assets and family in their home jurisdictions.

Those assets can be subject to tax in Australia on repatriation but also while the assets still are in the foreign country.

This is a broad topic far beyond a one-hour presentation, or a paper of a sensible length, so the focus will be on the following:

1. receiving a distribution from a foreign trust or deceased estate;
2. becoming a trustee, controller, or beneficiary of a foreign trust;
3. money held in foreign bank accounts; and
4. distributions from civil law entities.

[1] The author acknowledges the assistance of Matthew Meng of the Victorian Bar in reviewing the paper.

2 Who is an Australian resident?

This paper will focus on Australian resident individuals. Individual Australian tax residents are assessable on their world-wide income (whether sourced in or outside of Australia) whereas foreign residents are assessable only on their Australian sourced income (or on income on a basis other than source)[2]. Therefore, an individual's Australian tax residency status is of great significance in determining their liability for tax.

Section 6 of the *Income Tax Assessment Act 1936* (**ITAA 36**) defines tax residency as it applies to individuals as follows:

> "resident" or "resident of Australia" means:
>
> (a) a person…who resides in Australia and includes a person:
>
> (i) whose domicile is in Australia, unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia;
>
> (ii) who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that the person's usual place of abode is outside Australia and that the person does not intend to take up residence in Australia; or
>
> (ii) who is [a member, eligible employee for the purposes of the Superannuation Act 1976, or the spouse or a child under 16 years of age of either a member or eligible employee of a superannuation scheme established by deed under the Superannuation Act 1990].

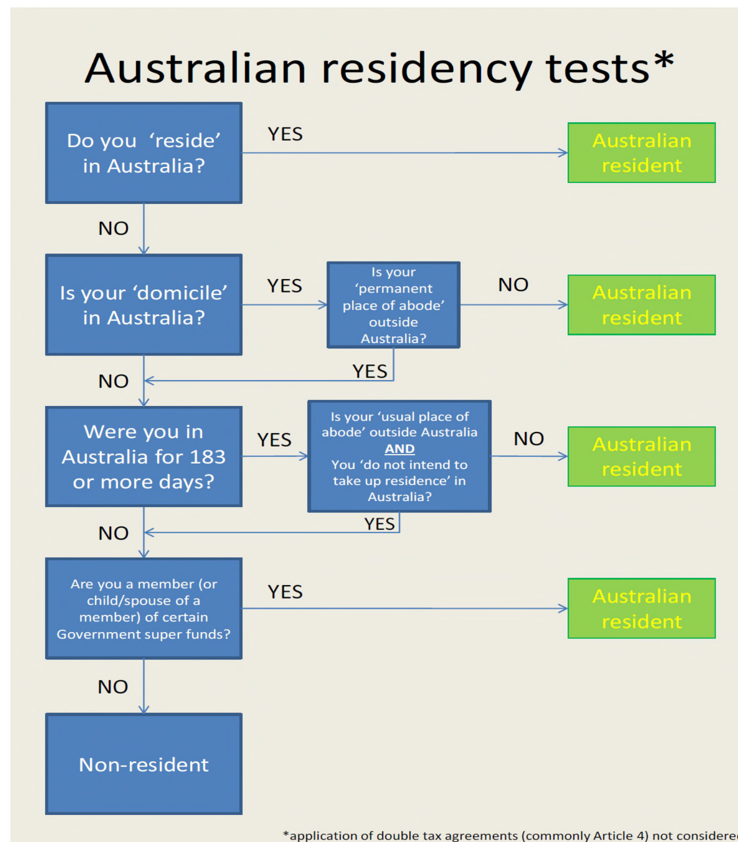
This definition effectively includes four alternative tests in determining an individual's residency of Australia for taxation purposes. An individual will be a resident of Australia if they fall within one of the following:

- 'resides test' – does the individual reside in Australia within the ordinary meaning of the expression; or
- 'domicile test' – the individual has an Australian domicile, unless the Commissioner is satisfied the individual's permanent place of abode is outside Australia; or
- '183 day test' – the individual has been in Australia either continuously or intermittently during more than one-half of the relevant year of income unless the Commissioner is satisfied the individual's usual place of abode is outside of Australia <u>and</u> the person does not intend to take up residence in Australia; or
- 'superannuation test' – is the individual a member, eligible employee, or the spouse or a child (under the age of 16) of either a member or eligible employee of certain Commonwealth superannuation funds.

[2] *Sections* 6-5, 6-10 *Income Tax Assessment Act 1997* (**ITAA 97**).

For an individual to be a tax resident of Australia, they need only satisfy one of these four tests.

The following table[3] summarises the operation of these tests:



Over time concepts such as 'reside', 'residence' 'domicile', 'place of abode' or 'permanent place of abode' have become legal concepts requiring application of common law rules.

With Australia's residence-based tax system having been enacted in the 1930s, significant case law has developed around the application of the Australian individual residency rules. The most recent being the Full Federal Court decision in *Harding v FCT* [2019] FCAFC 29.

Whilst for a majority of taxpayers the question of whether or not they are tax residents of Australia might be a clear one: for certain inbound (those where Australian residency needs to be established) or outbound (those ceasing Australian residency) taxpayers achieving certainty on whether they are Australia tax residents can be a complicated exercise.

[3] Consultation Guide, 'Review of the income tax residency rules for individuals', Board of Taxation (September 2018), page 32. In early 2019 the Board of Taxation completed its review of the individual residency tests. The results of the review are unknown at the date of writing.

2.1 Dual residence

It is possible for individuals to meet the requirements to be residents of more than one country. For example, one country may have a bright line 183-day test while an individual may still be an Australian resident under (say) the domicile test.

Australia has entered into 44 double tax agreements (**DTAs**).[4] A DTA is a formal bilateral agreement between Australia and an overseas jurisdiction for the purposes of the prevention of double taxation and fiscal evasion. The DTA records the two countries agreement as to the specific application and enforcement of their respective tax laws by:

1. allocating taxing rights between the two jurisdictions in respect of various categories of income (that is specifying which jurisdiction can tax the income);
2. in some cases (for example, interest, dividends, and royalties) limiting the amount of tax the local jurisdiction can impose); and
3. where both jurisdictions having taxing rights over the income:
    1. specifying the jurisdiction with primary taxing rights (that is, which jurisdiction gets "first bite" of the tax); and
    2. providing a mechanism in the other jurisdiction for the granting of a credit for tax already levied on the income.

For countries where Australia has entered into a DTA, most DTAs, and the OECD Model Tax Convention, United Nations Model Tax Convention, and United States Model Tax Convention from which most DTAs derive, contain "tie breaker" provisions for cases of dual residence. Generally, in "Article 4".

For example, the Article 4 of the United Kingdom/Australia DTA provides:

> The status of an individual who, by reason of the preceding provisions of this Article is a resident of both Contracting States, shall be determined as follows:
>
> (a) that individual shall be determined to be a resident only of the Contracting State in which a permanent home is available to that individual; but if a permanent home is available in both Sates, or in neither of them, that individual shall be deemed to be a resident only of the State with which the individual's personal and economic relations are closer (centre of vital interests);
> (b) if the Contracting State in which the centre of vital interests is situated cannot be determined, the individual shall be deemed to be a resident only of the State of which that individual is a national;
> (c) if the individual is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall endeavour to resolve the question by mutual agreement.

[4] References to DTAs in this paper are to bilateral agreements in relation to the taxation of income (and related items). While Australia does have agreements in place on other taxation issues (for example, inheritance taxes) the practical effect of these is limited and so we have not discussed in this paper.

Interestingly the "tie-breaker" refers to a "permanent home" rather than a "permanent place of abode" which the recent decision in Harding considered.

2.2 Residency and source

As set out earlier, Australian tax residents are assessed in Australia on ordinary and statutory income from all sources whether inside or outside of Australia unless a statutory rule overrides this general rule.[5] A foreign resident however is generally assessable only on income from Australian sources or on income on a basis other than having an Australian source.[6]

Australia's DTAs, for countries where Australia has such an agreement, can alter these general principles.

The "source rules" help Australia tax income derived by foreign residents while the "residency rules" cause the taxation of Australian tax residents on their worldwide income.

The residency of the trust (see below) will determine whether the trust's income from all sources is assessable in Australia (Australian trust) or only income with an Australian source or income on a basis other than having an Australian source (foreign trust). For beneficiaries, Australian resident beneficiaries are prima facie assessable on income from all sources including from foreign assets and foreign trusts.

That is, while different concepts, source and residency are "two sides of the same coin" when it comes to determining liability to Australian tax.

[5] Sections 6-5(2), 6-10(4) ITAA 97.
[6] Sections 6-5(3), 6-10(5) ITAA 97.

3 What is a foreign trust?

3.1 What is a trust?

For a trust to be a foreign trust, it needs first to be a trust.

The *Income Tax Assessment Act 1936* or 1997 do not define what is a 'trust' although a 'trust is an 'entity'.[7] French J in *Harmer v FCT* (1989) 20 ATR 1461 (**Harmer**) stated that a trust *"is notably a definition of a relationship by reference to obligations*". He went on to state that the four essential elements of a trust are:

1. the trustee who holds a legal or equitable interest in the trust property;
2. the trust property which must be property capable of being held on trust and which includes a chose in action;
3. one or more beneficiaries other than the trustee;
4. a personal obligation on the trustee to deal with the trust property for the benefit of beneficiaries with the obligation annexed to the trust property.

The ATO for practical purposes also can treat certain civil law entities (see below) as trusts for Australian tax purposes.

3.2 When is a trust a foreign trust?

Section 995-1 ITAA 97 says a foreign resident is a person who is not a resident of Australia. Therefore, a foreign trust is a trust that is not a resident trust.

A trust is a resident of Australia for an income year if the trust has a resident trustee at any time during the income year or the central management and control (**CMC**) of the trust was in Australia at any time during the income year.[8] A foreign resident trust is a trust that is not a resident trust.[9]

If a trust has multiple trustees, only one need be a resident for the trust to be a resident. This is because section 95(2) ITAA 36 refers to 'a trustee', which connotes that the requirement is satisfied if any trustee is a resident even if that trustee is one of a number of trustees where the other trustees are not Australian residents for taxation purposes.

In practice we often see the outcome with estates and testamentary trusts where all children of a foreign deceased are executors/trustees. If one of the children resides in Australia, the estate or

[7] Section 960-100 ITAA 97.
[8] Section 95(2) ITAA 36.
[9] Section 95(2) ITAA 36.

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testamentary trust will be an Australian tax resident with all the attendant tax and compliance obligations.

Therefore, to determine if a trust is not an Australian resident (and thus a foreign trust) we need to look at the residency tests for individuals (discussed above) and companies. Under section 6(1) ITAA 36 a company is a resident of Australia if it:

1. is incorporated in Australia; or
2. carries on business in Australia and either has its CMC in Australia or its voting power is controlled by shareholders who are residents of Australia.

The High Court considered the issue of whether a company is carrying on business in Australia, and what constitutes CMC of a company in *Bywater Investments Ltd v FCT* [2016] HCA 45 (**Bywater**). Following that decision, the ATO withdrew *Taxation Ruling* TR 2004/15 and issued *Taxation Ruling* TR 2018/5 that considers CMC test of residency.[10]

In TR 2004/15 the Commissioner considered for a foreign incorporated company to be a resident of Australia was a two-part test. The first was that the company carries on business in Australia, and the second was that the company's CMC must be in Australia.[11]

In TR 2018/5 the ATO now considers that if a company has its CMC in Australia it carries on business in Australia.[12] That is the ATO 'conflates' the two requirements.

The residency tests for companies and trusts both include the concept of CMC. While there is considerable jurisprudence, including Bywater, on CMC for companies there is not an Australian court decision considering CMC for trusts. However, in the Canadian Supreme Court decision of *Fundy Settlement v Canada* [2012] 1 SCR 520 the Court said that '*there are many similarities between a trust and a corporation*' and CMC is where *'[the trusts] real business is carried on*'.[13]

While the Australian corporate jurisprudence on CMC is useful in the context of trusts in determining what activities constitute CMC, it is likely the concept for trusts is somewhat different because section 95(2) ITAA 36 includes the word 'the' before 'central management and control' which the section 6(1) ITAA 36 residency test for companies does not. That is, a company may have multiple places of CMC,[14] while for trusts there either must be only one CMC (in Australia) or, if there is more than one, the predominant one must be in Australia.

Further, irrespective of the correctness (or otherwise) of the Commissioner's views in TR 2018/5, the residency test for a trust does not require that the trust carries on business in Australia merely that CMC be in Australia.

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[10] Robert Gordon in the paper, "*Recent developments in the tax residence of individuals, companies and trusts*", 18 April 2019, provides at excellent summary of the corporate residency tests.

[11] *Taxation Ruling* TR 2004/15 at [5].

[12] *Taxation Ruling* TR 2018/5 at [7]. Following the Bywater decision and the ATO in views in TR 2018/5, the Board of Taxation is undertaking a review of the corporate residency tests. The review is expected to be completed in 2020.

[13] *Fundy Settlement v Canada* [2012] 1 SCR 520 at paragraphs [14] to [15].

[14] See, for example, *Taxation Ruling* TR 2018/5 at paragraph [31]. See also, *Koitaki Para Rubber Estates Ltd v FCT* (1941) 64 CLR 241.

The residency tests for trusts are interactive. Therefore, when advising beneficiaries of a 'foreign trust', one needs to determine if the trust is indeed a foreign resident or an Australian resident trust. For example:

1. if there are individual trustees, is one of them an Australian resident;
2. a trust with a foreign company as trustee will be an Australian resident trust if the foreign company is an Australian resident under the company CMC test of residency; or
3. if there is a foreign resident trustee (individual or corporate), and the trustee exercises the CMC of a trust in Australia, the trust will be an Australian tax resident despite the trustee being a foreign resident.

These examples raise the possibility that the trust could be a resident of Australia and a foreign country. In this case, for countries where Australia has a DTA, most (but not all) agreements have a 'tie breaker' rule in circumstances of dual residency. However, does the DTA apply to a trust?

3.3 Application of DTAs to trusts

A DTA can only change local tax treatment in circumstances where a person who is a resident of at least one of the parties to the DTA derives the income or gain and entitled to the treaty benefit.

In most DTAs, Articles 1 and 3 sets out which persons are within the scope of the DTA. Typically, these Articles provide that the trust will only be within the scope of the DTA if the trust is a 'person' for the purposes of the DTA.

If the trust is not a 'person' for the purposes of the DTA, usually the trust will not qualify for benefits under the DTA. In the context of trusts, the definition of 'person' varies significantly across Australia's DTAs and may, or may not, include trusts. For example:

1. United States DTA: the term 'person' includes an individual, an estate of a deceased individual, a trust, a partnership, a company and any other body of persons;
2. New Zealand DTA: the term 'person' includes an individual, a trust, a partnership, a company and any other body of persons.
3. Singapore DTA: the term 'person' includes an individual, a company and any body of persons corporate or not corporate; and
4. United Kingdom DTA: the term 'person' includes an individual, a company and any other body of persons;
5. German DTA: the term 'person' includes an individual, a company and any other body of persons;
6. Switzerland DTA: the term 'person' includes an individual, a company, a trust and any other body of persons;
7. China DTA: the term 'person' includes an individual, a company and any other body of persons;

8. Japan DTA: the term 'person' includes an individual, a company and any other body of persons

In the context of both the United Kingdom and Singapore DTAs there is no reference to trust in the definition of 'person' (despite both being common law jurisdictions) while Germany, China, and Japan do not have a common law heritage.

In *Taxation Ruling* TR 2005/14, the Commissioner indicates in the context of the (former) New Zealand DTA the person requirement in the DTA was satisfied where the trustee was a company or individual on the basis that the treaty applied at the trustee level. (However, TR 2005/14 only dealt with single trustee trusts).

In jurisdictions where the relevant DTA is silent as to trusts, there is a material risk that trusts may not qualify for benefits under the DTA. For civil law and other jurisdictions where trusts are not a (common) feature it may not be a practical issue, it could be for jurisdictions such as the United Kingdom where trusts are commonplace.

We discussed the residency tie breaker provisions for individuals above. In the context of non-individuals, some DTAs have no tie breaker article which effectively denies treaty benefits to dual resident trusts. If the trust is resident in both countries, while the tie breaker varies significantly between DTAs, the most common tie breaker is for residency to be determined by the place of effective management.[15]

Australian jurisprudence has given little attention to 'place of effective management'. However, in a minority decision in Bywater, Gordon J noted that CMC and 'effective management' are different concepts.[16] In Gordon J's view, the place of effective management may ordinarily be the place where the board of directors makes decisions, but this is subject to consideration of all the facts and circumstances. [17]

The OECD Guidelines state:[18]

> *… The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the enterprises' business are in substance made. The place of effective management will ordinarily be where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where actions to be taken by the enterprise as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management. An enterprise may have more than one place of management, but it can have only one place of effective management at any one time.*

Australia is a party to the "*Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*" (**MLI**). The MLI adds an extra layer to the global international tax system:

1. the first layer is each country's own domestic tax laws and rules;

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[15] Alternative bases are, 'competent authority' – for example in New Zealand and Germany, and incorporation, for example in Canada, Denmark, Finland, the Philippines, Taiwan, and Thailand.

[16] [2016] HCA 45 at [139].

[17] [2016] HCA 45 at [169].

[18] https://www.oecd.org/tax/transfer-pricing/36221030.pdf at page 82.

2. the second layer are DTAs;
3. the third layer, given force from 1 January 2019 in Australia that can apply to all countries that sign the MLI.

The MLI can ‘alter’ the application of DTAs. Rather like how DTAs and domestic laws are read as one, the MLI applies when interpreting DTAs. However, the MLI only applies to “covered tax agreements” that both countries have agreed will be modified by the MLI.[19]

1. Article 3 of the MLI says that treaty benefits will be granted for income derived through fiscally transparent entities, such as partnerships or trusts, but only if one of the two jurisdictions treats the income as income of one of its residents under its domestic law. Australia has adopted Article 3 but will preserve existing corresponding bilateral detailed rules.
2. As discussed, most treaties use an entity’s place of effective management as the key tiebreaker test to determine a dual resident’s jurisdiction of tax residence for treaty purposes. Article 4 of the MLI expands the to include other factors and authorise the two tax administrations to agree on a single jurisdiction of residence. Australia has adopted Article 4 but not the rule that would allow the two tax administrations to grant treaty benefits in the absence of such an agreement.

In situations where there is no DTA with a country in which a trust or trustee is resident, or the DTA does not apply, and the trust may also be a resident of Australia, the possibility of double taxation can arise.

3.4 Is there a difference for capital gains tax?

Unlike for individuals and companies, for trusts there is a separate residency test for CGT purposes. For trusts other than unit trusts, the test for CGT purposes is the same as the section 95 ITAA 36 test.

For unit trusts, there is a different test for CGT purposes, with the section 95 ITAA 36 test for other purposes. A unit trust is an Australian tax resident for CGT purposes for an income year if at any time:

3. any property (not just real property) of the trust is situated in Australia or the trust carries on a business in Australia; and
4. the CMC of the trust is in Australia or Australian residents held more than 50% of the beneficial interests in the income or property of the trust.

Therefore, it is possible for a unit trust to be a foreign resident for most Australian tax purposes but a resident trust for CGT purposes (or vice versa). For example, a unit trust may have a foreign trustee and CMC (and so would not be an Australian tax resident for most purposes) but if the unit trust owned property situated in Australia and Australian residents held more than 50% of the units, the trust could be an Australian resident trust for CGT purposes.

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[19] Currently Australia has 16 “covered tax agreements”. The list is available here https://www.ato.gov.au/General/International-tax-agreements/In-detail/Multilateral-Instrument/.

On their face, the words “at any time” suggest that where a trust satisfies a residency condition for only part of an income year its is resident for the entire income year. However, in *Taxation Determination* TD 1999/83 the Commissioner states in the context of former Division 136 ITAA 97 (the precursor to Division 855 ITAA 97), that:

1. a trust becomes a ‘resident trust for CGT purposes’ at the time during an income year when the requirements of the definition of that expression are satisfied; and

2. a trust stops being a ‘resident trust for CGT purposes’ at the time during an income year when the requirements of the definition of that expression are satisfied.

Under the Commissioner’s interpretation trusts may, at least for CGT purposes, be resident for only part of an income year.

Does the Commissioner’s views in TD 1999/83 apply to resident trusts for purposes of section 95(2) ITAA 36? TD 1999/83 states that “*this construction does not affect the operation of Division 6 of the Income Tax Assessment Act 1936 or other general provisions of the income tax law*”.

4 A trust ceasing or becoming an Australian resident

A trust ceases being a resident of Australia

If a trust ceases being a ‘resident trust for CGT purposes’, CGT event I2 in section 104-170 ITAA 97 happens. The time of this event is when the trust stops being a ‘resident trust for CGT purposes’.[20]

A trust ceases being a ‘resident trust for CGT purposes’ at the time during an income year when the trust no longer meets the requirements of that definition.[21]

The trustee of the trust is required to work out if it has made a capital gain or a capital loss for each CGT asset that it owned (in the capacity as trustee of the trust) just before the time of the CGT event.[22] The trustee makes a capital gain (loss) if the market value of the asset (at the time of the event) is more than the asset’s cost base (reduced cost base).[23] If the trust is a fixed trust, foreign resident beneficiaries may be able to disregard their share of the capital gain.[24]

The only exceptions relate to ‘taxable Australian property’ that is:[25]

1. ‘taxable Australian real property’;
2. an asset used in carrying on a business through a permanent establishment in Australia; or
3. an option or right to acquire the above.

A trust that stops being a 'resident trust for CGT purposes' during an income year does not make any capital gain or capital loss in that income year from any CGT event that happens from the time at which it stops being a resident trust in the income year until the end of that income year unless the asset is ‘taxable Australian property’ and Division 855 applies.[26]

A trust becomes a resident of Australia

If a trust becomes a ‘resident trust for CGT purposes’, the trustee is taken to acquire the CGT assets it owns at their market value at the time the trust became a 'resident trust for CGT purposes' except for an asset:[27]

1. that is ‘taxable Australian property’; or

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[20] Section 104-170(2) ITAA 97.
[21] See *Taxation Determination* TD 1999/83.
[22] Section 104-170(3) ITAA 97
[23] Section 104-170(4).
[24] Section 855-40 ITAA 97.
[25] Section 104-170(3) ITAA 97.
[26] See TD 1999/83.
[27] Section 855-50(1) ITAA 97.

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2. the trustee acquired before 20 September 1985.

The above does not apply if the trust, just before it became a 'resident trust for CGT purposes', was a transferor trust.[28]

A trust becomes a 'resident trust for CGT purposes' at the time during an income year when the requirements of that definition (that is, residency of the trustee or central management and control of the trust in Australia) are satisfied.

A trust that becomes a 'resident trust for CGT purposes' during an income year does not make any capital gain or capital loss in that income year from any CGT event that happens from the beginning of the income year until the time at which it becomes a resident trust in the income year unless the asset is 'taxable Australian property' and Division 855 applies.[29]

[28] Section 855-50(4) ITAA 97.
[29] See TD 1999/83.

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5 Taxing Australian beneficiaries of foreign trusts

As set out earlier in this paper, for foreign trusts, only income with an Australian source or income on a basis other than having an Australian source is subject to tax in Australia.

However, for Australian resident beneficiaries, those beneficiaries can be subject to tax on worldwide income derived by a foreign trust if:

1. the trust does not make a distribution or deemed distribution to the beneficiary, but the beneficiary is attributed the net income of the foreign trust under the transferor trust rules;
2. the trust makes the beneficiary presently entitled to the income of the trust under section 97 ITAA 36, or creates in the beneficiary a vested or indefeasible interest in such income under subsection 95A(2) ITAA 36, the beneficiary is subject to tax on its share of the net income of the trust calculated under Australian tax laws; or
3. the trust pays to, or applies for the benefit of the beneficiary, an amount which may be assessable all or in part under section 99B ITAA 36.

5.1 Transferor trust rules

The transferor trust rules are complex. The object of Division 6AAA ITAA 36 that houses the transferor trust rules is to attack trusts (discretionary and non-discretionary) in low-tax jurisdictions that accumulate income free of Australian tax. The rules can apply more broadly than that.

5.1.1 Who is an attributable taxpayer?

In broad terms, the transferor trust rules can be triggered when an Australian resident transfers property or services to:[30]

1. a non-resident discretionary trust estate; or
2. a non-resident trust estate that is non-discretionary trust for either no consideration or for less than arm's length consideration.

An Australian resident that transfers property or services to a foreign trust is an 'attributable taxpayer' unless an exclusion applies.[31] There may be multiple attributable taxpayers for a foreign trust. It there are multiple taxpayers, then there will be double (or more) taxation on the same attributed income. Upon application, the Commissioner can reduce the attributable income assessed to each attributable taxpayer.

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[30] Section 102AAT ITAA 36.
[31] Section 102AAT ITAA 36.

The transfer of property or services is given an expanded meaning under Division 6AAA ITAA 36, to include:

1. transfer by way of initial settlement to create the trust; [32]
2. where one entity causes another entity to transfer property to a trust estate;[33]
3. back-to-back transfers; [34]
4. transferring property on arm's length terms but not in the course of carrying on a business;[35]
5. an individual transferred property or services to the trust prior to the individual becoming an Australian tax resident;[36]
6. acquisition by the trust of property not previously existing; [37]
7. the application of property or services for the benefit of, or following, the directions of the trustees; [38] and
8. transfers of property or services to a non-resident company where a non-resident trustee has a direct or indirect ownership interest.[39]

5.1.2 Exclusions

Several exclusions apply to the operation of the transferor trust provisions, including:

1. the transferor transferred property or services to a discretionary trust and:
    1. the transfer was in the ordinary course of business; and
    2. the transfer was on terms identical or similar to those that relate to transactions undertaken by the transferor (That is, on an arm's length basis and on similar terms and conditions);[40]
2. the transferor transferred property or services to a non-discretionary trust and:
    1. the trust was a non-discretionary trust at all times in the transferor's current year of income; and
    2. the transfer was for arm's length consideration;

[32] Section 102AAJ ITAA 36.
[33] Section 102AAK ITAA 36.
[34] Section 102AAK ITAA 36.
[35] Section 102AAT ITAA 36.
[36] Section 102AAT ITAA36.
[37] Section 102AAJ ITAA 36.
[38] Section 102AAJ ITAA 36.
[39] *Taxation Ruling* TR 2007/13.
[40] The onus would be on the taxpayer to prove this.

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3. transfers from deceased estates resulting from a will or codicil, unless the transfer was because of the exercise of a discretion or power of appointment;[41] and
4. a natural person transfers property to a non-resident family trust (that is, a trust established as a result of a relationship breakdown or established for the relief of a person in necessitous circumstances.

5.1.3 Calculating attributable income

The consequence of the transferor trust rules applying is the attributable taxpayer is assessed on the attributable income of the transferor trust.

The starting point for the calculation of attributable income is whether the trust is resident in a listed or unlisted country. Listed countries are New Zealand, the United States, the United Kingdom, Germany, France, Japan, and Canada.

To determine the attributable income of a foreign trust, the net income is calculated as though the trust were an Australian resident taxpayer subject to several assumptions and modifications:

1. if the trust is resident in a listed country, only the trust's 'eligible designated concession income' is considered when working out net income;
2. for a trust resident in an unlisted country, the starting point is the net income of the trust calculated in accordance with Australian tax rules.

The attributable income is then subject to several reductions including:[42]

1. amounts which are included in the assessable income of a beneficiary under section 97 or 102AAZD ITAA36 or the trustee under section 98, 99, or 99A ITAA 36;
2. amounts paid to a beneficiary resident in a listed country and subject to tax within a certain period;
3. distributions with a franking or exempting credit attached;
4. amounts subject to tax in a listed country and are not eligible designated concession income; and
5. Australian or foreign tax paid in respect of the attributed income.

Thankfully, provisions such as Division 230 and 974 (but not 775) of the ITAA 97 are excluded in calculating attributable income. The depreciation and CGT provisions are modified when calculating attributable income.

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[41] Section 102AAL ITAA36.
[42] Section 102AAU ITAA 36.

5.1.4 Controlled foreign company interaction

The controlled foreign company (**CFC**) rules in Part X ITAA 36 operate in a similar way to Division 6AAA ITAA 36 but with respect to foreign companies controlled by Australian residents (rather than foreign trusts with Australian transferors).[43]

A foreign company:[44]

1. will be treated as a CFC if a group of five or fewer Australian '1% entities', together with their associates, own or are entitled to acquire an interest of at least 50% in the foreign company;[45]
2. will normally be treated as a CFC if a single Australian entity owns, or is entitled to acquire, an associate-inclusive interest of at least 40% in the foreign company; or
3. will be treated as a CFC under the de facto control test if a group of five or fewer Australian entities, either alone or with associates, effectively controls the foreign company.

In determining whether a foreign company is a CFC, Part X provides tracing through interests in the company held by a controlled foreign trust (**CFT**).

A foreign trust will be a CFT where, broadly, 5 or fewer entities (together with associates), hold interests in the trust of 50% <u>or</u> there are one or more eligible transferors.[46] An eligible transferor is deemed to hold a 100% interest in the CFT.

For all intents and purposes the definition of eligible transferor in Part X is identical to that in Division 6AAA. Therefore, a transferor trust will likely be a CFT and a foreign company that the trust holds the requisite interest in (see above) will be a CFC. For example, a foreign company in which a transferor trust (CFT) owns a 45% interest in will likely be a CFC.

5.1.5 Foreign income tax offset interaction

Division 770 ITAA 97 holds the foreign income tax offset (**FITO**) rules. An Australian resident taxpayer (generally) can claim a non-refundable tax offset with respect to foreign income tax paid on amounts included in assessable income.[47]

Under section 770-130 a taxpayer is treated as having paid foreign income tax where the tax has been paid in respect of that income by someone else on their behalf under an arrangement with the taxpayer or under the law relating to that tax. For example, a foreign trust in which the taxpayer is a beneficiary.

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[43] If an Australian resident has the requisite interest in a CFC that resident will be an attributable taxpayer in the CFC under Part X ITAA36. As this paper focuses on foreign trusts and funds, we have not discussed the application of the CFC rules apart from the interaction with Division 6AAA ITAA 36. The Tax Institute website has many papers that discuss the CFC rules in depth.
[44] Section 340 ITAA 36.
[45] An Australian 1% entity is an Australian entity that, together with its associates, holds an interest of at least 1% in the foreign company.
[46] Section 342 ITAA 36.
[47] Section 770-10 ITAA 97.

Section 770-130 ITAA 97 would apply to presently entitled Australian beneficiaries to income of a foreign trust and the foreign trust paid foreign income tax with respect to that income. Section 770-130 can also apply to amounts assessed under section 99B ITAA 36.

In addition to situations where the tax is actually paid by the trust, a beneficiary may also be entitled to claim a FITO where the beneficiary receives a trust distribution that is attributable to another amount of income received by the trust on which foreign income tax has already been paid.[48] This special attribution rule could apply, for example, where the trust received income on which foreign tax has already been withheld, or where the trust is a beneficiary in another trust that paid the tax. The test for whether income is "attributable" to other income is set out in section 6B ITAA36.

When calculating attributable income of a transferor trust under section 102AAU ITAA 36, the income of the trust is reduced by any foreign taxes paid by the trust. That is, the trust deducts the amount of foreign tax.

An analogous approach to calculating attributable of an attributable taxpayer in a CFC under Part X ITAA 36. With respect to the attributable taxpayer claiming a FITO, under section 770-140 ITAA 97 a foreign income tax offset may be available to an attributable taxpayer assessed under the CFC rules. Section 770-140 "works" by grossing up the attributable income by the amount of the foreign income tax and then applying the FITO rules.

Section 770-140 does not apply to attributable income under the transferor trust rules.

5.2 Present entitlement and deemed present entitlement

For beneficiaries that are presently entitled under section 97 ITAA36 or deemed presently entitled under section 95A(2) ITAA 36, the net income of the foreign trust must be calculated in accordance with Australian tax rules including assuming the foreign trust is an Australian resident. That calculation would include attributable income under the transferor trust and or CFC rules if the foreign trust had interests in a transferor trust or CFC.

If a foreign trust makes a capital gain and that gain does not relate to taxable Australian property (**TAP**) foreign resident beneficiaries may in certain circumstances be taxed under section 99B rather than section 97 or 95A(2) ITAA 36. We discuss this in the next section of this paper.

5.3 Section 99B

Section 99B ITAA 36 was introduced in the late 1970s in response to the *Union Fidelity v FCT* (1969) 119 CLR 177 case which held that for the purposes of Division 6 only Australian sourced income could be taken into account.

[48] Subsection 770-130(3).

As the Explanatory Memorandum to the *Income Tax Assessment Amendment Bill (No 5) 1978* which introduced section 99B said, section 99B "*will usually apply where accumulated foreign income of a non-resident trust estate is distributed to a resident beneficiary*".

Unfortunately, nothing in the words of section 99B limit its operation to foreign trusts as recognised in the *Modernising the Taxation of Trust Income Consultation Paper* in 2011 although the ATO generally limits its compliance activity to foreign trusts.

Under section 99B distributions made by a (foreign) trust to or for the benefit of Australian resident beneficiaries can be assessable in the hands of those beneficiaries. A sting in the tail of section 99B is that the Australian beneficiary may also be liable to pay an interest charge on the distribution back to the time when the income representing the distribution was originally derived by the trust.[49]

Section 99B is a provision of 'last resort' and will not apply where the distribution represents:

1. corpus of the trust estate, but not an amount that is attributable to income derived by the trust that would have been included in the assessable income of a resident taxpayer had it been derived by that taxpayer;[50]

2. an amount that would not have been included in the assessable income of a resident taxpayer had that taxpayer derived it;

3. an amount included in the assessable income of the beneficiary under section 97 ITAA 36;

4. an amount assessed to the trustee of the trust or the trustee of another trust under section 98, 99, or 99A;

5. an amount included in the assessable income of a taxpayer under section 102AAZD of the transferor trust rules (see above).

Section 99B is wide ranging. The Commissioner in *Interpretative Decision* ID 2011/93 says that section 99B can apply in relation to income accumulated by a foreign trust when the beneficiary was a foreign resident, and then distributed <u>after</u> the beneficiary becomes an Australian resident.

In the context of CGT, the ATO released in December 2017 *Taxation Determinations* TD 2017/23 and TD 2017/24. Released in draft in November 2016, TD 2017/23 and TD 2017/24 consider certain aspects of the interaction of the capital gains provisions and the trust assessing provisions in Division 6 as those provisions apply to foreign trusts. In particular, where a foreign trust makes a capital gain on assets that are not taxable Australian property (**TAP**) and distributes that gain to Australian beneficiaries.

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[49] Section 102AAM.

[50] The Full Federal Court in *Howard v FCT* [2012] FCAFC 149 held that *"… [section 99B] will simply apply as many times as there are interposed layers of trusts. Each application of [section 99B] leads to a hypothetical question about whether the amounts received by the trust estate would have been assessable income if they had been earned by a resident taxpayer. Once an answer to that question is known at the level of the deepest trust the answer cascades back up to the original (genuine) resident taxpayer …"*.

The view expressed in TD 2017/23 and TD 2017/24 is that where a foreign trust makes a capital gain on the disposal of an asset that is not TAP, and the foreign trust distributes the capital gain to an Australian resident, the Australian resident will not benefit from the CGT discount or capital losses.

TD 2017/23

Section 95 ITAA 36 provides that the net income of a trust is calculated on the assumption that the trustee is an Australian resident taxpayer.

Section 855-10 ITAA 97 provides that a foreign resident, or the trustee of a foreign trust for CGT purposes, disregards a capital gain or loss from a CGT event on assets that are not TAP. The ATO view in TD 2017/23 is that section 855-10, in effect, takes precedence to the assumption under section 95. The effect of the ATO view (that the trustee of a foreign trust disregards a non-TAP capital gain or loss when calculating net income under section 95) is that the capital gain is not assessed to Australian resident beneficiaries under either section 97 (present entitlement) or section 102-5 ITAA 97 (specific entitlement).

The following example included in TD 2017/23 illustrates the application of the ATO view.

> The Kiwi Trust was established in New Zealand. The trust is a foreign trust for CGT purposes as the trustee company is incorporated in New Zealand and the trust is centrally managed and controlled there. The trustee can appoint *income* and capital of the trust to a range of beneficiaries, some of whom are resident in Australia.
>
> The trustee invests in shares in Australian companies that are not 'taxable Australian property'. The trustee sells some of those shares.
>
> As the trust is a foreign trust for CGT purposes and the shares are not 'taxable Australian property', no capital gains or losses from the sale will be reflected in the net income of the trust under section 95. Accordingly, Subdivision 115-C will not treat the trust's beneficiaries (or the trustee) as having capital gains in respect of the sale.
>
> The trustee distributes an amount attributable to the gain to a beneficiary resident in Australia. Section 99B may then apply to include an amount in the beneficiary's assessable income.

TD 2017/24

The ATO follows TD 2017/23 with TD 2017/24 which considers the application of section 99B. The ATO view in TD 2017/24 is that the distribution of an amount that had its origins in a capital gain from non-TAP of a foreign trust is assessed under section 99B and is not eligible for the CGT discount or offset by capital losses (or carry forward capital losses).

The following example, based on the one in TD 2017/24, illustrates the application of the ATO view.

> The Kiwi Trust sells shares in an Australian public company that it had owned for five years. The shares are not taxable Australian property.
>
> The trustee makes $50,000 capital gains from the share sale but these are not relevant in calculating the trust's net income.

> The trustee distributes an amount attributable to the capital gains to Erin, a resident of Australia. Erin has a $40,000 net capital loss that she has carried forward.
>
> Erin must include the entire $50,000 in her assessable income under section 99B. She cannot reduce the amount by her net capital loss or by the CGT discount.

The ATO view means that the tax outcomes for Australian beneficiaries of foreign trusts will be different depending on whether the asset is TAP (CGT discount and capital loss offset) or non-TAP (no CGT discount or capital loss offset).

The ATO views may also affect the calculation of attributable income for transferor trusts. In calculating net income included in attributable income you assume under section 95 that the foreign trust is an Australian resident.

The views in TD 2017/23 and TD 2017/24 may mean only the inclusion of capital gains or losses from TAP with non-TAP gains (presumably) assessed under section 99B.

Steward J recently discussed the role of section 95 ITAA 36 in *Sole Luna Pty Ltd as Trustee for the PA Wade No 2 Settlement Trust v FCT* [2019] FCA 1195 (**Sole Luna**).

In Sole Luna, the taxpayer argued that the statutory fiction created by section 95 was one that operated for all purposes of the ITAA 36 and ITAA 97. The Commissioner disagreed with the taxpayers' submission about section 95. He contended that the fiction created by section 95 served the purpose of the computation of the net income of a trust estate and no more. The net income calculated in accordance with section 95 was described as being only "notional" income, or to use the expression of Sundberg J in *Zeta Force Pty Ltd v FCT* (1998) 84 FCR 70 at 75, as being only an "artificial tax amount".

Steward J did not agree with the taxpayer's argument. The taxpayer was unsuccessful in Sole Luna, not just on the section 95 question, and has appealed to the Full Federal Court.

We await the outcome of that appeal and the impact (if any) on TD 2017/23 and TD 2017/24.

6 Changing the residence to Australia?

One way often mooted to reduce the complexities and tax leakages of foreign trusts with Australian resident beneficiaries is to consider changing the residency of the trust so that it becomes an Australian trust. The easiest way to achieve this would be to appoint an Australian trustee (preferably on 1 July to negate part-year issues).

However, while this may enable Australian resident beneficiaries' access to the CGT discount on non-TAP capital gains and reduce the chance of FITO leakage, you should consider the following:

1. does the trust become a dual resident of Australia and the foreign country, if so, does a DTA "tie breaker" apply (and how);
2. there may be "exit taxes" on leaving the foreign country if the trust ceases being a resident of that country;
3. if the repatriated trust wants to distribute to foreign beneficiaries (in addition to Australian beneficiaries) the tax issues are complex particularly with capital gains; and
4. unless the trust is a transferor trust, non-TAP assets of the trust have their cost bases reset to market value at the time of becoming an Australian resident trust. If the repatriated trust sells those assets and the capital gain reduces because of the cost base "step up" there is a risk:
    1. the "step up" in cost base could be assessable under section 99B ITAA 36; and
    2. the general anti-avoidance rules in Part IVA of the ITAA 36 could apply both to a reduced capital gain and increased FITO.

Nothing is simple in this area!

7 Foreign currency bank accounts

Foreign currency bank accounts and the associated transactions, whether held directly by an Australian resident, or by a foreign trust can result in tax liabilities either for the individual or in calculating the net income of the trust.

A foreign currency bank account is a chose in action which is a CGT asset.[51] Every withdrawal, transfer, or payment from a bank account is a CGT event (C2) as part of the CGT asset (the chose in action) ends at the time of the withdrawal, transfer, or payment.[52] This is irrespective of whether the funds are converted to Australian currency or another foreign currency.

Similarly, for foreign currency bank accounts opened after 1 July 2003 (or before 19 February 1986), the bank account represents a right to receive foreign currency and the withdrawal, transfer, or payment represents part of that right ending and constitutes forex event 2 under section 775-45 ITAA 97.[53]

Unless an exclusion applies, for example the asset is a personal use asset under the CGT rules or Division 775, the gain or loss may be assessable or deductible under Division 775 or included in net capital gains under the CGT rules.

[51] Section 108-5 ITAA 97.
[52] Section 104-25 ITAA 97. See *Interpretative Decision* ID 2003/551.
[53] See *Interpretative Decisions* ID 2004/855 and ID 2006/320.

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8 Civil law entities

The tax treatment of civil law entities in Australia depends on the characterisation as a type of entity recognized under Australian tax laws.[54] For example, some civil law entities have similarities to corporations and trusts - they have legal personality, exist for a purpose or persons but do not have shareholders or members.[55]

Once it has been determined, possibly with the assistance of the ATO, the classification of the civil law entity for Australian tax purposes – for example, as a foreign company, trust or other entity – then the Australian tax rules for Australian residents with interests in (say) a foreign trust can be applied.

8.1 Foundations (Stiftungen) and establishments (Anstalten)

Two popular civil law entities that have similarities to corporations and trusts are foundations and establishments.

Generally, a Liechtenstein foundation (Stiftung) can enter into contracts, sue and be sued in its own name and thus shows characteristics of a corporation. However, a Liechtenstein foundation has also characteristics of a trust as the foundation itself has no members or shareholders, the founder of the foundation has no ownership rights in the independent assets and the foundation's beneficiaries are not the owners of the foundation.[56]

The Liechtenstein establishment (Anstalt) is an entity, without members, participants, or shareholders. However, as the Liechtenstein establishment can have beneficiaries, it is kind of a hybrid between a corporation and a foundation.[57]

The main difference between a Liechtenstein establishment and a Liechtenstein foundation is that unlike a foundation, an establishment can conduct all kinds of business activities.[58]

The ATO has expressed views on the nature of a foundation and an establishment in Private Binding Rulings (**PBRs**).

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[54] The author thanks Annabel Rehmer formerly of Sladen Legal and now of PwC for her assistance with this section of the paper. Annabel informs the author that the correct plural form of Anstalt is Anstalten (not Anstalts) and Stiftungen (not Stiftungs).
[55] Robert Gordon, International Inheritance & Wealth Planning Issues, 30 April 2015, at page 19.
[56] PBR 1051209890341.
https://austaxpbr.com.au/document/PBR_1051209890341
[57] Robert Gordon, International Inheritance & Wealth Planning Issues, 30 April 2015, at page 19.
[58] Robert Gordon, International Inheritance & Wealth Planning Issues, 30 April 2015, at page 19.

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PBR 1051209890341[59]

In this PBR the ATO had to determine whether the X Foundation (a foundation (Stiftung) under the law of Liechtenstein) was a trust for the purposes of Division 6 ITAA 36.

The Liechtenstein X Foundation was established under the Liechtenstein *Persons and Companies Law Act* of 20 January 1926.

As the founder of Foundation X authorised the foundation board to manage (part of) his personal assets in the interest of one or more beneficiaries, the ATO determined that Foundation X constituted a relationship of trust between the the X Foundation, the foundation board and the beneficiaries from the foundation involved.

French J stated in *Harmer* that there are four essential elements of a trust:[60]

1. the trustee who holds a legal or equitable interest in the trust property;
2. the trust property which must be property capable of being held on trust and which includes a chose in action;
3. one or more beneficiaries other than the trustee; and
4. a personal obligation on the trustee to deal with the trust property for the benefit of beneficiaries which obligation is also annexed to the trust property.

The ATO considered that the X Foundation fulfilled the essential elements to be considered a trust for Australian tax purposes:

1. the foundation has legal ownership and possession of the foundation assets;
2. the foundation assets are capable of being held on trust;
3. the foundation board, in the role of a trustee, manages and administers the foundation assets for the benefit of beneficiaries of the foundation;
4. the beneficiaries of the Foundation were identified; and
5. a personal obligation to deal with the foundation assets only for the benefit of the beneficiaries was imposed on the foundation board.

Further, in *Mulherin v FCT*[61] the Full Federal Court found that the AAT had correctly affirmed the Commissioner's decision to assess the taxpayer's income from a Liechtenstein Foundation set up by the taxpayer on the basis that the Liechtenstein Foundation was a trust.

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[59] https://austaxpbr.com.au/document/PBR_1051209890341
https://www.ato.gov.au/law/view/view.htm?docid=EV/1051209890341&PiT=99991231235958

[60] *Harmer v FCT* (89 ATC 5180) at para. 22.

[61] *Mulherin v CoT* (2013) FCAFC 115.

PBR 1012763954378[62]

In this PBR the ATO had to consider whether the X Establishment (Anstalt) was a trust estate for the purposes of Division 6 ITAA 36.

Again, the ATO considered the essential elements of a trust (see above) and determined that the X Establishment was a trust estate for Australian tax purposes as it held the property on trust for the individual and their immediate family.

This contrasts with the views of the Commissioner in *Practice Statement Law Administration* PS LA 2007/7. In Example 2 the ATO expressed views on whether the Establishment (Anstalt) limited by shares was a company for purposes of the CFC regime. The ATO considered the Establishment (Anstalt) limited by shares as a company for those purposes.

8.2 German Kommanditgesellschaft (KG)

What is a German KG?

The KG, an unincorporated entity, is a limited commercial partnership in which at least one partner is subject to unlimited liability (the general partner), whilst the other partner or the other partners have only limited liability (limited partner/s).

A subform of the KG is the GmbH & Co. KG in which the general partner is an incorporated company like the limited liability company (GmbH). The general partner GmbH has unlimited liability for the obligations of the GmbH & Co. KG. However, the limited partners are required to make the initial contribution (Einlage) pursuant to the partnership agreement. When the initial paid contribution equals the maximum liability amount (Haftsumme) in accordance with the partnership agreement and is entered in the commercial register, the personal liability of the limited partners ceases.

At this stage, the company's creditors only have potential recourse to the corporate assets of the GmbH & Co. KG or to the assets of its general partner. The liability of the limited partners revives when a limited partner's initial contribution is repaid.

A KG is a tax-transparent entity and is therefore not subject to tax itself in Germany. Germany taxes the profits of the limited partnership on the partners and not the limited partnership. The taxation of income depends, for corporation tax purposes, on the status of its partners. Corporate partners are subject to German corporate income tax and individuals who are partners are subject to German income tax at their individual tax rate.

[62] https://austaxpbr.com.au/document/PBR_1012763954378

Treatment of a KG for Australian tax purposes

In the *Interpretative Decision* ID 2007/47[63] the ATO classified a German KG for Australian income tax purposes as a foreign hybrid limited partnership under subsection 830-10(1) of the ITAA 97.

8.3 Dutch Stichling

In Interpretative Decision ID 2008/2 the Commissioner states that a overseas pension fund constituted as a Stichting under Dutch legal concepts is a trust for purposes of accessing the CGT discount relying on the four criteria in *Harmer*.

In conclusion, how civil law entities are treated for Australian tax purposes depends not only on the interpretation of the laws under which the entities were established but also on the types of entities under Australian tax laws and the features of those entities. Square peg, round hole anyone?

[63] https://www.ato.gov.au/law/view/view.htm?docid=AID/AID200747/00001&PiT=99991231235958

9 Withdrawing entitlements from foreign pension (superannuation) funds

9.1 What is a superannuation fund?

Section 6 ITAA 36 defines a superannuation fund as:

1. a scheme for the payment of superannuation benefits upon death or retirement; or
2. a superannuation fund within the definition of "superannuation fund" in the *Superannuation Industry (Supervision) Act 1993* (**SISA**).

Section 10 of the SISA says that "superannuation fund" means a fund that:

1. is an indefinitely continuing fund <u>and</u> is a provident, benefit, superannuation or retirement fund; <u>or</u>
2. is a public sector superannuation scheme.

Under the ITAA 97, a superannuation fund can be either an "Australian superannuation fund" or a "foreign superannuation fund".

Australian superannuation funds are with complying superannuation funds or non-complying superannuation funds. Foreign superannuation funds are non-complying superannuation funds.

9.2 Transferring the balance in a foreign superannuation fund to a complying superannuation fund

Section 305-80 ITAA 97 deals with lump sums paid into complying superannuation funds from foreign superannuation funds.[64]

Broadly, an Australian resident is assessable on the applicable fund earnings (**AFE**) in respect of payments and transfers from foreign superannuation funds where that person has been a resident of Australia for more than 6 months.[65]

However, to the extent that that person transfers the lump sum to a complying Australian superannuation fund, the AFE is generally excluded from that person's assessable income.[66]

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[64] The author acknowledges Phil Broderick of Sladen Legal's assistance with this section of the paper.

[65] Section 305-70 ITAA 97.

[66] Sections 295-200 and 305-80 ITAA 97. Under section 305-80, if the lump sum is paid into a complying superannuation plan, the member can choose to have some or all the AFEs excluded from its assessable income. The amount the member chooses is included in the assessable income of the fund: see section 295-200.

Broadly, AFE is the income earned in the foreign superannuation fund whilst the member is a resident of Australia. That is, they are assessed on the accretion to the fund since they became a resident of Australia.

A super lump sum from a foreign superannuation fund will generally be tax-free if received within six months of the member becoming an Australian resident or within six months of their foreign employment being terminated.

If the Australian superannuation fund receives a lump sum directly from a foreign superannuation fund more than 6 months after becoming an Australian resident, the member can choose to have some or all of the assessable part of the lump sum treated as assessable income of the Australian superannuation fund.

By doing so, Australian superannuation fund pays tax – on the assessable part of the lump sum – at 15%, rather than the member paying tax at their marginal rate.

Unless the governing rules of the Australian superannuation fund provide an earlier time, the member can make this choice:

1. up until the day they lodge their income tax return for the year of transfer; or
2. the day they would have been required to lodge one if they do not need to lodge a tax return.

If the member makes this choice, they must complete and send the approved form to the Australian superannuation fund. The choice cannot be revoked or varied.

A transfer of from a foreign superannuation fund to an Australian superannuation fund is treated as a contribution and is subject to the contribution rules and caps. The vested amount of the transfer is treated as a non-concessional contribution. This will exclude AFE where the above election is made (as this is treated as fund earnings rather than a contribution). Any non-vested amount will be treated as a concessional contribution.

This can have significant consequences for members wishing to transfer their foreign super. For example:

1. a member may not be able to transfer any of their foreign super because they can no longer make non-concessional contributions as they:
    1. are aged 75+;
    2. are aged between 65 and 75 and have not satisfied the work test; or
    3. have $1.6 million or more of total superannuation balances at the prior 30 June;
2. the transfer may cause the member to have excess non-concessional contributions tax assessment if the amount causes them to exceed their applicable non-concessional contribution cap or bring forward amount; or
3. the transfer may cause the member to have excess concessional contributions tax assessment if the non-vested amount causes them to exceed their concessional contributions cap.

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If the foreign superannuation fund pays the lump sum directly to the member (or another person on their behalf) there is no impact on the Australian superannuation fund. The member includes the assessable amount of the payment their assessable income and taxed at their marginal tax rate.

When a foreign superannuation fund makes a payment to another foreign superannuation fund, there will be no tax payable by the Australian superannuation or by the member at the time of that payment. Tax is deferred until the benefit is eventually paid to the member or to an Australian superannuation fund, or otherwise dealt with on the member's behalf (that is, the monies exit the foreign superannuation environment).

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10 Conclusions

The increased global mobility of individuals and online transactions, together with the deregulation of financial markets and exchange controls since the 1980s, mean that Australian residents being entitled to foreign funds is, in many instances, “the new black”.

As set out in this paper the Australian tax rules that determine the Australian taxation consequences for Australian residents receiving amounts from foreign trusts is complex. Further, there may be exit or other taxes in the foreign jurisdiction to consider with a hope that there may be relief from double taxation under a DTA.

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