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# Australia

## International Estate Planning Guide

Individual Tax and Private Client Committee

### Contact:

Elissa Romanin

*Minter Ellison, Brisbane and Melbourne*

[elissa.romanin@minterellison.com](mailto:elissa.romanin@minterellison.com)

Gary Lanham

*Minter Ellison, Brisbane and Melbourne*

[gary.lanham@minterellison.com](mailto:gary.lanham@minterellison.com)

Craig Bowie

*Minter Ellison, Brisbane and Melbourne*

[craig.bowie@minterellison.com](mailto:craig.bowie@minterellison.com)

Nicole Gordon

*Minter Ellison, Brisbane and Melbourne*

[nicole.gordon@minterellison.com](mailto:nicole.gordon@minterellison.com)

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## I. Wills and disability planning documents

### A. Will formalities and enforceability of foreign wills

Australia is a federation and has government at both the federal and the state or federal territory levels. The law in relation to wills and the administration of estates is governed by state or federal territory law. Although there are eight jurisdictions (six states and two territories), there is substantial uniformity across the jurisdictions. The comments below are general in nature and do not propose to highlight any differences in the law in particular states or federal territories.

#### 1. FORMAL REQUIREMENTS

The following comments describe 'best practice' so far as the condition at death of a will or codicil is concerned. Relaxation of these requirements is referred to in relation to 'substantial compliance'. The price to be paid for 'saving' a will or codicil that would not satisfy 'best practice' standards but would satisfy 'substantial compliance' standards is that instead of the declaration of validity ('probate') being made at only moderate expense by a court official known as the Registrar in the case of a will or codicil that satisfies 'best practice' standards, that same probate may have to go before a judge (at considerably greater expense) in the case of a will or codicil that might meet 'substantial compliance' standards.

A will must be:

- in writing (it may be handwritten or typed or a combination of both, although such combinations are not desirable);
- signed at the foot of each page or at the end of each page either by the will-maker or by an agent for the will-maker in the will-maker's presence and at the will-maker's direction; and
- witnessed by at least two witnesses in the presence of the will-maker and each other. A witness must be at least 18 years of age. Generally, neither a witness nor the spouse of a witness may take a benefit under the will.

Also, it must be possible to determine the date on which the will was made. Usually, the date is written into the will.

Later alterations to a will are generally invalid unless made and executed in accordance with the formal requirements for a will. However, an alteration to a will which is not properly attested may be validated subsequently by a codicil (an instrument executed by the will-maker for the purpose of altering, confirming or explaining a previous will), if:

- the codicil is properly executed in accordance with the same formalities with which a will must be executed;
- the codicil refers to the previous unattested alteration; and
- the alteration does not appear to be merely deliberative (as opposed to an expression of final testamentary intent).

A will may be in writing but written in such a way that a question arises as to whether or not:

- all of the writing was before the will-maker when the will was executed (eg, if the will is written in several different colours of ink or in different handwriting);
- some part of the will has been misplaced since execution (eg, if marks appear on the will made by pins or paper clips, or rust marks suggesting contact with some sort of metal fastener which may have been used to attach additional documents); or
- words are missing from the will (eg, the date of execution of the will may not have been fully completed).

If such a question arises, it is necessary to put forward an explanation to the Registrar of the court when applying for probate. The types of problems outlined require different methods of resolution. For example:

- the accepted method of dealing with either different coloured ink or different handwriting in the will is to obtain evidence from a forensic document examiner;
- rust marks, pin holes, paper clip marks and so on must be explained in the ideal simply by affidavit evidence of some person who has knowledge of the circumstances. Frequently, it is difficult to find anyone, so one is reduced to putting forward the most plausible explanation that is consistent with the facts, including the circumstances in which the will was found; and
- the absence of a date usually has to be filled in by evidence from the witnesses or, if they cannot give such evidence, from any other person who was present at the time of execution of the will. The absence of a date on the will is not fatal provided evidence can be produced that there was no other will found in or about the same place where the will in question was found. In other words, the date on a will is crucial for establishing its order among other wills, but if evidence can be produced that is sufficiently satisfactory to show the person only ever made one will or that any other will that was made was obviously made before this one, then the absence of a date is not fatal.

## 2. Substantial compliance

Australian succession laws generally allow the courts to admit to probate an instrument executed in substantial compliance with the formalities, provided the court is satisfied that the instrument expresses the testamentary intention of the will-maker. This has been extended to embrace wills made in electronic format, including on an iPhone. Those types of wills invariably lack the usual formalities of a signature by the will-maker and signatures by witnesses.

Occasionally, a court will embark upon a limited interpretation of the words in the will. Also, the courts may be able to correct certain mistakes made by will-makers, in order to ensure that the will-maker's testamentary intention is realised. Time limits apply for applying to a court for an order rectifying a mistake.

A will can be revoked at any time.

Note that it is possible to register a will with a registry service (these registry services are privately owned) or to have a will held in safe deposit with an Australian solicitor.

## 3. TESTAMENTARY CAPACITY

Before a will may be admitted to probate, testamentary capacity of the will-maker must be proven. It must be shown that when the will was executed the will-maker understood the nature and effect of the will and understood the extent of the property being disposed of under the will.

Minors (those under 18 years of age) lack testamentary capacity as a matter of law, unless they are married. Otherwise, testamentary capacity is a question of fact.

On a practical note, the death certificate (required to obtain probate) will contain a list of the medical conditions that existed at the date of death, including conditions that were present but did not of themselves cause death. Often in the case of an elderly deceased, dementia, Alzheimer's disease or Parkinson's disease are listed on the death certificate. If so, then one must review the duration of the condition (also listed on the death certificate) to confirm whether or not the will was made during a period when that condition prevailed. When those two elements are together (a mental state among the medical causes and a duration during which the will was executed), some additional action may need to be taken. At the extreme, it may be necessary to apply to a medical practitioner who has knowledge of the deceased's circumstances and secure an affidavit. Often it is not wise to approach the medical practitioner who signs the death certificate because that is frequently a doctor at a hospital who only sees the deceased for a short period prior to death. In those circumstances, those doctors are notoriously hard to contact (because they are often registrars working long hours) and also they can comment only on what they saw sometimes in the last hours or the last days of life. It is generally preferable to locate the general practitioner who was

customarily treating the deceased. That person may be prepared to say that while there may have been dementia at date of death, dementia was either not present or was not present with sufficient severity to have deprived the person of testamentary capacity when the will was made.

#### 4. REQUIREMENT FOR KNOWLEDGE AND APPROVAL

Even if a will-maker has testamentary capacity when the will was executed, the will-maker must also have knowledge and approval of the contents of the will. Usually, in the absence of any suspicious circumstances, provided the will is duly executed the will-maker's knowledge and approval is assumed. However, suspicion will arise if a beneficiary has participated in the making of the will (eg, by drafting the will or instructing the drafter). In such a case, the beneficiary will have to prove that the benefit was properly left to the beneficiary. An absence of knowledge and approval may also be alleged in the context of an allegation of fraud or undue influence. The onus of proving undue influence or fraud is on the party alleging it. No plea should be made of undue influence or fraud unless evidence exists to support the allegation.

#### 5. ENFORCEABILITY OF FOREIGN WILLS

A will has a foreign connection if it was made outside Australia by a person who was, at that time, a foreign resident or who, at that time, had a domicile or habitual residence outside Australia.

Australian state and federal territory courts have the jurisdiction to declare as valid a will that has a foreign connection. Courts have, in certain circumstances, power to apply the Australian adoption of the conclusions reached at the Ninth Session of the Hague Conference on Private International Law (the convention concluded on 5 October 1961, on the Conflict of Laws Relating to the Form of Testamentary Dispositions).

In general, the formal validity of the will is measured by the formality requirements of the jurisdiction with which the deceased was most closely connected.

The validity considered by the courts under this jurisdiction is formal validity, not substantive validity. In other words, the court will consider whether or not the will has to be in writing, to be signed, to be witnessed, how many witnesses are required and so on. The court does not, under this jurisdiction, determine whether or not the provisions in the will validly dispose of the assets – that is a matter of substance.

##### *B. Will substitutes*

In most cases, the will is the preferred method of distributing property on death (particularly as Australia does not have a death tax). However, other arrangements may be used for various reasons, including to avoid will challenges. In Australia, there is a number of will substitutes, each discussed below. Will substitutes are legal means whereby the ownership of assets changes after death, other than by the operation of a will. For this reason, change of ownership by operation of a will is sometimes referred to as 'testamentary succession' whereas change of ownership by operation of a will substitute is sometimes referred to as 'post-death succession'.

##### 1. JOINT TENANCY

A joint tenancy is subject to the rule of 'survivorship', under which the interest of a deceased joint tenant passes immediately on death to any surviving joint tenant or joint tenants, regardless of any provision in the will. Joint tenancy is particularly popular as a method of property distribution between spouses, particularly in respect of real property and bank accounts.

##### 2. *INTER VIVOS* CREATION OF LIFE INTERESTS AND REMAINDERS

A person ('life tenant') may dispose of property to a trustee to be held on trust for the life tenant during their lifetime, and upon their death for another person ('remainderman'). The remainderman immediately obtains a present right to the property, subject only to the life

tenant's life interest. As the only interest in the property held by the life tenant is a life interest ceasing on death, the life tenant cannot pass any interest in the property under the life tenant's will. By drafting, the creation of the remainder can be made revocable, including by reserving a right in favour of the grantor life tenant to spend capital.

### 3. *INTER VIVOS* TRUSTS

Trusts are discussed below under III.

### 4. SUPERANNUATION (PENSION) FUND BINDING DEATH BENEFIT NOMINATIONS

Australian superannuation (pension) funds are required to pay 'death benefits' from the fund on a member's death. Death benefits are generally the unpaid amount to which the member is entitled from the fund at the time of their death plus any amount payable under life insurance cover with the superannuation fund.

In many circumstances, members of superannuation funds can make a binding nomination of the persons to whom the trustee of the fund must pay their death benefits if the fund's governing rules permit them to do so. However, there are restrictions on the extent to which funds' governing rules can permit binding death benefit nominations and the circumstances in which death benefit nominations will be binding. Generally, the governing rules of all funds can only permit binding death benefit nominations of nominees who are legal personal representatives or dependants of the member. This is the only restriction that applies in respect of 'self-managed superannuation funds' (SMSFs) (effectively funds run by members for their own benefit, that is, without an independent trustee). For superannuation funds other than SMSFs, further restrictions apply. For these funds, a death benefit nomination is generally only binding on the trustee if the trustee gives certain information to the member and the member makes the nomination in writing in the presence of (and together with declarations signed by) two witnesses over the age of 18 who are not nominees. Further, such nominations cease to have effect after three years unless they are re-confirmed. However, these formalities are not required, and the three-year rule does not apply if the governing rules of the fund allow members to make a binding death benefit nomination with the trustee's consent, and the trustee does consent to a proposed nomination after actively considering it.

### 5. LIFE INSURANCE POLICY WITH NOMINATED BENEFICIARIES

Persons who take out life insurance policies may, depending on the nature of the life insurance taken out, be able to nominate who receives the benefits of the life insurance policy upon the person's death. Whether or not there are any restrictions on who may be nominated is a matter for the insurer in defining the terms upon which they offer the life insurance. There are no particular statutory or other legal rules governing these matters.

### 6. DONATION *MORTIS CAUSA* (DEATHBED GIFTS)

A donation *mortis causa* is a gift made in contemplation of death. It is sometimes referred to as a 'deathbed gift'. Such a gift is uncommon in Australia. If it is made effectively, it passes title to the subject matter, such that the subject matter does not remain part of the donor's estate. The required elements are:

- the gift must be made in contemplation of the donor's death: for a gift to be made in contemplation of death, death must be more than inevitable; it needs to be impending;
- the gift must be intended to be absolute until the donor's death; and
- the donor must part with dominion over the subject matter of the gift: parting of dominion means actual delivery to the donee or his or her agent.

### C. *Powers of attorney, directives and similar disability documents*

#### 1. POWER OF ATTORNEY

Powers of attorney are available in all Australian state and federal territory jurisdictions. In Australia, a power of attorney is an instrument by which one person (usually called the

'principal' or 'donor') formally appoints another person to act for the principal in one or more transactions or to manage the principal's affairs generally.

There are two types of power of attorney:

- a general power of attorney will automatically cease in the event that the principal loses legal capacity; and
- an enduring power of attorney will continue to be valid if the principal loses legal capacity.

A loss of legal capacity occurs when a person is unable to comprehend the nature and legal effect of a document. In addition to the automatic revocation of a general power of attorney upon loss of legal capacity, a power of attorney cannot be created by a person once he or she has lost legal capacity, although a guardian may be appointed for the person in accordance with state/federal territory legislation (discussed below under I.C.3).

A power of attorney made in another Australian state is generally recognised if it was validly created in the jurisdiction in which it was made. A power of attorney made in a jurisdiction outside of Australia can be used in Australia, but it is recommended that it be notarised in the jurisdiction it was created in as complying with the relevant laws of that jurisdiction.

## 2. DIRECTIVES

Future medical directives (also called 'advance health directives') are available in some, but not all, Australian jurisdictions. These are directives about the medical treatment a person wishes to receive in the future. The law in relation to future medical directives is governed by Australian state and federal territory law, not all of which have enacted legislation to allow specifically for future medical directives. The laws in each state and federal territory regarding future medical directives are often quite different from each other and it is recommended that specialist advice be taken in relation to particular state and federal territory requirements.

In the relevant jurisdictions, a person who is legally competent may give a future health directive. The effect (where the directive prohibits certain medical care) is that, in the event of the person becoming terminally ill, medical practitioners are to refrain from giving certain medical care. Practitioners must comply and compliance, in good faith, will exempt the practitioner from any professional misconduct liability.

A future health directive made in another Australian state is recognised if it was validly created in the jurisdiction in which it was made, but generally only to the extent that the directives are allowed for in the state where the directive is being enforced. A future health directive made in a foreign jurisdiction will most likely not comply with the generally strict formal requirements for future medical directives in Australian jurisdictions and, therefore, may not be effective in Australia as such. However, the instructions contained in a foreign future health directive may still take effect outside of the statutory regimes under the Australian common law. In practice, if possible, a person who has made a foreign future health directive should make a corresponding future health directive in the most relevant Australian jurisdiction in accordance with the particular statutory requirements of that jurisdiction.

## 3. COURT-APPOINTED GUARDIANSHIP

As discussed above, a person who has lost legal capacity cannot make a power of attorney. In those circumstances, for decisions to be made on the person's behalf, it will be necessary to obtain an order to appoint a guardian in accordance with relevant state/federal territory legislation. The appointment will be made subject to approval by the relevant tribunal.

A court-appointed guardianship order made in another Australian state/federal territory is generally recognised if it was validly created in the jurisdiction in which it was made, although most jurisdictions have special registration procedures that must be followed in those circumstances. Guardianship statutes in most Australian jurisdictions do not provide for the recognition of a foreign guardianship order. Although Australian courts have inherent powers in relation to guardianship, it is recommended that a statutory guardianship order be

sought in the relevant Australian jurisdiction before the guardian makes any decision in respect of a person in Australia.

## **II. Estate administration**

### *A. Overview of administration procedures*

Under Australian law, the responsibility for administering deceased estates rests with the personal representative or representatives of the deceased.

In the case of administration pursuant to a will, the personal representative is known as the executor. The executor is chosen by the will-maker, in the sense that there will be a clause in the will devoted to appointing an executor or executors. The position of executor is voluntary. If there is a will but no executor appointed or no appointed executor willing or able to act, one of the beneficiaries becomes a de facto executor and is known as an administrator with the will.

Circumstances where a person dies, either without any will at all, or with a will which is totally ineffective, is known as 'intestacy'. In the case of intestacy, the personal representative is also known as an administrator. The right to administer on intestacy is determined broadly in an order of priority, set forth in each jurisdiction either in legislation or in rules of court, or in some cases simply by the established practice of the court, by which a person with a larger interest on intestacy generally has priority over a person with a smaller interest.

The personal representative is involved in the administration process until all of the estate has been completely distributed to the correct beneficiaries. The following are the key steps taken by the personal representative in the administration of an estate:

1. The initial vesting of the estate is with the personal representative. It is the personal representative's responsibility to establish title and gather assets. This procedure usually requires evidence of the validity and contents of the will in the form of court certificates known as probate (in the case of effective wills), letters of administration (in the case of intestacy) and letters of administration with the will (where there is a will that is effective to dispose of the estate, but is not effective to appoint an executor).
2. The personal representative is responsible for paying any taxes associated with the estate. These are most commonly taxes under federal income tax law, particularly capital gains tax (CGT). Generally, exemptions or concessions apply in respect of state/federal territory taxes. In relation to the period before the deceased's death, the personal representative must lodge any outstanding tax returns of the deceased up to the date of death, secure an assessment and pay the amount required to be paid upon assessment from the assets of the estate. In relation to the period after the deceased's death, the estate is treated as a separate taxpayer and the personal representative must lodge tax returns, secure assessments and pay assessments from the estate assets on the estate's behalf (see further below under IV.B).
3. The personal representative is responsible for distributing the estate. The distribution is generally made in accordance with the wishes of the will-maker as expressed in his/her will or, if there is no will, in accordance with the intestacy rules in the relevant jurisdiction. Distribution may also be subject to the outcome of a family provision application (see further below under II.B).

Although estates are frequently administered without obtaining formal valuations, such valuations may be necessary or desirable in some circumstances, for example, where there is a likelihood of a CGT issue arising (since the valuation will allow the personal representative to advise beneficiaries of the relevant asset's cost base for CGT purposes) or where the estate is, or is expected to be, challenged by way of family provision application.

### *B. Intestate succession and forced heirship*

#### 1. INTESTATE SUCCESSION

The intestacy rules under Australian law call effectively for the creation of an 'inventory' of

those most closely related to the deceased by blood, marriage or civil partnership/de facto relationship. Distributions are made in accordance with this inventory, without regard to the deceased's wishes (because, by definition, there is no will in which any wishes have been expressed).

Generally, in all Australian states and federal territories, spouses (lawful or de facto, including statutorily recognised civil partners) occupy the highest position, but share with any children by blood of the deceased. In most states and federal territories, a set value of the estate (eg, \$100,000 in Victoria) passes to the surviving spouse and the remainder is divided between the children by blood of the deceased and the surviving spouse on a percentage basis. The existence of these nearer kin (spouse and children) excludes more remote kin, but in the search for the nearest living kin, the inventory can reach back as far as grandparents, forward to lineal descendants without limit and sideways to as far as (in at least one of the Australian states) first cousins.

The intestacy rules are subject to a successful family provision application (discussed immediately below).

## 2. FORCED HEIRSHIP

There is no forced heirship regime as such in any Australian state or territory.

The nearest to a forced heirship regime, is the intestacy regime. The intestacy regime arises through necessity, so that if a person does not exercise his or her right to make a will, then the machinery of the state in effect makes one for that person (subject, as noted above, to a successful family provision application).

The succession regime in Australia, so far as wills are concerned, is one of full testamentary freedom, subject to validity or a successful family provision application.

A family provision application is a court application brought by a disappointed beneficiary (who must establish eligibility in accordance with the legislation dealing with family provision applications in each jurisdiction) claiming that he or she should receive more by way of adequate provision for his or her proper maintenance and support. The following principles apply:

- Determining what constitutes 'adequate' provision for the claimant requires a comparison between the applicant's financial circumstances and those of the beneficiaries who were favoured by the will or the intestacy, relative to the size of the estate. If the estate is large, then an applicant with a very modest claim on the merits might be partially successful, whereas if the estate is modest, then the applicant's claim will need to be stronger in order to receive a favourable distribution order.
- Determining what is 'proper' maintenance and support requires consideration (and evidence) of the totality of the relationship between the applicant and the deceased as well as the relationship between the applicant and the other beneficiaries.

### C. *Marital property*

To the extent marital property was held by the deceased and his or her spouse as joint tenants, the principles discussed above (under I.B.1) apply. In particular, the right of survivorship operates so that the deceased's interest in the property held as joint tenant passes automatically to his or her spouse (and any other joint tenants in equal shares), regardless of any provision in the deceased's will.

To the extent marital property was not held by the deceased and his or her spouse as joint tenants, the property will be distributed in the first instance in accordance with the deceased's will. If there is no will, the intestacy rules in all Australian jurisdictions make special provision in relation to certain items of matrimonial property. In particular, spouses in all jurisdictions can elect to take the deceased's interest in the matrimonial home and any household or personal chattels.

### D. *Tenancies, survivorship accounts and payable on death accounts*

The principles applicable in relation to joint tenancies are discussed above under I.B.1. There is no concept in Australia of 'survivorship accounts' separate from the general concept of property held in a joint tenancy. There is no concept of 'payable on death accounts' recognised in Australian law separate from general concepts of trust accounts.

### **III. Trusts, foundations and other planning structures**

#### *A. Common techniques*

Australian law recognises and commonly uses trusts in the structuring of family estates. Trust law is regulated by state and federal territory legislation.<sup>1</sup> A trust in Australian law is a device by which one person ('trustee') holds property ('trust property') for the benefit of one or more other persons ('beneficiaries', of whom the trustee may be one). This definition reveals that there are three things needed for a valid trust to exist: (1) a trustee; (2) trust property; and (3) beneficiaries.

Australian law imposes an equitable obligation upon the trustee to deal with the trust property for the benefit of the beneficiaries, any one of whom may enforce that obligation.

A trust is not a legal person in Australia. As such, for tax purposes, a trust is generally treated as a flow-through vehicle so that income is taxed in the hands of the individual beneficiaries rather than taxed in the trust itself. However, some trusts are taxed as if they were companies.

Trusts can be divided into two broad categories: discretionary trusts and fixed trusts. The trustee of a discretionary trust has discretion as to the distribution of the income and capital of the trust, usually as to whether income will be distributed and to whom it will be distributed. The trustee of a fixed trust has no such discretion. A fixed trust gives the beneficiaries a fixed entitlement in the income and capital of the trust in proportion to the interests that they hold, and the trustee must make distributions only in accordance with these entitlements.

A common structure used for family estate planning includes a corporate trustee with the beneficiaries as directors of the trustee corporation and members of the family as the beneficiaries. A common example has a corporate trustee with mother and father as directors, the family's capital assets and money as the trust property and the mother, father and children as the beneficiaries. These structures will commonly include a corporate beneficiary as the final beneficiary since this may result in a lower overall tax liability in respect of trust distributions (discussed further below under IV).

The key benefits of this type of structure are:

- trust property may be protected from provisions of a will;
- trust property may be protected from creditors and spouses of beneficiaries; and
- the corporate trustee has discretion to distribute income and capital in a way that may minimise tax liabilities.

#### *B. Fiduciary duties (trustee, board members, directors etc)*

##### 1. TRUSTEES' FIDUCIARY DUTIES

Trustees occupy a fiduciary position in relation to the beneficiaries of the trust and owe those beneficiaries fiduciary duties under Australian law. The central concept in the Australian law of fiduciary obligations is the concept of loyalty. The fiduciary's general duty of loyalty to his or her principal is regarded as encompassing two specific fiduciary duties:

1. The fiduciary must not enter into a transaction, arrangement or other engagement in which a conflict does, or might, arise between the fiduciary's personal interest and the fiduciary's duty to his or her principal, or between the fiduciary's duties to multiple principals, without the principal's informed consent.
2. The fiduciary must not use his or her position as fiduciary or knowledge, or an opportunity obtained or received because of that position to gain a profit or advantage

for him or herself, or for another person without the principal's informed consent.

Thus, a trustee must not, for example, receive remuneration for being a trustee, deal with any trust property for the benefit of any person other than the beneficiaries, or act as the solicitor for the estate and receive fees for so acting, unless authorised by the trust instrument or all of the beneficiaries being *sui juris*.

Trustees also have various other duties that are not strictly fiduciary in nature. These duties do not arise from the trustee's position as a fiduciary but from his or her role as trustee. They include duties for the trustee to:

- acquaint him or herself with the terms of the trust and comply with those terms;
- ensure that all trust property is vested in the current trustee or trustees;
- maintain control of the trust property within the joint control of all trustees;
- preserve the capital and income of the trust property, including an obligation to invest funds and dispose of property in certain circumstances;
- use reasonable diligence and caution when dealing with trust property;
- act personally except when it is necessary to seek external advice;
- not permit others, including the beneficiary, to fetter the trustee's discretion;
- use his or her discretion impartially between beneficiaries;
- distribute income and capital between the beneficiaries correctly (in accordance with the trust instrument);
- decide unanimously with any other trustees (except where otherwise agreed in the trust instrument);
- keep proper accounts;
- provide beneficiaries with access to information concerning the trustee's management of the trust property generally and the beneficiary's share; and
- duly and properly invest trust money coming into his or her hands that is not presently used for the purposes of the trust.

## 2. COMPANY DIRECTOR'S DUTIES

Company directors are fiduciaries of the company (not of the company's shareholders) under Australian law and, accordingly, owe to the company the same duties of loyalty as trustees owe to beneficiaries. These are the duties not to improperly benefit or gain from their position and to avoid conflicts of interest and duty, and conflicts of duty and duty. Those fiduciary duties, and other duties, are now also given statutory force by the federal Corporations Act. The duties imposed on company directors and other company officers by that Act include to:

- exercise their powers and discharge their duties with the degree of care and diligence that would be exercised by a reasonable director occupying the same position in a corporation in the same circumstances;
- act in good faith, in the best interests of the corporation and for a proper purpose;
- not improperly use their position as director or information gained in that position;
- disclose material personal interests; and
- prevent the company from trading while insolvent.

Directors also owe duties of confidentiality under the general law.

### C. Treatment of foreign trusts and foundations

Australia has ratified the Hague Convention on the Law Applicable to Trusts and on their Recognition and given the Convention the force of domestic law by the Trusts (Hague Convention) Act 1991. The effect of the convention, as embodied in the domestic legislation,

is that trusts created in accordance with their governing law (which may be specified by the settlor or is otherwise the law with which the trust is most closely connected) are recognised in Australia.

Australia also recognises features of foreign corporations that are duly incorporated in their place of creation. In particular, Australia recognises the legal status, membership, officers and internal dealings of a foreign corporation in accordance with the laws of the place where the corporation was formed. This means, for example, that foreign corporations can sue and be sued in Australia as legal entities without being registered in Australia, provided they have status as separate legal entities in their place of incorporation. However, a foreign corporation must be registered in Australia if it wishes to carry on business in Australia.

There is no Australian law relating to the recognition of foundations separate from the laws relating to the recognition of foreign trusts and corporations generally.

#### **IV. Taxation**

##### *A. Domicile and residency*

The residency of an individual or entity is relevant to determining their income tax liability (discussed below under IV.C). The tests for determining residency vary depending upon the nature of the individual or entity.

##### 1. INDIVIDUALS

An individual's tax residence is determined annually. Under current law, an individual will be an Australian tax resident if any one of the following requirements is satisfied:

- The individual is an Australian resident according to ordinary concepts under common law. Residence according to ordinary concepts is generally taken to mean 'to dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place'.
- The individual has an Australian domicile (by origin, independent choice or dependency), unless the individual's permanent place of abode is outside of Australia.
- The individual has been in Australia for more than 183 days in the relevant income year, unless the individual's usual (as opposed to their permanent) place of abode is outside of Australia and the individual does not intend to take up residence in Australia.
- The individual is a member of an Australian Commonwealth superannuation scheme, or is a spouse or child under 16 of such a person.

Citizenship or visa status is not determinative of residency for tax purposes.

It was announced in the 2021/22 Federal Budget on 11 May 2021 that the individual residency test would be amended and will take effect from the first financial year after the enabling legislation is passed. The primary test will be a simple 'bright line' test – a person who is physically present in Australia for 183 days or more in any income year will be treated as an Australian tax resident. The government has said that individuals who do not meet the primary test will be subject to secondary tests that depend on a combination of physical presence and measurable, objective criteria.

##### 2. COMPANIES

A company's tax residence is determined annually. A company will be an Australian tax resident if any of the following requirements is satisfied:

- the company was incorporated in Australia; or
- the company carries on a business in Australia and either:
  1. its central management and control is in Australia; or
  2. its voting power is controlled by Australian residents.

It was announced in the 2020/21 Federal Budget on 6 October 2020 that the corporate

residency test will be modified such that a company incorporated offshore will be treated as an Australian tax resident if it has a 'significant economic connection to Australia'. This will require the company's core commercial activities to be undertaken in Australia and its central management and control to also be in Australia. Accordingly, a foreign incorporated company that has its central management and control in Australia should not be an Australian tax resident if it does not also undertake core commercial activities here. Once introduced, taxpayers will have the option of applying the new law from 15 March 2017 or from the first income year after royal assent.

### 3. TRUSTS

As noted, trusts are generally not treated as separate entities for tax purposes but rather as flow-through vehicles. In these circumstances, it is the residency of the beneficiaries that is relevant. In the limited circumstances in which a trust is treated as a separate entity for Australian tax purposes, its residence depends upon the nature of the trust. In the case of an 'accumulation trust', in which income or gains are accumulated in the trust in an income year, a trustee of the trust is taxed as a separate entity in respect of that income or those gains and the trust estate will be an Australian resident if any one of the following requirements is satisfied:

- a trustee of the trust was an Australian tax resident at any time during the relevant income year; or
- the central management and control of the trust estate was in Australia at any time during the relevant income year.

In the case of a 'corporate unit trust' or 'public trading trust', which are generally taxed as if they were a company, the trust will be an Australian resident if both of the following requirements are satisfied:

- any trust property is situated in Australia or the trustee carries on business in Australia; and
- either central management and control of the trust is in Australia or Australian resident persons hold more than 50 per cent of the beneficial interests in the income or property of the trust.

It is expected that these residency tests will also be updated in line with the changes to the corporate residency measures.

### 4. TEMPORARY RESIDENCY

Australian law has special tax rules that affect individuals who are an Australian resident for tax purposes and satisfy the requirements for being a temporary resident. An individual is a temporary resident only if he or she satisfies both of the following requirements:

- the individual holds a temporary resident visa; and
- neither the individual nor his or her spouse resides in Australia or is an Australian citizen or the holder of a permanent visa or protected category visa.

Being a temporary resident has the following main tax consequences:

- A temporary resident is generally not taxed on income derived directly or indirectly from a foreign source, except on remuneration from employment undertaken or personal services provided while he or she is a temporary resident.
- A temporary resident is generally only taxed on capital gains on 'taxable Australian property' (discussed below under IV.C.2).
- A temporary resident is generally exempt from the usual ten per cent interest withholding tax on interest payable by residents paid to a foreign lender.
- A temporary resident on whose behalf an employer makes Australian pension (superannuation) contributions may, in some circumstances, apply to the Australian

Tax Office (ATO) after departing Australia to claim a lump sum payment of the contributions (less any tax applied within the superannuation fund and subject to a one-off withholding tax of up to 45 per cent or 65 per cent for amounts attributable to superannuation contributions made for working holiday makers).

## 5. TAXATION ON EXIT

Australia does not impose an exit tax as such. However, when an individual, company or trust that is an Australian resident ceases to be an Australian resident, he or she may be required to pay CGT on the market value of assets (other than taxable Australian property) held on the leaving date. Individuals (not companies or trusts) can elect to defer this CGT in certain circumstances. There are no such CGT implications for temporary or foreign residents on leaving Australia.

### B. Gift, estate and inheritance taxes

#### 1. FEDERAL TAXES

Australia does not impose gift, estate or inheritance taxes as such. However, transfers of money that might be considered 'gifts' in laypersons' terms may be treated as being income in reality in limited circumstances, for example, where the 'gift' is closely associated with the recipient's previous employment. Further, *inter vivos* and testamentary gifts of property may have CGT or other tax consequences in certain circumstances. In particular:

- *Inter vivos* gifts between related parties, including the gift of a life interest in an asset, may give rise to a capital gain for the giver (based on the market value of the gift). However, the giver may be able to claim a deduction for the gift if it is made to a charity or another entity that is endorsed by the ATO as a 'deductible gift recipient'.
- Testamentary gifts generally do not give rise to a capital gain. However, they may do so if the beneficiary is a foreign resident and the property is not taxable Australian property (discussed below under IV.C.2).

There will also generally be CGT consequences when a gift recipient disposes of property he or she has received, unless the gift was a testamentary gift of the deceased's main residence and the recipient disposes of it within two years of the deceased's death.

As discussed above under II.A, any income received by the estate after the deceased's death (eg, rental income from property held in the estate) will be taxable as usual and tax will be payable out of the estate.

#### 2. STATE/FEDERAL TERRITORY TAXES

Persons are generally required under state/federal territory laws to pay stamp duty on the acquisition of real property and various other assets (eg, non-land business assets and shares in landholder companies), even if the property is acquired by way of gift, unless the gift was a testamentary gift. The duty rate on a transfer of real property varies from nil to 5.95 per cent among the states and federal territories, depending upon the value of the property in question. An additional duty rate, of up to eight per cent, applies to real property acquired by foreigners in most states and federal territories. The additional duty extends to persons or entities subject to varying degrees of foreign control or association, depending on the state or territory. The types of real property to which it applies also varies between states and territories, although it is generally restricted to residential property.

States and federal territories also impose land tax on the unimproved value of land (excluding buildings) up to 2.75 per cent, although there are tax-free thresholds and generally exemptions for a person's principal place of residence. Subject to these concessions, the personal representative of a deceased estate will be liable to pay from the estate land tax on any land held in the estate.

### C. Taxes on income and capital

The Australian tax year generally runs from 1 July to 30 June. Income tax returns are generally due by 31 October and penalties apply for late lodgement. Individuals must

generally pay income tax within 21 days after the tax return is lodged, although tax on employment income is generally withheld by the employer during the year and a credit given on assessment. Similarly, although the due date for companies to pay income tax is technically the first day of the sixth month after the end of the tax year, in practice, companies must pay their income tax in quarterly 'pay-as-you-go' (PAYG) instalments (monthly instalments apply for large entities). Trusts and partnerships are generally flow-through vehicles (meaning that tax liability generally falls on the beneficiaries of the trust or the partners of the partnership respectively), but must still lodge tax returns. The circumstances in which trusts are taxed separately are discussed under IV.A.3.

Australian income tax liability is determined according to the principles of residency and 'source', subject to any applicable double taxation agreement (DTA). The principles applied in determining residency are discussed under IV.A. In relation to the connection between residency and source, the general rules are that:

- Australian tax residents pay tax on all income (including capital gains) from any source, whether in or outside Australia (subject to any applicable DTA);
- foreign tax residents pay tax only on income (other than capital gains) derived directly or indirectly from Australian sources, and capital gains on taxable Australian property; and
- temporary tax residents pay tax on Australian-sourced income (other than capital gains) and remuneration from employment undertaken or personal services provided while they are a temporary resident whether inside or outside Australia, and capital gains on taxable Australian property.

#### 1. TYPES AND SOURCES OF INCOME

The source of income depends upon the type of income. Assessable income for Australian tax purposes includes ordinary income (income according to ordinary concepts, including income from employment and personal services and profits from carrying on a business) and statutory income (amounts deemed by statute to constitute income for tax purposes, notably capital gains, which are discussed further below).

Setting aside capital gains, the main types of income and the associated sources (subject to any applicable DTA) are as follows:

- employment income: where the services are performed;
- business profits: where the contract is performed (although the place where the contract was formed and the place where consideration under the contract was paid may be relevant);
- interest: where the contract under which the interest is payable was negotiated and made;
- dividends: where the company made the profits from which the dividends were paid (although the company's residence may be relevant);
- royalties: Australia, if the royalty payment flows from Australia; otherwise, where the right giving rise to the royalty is located; and
- rental income: for real property, where the property is located; for goods, factors include where the contract is formed and where the goods are used.

#### 2. CAPITAL GAINS

As noted above, Australian residents pay income tax on all capital gains and foreign and temporary residents pay income tax on capital gains on taxable Australian property (subject to any applicable DTA). Generally, capital gains arise when a 'CGT event' happens to a 'CGT asset' and the proceeds from the event (or the market value of the asset in some circumstances) exceed the amounts expended on acquiring and maintaining the asset ('cost base'). CGT assets include all types of property and rights that are not property. Common

CGT events are:

- the disposal of an asset (eg, by sale);
- the loss, destruction or cancellation of an asset;
- the creation of a trust over, or the grant of an option to acquire, an asset; and
- the grant of a lease.

'Taxable Australian property' is a subset of CGT assets, broadly including:

- real property situated in Australia (including certain indirect interests in such property);
- business assets of a permanent establishment in Australia; and
- an option to acquire either of those.

There is no separate CGT in Australia. Rather, capital gains are included in an entity's assessable income together with any other income and taxed at the usual rates applicable to the entity. However, discounts and concessions are available in some circumstances. For example, individuals and trusts (not companies) who hold the relevant CGT asset for at least 12 months before disposing of it receive a 50 per cent CGT discount, although this discount is not available to foreign residents in respect of capital gains accrued after 1930 on 8 May 2012 (unless the foreign resident chooses to obtain a market valuation of the assets as of 8 May 2012). It has been proposed that the CGT discount be reduced to 25 per cent in the future. Entities can also defer capital gains through 'rollovers' in certain circumstances (eg, when they replace an asset).

### 3. TAX RATES

The individual tax rates for Australian residents and foreign residents in the 2020/21 income year are as follows:

<i>Taxable income (A\$)</i>	<i>Australian resident tax rate (%)</i>	<i>Foreign resident tax rate (%)</i>
0–18,200	0	32.5
18,201–45,000	19	32.5
45,001–120,000	32.5	32.5
120,001–180,000	37	37
180,001 and above	45	45

Special rates apply to unearned income earned by children, and to income earned by working holiday makers.

The company tax rate is currently 30 per cent (regardless of country of residence), although there is a lower rate of 26 per cent which applies to certain small companies. It is proposed that the lower rate be progressively applied to larger companies, and that the rate be lowered, in the future.

### Notes

- 1 The Trustee Act 1925 (ACT); the Trustee Acts 1893 and 1907 (NT); the Trustee Act 1925 (NSW); the Trusts Act 1973 (Qld); the Trustee Act 1936 (SA); the Trustee Act 1898 (Tas); the Trustee Act 1958 (Vic); and the Trustees Act 1962 (WA).