

Non-Resident – No Formal Trust Deed – Liable for Income Tax as a Trustee

In the recent case of Leighton v Federal Commissioner of Taxation [2010] FCA 1086, the Federal Court of Australia had to consider whether a non-resident individual was the trustee of a trust estate and therefore liable for income tax on the net income of the trust estate which had an Australian source in circumstances where there was no formal trust deed. Corporate and Tax Partner, Alan Jessup explains the case.

In this case a non-resident individual had been engaged by two non-resident corporations to engage in share trading in Australia. The non-resident individual did this by using share trading accounts in the names of the two non-resident corporations with moneys funnelled through a custodian arrangement with an Australian bank held in that non-resident's individual's own name. Presumably it was done this way to avoid the non-resident corporations having to register as foreign companies in Australia if they conducted the share trading directly.

The income tax legislation in general terms provides that where there is a non-resident beneficiary of a trust estate who is presently entitled to a share of the income of the trust estate, the trustee of the trust estate is liable to pay tax in respect of so much of that share of the net income of the trust estate as is attributable to sources in Australia.

Therefore, if the non-resident individual was a trustee of a trust estate, then the Commissioner was entitled to assess the non-resident individual on the profits made from the share trading.

The Court looked at the definition of "trustee" in the legislation and noted that the definition went beyond the meaning of "trustee" in the conventional sense. The definition is not confined to circumstances where a person is appointed or constituted trustee by the act of parties

(e.g. a formal trust deed or by operation of law (e.g. a resulting, constructive or implied trust)). The definition also includes a person having or taking upon himself the administration or control of income affected by any express or implied trust, or a person acting in any fiduciary capacity, or having the possession, control or management of the income of a person under any legal or other disability.

The Court noted that although "trust estate" was not defined from the case law it was synonymous with "trust property" and in the context of the income tax legislation was a reference to the trust property which gives rise to the income derived by the trustee.

The Court found that in this case the non-resident individual satisfied the definition of "trustee". Firstly non-resident individual had contracted to administer and control the purchase, sale, settlement and safekeeping of securities and therefore he controlled the income, the shares and the settlement of the share trades through the custodian bank account. Secondly the moneys of the non-resident companies that were to be used for the share trading and received by the non-resident individual into the custodian account in that non-resident individual's name were to be kept separate from the non-resident individual's personal moneys and were to be accounted for separately consistent with a fiduciary obligation. Therefore the non-resident individual had the administration and control of income from the share trading affected by a trust in favour, of the two non-resident companies.

The Court also found that the non-resident trustee was a trustee of the trust estate from which the income derived. In this case the trust estate included the shares held and the income earned from the share trading. The income of that trust estate was, for the above reasons, affected by an express or implied trust in favour of the two non-resident companies. The non-resident individual was not administering or controlling the shares and the income derived from the share trading for his own benefit but was doing so for the benefit of the two non-resident companies.

This meant the above provisions were satisfied for the non-resident individual to be liable for the tax on the profits from the share trading as the two non-resident companies were presently entitled to those profits and the non-resident individual was the trustee of that trust estate from which the profits derived.

No doubt in structuring the transaction, no thought was given by the parties that the non-resident individual might be a trustee of a trust estate and therefore be liable for tax on the profits to which the non-resident companies were entitled. Care always needs to be taken when structuring transactions to ensure that the income tax consequences are considered.