

Types of Private Unit Trusts

Fixed

**Fixed +
SIS Reg 13.22C
Compliant**

**Other
Fixed
Unit Trusts**

Hybrid

**Voting Units Only
(Income & Capital
Discretionary)**

**Units for Voting +
Income or Capital
(Otherwise
Discretionary)**

Private Unit Trusts Established in Australia

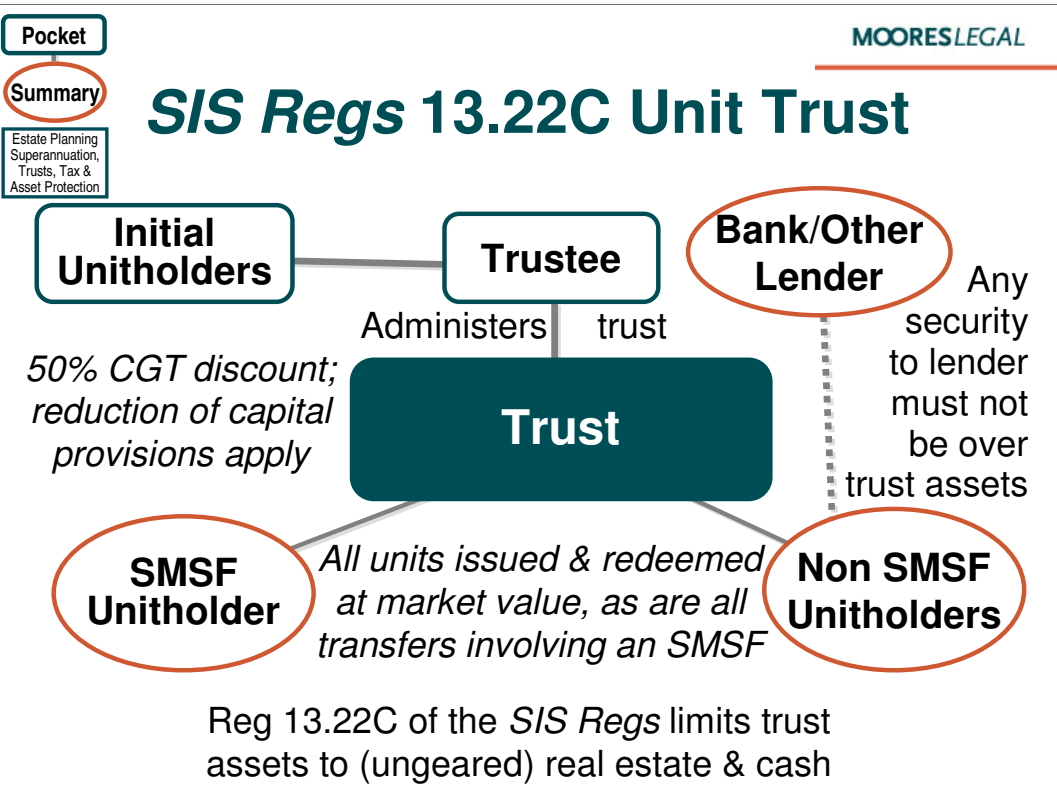
The incidence of private unit trusts being established in Australia has fallen significantly since their heyday in the early 1980s. In the 21st century, private companies, partnerships of family trusts or instalment warrant contracts are often established in preference to private unit trusts, due to considerations as diverse as retaining profits at 30%, claiming income losses at investor level or ensuring that liability for a capital gains occurs within an SMSF.

Two ongoing advantages of unit trusts that mean that they continue to be utilised, albeit in much lower numbers, are:

- eligibility (unlike most companies) for the general 50% CGT discount in Subdivision 115-A of ITAA 1997
- cashflow advantages where income from sources other than dividends is to pass to parties with an income tax rate lower than 30%, eg superannuation funds and entities exempt from income tax – these parties do not need to seek a refund of franking credits from the non-dividend income of a unit trust as they would if they received dividend income.

4 Main Types of Private Fixed and Hybrid Unit Trusts

- Reg 13.22C unit trusts – often established as an alternative to an instalment warrant contract and trust for an SMSF investing in real estate
- fixed unit trusts with no SMSF unitholding, thus able to hold investments other than just real estate and cash, but otherwise with the same terms as a reg 13.22C trust
- hybrid trusts with units having voting entitlements only – often established by professional practices wanting to minimise the level of payroll and other tax payable if the participating principals were seen to be employees
- other forms of hybrid trusts – usually ungeared and operating in a way that avoids the need for a family trust election.



Major Reasons for a Reg 13.22C Unit Trust

To hold real estate that is to be beneficially owned in whole or in part by the trustees of one or more self managed superannuation funds (“SMSFs”) and often, initially at least, partly by individuals or other related parties as well. # To give the trustee of an SMSF the option to take up further equity via the issue of units, rather than the transfer of an interest in the real estate. # To avoid the need for a SMSF unitholder to have to seek a refund of excess franking credits.

Prohibition on Gearing in Trust

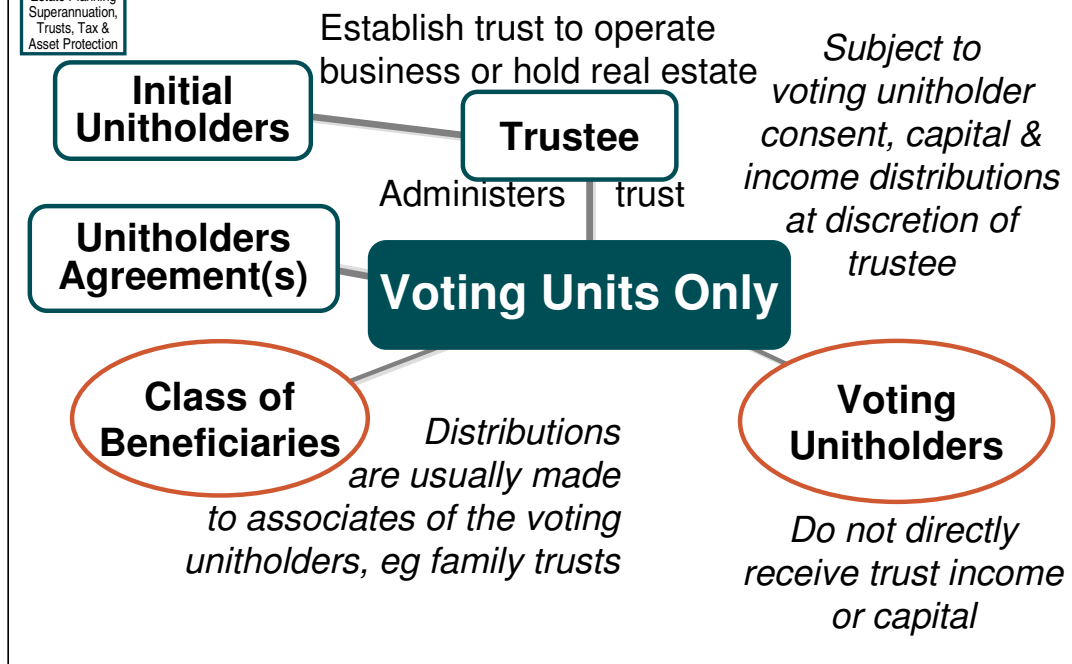
Reg 13.22C unit trusts are often utilised as an alternative to acquiring real estate via an instalment warrant contract and trust. If borrowing is contemplated, that borrowing must occur via the non-SMSF unitholders and the assets of the trust must not be used as a security for the borrowing. (Often the non-SMSF unitholders will use other security instead, eg equity in a family home and will claim an income tax deduction for interest paid at their higher income tax rates. Concessions apply for gearing if both the geared property and the units were acquired prior to 11 August 1999.)

Comparison with Other Fixed Unit Trusts

There will be many similarities between unit trusts meeting the requirements of reg 13.22C of the *SIS Regs* and other fixed unit trusts. The terms of the trust deed and the unit certificates will often be the same, with the issue and redemption of units being at market value, the definition of income will usually be the accounting definition and CGT event E4 will apply to capital gains. Three key differences are:

- that for as long as (and whenever) the trust has SMSF unitholders, the investments of a reg 13.22C trust need to be confined to real estate and cash
- residential real estate needs to be acquired from, and leased to, 3rd parties
- the absence of any gearing or securing of the trust assets.

Hybrid Trust – Voting Units



Major Reasons for an Australian Hybrid Trust with Voting Units Only

Providing a professional practice with a structure that does not stop and start when principals enter and exit and minimises exposure to employment related taxes such as payroll tax. # Ability to vary from year to year the benefits beneficiaries receive from trust income and capital (the latter potentially qualifying for the general 50% CGT discount). # Ability to distribute tax exempt amounts and retain their tax free status in the hands of beneficiaries (in contrast to capital payments from companies and fixed unit trusts).

Note: With family trust elections rules having particular significance for non-fixed trusts, hybrid/non-fixed unit trusts not confined to a single family usually should only be established if both receipt of dividend franking credits and annual income losses are unlikely. SMSFs should not invest in hybrid unit trusts because of the non-arm's length income penalties in section 295-550 of *ITAA 1997*.

Trust Income and Capital

Generally, beneficiaries (rather than the trustee) are taxed on the income of the trust, based on any specific entitlements they may be given (eg to net capital gains or franked dividend income) or by the proportion of income they are allocated. The beneficiaries receive credit for any income tax already paid, eg via dividend franking credits. Any trust income that is accumulated by the trustee is taxed at 46.5%. Capital profits (usually subject to a 50% discount) are taxed both when trust assets are disposed to 3rd parties and on winding up of the trust. Loans to the trust may be interest free or interest bearing. The reduction of capital rules for CGT Event E4 of *ITAA 1997* do not apply if the trustee distributes to non-unitholder beneficiaries – the generally more favourable CGT Event E5 applies instead.

Unit Trusts – Further Reading

**Australian Master Estate
Planning Guide –
Chapter 41 in the
Premium Edition**

**You Can't Take It
With You –
Chapter 10**

The latest version of this Pocket Summary is at
www.mooreslegal.com.au/services/estateplanning/pocketsummaries

Further Reading

- *Australian Master Estate Planning Guide* – Allan Swan, to be published (in both a Standard and Premium Edition) by CCH in 2012.
- *Estate Planning Documents* – Allan Swan, Moores Legal (includes many of the Pocket Summary series).
- *You Can't Take It With You* – Andrew Simpson, Wrightbooks.
- *Tax Issues in Family Law Property Settlements* – Peter Szabo, Moores Legal.

Australia-wide Seminar, Workshop & other Presentations – Allan Swan

EPSTTAP Introductory: • Estate Planning – The A-Z • SMSFs – The A-Z (includes page 2 of this Pocket Summary) • Trusts – The A-Z (all).

EPSTTAP Advanced: • Estate Planning – Case Studies • Estate Planning Masterclass • Superannuation – Death Benefits & Binding Nominations (2) • Testamentary Trusts – Drafting the 6 Major Types • Trusts & Deceased Estates – Income & Capital Distributions (all) • AMEPG Chapter Workshops.

Allan's local Moores Legal client, community & discussion group topics are:

- Estate Planning – Protecting & Enhancing Wealth • Estate Planning – Vulnerable Family Members • Family Trusts – Income & Capital Overview • Farm Succession – Avoiding Tax Pitfalls & Anticipating Disputes • Providing an Estate Planning Service for Clients • SMSFs – Instalment Warrants, Pensions & Binding Death Benefit Nominations • Tax & Business Structures Overview (1) • Update – Estate Planning, Superannuation, Trusts, Tax & Asset Protection.

To book Allan for any of these topics, contact Lilian Bruère on 03 9843 2153. All Pocket Summaries are copyright and are for general information purposes only and should not be relied on as (or in substitution for) legal or other professional advice.