

Explanatory Memorandum

NSW Property Investment Structures

October 2023

Subject	NSW Property Investment Structures
Alert Status	High
Topic	Land Tax
Legislation	Land Tax Management Act 1956 (Sections 3A and 3B)
Case Law	N/A
Comments	This memorandum looks at the benefits of using a unit trust for the purposes of investing in residential property
More info	www.macquariegs.com.au

Why N.S.W. property investors shouldn't acquire property in their own name since 2006. NOTE: Government change key to new investment structure

The most important issue today when investing in residential real estate is flexibility in relation to what you can do with the property in the future. Over 90% of investors acquire their property in the wrong structure and therefore remove the following steps:

Step 1 – Transfer to a Superannuation Fund

The ability to transfer a residential investment property to a self managed superannuation fund is paramount as most property investors see their investment as “providing for their retirement”. If the property is acquired in an individual's name, a discretionary or hybrid trust or in a company structure then the SIS Act provides that the trustee of a self managed fund is prohibited from acquiring the property.

If the property is acquired on terms of a unit trust, from an arms-length party then the SIS Act and SIS Regs allow the trustee of a self managed superfund to acquire units in the unit trust once the unit trust is free of debt and the assets aren't used as security. When the debt is repaid the best structure to hold a property is a self managed superfund with all the tax concessions associated with super.

If the unitholder has borrowed in their own name to access negative gearing, then the trustee of a self managed superfund may invest if the asset of the unit trust isn't being used as security. Over time the unitholders other assets (i.e., family home) may be used as security and a salary sacrifice arrangement be used to reduce the debt at a 15% tax rate.

Step 2 – Stamp Duty on change of owner

If the decision to change the ownership of a residential investment property occurs within a family group stamp duty is a concern. A property transferred from individuals to a discretionary trust incurs stamp duty at ad valorem rates. Basically, if the property is owned by an individual, a

discretionary or hybrid trust or a company then any change in ownership will attract stamp duty.

If, however, the property is held on terms of a unit trust and its unencumbered value is less than \$2million then the issue of units to a new entity and the redemption from the old entity does NOT attract any stamp duty. For example, if a unit trust owns a property worth \$1,600,000 and the sole unitholder, being an individual, redeems and the trustee of a self managed superfund is issued units by the trustee of the unit trust no duty applies.

Step 3 - Refinancing non-deductible debt

The ability to refinance non-deductible debt and convert it to deductible debt can only be achieved when an individual has an equity position in the property which isn't direct ownership. This can only be achieved with a unit trust or a hybrid trust structure.

If the trustee of a trust uses borrowed funds to redeem the units of a unitholder the interest is deductible. Justice Hill identified this in *FCT v Roberts; Smith* 92 ATC 4380 where he said that interest is deductible to an entity, if the borrower replaces funds employed in the entity's business by financing a payment by the entity in discharge or reduction of an obligation to a person who is entitled to be paid those funds.

Step 4 - Unnecessary land tax

If the property is held by a discretionary trust, hybrid trust, standard unit trust or company then the land tax threshold is lost. From 31 December 2005 all unit trusts are classified as special trusts and therefore no longer receive the land tax threshold.

Many advisors believe that the only way of accessing the threshold is to have the investment property held in the individuals own name. Considering it adds an additional \$15,504 in land tax it is a valid concern. MGS has developed a unit trust which qualifies for the exemption and therefore all the benefits discussed above as well as the favourable land tax concession are available.

The trust is a unit trust whereby the unitholders are presently entitled to the income and capital of the trust. It is not enough for it to simply be a fixed trust to comply with the relevant N.S.W. Office of State Revenue requirements. The deed needs to be very specific in relation to section 3A(3B) of the Land Tax Management Act 1956.

To provide a level of comfort MGS worked with the N.S.W. Office of State Revenue and once an agreeable position had been reached applied for and received a private binding ruling which is available for customers of MGS.

Step 5 – Comparison table

	Land Tax T/Hold	Change ownership w/out stamp duty	SMSF acquire an interest	Refinance to pay down non-deductible debt
Land Tax Unit Trust	Yes	Yes ¹	Yes ²	Yes
Company	Yes	No	Yes ²	No
Individual	Yes	No	No ³	No
Partnership	Yes	No	No ³	No
Standard Unit Trust	No	Yes ¹	Yes ²	Yes
Hybrid Unit Trust	No	No	No ³	Yes
Discretionary Trust	No	No	No ³	No

¹ Unencumbered value must be less than \$2million.

² SIS Act and SIS Regs require no borrowing in company or unit trust and assets not be subject to charge.

³ SMSF can acquire "business real property".

Step 6 – Other Considerations

Capital gains tax, goods and services tax and other issues including the SIS Act need to be considered in undertaking any of the above transactions. Advice should be sought concerning these areas.

NOTE: The above information is meant as a general guide only, and the information applies to Property Trust deeds provided by MGS.

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