# **Explanatory** Memorandum

## Unit Trust

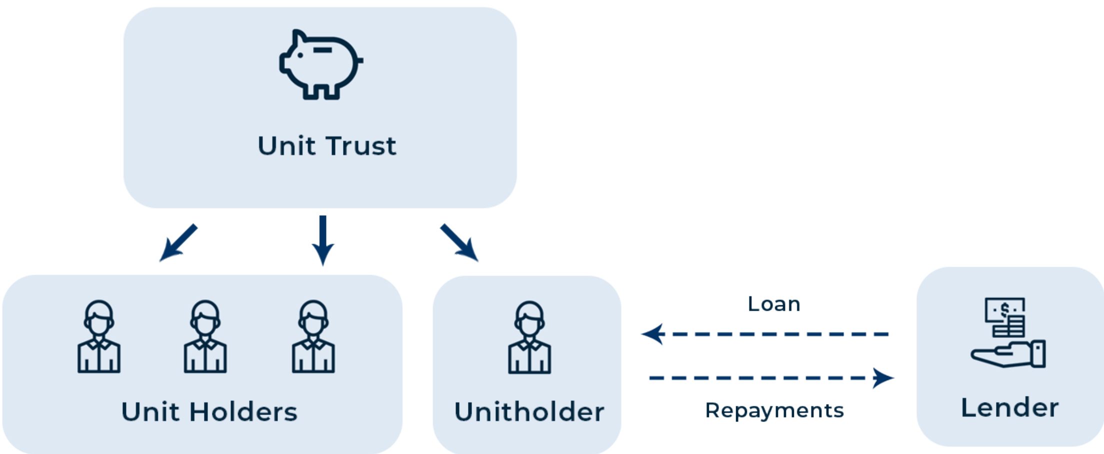
October 2023

| | |
|---|---|
| Subject | Unit Trust |
| Alert Status | **Medium** |
| Topic | Trusts |
| Legislation | Income Tax Assessment Act 1936<br>Income Tax Assessment Act 1997 |
| Case Law | N/A |
| Comments | Trusts are an important tool for investors. Understanding how they operate and what advantages can be achieved is essential. |
| More info | www.macquariegs.com.au |

Unit trusts have traditionally been used to hold property and other assets with a view to changing the ownership by changing the unit holder. They are also used for negative gearing and with self managed superannuation funds.

### Explanatory Memorandums – Unit Trust

The following memorandum is provided as a guide to provide a general overview of the operation of a unit trust sourced from Macquarie Group Services. It is not intended to be an exhaustive nor complete statement but should merely be viewed as an introduction to unit trusts in general (and ours in particular) and further reading is encouraged. Many accounting and legal matters have not been addressed, and the *Fringe Benefits Tax Assessment Act 1986* (Cth) and various other enactments, including the State and Territory stamp duty and land tax statutes, have implications which have not been exhaustively discussed here. Both Trustees and Beneficiaries should have an understanding of unit trusts, to enable them to exercise their rights, powers and duties in accordance with the Deed of Trust. The Deed of Trust should be read immediately by those parties, and any queries or concerns raised with their professional advisers.





Macquarie Group Services

**Macquarie Group Services Pty Ltd**
Level 7, 77 Castlereagh St, Sydney NSW 2000
(02) 9231 5111 contact@macquariegs.com.au www.macquariegs.com.au

## Deed of Trust

A unit trust is usually established with the payment of an amount, called the Initial Amount, by the Initial Unit Holders to the Trustee to acquire the Initial Units to be held in accordance with the Deed of Trust for the benefit of the Beneficiaries/Unit Holders. The Trustee is to hold all trust property (known as the Trust Fund) and invest such assets for the Beneficiaries/Unit Holders. The Beneficiaries/Unit Holders may remove/replace the Trustee in accordance with the Deed of Trust.

The Deed of Trust provides for a Vesting Day on which the Trust is to terminate. On the Vesting Day, the Beneficiaries/Unit Holders are entitled to the whole of the Trust Fund. Until that day, however, distributions of income or capital of the Trust are made in proportion to the number of units held by the Beneficiaries/Unit Holders, with reference to the Deed of Trust.

## Initial Unit Holder

A trust *inter vivos* (which means it's formed during the life of its creator, as opposed to being formed under the Will of the creator) may be constituted either by a declaration of trust in respect of specified property, or by the settlement of money (the Initial Amount) or other property by a person (the Initial Unit Holder) upon the Trustee upon trust, to deal with it as provided in the Deed of Trust.

A liability to stamp duty usually arises in most jurisdictions when a trust is constituted and, therefore, consideration should be given to the amount of the Initial Amount and any gifts or transfers of property to the Trust – the stamp duty liability will often be a function of the value of the gift or property transferred to the Trust.

## Beneficiary/Unit Holder

A person becomes a Beneficiary/Unit Holder of the Trust by virtue of their specific identification as such and their execution of all of the relevant documentation, e.g. Application for Units. Although it's not a requirement, a Beneficiary/Unit Holder may also be the "test individual" for the purposes of Family Trust Elections.

A Beneficiary/Unit Holder does not have any proprietary interest in the Trust Fund (*Gartside* v *IRC* (1968) AC 553) and has no interest in the Trust Fund pending the completion of administration. Instead, the Beneficiary/Unit Holder's interest is a *chose in action* which entitles them to a right of due administration, i.e. to call upon the Trustee to deal appropriately with the income and or capital of the Trust. In other words, the Beneficiaries/Unit Holders have the right to secure proper administration of the Trust, including the proper management and exercise of the Trustee's power and discretions.

Beneficiaries/Unit Holders are vested with the power to give the Trustee consent to act in various ways, e.g. to redeem units, to create new or additional units, to determine an earlier Vesting Date and to vary the Deed of Trust. The occupancy of this role is not optional and can never be vacant (otherwise the Trust cannot exist), with the result that the Trustee cannot act without constriction in the areas mentioned. The Family Court is likely to find that a Beneficiary/Unit Holder has control of the Trust for property settlement purposes.

The Beneficiary/Unit Holder also has the power, exercisable by written or oral resolution, at any time and from time to time to remove any Trustee and may also appoint any new or additional Trustee.

**Trustee**

A Trustee of an *inter vivos* express trust (which usually means that evidence for the creation of the trust exists in written or oral form) may be appointed:

1. by the settlor;

2. pursuant to an express power contained in the Deed of Trust;

3. by the courts in certain instances; and

4. under the provisions of the various *Trustee Acts* of the States and Territories.

The Trustee of a Macquarie Group Services Unit Trust holds the legal title to the Trust Fund, and gains its powers from the Deed of Trust, legislation and from the common law.

The Trustee may be one or more individuals or a company (typically a $2.00 corporate Trustee wherein the spouses or one of the spouses of a particular family unit are directors and shareholders).

Trustees owe a fiduciary duty to the Beneficiaries/Unit Holders of the Trust, and also have various other duties, including the duty to: preserve the Trust Fund; keep and to render to the Beneficiaries/Unit Holders full and candid accounts; act personally; acquaint and be familiar with the Deed of Trust; exercise reasonable care; act impartially between the Beneficiaries/Unit Holders, subject to the terms of the Deed of Trust; act gratuitously and not to profit from the Trust; and the duty not to deal with the Trust Fund for their own benefit or otherwise to profit by the Trust.

While remedies are available for breach of duty, Beneficiaries/Unit Holders generally do not have the power to compel the Trustee to exercise a discretion. The duties of a Trustee are many, and they may be held personally liable for debts incurred in their capacity as a Trustee. Nevertheless, the Trustee has the right of indemnity out of Trust assets for such liability, although it should be understood that it may sometimes occur that Trust assets are less than those liabilities.

A person or company may disclaim the Trust if they do not wish to act as Trustee. However, to be effective, they must disclaim it in writing to the Initial Unit Holder as soon as possible. A trusteeship may only be disclaimed before acceptance, and a Trustee may only retire after acceptance if:

1. they're authorised by the Deed of Trust to do so;

2. a new Trustee is appointed in their stead;

3. if the conditions prescribed by a provision in a *Trustee Act* of a State or Territory are satisfied; or

4. if it's permitted by a court.

If the Trust is a trading trust, then it's advisable that the Trustee be a company rather than individuals. In all cases, however, resolutions should be signed and maintained when the Trustee makes a decision or takes an action.

The Trustee is to maintain proper accounting records (including books of accounts), which show all receipts, payments, and distributions of income. A Profit and Loss Statement and a Balance Sheet should be prepared, and all relevant returns and statements lodged with the various revenue authorities where any relevant income is derived, assets held, or activities are engaged in by the Trust.

**Distributions of Income**

Distributions from a Trust may take many forms and have different implications for a Trustee and a Beneficiary/Unit Holder. Generally, the entirety of the net Trust income earned in each financial year is distributed amongst the Beneficiaries/Unit Holders in proportion to the number of units held by each of them and the Trustee has no power to accumulate, i.e. withhold from distribution, any of the net Trust income.

If the whole of the net Trust income is distributed to adult Beneficiaries/Unit Holders, the amount received by each of them is taxable in their hands as an addition to their total assessable income. Thus, if a particular Beneficiary/Unit Holder received a distribution of $10 000 from the Trustee, and also earned salary/wages of $40 000 in the same period, for example, then their total assessable income for the year in question would be $50 000. Their tax liability would be the amount of tax payable on a total assessable income of $50 000 less any deductions.

Tax on income held on trust for, or applied for the benefit of, Beneficiaries/Unit Holders under the age of 18 (or any other Beneficiary/Unit Holder under a legal disability) is effectively paid by the Trustee on behalf of the Beneficiary/Unit Holder. Special provisions apply where such a Beneficiary/Unit Holder has income from other sources, and higher rates of tax apply to income held, applied, or distributed to minors - in general, $416 in total may be safely distributed to a child Beneficiary/Unit Holder without attracting the higher rates of tax.

When distributing income to Beneficiaries/Unit Holders, it is possible to separately characterise the amounts concerned. For example, where the Trust income includes, say, the receipt of franked dividends, interest income and taxable capital gains, then the distribution received by the Beneficiary/Unit Holder can be divided into these three portions. This will be particularly important where, for example, franking credits are to be passed onto Beneficiaries/Unit Holders.

**Distribution of Capital Gains**

As a result of the existence of taxation on capital gains, careful consideration will need to be given to the consequences for the Trust of various types of transactions which may give rise to a taxable capital gain.

In particular, if the Trustee sells a trust asset to an arm's-length person and realises a gain on the disposal, the gain will be included in the assessable income of the Trust to be distributed in the same way as any other income. Capital losses may be subtracted from the gain (but not from any other type of income) before a net amount is included as assessable income of the Trust.

It is sometimes the case that the "accounting" income of a Trust is not equal to its net income according to tax law – this often arises due to the difference in the treatment of consideration received on the disposal of CGT assets.

The now judicially accepted "proportionate theory" (acknowledged by the Commissioner of Taxation in Practice Statement PS LA 2005/1 (GA)) essentially provides that where there are differences between accounting and tax law income for a Trust arising from the disposal of its CGT assets, the distribution (and assessability) of its realised capital gains to the Beneficiaries/Unit Holders will be in the same proportion as the distribution of its ordinary income.
Other situations may give rise to deemed capital gains and, therefore, require careful consideration. For example, if Trust assets are appointed or distributed to any particular Beneficiary/Unit Holder, the Trustee is regarded as having sold the asset to that Beneficiary/Unit Holder at its then market value and a capital gain may arise (depending on the cost-base of the asset).

For CGT purposes, the units in a Unit Trust will be treated as an "asset". Accordingly, the disposal of units by a Beneficiary/Unit Holder could give rise to a capital gains tax liability in the hands of the Beneficiary/Unit Holder. Further, the capital gains tax legislation provides for the deemed disposal of units, where distributions of tax-free amounts are made on units, e.g. CGT discounts, and those tax-free amounts that exceed the cost-base of the units.

For this reason, it is very important that advice is sought prior to entering into major investment transactions using a Unit Trust. As a general guide, any borrowings that need to be undertaken should be entered into by the Beneficiaries/Unit Holders, who would then invest those funds (together with their own capital) on unit capital subscriptions. This could shelter the Beneficiary/Unit Holder from unnecessary tax exposure in future years.

**Other Distribution Matters and Distributions to Minors**

Very importantly, a decision in relation to the income of the Trust should be made before 30 June in each and every year by the Trustee, and such decision recorded in a written resolution of the Trustee on or before that date (see Income Tax Ruling IT 347). The resolution may be prepared and signed after 30 June, provided that it records what actually took place on or before 30 June. Although the long-standing practice of the Commissioner of Taxation is to allow two months for such a decision to be made (i.e. up until 31 August in each year), that stance is not law and may be ignored by the Australian Taxation Office (or any other revenue authority) without it having to provide any justification.


**Macquarie Group Services Pty Ltd**
Level 7, 77 Castlereagh St, Sydney NSW 2000
(02) 9231 5111 contact@macquariegs.com.au www.macquariegs.com.au

A problem obviously arises, then, in that until accounts for the Trust for a financial year have been prepared, it may well be impossible to estimate with accuracy the amount of the net income of the Trust.

This difficulty can be overcome by the Trustee resolving on or before 30 June to distribute the income in accordance with the proportional rights of the Beneficiaries/Unit Holders - for example:

| Beneficiary | Proportion % |
|---|---|
| X | 50 |
| Y | 30 |
| Z | 20 |
| | 100 |

After the exact amount of the net Trust income is known, and the proportion to which each Beneficiary/Unit Holder is entitled has been calculated, those specific amounts should be recorded in further Trustee resolutions.

Notably, a distribution to a Beneficiary/Unit Holder need not entail a physical payment to them. If the Trustee wishes to retain the money which it has distributed to a particular adult Beneficiary/Unit Holder, then it may, with the consent of the relevant Beneficiary/Unit Holder, establish a loan account in the books of the Trust in their name, and then credit the amount of the distribution to that loan account.

The Trustee can then deal with the amount of the loan in accordance with the powers given to it by the Deed of Trust, but the Beneficiary/Unit Holder can call for payment of the amount credited to their account at any time in the absence of any arrangement to the contrary. It should be remembered, however, that the amount credited to the Beneficiary/Unit Holder's loan account is assessable income to them and will also constitute "property" for the purposes of the *Bankruptcy Act 1966* (Cth).

The situation could arise where a child Beneficiary approaching the age of majority is entitled to receive a substantial amount from the Trustee, the payment of which would be a matter of some difficulty. If this situation arises, it's possible to avert the necessity for the Trustee to actually make a payment of the amount due, and discussions with professional advisers at the appropriate time are recommended.

**Distribution of Corpus**

On the winding-up of the Trust on the Vesting Day, or at any time before, the Trustee may exercise its discretion as to the manner in which the corpus (sometimes referred to as the "capital") of the Trust Fund will be distributed to the various Beneficiaries in accordance with the Deed of Trust. Corpus usually includes amounts settled on the Trust, or amounts that do not form part of its net income, e.g. depreciation.

From the Vesting Day, any assets belonging to the Trust or constituting the Trust Fund are held by the Trustee until payment or transfer specifically for the Beneficiaries/Unit Holders in their proportional entitlements.

The Trustee need not realise the assets of the Trust on the Vesting Day and distribute monies to the Beneficiaries/Unit Holders – indeed, the Trustee may transfer those assets to the Beneficiaries/Unit Holders *in specie*, i.e. in kind.

### Entering into Contracts

It is the Trustee who enters into contracts on behalf of the Trust and, although the Trustee is not required to state its capacity, it's advisable to do so and avoid confusion as to the beneficial ownership of assets and rights.

If asked whether a person or entity is acting in the capacity of Trustee, it would be advised that responses be both factual and in good faith.

### Resolutions

When undertaking any transactions, including the acquisition of assets, or making distributions from the Trust, the Trustee should evince its intention to do so by way of resolution. Resolutions should be filed in the Trust binder and maintained as a record of the decisions and agreements affecting the Trust Fund and/or its net income. As noted above, a resolution by the Trustee to distribute the net Trust income should be made on or before 30 June each year.

### Income Streaming

Trust income retains its character when it is distributed to Beneficiaries. Therefore, if a Trust derives interest income, trading income and capital gains, each Beneficiary who receives a distribution of net Trust income will receive a proportion of each of those types of income, and the tax paid by them must be calculated accordingly.

Trust distributions can be made more tax-effective by employing the process known as streaming. Streaming is the distribution of different types of income and capital gains to particular Beneficiaries, in order that the overall tax payable by all Beneficiaries and the Trustee is minimised.

Where a trust estate has a net capital gain, a franked distribution or a franking credit for an income year, the position before the income year ending 30 June 2011 was that these amounts were brought into the calculation of the net income, section 95 of the Income Tax Assessment Act 1936 (ITAA36) of the trust estate for the income year and that net income was attributed to the beneficiaries proportionately according to the presently entitled share of the trust income of the trust estate. That is no longer the position.

Where a trust estate has a net capital gain in the income year ending 30 June 2011 or later, the Tax Laws Amendment (2011 Measures No. 5) Act 2011 (Cth) applies.

In very broad terms, where a trust estate has a net capital gain and 'net income' for an income year, a capital gain that is not reduced to nil by the application of the method statement in section 102-5 of the ITAA97 is taken out of the operation of Division 6 of Part III of the ITAA36: Division 6E of that Part.

Instead, its treatment is governed by the provisions of Division 115 of the ITAA97, and in particular Subdivision 115-C of that Act.

The position is that:

(a) to the extent to which a beneficiary is 'specifically entitled' to an amount of the capital gain (before applying the method statement), an appropriate part of the gain (after applying the method statement) is attributed to the beneficiary as a capital gain.

(b) to the extent to which there is no beneficiary 'specifically entitled' to an amount of the capital gain (before applying the method statement), beneficiaries have an appropriate part of the gain (after applying the method statement) attributed to them on a pro rata basis according to their share of the distributable income of the trust estate.

(c) If there is no distributable income of the trust estate for that income year (or there is part of the distributable income to which no beneficiary is presently entitled), the trustee is taxed on the amount of the capital gain (or the appropriate part of the capital gain) after applying the method statement.

**Income Streaming Possibilities**

Capital gains to Beneficiaries/Unit Holders who can apply capital losses against them.

Capital gains to Beneficiaries/Unit Holders on low marginal tax rates.

Capital gains from collectibles to Beneficiaries/Unit Holders who can apply capital losses from collectibles against them.

Interest income, royalties, and unfranked dividends to non-resident Beneficiaries/Unit Holders to make use of the lower withholding tax rates.

Trading income, dividends, etc. to Beneficiaries/Unit Holders on low marginal rates of tax or who have carry-forward income losses.

Foreign source income to non-resident Beneficiaries/Unit Holders so that no tax is payable.

**Refinancing**

As with all other types of Trusts, the "refinancing principle" from *FC of T v. Roberts & Smith* 92 ATC 4380, would allow the Trustee of a Unit Trust a deduction for interest expenses incurred on funds borrowed and used to reduce or extinguish a Beneficiary/Unit Holder's interest in the corpus, or which is used to discharge a liability to pay a Beneficiary/Unit Holder a share of the income of the Trust.

**Family Law Acts and Trusts**

It is not proposed to discuss in any detail the impact which certain provisions of the *Family Law Act 1975* (Cth) may have on trusts. The following is intended only as an alert to the possibility of interference by the Family Court in plans or arrangements which may be contemplated by a person whose marital situation is not secure. In any such case, it would be prudent to seek legal advice from someone well-versed in the *Family Law Act 1975* (Cth) before executing any trust, particularly one which is intended to preclude or limit claims which may be made by a (former) spouse or partner.

Nevertheless, brief mention should be made of several of the powers which the Family Court has and which, in certain circumstances, may affect provisions contained in a trust, and the exercise of any powers conferred by the Deed of Trust upon the Trustee.

Problems would usually only arise where there is a marital or relationship break-up. When this occurs, the Family Court has wide powers in relation to the property of the parties to the marriage or relationship. The pitfall, into which the unwary may fall, is to believe that if income-producing assets are transferred to a Unit Trust, the exercise of the Trustee's powers is immune from interference by the Family Court.

For example, where there is a Trust the ultimate Beneficiaries/Unit Holders of which are the children of the Initial Unit Holder, the Court's considerable powers in regard to the maintenance of those children will generally include the ability to appoint or remove Trustees (paragraph 80(1)(e) of the *Family Law Act 1975* (Cth). Thus, for example, the Court could remove the existing Trustee and appoint the divorced spouse or former partner to that role. Again, if a person who fears that their marriage or relationship is about to break-up transfers assets to a Unit Trust, in the hope that it will prevent their spouse or partner from making claims against them, this may prove to be false hope. Under subsections 90AF(1) and 90AF(2) of the *Family Law Act 1975* (Cth), the Family Court has power to make any order or to grant any injunction that directs a third-party to do a thing in relation to the property of a party to a marriage, or which alters the rights, liabilities or property interests of a third-party in relation to a marriage.

As a result, even if a person causes assets and/or income to be held by a Unit Trust simply for tax-planning reasons, and with no thought of avoiding any claim by their spouse or partner, the provisions of the Trust may not be inviolate. This may be so, even if the assets were never the property of that person or the subject of any disposition made by that person. In other words, where the Trust Fund can be applied for the benefit of a couple and their children, it appears that the Family Court would be able to treat it as family property and would have wide powers in relation thereto.

Nevertheless, the Court will not find that a party has control of a Trust merely by virtue of being a Beneficiary/Unit Holder *per se*. Although a Beneficiary/Unit Holder has a right to call upon the Trustee to deal with the Trust Fund in a manner appropriate to the due administration of the Trust and for payment to them of their proportional entitlements to the net income of the Trust, which is an equitable *chose in action* which is itself "property" in the strict sense, the

Beneficiary/Unit Holder has no interest, vested or contingent, in the Trust Fund itself, nor in any particular asset of the Trust. Thus, unless the Trust was the Beneficiary's alter ego or "puppet" the only property of the Beneficiary is their equitable *chose in action* (*Shaw and Shaw* (1989) FLC 92-030 at p 77,416).

Further, as stated above, as the Beneficiary/Unit Holder has effective control over the Trust, the Trust Fund is accountable in *Family Law Act 1975* (Cth) property settlement matters.

**Minors**

Careful consideration must be given when distributing either income or capital to minors (who, for the purposes of the Income Tax laws are natural persons under 18 years of age). This is because of the penal rates of tax that apply to such distributions, which are as follows.

Where the eligible taxable income of a resident minor is less than a threshold ($416 for the 2022/2023 financial year) the special (higher) rates do not apply; instead, the general rates applicable to resident adults apply to the whole of the taxable income. Resident minors may also be eligible for the rebate for low income-earners, which effectively increases this threshold, if the minor has no other income.

Where the eligible taxable income of a resident minor is within a certain band (i.e. in excess of $416 and less than $1308 for the 2022/2023 financial year), then the tax on the eligible taxable income is the greater of:

1. 66% of the excess over the lower threshold; and
2. the difference between tax on the whole of the taxable income and the tax on the taxable income other than the eligible taxable income.

Where the eligible taxable income exceeds the upper threshold ($1307 for the 2022/2023 financial year), tax is payable on the whole of the eligible taxable income at the highest marginal rate.

However, this is not the case where the Trust is a Capital Vested (or Child Maintenance) Trust, in which case income distributed to minors is taxed at non-penal adult rates. Capital Vested Trusts are created at the death of a person or upon a marriage or relationship break-up, whereby the assets of the Trust must vest in the Capital Vested Beneficiaries. Before any distributions are made to any minors, the Trustee should consult their accountant or financial adviser.

**Stamp Duty and Land Tax**

The issue of units in a Unit Trust will not normally constitute a dutiable transaction for the purposes of any of the relevant State/Territory statutes dealing with stamp duty. On the other hand, a redemption or transfer of such units may attract duty, sometimes depending upon the value of the transaction and the nature of the underlying assets of the trust.

Most State/Territory statutes dealing with the imposition of land tax provide for special non-concessional rates of such an impost for land held in trusts that are not "fixed." Although the definitions of what constitutes a “fixed” trust for these purposes varies between the jurisdictions, it usually requires that all of the interests to the income and capital of the relevant trust are vested and indefeasible, which can be said of a Unit Trust.

If any queries exist or a further explanation is required following reading the above together with the Deed of Trust, please contact your professional adviser.

NOTE: The above information is meant as a general guide only, and the information applies to unit trust deeds provided by Macquarie Group Services Pty Limited.

Advice Warning: This document is intended to provide general information only without taking into account any particular person's objectives, financial situation or needs. Investors should, before acting on this information, consider the appropriateness of this information having regard to their personal objectives, financial situation or needs. We recommend investors obtain financial advice specific to their situation before making any financial investment or insurance decision.



**Macquarie Group Services Pty Ltd**
Level 7, 77 Castlereagh St, Sydney NSW 2000
(02) 9231 5111 contact@macquariegs.com.au www.macquariegs.com.au