Explanatory Memorandum

Why VIC Property Investors should not acquire property in their own name

October 2023

Subject	VIC Property Trust
Alert Status	**High**
Topic	Land Tax
Legislation	Land Tax Act 2005 (Division 2A of Part 3)
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

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 options:

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". The decision may occur at some distant date and by that time the opportunity is lost. If a residential investment 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 as long as 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 trust, including a self managed superannuation fund, incurs transfer duty at ad valorem rates.

If, however, the property is held on terms of a unit trust and its unencumbered value is less than $1million 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 $900,000 and the unitholders, being individuals, redeem and the trustee of a self managed superfund is issued units by the trustee of the unit trust then no transfer 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 is not direct ownership. This can 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

Holding a property in a VIC Property Trust provides the unitholder with an equivalent land tax position to that of holding land in their own names.

The VIC Property Trust is not subject to the Land Tax Surcharge on Trusts when the Trustee discloses the identity of unitholders. VIC OSR issue secondary assessments to unitholders. Where the unitholder owns other land, the aggregate value is considered.

If no other land is owned an assessment will not be issued. Unitholders who reside in the Trust property may be eligible for PPOR exemption in whole or part.

MGS recommend each property be held in a separate Property Trust. The benefits of this include:

1. Access to a separate threshold rather than direct aggregated land value; and
2. Stamp duty savings on change of beneficial owner
3. Avoids CGT problem of realised gains if one property is sold and other retained;
4. Offers a strategy whereas value increases one property can be refinanced as unencumbered and the other used as security. Unencumbered property is ideal for SMSF unit acquisition.

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
VIC Property 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
Hybrid Unit Trust	Yes	Yes[1]	No[3]	Yes
Discretionary Trust	Yes	Yes[1]	No[3]	No

1 *Value must be less than $1million.*
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, GST 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.

The VIC Property Trust is not merely a unit trust. The trust is also capable of issuing *ordinary and special units* with entitlements determined by the trustee. This *may* be used for introducing third parties who join the unitholders in special financing arrangements in minor developments.

NOTE: The above information is meant as a general guide only, and the information applies to VIC Land Tax Unit Trusts provided by MGS.

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