How-to Guide

Determining a Rental Property Structure

October 2023

Description	This guide looks at the considerations when structuring a rental property
Other relevant guides	- *How to set up a Land Tax Unit Trust* - *How to negative gear with a Unit Trust* - How to negative gear with a Discretionary Trust
Documents required	- *Land Tax Unit Trust* - Discretionary Trust - Self Managed Superannuation Fund
Notes	When acquiring a rental property, a number of considerations need to be resolved prior to its purchase. Stamp duty, land tax, income tax, capital gains tax and superannuation all need to be taken into consideration.

Step 1 – Will the purchase involve debt?

If the purchase will involve debt, then consideration needs to be given to who will be entitled to a tax deduction on the interest.

If the property is to be owned by a self managed superannuation fund from the beginning, then this guide has no further application and refer to – How to Guide – Establishing a Self Managed Superfund and borrowing to acquire a property.

The most tax effective and flexible structure to hold a rental property where a loss is to be claimed by a high income earner is a Land Tax Unit Trust. The high income earner borrows and acquires units in the Land Tax Unit Trust. When the loss turns into a surplus then consideration can be given to redeeming units and issuing units to another taxpayer or entity.

A popular investment vehicle was a hybrid discretionary trust. This structure should still be considered where the purchase involves debt, however great care needs to be taken or the Australian Taxation Office may deny the interest deduction.

<u>NOTE</u>: The person who may be entitled to the loss will not necessarily own the property.

<u>WARNING</u>: The ATO looks closely at the use of trusts and tax deductions for individuals who borrow to invest in trusts. Either use a Land Tax Unit Trust or a Hybrid Discretionary Trust that has been approved by the ATO.

Step 2 – Consider the land tax and stamp duty considerations

Consider the annual cost of holding the property (i.e. land tax) and the cost of transferring the property to another entity in the future (i.e. stamp duty).

For example, in N.S.W. the definition of owner includes joint owners. If a husband and wife acquire two rental properties jointly, they receive one land tax threshold. If they acquire one rental property each, they receive two land tax thresholds (i.e. one each).

The best structure for land tax is a Land Tax Unit Trust. The structure receives the land tax threshold in N.S.W. It is the only trust apart from a self managed superfund that receives the threshold.

If you intend to transfer the property later to a discretionary trust or self managed superfund, then a liability to stamp duty might arise at the time of the transfer. Acquiring the property in a Land Tax Unit Trust allows for the issue and redemption of the units to a discretionary trust or self managed superfund without stamp duty in N.S.W., W.A and VIC. Property value must be less than $2million in N.S.W. and W.A. and $1million in VIC.

NOTE: Only acquire one property per Land Tax Unit Trust.

Step 3 – Avoid poisoning residential property

The majority of people who invest in property consider the investment as one that goes towards providing for their retirement. Therefore, it is important that they are able to transfer the property to a tax advantaged self managed superannuation fund in the future.

A self managed superfund is prohibited from acquiring a residential property from a member or a related party of a member. The only way of structuring a residential property so that it can be transferred to a self managed superfund is to acquire the property in a unit trust, preferably a Land Tax Unit Trust, from the beginning.

If the property is owned by a unit trust a self managed superannuation fund can acquire units in the unit trust. The following features have to be present at the time the self managed superannuation fund acquires units:

1. The unit trust has no debt,
2. The assets of the unit trust aren't be used as security,
3. The unit trust doesn't have an interest in another entity,
4. The unit trust hasn't acquired a property from a member of the fund unless it is business real property,
5. The property is leased to an arms-length party.

Step 4 – Income tax and capital gains tax considerations

One of the most important considerations when investing is the income tax and capital gains tax consequences.

Income Tax – The income tax consequences need to be considered for both now and the future. Who should receive income following the purchase may not be the same in 5 years, 10

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

years, or 20 years. This is the case in the majority of cases. A structure should be used that allows changes to who receives the income while providing for certainty in relation to any deductions.

Capital Gains Tax – Capital Gains earnt by a self managed superfund, discretionary trust, unit trust or individual where the asset has been held for more than 12 months is subject to a 50% discount. Only 50% of the gain is subject to income tax.

The capital gains may be large over time and once again consideration needs to be given to who would be best to receive the capital gain when the property is eventually sold. Flexibility with capital gains can only be achieved if a trust holds the property.

Other Important Information

1. The contract for the sale of the property only needs to name the trustee of the unit trust as purchaser if the property is being purchased by a unit trust or Land Tax Unit Trust. Evidence that the trust used its funds to acquire the property is important;
2. A sole trustee of a unit trust or Land Tax Unit Trust may also be one if its unit holders, but not the only one;
3. Unit trusts and discretionary trusts are eligible to receive the general 50% Capital Gains Tax discount;
4. If a trust is acquiring real property, then the trust must have been in existence and evidenced in writing prior to the exchange of contracts for its purchase;
5. If the trustee of a trust doesn't distribute all of its income in a financial year, they are generally taxed at the highest rate on those undistributed amounts;
6. If a trust is merely a passive investor in income-producing assets, its recommended that senior people from the group of people who will benefit under it are made its trustees;
7. The power of appointment under a trust is NOT property and does not pass to a trustee in bankruptcy in the event of the bankruptcy of the appointor;
8. If the trustee of a trust is sued for an amount representing more than the available assets of the trust, they will generally become personally liable; and
9. Distributions of the income of a trust to minors (i.e. people under 18 years of age) are generally taxed at the penal rate of 66%.

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

Advice Warning: This document is intended to provide general information only and has been prepared by Macquarie Group Services Pty Ltd ABN 70 090 831 039 (AFSL 399059) 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.