



Leveraged Trusts

Access the benefits of enhanced wealth preservation and negative gearing

A hybrid trust is a structure for **holding investments** when you want to access enhanced “asset protection” and “negative gearing”.

A hybrid trust is an alternative to both a standard “discretionary” or “family” trust, which generally do not allow negative gearing in your own personal name while holding an asset through a trust, or simply holding the asset in your own personal name.

When used appropriately, a hybrid trust offers a number of potential advantages, including:

- Enhanced **“Asset protection”**: appreciation in the value of property held within a hybrid trust has a degree of protection from unwarranted claims made against you personally. It is also possible to use a trust to “obscure” (although not completely hide) the ownership of assets, (although proper disclosures must be made to all regulatory authorities).
- Access to **“negative gearing”**: the money used to purchase trust property can be provided by you taking up “Income Units” in the trust. Because the Income Units may be expected to produce assessable income (and in fact have the right to all such income), you should be entitled to claim a tax deduction for interest paid on funds used to purchase the Income Units. If the interest exceeds the income paid on the Income Units in the initial years, you can claim a deduction against your other personal income for the difference, i.e. “negative gear” the investment. But you must have the intention, and it must be reasonable to conclude, that the assessable income on the units will eventually exceed the negative gearing in the initial years.
- Flexibility with respect to passing investments among family members, and between generations (i.e. **“Estate Planning”**). This is because passing “control” over trust property does not necessarily trigger a transfer of the trust property – avoiding a liability for stamp duty or CGT.
- The ability to “stream” capital gains to one or a number of taxpayers from year to year (i.e. **“capital streaming”**). This is provided that the capital gain on the property exceeds any accumulated negative gearing by the time of disposal, i.e. you can only stream the surplus gain over and above the total net holdings cost.

In summary, an appropriately implemented hybrid trust promotes:

- Asset protection benefits;
- Estate and succession planning benefits; and
- Tax efficiency.

Proper care and consideration

As with all things, the potential benefits of a hybrid trust do not come without care and effort. Consideration needs to be given to the following potential disadvantages associated with a hybrid trust:

- Some banks will not lend money to a hybrid trust, or to an individual who intends to use the money to subscribe for Income Units in the trust, or may seek to charge a higher



establishment fee to review the structure. You should consult with your bank to ensure they will lend to either you or the structure.

- “Tax losses” that arise in the trust cannot be “distributed” to beneficiaries. Instead, the losses must be carried forward within the trust, and offset against future trust income. The ability to carry forward tax losses is subject to a number of strict tests. However, provided the funding occurs at the level of the holder of the Income Units, then losses within the trust should be avoided.
- The value of trust assets must be sufficient to justify the expense of setting up and then administering the trust. If the trust earns income or capital gains, financial accounts will need to be prepared and a tax return lodged.
- Distributions from a trust can impact on a beneficiary’s entitlement to receive the old age pension or other social security.
- The redemption of Income Units may give rise to a liability to stamp duty. However, this should be limited to the fixed redemption value of the Income Units, rather than the market value of the trust property as the later redemption date.
- Administering a trust may require a level of cooperation between family members, who may not share common goals. This can lead to family disharmony, particularly if control over a trust passes to the next generation without appropriate planning.

The basics of a hybrid trust

A “trust” is not a “legal entity” (such as a company) but is a “legal relationship” between at least two parties: namely, the **Trustee** and the **Beneficiaries**. The Trustee holds the “legal” ownership of property and is obliged to hold and use the property for the *benefit* of the Beneficiaries.

A “hybrid trust” is one of a number of different trusts. A hybrid trust involves two categories of Beneficiaries, “discretionary beneficiaries” and holders of fixed Income Units. The holders of fixed Income Units are entitled to the income of the trust (other than surplus capital gains). As a general rule, the Trustee may then pay any surplus capital gains to one or more of the discretionary beneficiaries.¹

The key aspect of a hybrid trust is that the holder of Income Units may claim negative gearing advantages, while the surplus increase in value of the trust property remains within the trust for the benefit of the discretionary beneficiaries.

How do I set up a Leveraged Trust?

A hybrid trust is established by a **Settlor** giving the **Trustee** a small sum of money, say \$10 (the **Settled Sum**) to be held for the class of potential **Discretionary Beneficiaries**. The **Settlor** is usually a person who is not related to the Trustee or the intended Beneficiaries, i.e. a solicitor.

The **Trustee** is the person who holds the legal title to the trust property, and who therefore controls the trust property from day-to-day. It is possible for a trust to have multiple Trustees. The Trustee can either be a company or an individual.

The “class” of “**Discretionary Beneficiaries**” is defined with reference to one or more “**Named Beneficiaries**”. The Named Beneficiary is usually you, your spouse and/or your children. The wider class of “Discretionary Beneficiaries” is then defined to include the Named Beneficiaries, as well as a very wide group of individuals and other legal entities that are in some way related to or associated with the Named Beneficiaries.

¹ If the return to the holders of Income Units is ultimately insufficient to make good the net negative gearing amount, then a portion of any capital gain may also be distributed to the holders of Income Units.



The Trustee may then issue **Income Units** to raise funds to purchase further property. It is common for an individual to borrow funds and use those funds to subscribe for the Income Units. It is essential that the borrowings be in the personal name of the person wishing to subscribe for Income Units. The trust may provide additional financial support for these borrowings, e.g. security over the property purchased.

Finally, the Trust Deed usually names an **Appointor**. The Appointor has the power to change the Trustee from time to time. Because the Appointor can change the Trustee – including by appointing themselves as Trustee, the Appointor has **ultimate control** over the trust – and therefore should be chosen with due care. The Appointor can be a company or an individual. It is possible for the role of Appointor to be shared between two or more persons.

What next?

A hybrid trust is established by a written document called a **Trust Deed**. The Trust Deed regulates all the parties to the trust. It is critical that the Trust Deed be drafted appropriately and takes into account the current and future objectives of the parties involved.

It is also critical that the Trust Deed accommodates estate and succession planning objectives from the outset.

If you would like to speak to someone about exploring the use of a leveraged trust, call us on **1300 654 590** or email us at wehelp@adlvlaw.com.au.

Further information can also be found on our website at www.adlvlaw.com.au.