



## Unit trusts

This Solution Brief provides a summary of what a unit trust is, and how they work.

A '**unit trust**' is a commonly used structure for 'pooling money' and holding investment assets, particularly property. They are sometimes used for carrying on a small business, but this is less common.

### What is a unit trust?

A 'trust' is a legal relationship between at least two parties: a **trustee** and a **beneficiary**. The trustee holds the 'legal title' to assets on behalf of the beneficiaries. If the trustee earns income from the assets, this income then flows through to the beneficiaries.

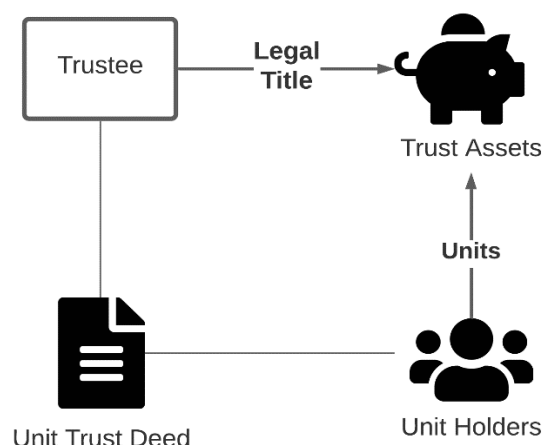
A 'unit trust' is a type of trust in which the respective 'interests' of the beneficiaries in the assets and income held by the trustee are divided into a number of '**units**'. Each unit represents a certain (usually fixed) entitlement to benefit from the assets and any income. Beneficiaries can subscribe for new units, redeem existing units, and transfer units to other people. A beneficiary of a unit trust is referred to as a '**unit holder**'.

### How do you set up a unit trust?

A unit trust is formed when someone agrees to be the trustee, and one or more persons agree to **subscribe for the initial units**. The money used to subscribe for the units becomes the initial capital of the unit trust. The trustee can then use that capital to buy trust assets to be held by the trustee on behalf of the unit holders. The arrangement is recorded in a **Unit Trust Deed**. There will also be various 'minutes' and 'resolutions' recording the creation of the units and other administrative matters. It is very common for the trustee to be a **company**, rather than individuals.

Sometimes unit holders will also enter a separate document to regulate how they are going to set up and administer the unit trust – called a **Unit Holders' Agreement**. In our view, it makes more sense to have all these rules in one consistent document, namely a well-drafted and tailored Unit Trust Deed.

A unit trust looks like this:





## **What are some benefits and pitfalls of a unit trust?**

A unit trust can offer several potential benefits:

- Unlike a 'discretionary trust', unit holders have a fixed and discrete interest in the assets and income of the unit trust. This fixed interest is an 'asset' of the unit holder, and this asset can be dealt with, such as being sold or gifted to others;
- A unit trust is a better entity to use to hold assets with other unrelated parties, such as co-investors. Once again, this is because both parties have a fixed and defined interest in the assets and income – so they can 'pool' their resources but still have a distinct interest;
- A unit trust is a 'flow-through' entity for tax purposes. This means that any net income and capital gains flow directly through to the unit holders and are not subject to tax in the hands of the trustee. Each unit holder is then responsible for their own tax. This flow-through treatment means that the underlying unit holders may qualify for the 50% CGT discount, whereas this concession is not available to a company; and
- It is generally easier to issue and redeem units, than it is to issue and cancel shares in a company.

However, there are some potential downsides to using a unit trust. These include:

- If you make a net loss from the trust assets, this loss is 'trapped' in the unit trust, and cannot be used to offset other net income in the hands of the unit holders. Furthermore, it is very difficult to 'inject' new sources of income into a unit trust to offset accumulated losses, especially when there are unrelated unit holders;
- It is more difficult to retain surplus money within a unit trust for working capital or reinvestment purposes. This is because all the income is distributed for tax purposes to the unit holders each year. If this net income is needed to be retained in the unit trust, then the unit holders need to 'lend it back' to the trust, or leave it as an outstanding present entitlement;
- Because a unit trust is not a tax-paying entity, the effective rate of tax on its income will be equal to the rate of tax applicable to its unit holders. If the unit holders are individuals, then the rate could be significantly higher than the flat company tax rate. If the unit holders are companies, and undistributed income is retained in the unit trust, then Division 7A 'deemed dividend' implications can arise; and
- For certain tax attributes to flow-through a unit trust, e.g. franking credits, and for losses to be carried forward, the trust will need to qualify as a 'fixed trust' for tax purposes. This is very difficult to achieve, and many 'off-the-shelf' Unit Trust Deeds are unlikely to qualify as compliant fixed trusts.

The bottom line is that most people do not fully appreciate the complexities involved in successfully involving a unit trust within your business and investment structures. However, when used appropriately, with a quality tailored Unit Trust Deed, they can be a very useful addition to your structure.

## **What next?**

If you would like to speak to someone about getting the right structure for your business and investment activities, call us on [1300 654 590](tel:1300654590) or email us at [wehelp@adlvlaw.com.au](mailto:wehelp@adlvlaw.com.au).

Further information can also be found on our website at [www.adlvlaw.com.au](http://www.adlvlaw.com.au).