TRUSTS – FIXED UNIT TRUST

Information here may help you as a guide to provide general overview of operation of a Fixed Unit trust and explain the commercial advantages and disadvantages of conducting business or investing with a fixed unit trust structure.   There are many tax planning, asset protection and distribution of wealth issues which must be considered before a decision is made to establish a fixed unit trust. Those who intend using this tax structure, information contained herein should be taken as starting point of their investigation. Many accounting and legal matters, such as, stamp duty and land tax, have not been addressed here in detail. We are not in a position to advice you, trustees and beneficiaries should read the trust deed to better understand their rights, powers, obligations and duties. This guide is not intended to replace any legal advice; we do not know if a fixed unit trust will suit your purpose, as we do not know your purpose, readers should consult a qualified legal practitioner or accountant for advice.

CONTACT US

Email
enquiries@richards.net.au

Phone
02 4782 1148

Postal
PO Box 744, Katoomba

Address
180 Katoomba St,
Katoomba

Website
Richards.net.au

What is a Fixed Unit trust?

A trust is established for (usually) un-related parties with a payment of an amount, called "initial sum" by the initial unit holders to the trustee to be held in trust in accordance with the deed for the benefit of the unit holders.

A fixed unit trust is a trust where the rights of the beneficiaries (unit holders) to income and capital are fixed. This is in the sense that they are not subject to any discretions on the part of a trustee, and are unitized, in the sense that those rights are divided amongst the beneficiaries based on how many units have been issued to them.

A fixed unit trust is where the unit holders, who are all predominantly un-related members of two or more separate families getting together to hold an asset together (usually a large property or shareholding) or run a business together. The trustee has no discretion on which unit holder gets which distribution portion of income or capital of the trust. All income and capital is distributed according to unit holding.

The trustee owns the property of the trust and distributes each year; income of the trust, to various unit holders with a common purpose. This common purpose includes minimizing the total income tax, capital gain tax and asset protection. No income of the trust can be accumulated in the trust. All income of the trust must be distributed each year.

The trust runs for 80 years or earlier, this termination date is called “vesting day”, when unit holders are entitled to the whole of the trust fund according to their unit holding. Until that day, the trust assets are held by the trustee.

In a fixed unit trust all units have the same rights to income and capital distribution and voting rights in a meeting.

This fixed unit trust can be terminated by the unit holders in a special meeting. On termination, all assets are distributed to unit holders according to the units held by them on termination date.

Why do we need a trust deed?

Trusts are created by a legal document called “trust deed” prepared by a solicitor which outlines the purpose of the trust, the rights and obligations of the trustees and unit holders, powers of the trustee, and identifies various parties such as initial unit holders & Trustee(s).

For a trust to exist four elements must be present. These are:

- a trustee;
- a beneficiary, (called in the case of a unit trust, a “unit holder”);
- trust property; and
- an equitable obligation on the part of the trustee to hold the property for the benefit of the beneficiary.

What is a unit?

A unit is a piece of property that entitles the unit holder to a specified proportion of the income and capital of the trust.

A unit held under a trust is different from a share in a company. A share confers on the holder no legal or equitable interest in the assets of the company; Units under the fixed trust deed confer a proprietary interest in all the property which is subject to trust of a deed.

In other words, a unit in a fixed unit trust confers on the unit holder an equitable interest in both the underlying capital and the income of the trust.

Role of Trustee

Trustee is appointed by unit holders with powers contained in the trust deed. Trustee owes a duty of care of "good faith" to the unit holders and the deed requires that all trustee(s), at all times, act in best interests of all unit holders.

Trustee may be held personally liable for debts incurred in their capacity as a trustee but have the right to be indemnified out of the assets of the trust. A trustee can resign if he / she so wishes by giving notice to all unit holders.

Trustee(s) are responsible to look after trust funds by investing & managing it and distributing to various unit holders at the end of the financial year. They must also maintain books of account and lodge relevant income tax returns with the tax office.

Who should be the trustee? Usually unit holders of the fixed unit trust incorporate a (new) company to act as a trustee and nominate various unit holders as directors of the company. Individual trustee(s) can also be unit holders, however, most advisors would prefer a company as trustee of the trust and unit holders (who can also be directors of the trustee company) are beneficiaries of the trust.

There is no rule that Individual trustees cannot also be unit holders, but since trustee(s) are to be seen to act in the benefit of ALL unit holders, having one or few Individual unit holders as trustee(s) may break that fiduciary duty of trustee(s). Hence many advisors prefer a company to act as trustee.

Who Controls the Fixed Unit Trust? The unit holders as a group control the trust. This is because the trust deed gives them the power to direct the trustee and if necessary, dismiss the trustee and appoint another person to act as the trustee instead.

The deed specifies the percentage vote required for a resolution of a meeting of unit holders to be effective. Usually it is 75% unless the unit holders decide otherwise.

Advantages of having a company as a trustee

Besides fiduciary duty advantage as listed above, following are other benefits of having a company as a trustee:

- Assets of the trust are held in the name of trustee(s), if trustee is a company then private assets of Individual trustees generally cannot be confused as trust assets;
- In case of death of individual trustee all assets of the trust have to be again transferred in the name of new individual trustee, however if a company is a trustee, there is no change of ownership of assets even in case of death of director of trustee company;
- The directors of Trustee Company can be unit holders in their individual capacity whilst still being in control of the trust.

The disadvantages of using a company as trustee are largely the extra cost of setting up and running a company each year.

Duties & Powers of Trustee

Trustee must act in "Good faith" whilst handling trust affairs, this means that trustee must put interest of the trust ahead of his or her personal interest and act in a manner a person would in dealing his or her own personal assets.

Below are some duties of trustees:

- follow the trust deed;
- hold assets of the trust and manage its investments;
- engage experts for benefit of the trust;
- delegate duties to a competent persons, however the trustee is still responsible for delegated tasks;
- invest trust's assets in accordance with law and as per the trust deed;
- to maintain proper books of accounts including minutes of meetings of the trustees/directors of the trustee company, lodge returns with ATO; and
- to keep the trust's assets separate from other personal assets.

Advantages of Fixed Unit Trust

Fixed Unit trusts structure has many advantages over other tax structures like, partnership, company etc, however it has its own limitations. Below is a list of advantages, please note that this list is not exhaustive, you must seek your own independent legal and accounting advice.

a) Income Tax

- Net income in a financial year is distributed amongst unit holders. This distribution has to be included in the unit holders' income in the financial year when the trust has earned the income and not the year when the income is distributed, e g, trust income of $10,000 is earned in financial year ended 30th June 2000 and distributed to the beneficiary on 15th August 2001, this income has to be included in the beneficiaries income tax return for the financial year ended 30th June 2000 and not 2001.
- The classification of trust income, for example, dividend income, foreign income, or capital gain continues to be recognized under the same classification in the individual unit holder's income tax return and any imputation credit or foreign tax credits follows through to the unit holder as per trustee's distribution.
- If unit holders are under 18 years of age, by any income distribution to them, trustees can avail their tax free threshold and low income rebates.
- If unit holder is a company the company will pay tax at company tax rate (at the time of writing 27.5%).
- The trustee of a fixed unit trust must distribute all income of the trust and cannot accumulate income of the trust.
- Only net income of the trust has to be distributed, a trust can also contribute superannuation for all unit holders in proportion to their unit holding, which means that tax on income of the trust can be limited to tax rate on contribution to a superannuation fund, which at the time of writing is 15%.
- If the fixed unit trust has a loss and has received imputation credits in the financial year, the trustee can lodge its own income tax return and carry forward the loss to the next financial year and claim a refund of imputation credits.
- If units are owned via family trusts - various income tax, asset protection and estate planning advantages connected to family trusts are also available to unit holders.

b) Capital Gain Tax

- On disposal of any asset of the trust, all unit holders are entitled to a 50% discount factor on capital gains, if assets are disposed after one year, this discount flows throw to unit holders' on distribution of capital income. The rate of discount varies depending on the entity type.

c) Asset Protection

- Any distribution to a unit holder need not be physically paid to them. If the unit holders agree, trustee can retain money which it has decided to distribute to unit holders and establish a bare trust for that unit holder within the fixed unit trust. The trustee can then invest that money on behalf of the unit holder as per powers given to them by the trust deed.
- Money's belonging to unit holders who are under a legal disability, like minors; distribution money from a fixed unit trust, can be held by the trustee, under a bare trust arrangement, till they reach 18 years of age. The trustee may apply money held for minor unit holder in payment of education, clothing and other similar expenses which are for maintenance, education or benefit of minor beneficiary. Alternatively, trustees can distribute minor's money, to their parent or guardian.

d) Land Tax

- This fixed unit trust is treated as a "fixed unit trust" within the scope of Land Tax legislation in many states. What this means is that this fixed trust will receive threshold available to trustees who own land under this trust deed structure.
- For example Section 3A Land Tax Management Act 1956 of NSW states a trust is a "fixed trust" if equitable estate in all of the land that is the subject of the trust is owned by a person or persons who are owners of the land for land tax purposes and equitable interest of the trustee as trustee of the trust is to be disregarded. That means that the persons who are beneficiaries of the trust (unit holders) under the trust deed are taken to be the owners of an equitable estate in the land that is subject to the trust.
- This equitable interest is created because this trust deed specifically provides that the beneficiaries of the trust are presently entitled to the income of the trust and capital of the trust and can require the trustee to wind up the trust and distribute the trust property to the unit holders.

Disadvantages of a Fixed Unit trust?

This trust cannot distribute capital or revenue losses to its beneficiaries. Which means that any losses have to be carried forward till a profit is achieved. Hence, when a trust incurs a loss beneficiaries are not able to offset that loss against any other assessable income that they may derive from other sources such as salary, interest, dividend etc.

As a result, should a trust incur a net loss, its beneficiaries, may be wise to have debt held at the unit holder level, rather than at the trust level, to avoid negative gearing type losses being locked up in the trust.

In a Fixed Unit Trust there is no discretion with the trustee as all income of the trust has to be distributed to the unit holders. This means, that all income of the trust cannot be accumulated and has to be distributed to unit holders even in a financial year when a unit holder has high taxable income. A fixed unit trust cannot accumulate income and pay tax in its own right.

Whose name are assets held by a fixed unit trust?

The trustee is the legal owner of trust's property. This means that trustee's name should appear on all ownership documents, such as shares, managed funds, property etc. However, this ownership of asset is not in their "own benefit", but as a beneficial owner, on behalf of the trust.

Hence, wherever applicable, assets ownership documents should carry the tag "As Trustee For" ATF,

e.g. the owner of the trusts share can be either "Mr R Smith ATF Smith Family Trust" , in case of individual trustee or "R Smith Pty Ltd ATF Smith Family Trust" in case of company trustee.

In some instances, above name cannot be inserted in the ownership documents, as most land title offices do not recognise a trust and will only register title of property in the name of the trustee only, who will be the legal owner of the property. The land titles will not allow the above tag.

In these circumstances, property has to be registered in the name of Individual Trustee or company trustee wherever relevant. Some advisors recommend drawing up a separate "declaration of trust" deed for each such asset.

Vesting of Trust

After 80 years of creation date, or earlier, if the trustee decides, the trust will "vest" or cease. The

trustee will on "vesting date", put together all the trust's property, its capital and distribute to all unit holders (beneficiaries). In a Fixed unit trust, the unit holders also have a right to terminate the trust and may request the trustee to wind up the trust and distribute the trust's property to all unit holders.