

# Buying a property in a Family or Discretionary Trust

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Buying property in Family or Discretionary trusts has been a popular way to invest for years. Family trusts are commonly known as 'discretionary trusts for the benefit of a *family group*, controlled by the parents as trustees – either themselves or as directors of a corporate trustee.

The family group are usually parents and their children, with spouses and other family members also able to benefit. Family trusts can last up to 80 years, or a shorter time determined by the Trustee subject to the terms of the Trust deed.

A benefit of family trusts is that income generated from trust assets e.g., rent from real estate can be distributed to family members with a lower tax rate and so less tax is paid. A family trust can provide protection to assets from marriage breakdowns, claims on an estate of a deceased beneficiary and bankruptcy. The level of protection depends on how the trust deed is structured.



A trust structure is an ownership structure where the legal owner is not the beneficial, or eventual owner, i.e. a person or company owns an asset on behalf of someone else, creating a separation between the owner of the asset and who will gain the benefit of the asset. The

benefits of trusts include increased asset protection, particularly when using a corporate trustee, and you can access negative gearing benefits for unit trusts if your loans are structured correctly.

***There are two main types of trusts you can purchase property within:***

- Unit trusts (sometimes referred to as fixed trusts)
- Discretionary trusts (sometimes referred to as family trusts).

Trusts are also generally entitled to the 50% CGT general discount if an asset is owned for at least 12 months, but companies cannot claim CGT discount.

## **Advantages of Property (Family or Discretionary Trust) Trusts**

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Placing your investment property in a discretionary trust can be an effective asset protection strategy. A well-constructed discretionary trust provides protection for the trust property from potential claims by creditors if the beneficiary becomes bankrupt or is subject to a lawsuit. This is because the trustee, being the legal owner of the assets, has discretionary power to distribute the income and capital of the trust to beneficiaries. The beneficiaries have no proprietary interest in the trust property, they have a mere expectation to be considered by the trustee for making a distribution.

By owning your investment property in a discretionary trust structure, you can legally split income generated by that property in the most tax-effective way. The trustee has discretion over income and capital distribution, which allows to minimise of taxes by distributing income to beneficiaries in lower tax brackets.

## **Disadvantages of Trusts**

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To be effective for asset protection and tax minimisation purposes, the discretionary trust must be properly set up and administered. Apart from registration costs and stamp duty, you may need to pay expenses or legal advice for drafting or reviewing your trust deed to ensure its terms meet your asset protection and tax minimisation objectives.

There are also costs associated with managing the trust's tax affairs, including maintaining proper records, lodging tax returns and preparing a separate set of financial statements each year.

There are number of issues that can arise from improperly running a trust structure resulting in adverse tax and legal consequences. Investors considering buying property in a trust should consult appropriately qualified professionals before making such a decision to ensure they are fully aware of the implications.

## ***Higher land tax payable in some states***

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One of the aspects often overlooked when considering choices of structures for holding investment property is land tax. Land tax is imposed by the states in which the land is situated and the rules in each state are different.

For example, in NSW, discretionary trusts do not enjoy the benefit of the land tax threshold applicable to other entities, such as individuals, companies, super funds and fixed trusts, and are taxed at a flat rate of 1.6% of the taxable value of the property.

In addition, a trustee of a discretionary trust may be subject to a foreign resident surcharge as it may be deemed to be a foreign person for the purposes of land tax legislation if the trust has a potential beneficiary who is a foreign resident (whether they receive a distribution).

There is no perfect solution, with each scenario presenting both advantages and disadvantages. What's important is that you understand what you're trying to achieve with your property investment and the long-term implications.

### ***The expense to transfer property out of the trust***

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If the family member/s who control the family trust wish to transfer the property from the trust to say, an adult child, stamp duty and capital gains tax (if the property has increased in value) will be payable. With care CGT may be reduced by 50% if the property has been owned by the trust for more than 12 months and it can be distributed to the beneficiary rather than transferred. Legal advice is required to ensure it is done properly.

### ***When parents who control the trust get older***

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They cannot leave the property owned by a family trust to their children in their Wills. A family trust is a separate legal entity. What can be done is to fix the future control of the trust for the next generation. Careful estate planning can achieve a smooth transition of control of the trust to adult children.

Always seek advice from your accountant and legal representatives when considering property trusts.

### **\*\*\* NOTE: CHANGES TO TRUST DISTRIBUTIONS EFFECTIVE FROM 1 JULY 2022**

The [ATO](#) has announced a major crackdown on the taxation of family trusts. In a long-awaited ruling, the ATO has focused on common tax planning strategies involving distributions to companies and family members. This means that family groups will urgently need to reconsider how they are using their family trust.

### **What should I do with my trust?**

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If you have a family trust, it is important to consider whether any of the new ATO proposals could be problematic for you. If your trust is distributed to a range of family members, or to companies, then you should review your situation in detail with your accountant.

While some of the ATO proposals has been released in draft form, or is not proposed to apply until 1 July 2022, other parts of the ATO view are intended to apply retrospectively. Accordingly, considering the issues and addressing them well before 30 June 2022 will be vital.

Trusts will continue to be an effective structure for managing family wealth, but the tax planning aspect will become more complex and tailored. Most family groups will need to revisit their tax planning in the lead-up to 30 June 2022.

Contact us today to make an appointment with our specialist tax adviser.

**BOOK YOUR COMPLIMENTARY CONSULTATION NOW** – We offer a 15-minute free consultation to discuss your tax, property investment and business needs.

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