N.S.W. Land Tax Unit Trust Report

Description	Other relevant guides	Who this applies to	Notes
This report looks at the benefits of using a Land Tax Unit Trust when investing in property in N.S.W.	- How to set up a Land Tax Unit Trust, - How to avoid poisoning your property - Explanatory Memorandum – N.S.W. Land Tax Unit Trust	- Residential property investors, - Commercial property investors, - Industrial property investors,	The difference in land tax and other taxes that can be achieved is significant. Investors need to consider these before acquisition.

The Problems

1. Investors invariably pay too much land tax due to a poor structure,
2. No flexibility to transfer to super if residential investment acquired in own name,
3. Pay unnecessary stamp duty on movement which could be avoided,
4. Can't borrow to pay down non-deductible debt,
5. Pay more income tax and capital gains tax.

The majority of property investors receive either no or very poor advice when acquiring a property investment. Considerations including land tax and many more aren't considered, usually to the detriment of the investor.

This report also considers how to avoid stamp duty to move the ownership to a discretionary trust or self managed superfund. The report also looks at the 2 best property investment structures. The first we will look at immediately as the other is restricted to those people with enough in their superannuation for a deposit on a property.

The Answer

N.S.W. Land Tax Unit Trust

This is by far the most flexible structure and the one which results in the most state and federal tax advantages.

1. The Land Tax Problem.

To achieve the advantages of points 2 to 5 above a rental property should be acquired in a unit trust. Acquiring a property in a unit trust allows the transfer of units to your self managed superfund when the debt is repaid; avoid stamp duty on the transfer of units if the property is worth less than $2million, restructure to pay down non-deductible debt and tax savings.

Since 2006 the N.S.W. State Government removed the land tax threshold for unit trusts holding land in New South Wales. This means up to $6,000 per annum can be lost in achieving the flexibility discussed above. A large price to pay especially for a family that acquires two residential properties that otherwise could have received a $12,000 threshold (a combination of two thresholds).

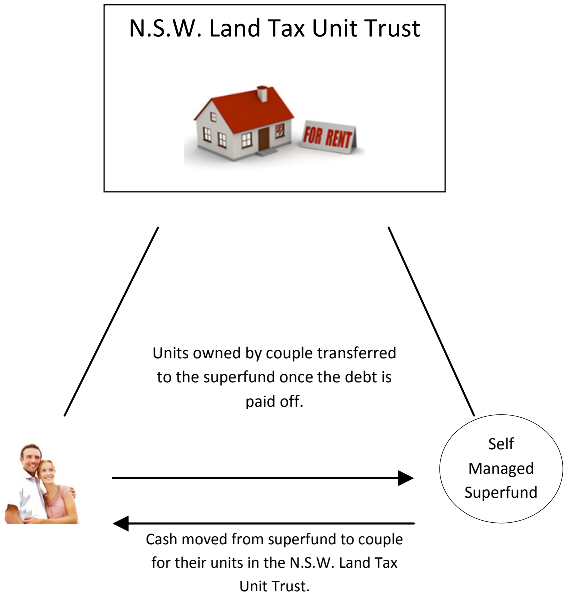
InvestorOne has developed a unit trust called the N.S.W. Land Tax Unit Trust. The trust receives the land tax threshold and this provides for some significant planning opportunities. If 3 properties are owned by a family and each held in a separate N.S.W. Land Tax Unit Trust and Dad holds all the units in one, Mum another and a self managed superfund the last an $18,000 threshold is received (a combination of three thresholds).

It costs no more in land tax to hold a property in a N.S.W. Land Tax Unit Trust, and in certain situations less, than an individual. The problems discussed below relate to the shortfalls of owning a property in an individual's name or by two or more individual's names.

2. Transfer to a superfund and cash out the fund

With all Australian workers having close to 10% of their salaries paid into super, large balances are starting to build up. The majority of property investors state that their intention in acquiring a property was to provide for their retirement. However, over 90% of investors acquire their residential investment property in a way that means it is illegal to transfer their property to their own superfund.

NOTE: A self managed superfund is prohibited from acquiring a residential property from a member or a related party of a member (i.e. company, relative, partner, discretionary trust, etc).



This enables the couple in the above example to take some or their entire super in exchange for their units and possibly pays off non-deductible debt or upgrades their home or helps their kids to acquire a property.

The other advantage is that the rents would be taxable at 15% in the superfund and any capital gain is subject to 10%. If the fund is in pension phase there is no tax on income or capital gains.

Why would you acquire a property in your own name and always be subject to higher tax and not be able to swap with your superfund when you need the cash.

3. Pay unnecessary stamp duty to transfer to a related entity

If an individual owns a rental property and wishes to transfer the property to a trust for asset protection or to a self managed superfund they are required to pay full duty. A narrow small exemption now applies to transfers to a self managed superfund, however it will have limited application and won't apply to most investors.

No stamp duty applies if a unit trust that owns a property worth less than $2million issues new units for example to a self managed superfund and redeems the units owned by individuals. Even a transfer of the units only attracts nominal duty in the hundreds of dollars. Conditions apply before a self managed superfund would be allowed to acquire the units (i.e. the unit trust would have to be debt and security free).

This is crucial for investors who may want to move their property to a self managed superfund in the future to access the cash and those who wish to refinance and retire some non-deductible debt.

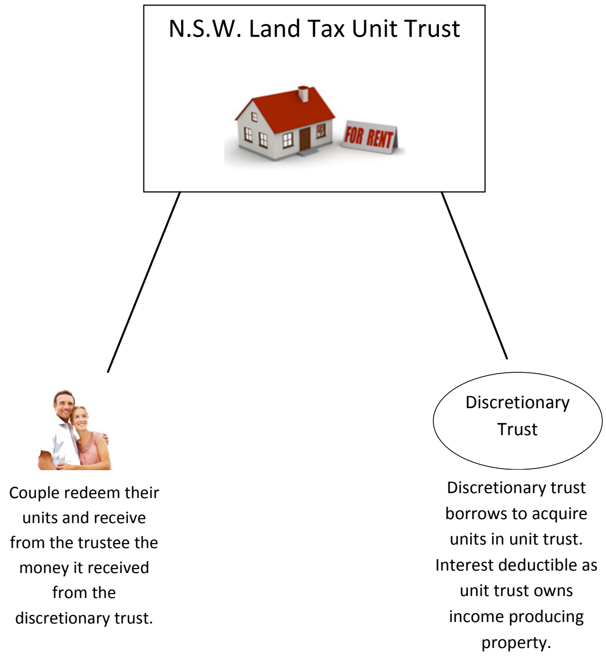
Why would you acquire a property in your own name and be subject to full duty if you wanted to transfer the property to another entity when it could easily be avoided.

4. Can't borrow to pay down non-deductible debt

Individuals who own property either alone or with another person are unable to refinance their property and use the proceeds to pay down non-deductible debt or acquire a new home, holiday home or help the kids.

The property can be used as security, however the only way the interest would be deductible is if the person used the money from the refinance to acquire an income producing property. This is not the case with a unit trust. Following the repayment of the original loan a second loan could be taken out and a personal, non-income producing asset acquired and the interest would be deductible.

Consider the diagram and consequences on the next page.



In the above example the couple took out the first deductible loan to acquire their units which were in turn used by the unit trust to acquire the property. Following the repayment of their loan the discretionary trust borrows to acquire units. What the couple do with the proceeds from the redemption of their units is irrelevant to the deductibility of the interest on the loan taken out by the discretionary trust. The couple could use the funds to acquire a private holiday house.

Why would you acquire a property in your own name and not be able to refinance and get a tax deduction for the interest on a loan and acquire a personal asset or pay down non-deductible debt.

5. Pay more income tax and capital gains tax

Individuals are subject to the highest marginal rates of tax of up to 46.5%. Even though the capital gain is halved if an asset is owned for more than 12 months the rate can be still as high as 23.25%.

Since most investors acquire an investment property in the name of the highest income earners name for negative gearing and never move it, the income and capital gains are taxed at close to the highest rate over the life of the property.

This also means that to pay off non-deductible debt the individual has to earn almost $1 to pay off 50 cents in debt. The structure outlined in 4. above allows an individual to use $1 to pay off $1 in debt. That's twice as fast.

A self managed superfund pays 15% on earnings, 10% on capital gains and pays no tax if the members are in pension phase. A capital gain of $200,000 would be subject to up to $46,500 in the hands of an individual, $20,000 in the hands of a self managed superfund and $0 if the fund was in pension phase.

Why would you acquire a property in your own name and for the life of the property ownership and on its sale be subject to the highest marginal tax rates.

Comparison table

	Land Tax T/Hold	**Change ownership w/out stamp duty**	**SMSF acquire an interest**	**Refinance to pay down non-deductible debt.**
Land Tax Unit Trust	**Yes**	**Yes**[1]	**Yes**[2]	**Yes**
Company	Yes	No	Yes[2]	No
Individual	Yes	No	No[3]	No
Partnership	Yes	No	No[3]	No
Standard Unit Trust	No	Yes[1]	Yes[2]	Yes
Hybrid Trust	No	No	No[3]	Yes
Discretionary Trust	No	No	No[3]	No

1 *Unencumbered value must be less than $2million.*
2 *SIS Act and SIS Regs require no borrowing in company or unit trust and assets not be subject to charge.*
3 *SMSF can acquire "business real property".*

Other Considerations

Capital gains tax, goods and services tax and other issues including the SIS Act need to be considered in undertaking any of the above transactions. Advice should be sought concerning these areas.

Other Important Information

1. A trust has a maximum life of 80 years;
2. A sole trustee of a unit trust may also be one if its unitholders, but not the only one;
3. The unitholder of a Land Tax Unit Trust can call on its trustee to distribute the trust's income or capital to them;
4. Additional unitholders can be added at any time;
5. 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;
6. A Land Tax Unit Trust is eligible to receive the general 50% Capital Gains Tax discount;
7. The trustee of a unit trust is obliged to distribute its income and capital to its unitholders in proportion to their respective unitholdings;
8. Distributions of the income of a trust to minors (ie. people under 18 years of age) are generally taxed at the penal rate of 66%;
9. 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;
10. If a business is conducted through a trust, then its trustee should be a company;
11. 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;
12. There are taxation concessions when a superannuation fund invests in a unit trust (subject to certain restrictions).

NOTE: the above information is meant as a general guide only, and the information applies to Superannuation Funds provided by InvestorOne.