SMSFAdviser

Unit trusts can benefit SMSFs; but care needs to be taken

By Keeli Cambourne, Deputy Editor, SMSF Adviser and Matthew Burgess, Director, View Legal

A unit trust is often an attractive investment vehicle for SMSFs as it can offer many similar benefits to a corporate structure, but there are issues of which trustees need to be made aware, says a legal specialist.

Matthew Burgess, director of View Legal, said unit trusts have several benefits available to companies including access to the general CGT 50 per cent discount or 33 per cent for unit trusts where units are owned by SMSFs, as well as the ability to issue units with different rights to income and capital.

“They also have no requirements for formal disclosure to ASIC and other regulatory bodies and ensure asset protection risks are isolated from other assets with no requirements for a formal audit,” he said.

“There are, however, a range of issues that need to be managed, including the non-arm’s length income rules that may mean that if the unit trust is not ‘fixed’ any income derived by the SMSF will be taxed at penalty rates.”

Burgess said unit trusts are often viewed as the preferred structure for holding capital-appreciating assets where unrelated third-party investors and traditional unit trusts provide that the beneficial interest in the trust property is held in proportion to the units held by each unitholder.

“However, it is important to understand that under the Tax Act, a unit trust may be deemed for tax purposes to be a ‘public trading trust,” he said.

He explained that where a unit trust is deemed a public trading trust, the trust is taxed as if it were a company, and all of the tax advantages outlined above will effectively be lost.

“For example, the trust’s income regardless of whether it is distributed or not is taxed at the corporate tax rate, and more specifically, capital gains are taxed at the corporate tax rate, with no access to the general CGT discount,” he said.

“Additionally, there may be insufficient franking credits for intended distributions due to things such as depreciation rules. Furthermore, if the trustee of the trust is unaware that it is a public trading trust, it may be held that all distributions are unfranked dividends causing significant excess tax to be paid.”

Burgess added there would be a timing delay for the unitholder in receipt of income, as the tax paid by the unit trust is refundable via a franking credit when the unitholder ultimately lodges its tax return.

“Historically, a unit trust could be deemed to be a public trading trust where one or more SMSFs held a right to 20 per cent or more of the income or capital of the trust and a number of other technical rules were satisfied,” he said.

“However, changes in 2016 removed the 20 per cent tracing rule for public trading trusts for SMSFs which means a unit trust where units are owned via one or more SMSFs should never be taxed as a company.”

He concluded the preferred outcome is unit trusts owned by SMSFs that avoid being treated as a company for tax purposes.