UNIT TRUSTS

Definition of a Unit Trust

A unit trust is a distinct type of trust which apportions the beneficial ownership of the trust property in specific units. A unit trust in effect has features of both a company and a discretionary trust. Even though a unit trust is a trust, unlike a discretionary trust, the trust property in a unit trust is held absolutely for the unit holders meaning a trustee does not have the discretion to allocate capital and income to unit holders (unless the units are of different classes).

Similar to a company, unit holders subscribe for units in the trust. However, unlike a company whose income is taxed at the company level with franked distributions to the shareholders, a unit trust income 'flows' to and is taxed in the hands of the unit holders.
In the case of a company, the shareholders generally hold no personal interest in the trust assets but unitholders have an interest in the underlying property.

The parties involved

<u>The trustee(s)</u>

The trustee is usually given substantial powers under a unit trust deed. The trustee is the legal owner of the assets and is responsible for the management of the trust fund.
The trust transactions are carried out using the name of the trustee who signs all of the trust documents in their capacity as trustee. This means they are liable and accountable for their actions which generally should be pursuant to the terms set out in the trust deed.
A trustee can be a person or a company although it is recommended that a company be a trustee.

<u>The beneficiaries (unit holders)</u>

The unit holders are the people or entities who the trustee holds the property absolutely for the benefit of. This means they have an immediate interest in the underlying trust property in proportion to their unitholding.

How to establish a Unit Trust

Like a 'normal' trust, a settlor establishes the unit trust. The terms of the unit trust are recorded in a trust deed. The initial unit holders (subscribers) subscribe for units, paying a set amount to the trustee for the number of units they hold. These units can be partly or fully paid but in most cases, the unit holders have equal rights under the trust deed.

Major advantages of a unit trust

- A unit trust clearly sets out the rights of the different parties;
- Units under a unit trust are easily transferrable;
- The trustee can re-acquire units;
- There is less regulation to a unit trust than a company;
- It may be simpler to wind up a unit trust than a company;
- There may be taxation advantages to using a unit trust for specific projects or purposes; and

2/128 Centre Dandenong Road, Dingley VIC 3172
PO Box 250, DINGLEY VIC 3172
Ausdoc: DX 33401 Dingley

TELEPHONE: 03 8555 3895 **FACSIMILE**: 03 8555 3865

LYTTLETONS LAWYERS PTY LTD
ABN: 88 163 725 077

- A unit trust can be modified to suit the needs of the beneficiaries and trustee (s).

Major disadvantages of a unit trust

- Unit trusts do not offer the same degree of protection as discretionary trusts especially for asset protection as the units are treated as a person's assets meaning they are available to creditors;
- A discretionary trust can make tax free distributions more easily than a unit trust.
- A discretionary trust can 'stream' income in certain circumstances unlike a unit trust;
- Unlike a company, unit holders, although they have an absolute interest in the assets of the unit trust, cannot generally secure or borrow against the assets of the unit trust; and
- Unlike a company, the trustee cannot generally incur or borrow personal debts against assets of the unit trust (unless the debt is for the purpose of the unit trust).

Legal advice

We recommend that you seek legal and tax advice before setting up a unit trust deed. If you are a potential unit holder or trustee and you are considering making a unit trust, Lyttletons Lawyers can assist with formulating a trust deed for your specific needs.

Krystina Guo
Pranesh Lal
LYTTLETONS LAWYERS