Explanatory Notes

Unit Trusts

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General Outline

Unit trusts can be confusing and complex, especially if you are using them for the first time.

To assist you, we have prepared these notes on the nature and operation of our unit trust. If you are uncertain of the nature of any of the Trustee's rights or obligations as to whether a particular transaction may lawfully be entered into by the Trustee, you should immediately obtain professional advice as decisions made or discretions exercised by the Trustee may have significant tax and other consequences.

In any event, we recommend that you read the contents of the Unit Trust Deed carefully and discuss it with your adviser.

Nature of the Trust

A Unit Trust is an equitable obligation binding a person or company (a "Trustee") to deal with property over which he has control ("Trust Property") for the benefit of named beneficiaries or classes of beneficiaries ("Unit Holders").

The key feature of a trust is that it creates an obligation. This obligation requires the Trustee to exercise control over the Trust Property for the benefit of the Unit Holders.

A Unit Trust is a trust in which the beneficial ownership of the Trust Property is divided into a number of Units. A Unit Trust is governed by the same general principles as for discretionary trusts, that is, there must be property vested in the Trustee for the benefit of beneficiaries.

In contrast to a discretionary trust, the Trust Property is held upon trust for the Unit Holders at the relevant time. The Trustee does not normally have a discretion to determine or distribute capital or income among the Unit Holders, unless Units are of different classes with different rights attached to each class. Unit Trusts are for this reason often called fixed trusts. However, this should not be confused with the expression "fixed trust" when used in relation to the tax treatment of a Unit Trust. Taxation laws use the term to mean something quite different. If you have any questions regarding the distinction please seek professional advice.

A feature of Units Trusts is that they permit the association of a number of unrelated entities in a venture without incurring the disadvantages associated with high rates of combined company tax and shareholders being taxed on dividends.

The Unit Trust

The terms of the Unit Trust are contained in a trust deed executed by the Settlor and the Trustee. The Unit Trust Deed contains the following features:

- It is established by a Settlor. The Settlor is the person or entity who formally settles or creates the Unit Trust by the payment of a nominal sum to the Trustee which constitutes the initial Trust Property. Stamp duty may be payable in some jurisdictions on the creation of a trust and may be calculated by reference to the amount settled or at a flat rate. Stamp duty may also be payable for the issue, allotment or disposition of units in the Trust.

- The Trustee is authorised to expend money to make investments and to collect and receive all dividends, interest, rent and other income from the investments forming the Trust Property. The Trustee pays out of the gross income of the Trust all costs, disbursements, commissions, fees and taxes and other outgoings in respect of the investments and the administration of the Trust Property.

- The Trustee is required to pay, apply or set aside the net income of the Trust Property for each Accounting Period (ie. each financial year) to or for the benefit of the Unit Holders, in proportion to the number of Units of each class of which they are registered as Unit Holders.
- The Trustee may from time to time issue further units in the Unit Trust to persons who are not existing Unit Holders. However, before doing this, the Trustee must first offer the new Units to existing Unit Holders in accordance with the pre-emptive rights in the Trust Deed. The Unit Holders may however, waive this obligation by Ordinary Resolution.
- The Trustee may redeem Units from existing Unit Holders provided that it/he first complies with the restrictions imposed upon the transfer or redemption of units.
- Assets (including a business) may be sold to the Trustee (at an independent market valuation if the purchase is not at arm's length) and the purchase price may remain as a loan, free of interest and repayable on demand. Loans or gifts may also be made to the Trustee and the loan or gift moneys may be used by the Trustee to purchase assets that form part of the Trust Property.
- For legal reasons, the Unit Trust must terminate and does so on a date known as the "Vesting Day". The Vesting Day is the earlier of the date which is 80 years after the date of execution of the Trust Deed or 20 years after the death of the last survivor, now living, of the descendants of Queen Elizabeth II. The Unit Trust may also be wound up at an earlier date. There is a formal legal process that must be undertaken to do so.
- The Trust Property may be classified as either "income" or "capital" and may be split into a variety of categories to most effectively minimise the Trustee's and Unit Holders' tax liability.

The Settlor

The Settlor should be an independent person or entity who should not be either:

- a Unit Holder; or
- the Trustee.

The Settlor contributes a nominal sum to establish the Trust (this is generally $10.00). The payment of the settlement sum should be recorded in the books of the Trust, and be the first amount deposited into a new bank account established for the Trust. This amount should never be repaid to the Settlor.

The Trustee

The Trustee may be one or more individuals or companies. The benefit of using a corporate Trustee is that the liability of each shareholder is limited to the value of their own shares. The shareholders of the company may also be Unit Holders of the Trust.

Note, however, that the Trustee is liable for any debts or liabilities incurred in the course of carrying on the Trust. The Trustee has a right of indemnity from the Trust Property to recoup those liabilities.

The Trustee may also be a Unit Holder but cannot be the sole Unit Holder.

> Under Trust Law, if the Trustee and the Beneficiary are one and the same legal entity, the trust will terminate since the legal and the beneficial ownership of the Trust Property have merged.

The Trustee may be removed and/or replaced by the Unit Holders or may resign by notice to the Unit Holders. If you wish to replace the Trustee, a deed of appointment and retirement of the Trustee is required. We recommend that you contact us in those circumstances as this must be done in accordance with the terms of the Trust Deed. Failure to ensure that amendments such as this one are properly carried out may have significant adverse consequences.

> The powers and discretions conferred upon the Trustee are extensive. We recommend that you read these powers carefully. If you do not understand any of them, please seek professional advice.

The Beneficiaries or Unit Holders

Beneficiaries in the Unit Trust Deed are called Unit Holders. The Trustee may issue Units in different classes and may do so at a discount or issue them partly paid. Unless stated in the Trust Deed, all Units will be of the same class.

If you require different classes of Units to be issued with different rights attaching to each class, we recommend that you seek professional advice before doing so as this decision may affect not only the Unit Trust but also the rights of each of the other Unit Holders or class of Unit Holders.

The Trust Deed provides for the distribution of the capital and undistributed income of the Unit Trust to the Unit Holders upon the termination of the Unit Trust.

Unit Transfers

Units may be sold or transferred by a Unit Holder in accordance with the terms of the Trust Deed. A Unit Holder will receive from the Trustee a unit certificate with the number and class of Units in the Unit Trust with which that Unit Holder has been issued.

> Before selling or transferring any Units, it is important to keep in mind that these actions may have stamp duty and/or capital gains tax consequences. It is therefore, critical that you obtain professional advice before doing so.

Unit Issues

The Trust Deed confers a power upon the Trustee to issue, upon application, further Units to Unit Holders and to other Eligible Persons as additional Unit Holders. This must, however, be done in accordance with the pre-emptive rights provisions of the Trust Deed

> Before exercising this power, the Trustee should also seek legal advice particularly regarding any stamp duty and tax implications of that decision.

Corporate Unit Holders

It is also possible to nominate a company as a Unit Holder, taking advantage of the current lower rate of tax for companies. The use of a corporate Unit Holder is only generally beneficial where the company tax rate is lower than an individual's marginal rate of tax. A cash flow advantage may also result from distributions to a company, as the timing of collection of estimated tax in advance of final assessment is significantly later for companies than the provisional tax instalment system for individuals.

Distribution of Income

The Unit Trust income is paid, allocated or credited to Unit Holders in accordance with the rights attached to each class of Units and the proportion of Units held by each Unit Holder.

Distribution to Minors

Particular care must be taken when distributing Trust Income to Unit Holders or Discretionary Beneficiaries under the age of eighteen (18) years. We recommend that you seek professional advice regarding the tax rates imposed on minors.

Income Attribution

It is important to consider and, if appropriate, to provide for income attribution. The Unit Trust Deed has been prepared to allow income attribution provided there are multiple Unit classes contained within the deed.

Generally speaking, this means that the Trust Deed may provide that the income of the Unit Trust retains its character when it is distributed to those particular classes of Unit Holders.

The standard Trust Deed provides that the various types of income specified in the tax laws may be distributed separately from the balance of the income of the Unit Trust to certain classes of Units. In particular, income-streaming provisions are important in relation to interest income, dividend income and capital gains, and together mean enhanced flexibility when using a Unit Trust as opposed to other entities.

Dividends

With the introduction of dividend imputation, it is important to ensure that franked dividends are distributed to individuals who are best able to use the franking credits available. The Trust Deed allows you to establish a class or classes of Units which enable the benefit of franked dividends to be passed to the Unit Holders of that class of Units in the most flexible fashion.

Present Entitlement

Unit Holders are taxed on their share of the Trust income only to which they are presently entitled.

Personal Services Income

In using a Unit Trust to carry on a business, it is important that the income of that business is not derived solely from the personal exertion of one individual.

Should this be the case, the Commissioner of Taxation may not accept that the income correctly belongs to the Unit Trust, and may seek to assess the individual personally, negating any benefit in using a Unit Trust.

Superannuation

A trust creates, through the Trustee, an employer/employee relationship in the case of a trading concern. You should seek professional advice about the tax-deductible benefits of superannuation for employees (including working directors) based on employer contributions, as opposed to individual superannuation contributions.

Asset Protection and Limited Liability

Whilst the HYFU Trust is not a separate legal entity, it does hold a favourable legal position.

Assets held by the Trustee are held for the benefit of all the Unit Holders. The Unit Holders are incapable of charging the assets of the Unit Trust with their own debt. They may, however, seek to encumber their Units with the consent of other Unit Holders and the Trustee.

The Trustee should not incur debts and/or secure those debts against the assets of the Unit Trust except where the debts are incurred for the benefit of or for the purposes of the Unit Trust. Used correctly, assets can be isolated from the liabilities of the Unit Holders and, in many cases, the liabilities of the Trustee.

Distribution of Capital

The Trustee may distribute the whole or a part of the capital to the Unit Holders on or before the Vesting Day. In certain circumstances, distribution of capital can be made by redemption of Units by the Trustee for distributions of capital that are considered or deemed not to be taxable income. In these circumstances such a distribution can have potential tax implications for the cost base of the Unit for capital gains tax purposes.

> Before any such distribution is to be made you should professional seek advice.

Capital Gains

It is possible for special classes of Units to be classified to allow for the distribution of capital gains from the Unit Trust. It is important to consider whether there are to be special classes of Units entitled to receive distributions of this kind and whether the Unit Holders have capital losses that may be offset against capital gains. It is also important to consider the most tax effective distribution of the capital gain given the provisions of the *Income Tax Assessment Act 1997*. Again, you should seek professional advice in relation to those issues.

Losses Incurred by the Unit Trust

Losses (whether of an income or capital nature) incurred by the Unit Trust cannot be transferred or distributed to any of the Unit Holders. They are "quarantined" in the Unit Trust and may be carried forward and be offset against future gains. If the Unit Trust terminates before the losses can be offset, they are lost.

This differs significantly from a partnership, where the losses incurred by the partnership are distributed to each of the individual partners to be included in their personal income tax returns and offset against other assessable income.

Records and Accounts

A trust is not a taxable entity even though the Trustee must file a Return of Trust Income each year and, in certain circumstances, the Trustee may be liable to be assessed and to pay tax on the whole or part of the Trust Income in that representative capacity

All decisions of the Trustee should be recorded in minutes and the transactions recorded in the books of account of the Unit Trust. The Trustee owes a duty to account to the Unit Holders.

> The Trustee must ensure that it does not mix it's own monies or monies not associated with the Trust with trust funds whether on the books of account of the Unit Trust or in the bank accounts that have been set up by the Trustee for the regulation of Trust funds.

If the Trustee is a company, we recommend that the corporate Trustee’s sole activity be to act as Trustee for the Unit Trust. However, if the Trustee carries on more than one function, the distinction between the Trustee acting in its capacity as trustee as opposed to its acting on its own behalf must always be maintained. Separate books of account should be kept for the Unit Trust and the company and its bank accounts should indicate the capacity in which the Trustee is acting, eg. the account should be styled "X Pty Ltd as trustee for the X Unit Trust" in the case of the Unit Trust (although this is not legally required).

It is not necessary for the accounts of the Unit Trust to be audited. Where a company is the Trustee, its annual accounts and reports will reveal this fact and show the assets and liabilities of the Trust. The accounts of the Trust should indicate whether or not the assets of the Unit Trust are sufficient to meet the liabilities that the Trustee has incurred in that capacity.

Pre-Emptive Rights

The Unit Trust contains a series of restrictions imposed upon Unit Holders, preventing them from selling or transferring any Units in the Unit Trust to a person who is not an existing Unit Holder, without first offering those Units to the existing Unit Holders in the same class. These rights conferred upon the existing Unit Holders are often referred to as pre-emptive rights.

The Unit Trust provides that any Unit Holder, who wishes to sell or transfer all or any of his Units, must give notice in writing to the Trustee. The Trustee is then appointed as his agent for the sale of the Units to one or more of the existing Unit Holders in the class at a price to be agreed upon, or failing agreement, to be determined by an independent person appointed by the Trustee.

After the price of the Units has been agreed upon or fixed, the Trustee then will give a notice to the other existing Unit Holders in the class, stating the number and price of the Units which are to be sold. The Trustee invites each of those existing Unit Holders to state in writing whether that Unit Holder is willing to purchase.

The Trustee then allocates the Units being sold to those Unit Holders who have expressed a willingness to purchase them in proportion as nearly as may be possible to the number of Units held by them prior to that sale.

Should no existing Unit Holders wish to acquire the Units then the seller may sell and transfer those units to any other Unit Holder in any other class and then to any Eligible Person for a price not less than the price offered to the existing Unit Holders.

> If you are using a corporate Trustee, the constitution of the corporate trustee should contain similar pre-emptive rights in relation to the shares in the corporate trustee, as those contained in the Trust deed in relation to the Ordinary Units.

This ensures that the control and decision making ability of the corporate Trustee is maintained in the same proportion as the unitholdings in the Unit Trust. If you have an existing company that you wish to act as Trustee of the Unit Trust, we recommend that you have the constitution examined to ensure that it is consistent with the pre-emptive rights contained in the Trust Deed.

Stamp Duty

Stamp duty may be assessed if there is a "re-settlement" of the Trust Property. A resettlement may occur in several circumstances. As this can have a significant financial impact, always seek professional assistance *before* making that decision.

If a Trust asset is transferred to a Unit Holder, the transfer may attract conveyance duty on the full unencumbered value of the asset transferred. In some cases, concessional rates of duty may apply. Legal advice should be sought in relation to those transactions *before* signing any documents of this nature.

Important Note

This publication is intended to convey general information only in relation to its subject matter. It is not intended nor should it be treated as legal advice by the reader. Any specific questions or issues should be directed to your accountant or qualified legal practitioner.

We do not provide legal, accounting, taxation, superannuation or investment advice or advice regarding stamp duty or other state or territory taxes nor in respect of any other matter.

Please note that superannuation laws and practice, taxation laws and practice, trust laws and stamp duty laws are continually changing and that significant fees, taxes, duties and penalties can be imposed when entering into arrangements of this type.

You must satisfy yourself that all documents comply with the relevant legislation and the law regarding arrangements of this type.
Advice should be obtained from qualified and licensed professionals before signing any documents.

We disclaim all liability for anything done or omitted to be done in respect of any documents supplied or arrangements entered into by you or your clients.