Centuria

# Guide to understanding tax deferred distributions from property trusts

This information is intended to be an information guide only. We recommend that you seek your own professional tax advice before concluding on the particular taxation treatment that may apply to you.

## What are tax deferred distributions?

Tax deferred distributions arise when a trust's cash distributions exceed its net taxable income for a particular income year. The reason for this difference is usually due to non-cash deductions or tax concessions available (for example, tax depreciation on plant and equipment) which reduce the net taxable income of the property trust.

## What are the potential benefits of tax deferred distributions?

Depending on your individual circumstances, tax deferred amounts from property trusts may provide several potential benefits for long-term investors who hold their investments on capital account, including:

- Tax deferred distributions are generally not taxed when received. Rather, they reduce the cost base of your units in the property trust. However, if the cost base of the units is reduced to nil, capital gains may arise to the extent of any excess tax deferred distributions.
- Tax deferred distributions are generally not taxed when received however tax can be payable only when the units in the trust are sold, redeemed or transferred (if rollover relief is not available). They should result in a reduced cost bases and, consequently, larger capital gains (or reduced capital losses).
- If you hold units in the property trust for at least 12 months you are entitled to discount capital gains treatment. This means that the income tax payable on the tax deferred distributions should effectively be reduced to the extent of your discount percentage (being 50% for individuals and trusts, and 33.33% for complying superannuation funds).
- For complying superannuation funds in the allocated pension phase, capital gains from the disposal or redemption of units in the property trust may be tax-free, even where those units were acquired in the accumulation phase and the capital gains have been increased by the cost base reductions from tax deferred distributions received in the accumulation phase. In such circumstances, tax deferred distributions can ultimately be tax-free.
- For foreign investors who are entitled to the non-resident capital gains tax (CGT) concession, tax deferred distributions are generally tax-free, even if the cost base in their units in the property trust has been reduced to nil.

## Example:

This example demonstrates the effect of tax deferred distributions for an Australian resident individual at the top marginal tax rate plus the standard Medicare levy (a total of 47%). The individual invests $100,000 in a property trust that pays 5% distributions per year over a 3-year period, qualifies for discount capital gains treatment, and has no capital losses. It is assumed that the units will be redeemed for $100,000 at the end of Year 3 to illustrate the impact of tax deferred distributions.

| | **Unlisted property fund (no tax deferred component)** | **Unlisted property fund (100% tax deferred component)** |
|---|---:|---:|
| **Year 1** | | |
| Distribution received | $5,000.00 | $5,000.00 |
| Tax deferred component | $0.00 | $5,000.00 |
| Less: Income tax (47%) | -$2,350.00 | $0.00 |
| Total after tax return | $2,650.00 | $5,000.00 |
| **Year 2** | | |
| Distribution received | $5,000.00 | $5,000.00 |
| Tax deferred component | $0.00 | $5,000.00 |
| Less: Income tax (47%) | -$2,350.00 | $0.00 |
| Total after tax return | $2,650.00 | $5,000.00 |
| **Year 3** | | |
| Distribution received | $5,000.00 | $5,000.00 |
| Tax deferred component | $0.00 | $5,000.00 |
| Less: Income tax (47%) | -$2,350.00 | $0.00 |
| Total after tax return | $2,650.00 | $5,000.00 |
| Total investment period | | |
| Total distributions received | $15,000.00 | $15,000.00 |
| Total tax deferred components received | $0.00 | $15,000.00 |
| Less: Total income tax | -$7,050.00 | $0.00 |
| CGT* | Nil | -$3,525.00 |
| **Total after tax return** | **$7,950.00** | **$11,475.00** |
| **Tax saved** | | **$3,525.00** |

* The tax deferred distributions would have reduced the investor's cost base in the units by $15,000 (3 x tax deferred distributions of $5,000), thereby giving rise to a capital gain of $15,000 upon disposal of the units. As the investor is on the top marginal tax rate and is eligible for a 50% discounted capital gains treatment, this will give rise to a CGT liability of $3,525 (being $15,000 x 50% x 47%).

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