Centuria

Guide to understanding tax deferred distributions from property trusts

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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?

- 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, they will reduce the cost base of the units and consequently result in larger capital gains (or reduced capital losses) on disposal of the units.

What are the impacts of the proposed 2026-2027 budget changes on the tax deferred distributions?

- Subject to the proposed capital gains tax (**CGT**) changes announced in the 2026/27 Australian Federal Budget being enacted as law, if you hold units in a property trust for at least 12 months, you are entitled to discount capital gains treatment for gains accrued up until 30 June 2027 (**pre-1 July 2027 gains**) while cost base indexation will apply for gains accruing from this point (**post-1 July 2027 gains**).
- Tax deferred distributions made to you before 1 July 2027 will reduce the cost base used to calculate your pre-1 July 2027 gains, while tax deferred distributions made to you after this date will reduce your 'deemed cost base' at 1 July 2027 before indexation.
- Australian superannuation funds do not appear to be impacted by the proposed CGT changes, and their 1/3 CGT discount should continue to apply to the gains made over the duration of their ownership of the units.
- Foreign investors currently do not receive the benefit of the CGT discount and therefore should be largely unaffected by these changes.
- The proposed CGT changes may increase the effective tax payable on capital gains, particularly through the introduction of a minimum tax rate and reduced access to CGT discounts. Tax deferred distributions continue to provide meaningful benefits for investors, as the deferral of tax creates an opportunity for investors to reinvest a greater proportion of their distributions over time, which may enhance compounding returns. This benefit remains relevant even under the proposed changes to the CGT regime.

While the proposed Budget changes may reduce the concessional treatment of capital gains (including limiting CGT discounts or introducing a higher effective tax rate), tax deferred distributions can still deliver a meaningful benefit by allowing investors to defer tax until a realisation event. This deferral enables investors to retain and reinvest cash that would otherwise be paid as annual income tax, enhancing compounding returns over time through the "time value of money," as a greater proportion of capital remains invested for longer.

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 (47%). The individual invests $100,000 in a property unit trust that pays 5% distributions per year over a 3-year period and qualifies for discount capital gains treatment. The example assumes no increase in capital value of the units.

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

*The tax deferred distributions reduce 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 units. As the investor is taxed at 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%).

**Under the proposed CGT changes, the gain (ignoring indexation to cost base for the purpose of this example) arising as a result of the reduced cost base attributable to tax deferred distributions is taxed at the full marginal tax rate of 47%, resulting in a CGT liability of $7,050 (being $15,000 x 47%).

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