Negative gearing trusts

Uses and strategy

Key points

- Individuals generally cannot claim a deduction for interest incurred to acquire assets held by discretionary trusts
- Our negative gearing trust is specifically drafted:
  - so that an asset can be held in a trust for greater asset protection
  - to allow an individual to claim a deduction for interest incurred on a bank loan used to acquire the asset (even though it is held by a trust)
  - to provide flexibility in relation to distributions of surplus income and capital

Why use a negative gearing trust?

1. A negative gearing trust is intended to assist high-risk and high-income earning clients who want to claim negative gearing deductions on investment loans in their own name, while protecting the asset or investments from potential claims against the individual.

Negative gearing trust strategy

2. The structure is illustrated in the diagram below and involves the following steps:

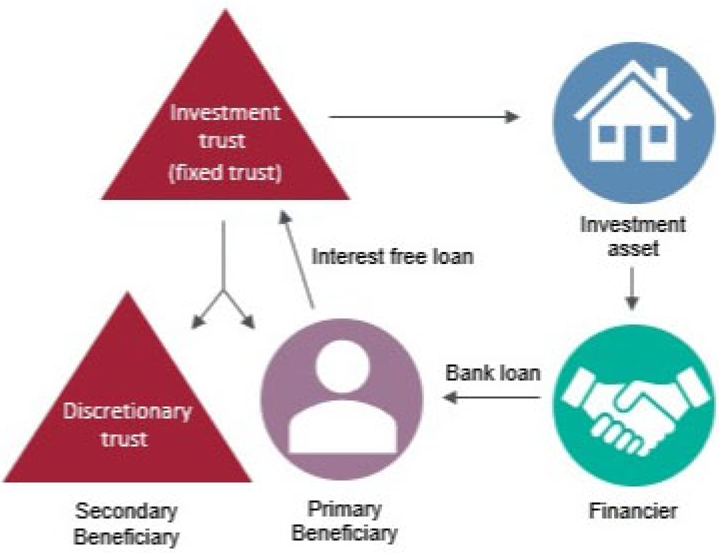
   (a) Primary beneficiary borrows from the bank.

   (b) Primary beneficiary uses borrowed funds to make interest free loan to the investment trust (stakeholder loan).

   (c) Trust uses the funds to buy an investment asset.

   (d) Trust does not have to pay interest on the stakeholder loan but, while any part of that loan remains outstanding, the trustee must distribute to the primary beneficiary an amount equal to trust net income in each year or the interest paid on the bank loan (whichever is less).

   (e) If the net income in any year does not cover the interest (which will be the case in early years) the shortfall is added to the minimum distribution amount required in the subsequent year(s).



3. The ATO have ruled that the primary beneficiary in an arrangement that was substantially the same as in this example can claim tax deductions for interest on the bank loan (Private Binding Ruling No.1012502598156).

4. The way in which the trust deed is structured means the primary beneficiary has a fixed interest in the trust income, which has practical implications because the ATO appear to automatically question claims for interest where money is on lent to discretionary or hybrid trusts.

5. There are a number of advantages in this including:

   (a) The primary beneficiary can claim the interest deductions in their personal tax return.

   (b) As the asset is acquired in a trust, it is substantially protected from any claims against the primary beneficiary.

   (c) Any capital gains that are made can be distributed to a wide class of beneficiaries and do not have to be included in the assessable income of the primary beneficiary who makes the stakeholder loan – provided they have recouped all the interest paid to the bank.

   (d) Because the net income of the trust will be significantly less than the interest payable to the bank in the early years (particularly if investing in real property with depreciation and building write- offs) the primary beneficiary will get a tax deduction for substantially all of the interest payable on the bank loan.

About us

6. Cooper Grace Ward has a team of experts that can provide straightforward, commercial advice that takes into account your unique circumstances and is tailored to your needs.

7. We can provide your business with a competitive advantage and help you achieve your financial goals sooner.

Further information

8. If you would like more information, please contact a member of our team.