Accounting/Bookkeeping for Trusts

What you need to know about record keeping for investment trusts, and what interest is tax deductable.

It is important to remember that a while a trust is not a separate legal entity; it is a separate entity for tax purposes and needs to be treated as such.

Generally only the entity that incurs an expense is entitled to a tax deduction for the expense, and for it to be deductible it must be in the course of earning assessable income for the entity. What does that mean; if you incur interest expense but do not have an expectation of earning assessable income (or for an investment in a trust an absolute entitlement to income) from the investment of the loaned funds you can not claim a tax deduction for the interest.

A little background for those who may have forgotten, a trust has four main participants;

1. The trustee, they have legal ownership of the trusts assets. The trustee can be either a company or individuals; all the assets are held in the trustees name.
2. Settlor, this is the person who creates the trust by giving over an asset/s to be held in trust for the beneficiaries. As the name implies the asset that the settlor puts in Trust is held by the trustee for the benefit of someone else other than the trustee or the settlor.
3. Appointer, this is the entity that has ultimate control of the trust as they have the power to appoint and remove the trustee.
4. Beneficiaries; receive the ultimate benefit of the assets held in trust. They are not the legal owners but they are the beneficial owners of the trusts assets.

Borrowing money to purchase an asset in a trust,

- **A discretionary trust:** the trust will be the entity that is entitled to claim the interest deduction on the loan. The loan should be in the trustees name "As Trustee for" the trust.

  If a third party (individuals, company or trust) takes out the loan and on lends it to the trust their must be an enforceable documented loan from that entity to the Trust, and the Trust must pay interest on the loan. The third party will then account for the interest income it receives from the Trust and is able to claim the interest expense in relation to the on lent loan. Generally the net effect to the third party is nil as the interest income and expense contra each other out.

- **A Unit Trust or Hybrid (negative gearing) Trust:** in this situation the Trust or the third party can claim the interest on borrowed funds. For the third party to claim the interest instead of the Trust, the third party borrows the money and uses the borrowed funds to purchase units in the Trust. The class of units purchased will entitle the third party to the income from specific asset/s owned by the Trust, such as a rental property to the exclusion of other classes of unitholders and other Trust beneficiaries. This give the unitholder both an expectation of receiving assessable income and an absolute right to the income.

  For this type of Trust to be effective all unit registers, unit certificates and documentation must be done correctly or the desired effect will be completely unwound.

A common case scenario, you have a Trust that borrowed money from a bank to purchase a rental property, the rental property expenses exceed the income from the property so you need to tip money in to pay expenses and make loan repayments. You draw money down from a personal line of credit account to tip in, **unless** there is a documented loan that is on a commercial basis between you and the Trust the interest on the money tipped into the trust is not tax deductible.

Record Keeping:

Each trust must have its own bank account, it should be in the name of the trustee “As Trustee for” the Trust. Any major purchases of the Trust should go through this bank account, along with all loan repayments where the trustee is the borrower. Only transactions relating to the trust should go through this account.

Where the only assets of a trust are rental properties and investments, in most cases it would be adequate to use the bank statements as your means of record keeping for the trust. The only other documentation that would be require are invoices, receipts, rental statements, purchase and sale contracts, etc. A petty cash account can be kept to account for small items the trustee has purchased on behalf of the trust, however where possible the Trust bank account should be used.

A properly maintained bank account where all expenses except for minor cash expenses are paid via electronic funds transfer, BPay or cheque is an easy way to record the Trusts expenses. All trust income should also go into the bank account to make it easy to keep an accurate record. All you are required to do then is write on the bank statement beside the income or expense what it is, where the transaction is not self explanatory.

e.g. 24/5/2012 Cheque 000234 .... 500.20

simply right beside the cheque what it is for, i.e. plumber repair sink.