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SMSF's Can Now Borrow!

As if the Simpler Super laws did not bring in enough exciting changes, the government recently enacted laws allowing a SMSF Trustee to borrow where it wants to acquire an asset. Importantly the borrowing possibilities are wide, the rules broad and with a good asset base in an SMSF the opportunities for leverage is significant.

There are a number of benefits for a SMSF using leverage in the fund. Of course, great care must be had to what happens in the event of a loss in value of any asset acquired under a borrowing arrangement. It is also crucial to get the paperwork and documentation right the first time around. If a mistake is made, it can result in serious financial penalties for the Trustee of the Fund and potential financial consequences for fund members.

In a major surprise the Superannuation Laws have changed to now allow a SMSF to borrow.

The Old Borrowing Laws

The previous borrowing restrictions prevented the Trustee of a superannuation fund from borrowing. Unfortunately, this section presented a major problem when the government began offering shares in Telstra to the public by way of an instalment offering.

In short, the way a Telstra instalment worked was that an investor, such as the Trustee of a SMSF paid an amount up front to acquire a share on Lay-By. The up front payment included an interest component with a final instalment amount to be paid for full ownership at some future date. Although there appeared to be an underlying borrowing, the ATO issued a SMSF ruling to the effect that in their view there was no borrowing. This allowed a Trustee of a SMSF to acquire Telstra and other instalment warrant products.

However, last year, things changed dramatically when the ATO reversed their prior rulings and issued a new ruling to the effect that there was an underlying borrowing embedded in an instalment warrant. As can be expected, the decision created turmoil in the instalment warrant market and following fierce lobbying the government introduced amending legislation.

Without a change in the laws, Trustees of SMSFs with Telstra instalment warrants could have been in trouble.



The New Borrowing Rules

The Superannuation Laws have now been amended to allow the Trustee of a SMSF to borrow in the following circumstances.

1. The borrowing is in the name of the SMSF Trustee.
2. The borrowing is to acquire an asset that the SMSF Trustee is allowed to acquire. For example, a SMSF can not acquire residential property from a member or their business, but their business premises would be suitable as would residential property from a non-related party.
3. The asset must be held by a separate Trustee ("the holding Trustee") under an arrangement where the Trustee of the SMSF makes an instalment payment into the trust to obtain beneficial ownership with further payments required to obtain full legal ownership. Any income such as dividends, rents or interest accrues for the benefit of the SMSF Trustee.
4. The borrowing is non-recourse and at the end of the loan period, provided all payments have been made to the lender, the holding Trustee will transfer full legal ownership of the asset to the Trustee of the SMSF.

The borrowing rules allow the Trustee of a SMSF to leverage its wealth for the benefit of future generations.

The Benefits of SMSF Borrowing

There are a number of important advantages to a SMSF putting in place the above structure:

1. It maximises the wealth effect in the SMSF in times when assets of the fund are rising.
2. The borrowing can be for a short period or for a period of up to 30 years allowing it to be structured to the underlying circumstances of the fund members.
3. Members and related businesses can act as lenders provided that all lending is at arm's length.
4. It increases the flow of non-contribution funds into the SMSF thereby circumventing the excess contributions tax rules.

Members and related business entities can act as lenders.

SMSF Borrowing Strategies

Here are some strategies that you may want to consider:

1. Member Financing – the member may wish to transfer a parcel of listed shares, managed funds or business property that they own into the fund by way of the borrowing rules. The member may act as the trustee of the borrowing trust as well as the lender. Over time the SMSF can make repayments which can then be contributed back into the fund by the member subject to the contribution rules.
2. Buying a big asset – borrowing lets the Trustee of a SMSF obtain leverage to acquire those assets that normally would be out of its reach. This may include farms, non-member owned residential property, business real property and property developments.
3. Contributing more assets into a SMSF – the contribution rules limit the dollar amount of contributions that may be contributed to a fund. However, as an investment in the SMSF borrowing arrangement is generally accounted for as net of liabilities, where the member has shares, business real property, managed fund or any other asset they are legally allowed to contribute to the fund – more can be achieved with SMSF borrowing.

Warning – Get Advice First!

As with all SMSF matters, great care must be taken to ensure that the borrowing strategy employed is legal, compliant with the superannuation laws and does what everyone expects. In addition, a review of what may happen in the event of the death or incapacity of the member – particularly where member financing is employed must be undertaken.

It is crucial to get the best SMSF advice when considering the borrowing rules.

For more information on any aspect of superannuation, please do not hesitate to contact Michelle Saunders on (08) 6311 6911 or Marissa Bechta on (08) 6311 6933

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