Self-managed superannuation funds and borrowing

So self managed superannuation funds can borrow? Well, it depends!!!

Opportunity

In 2007 the ***Superannuation Industry (supervision) Act 1993*** (SIS Act) was amended to allow self managed superannuation funds to borrow in certain circumstances.

The amendments were intended to allow a superannuation fund to invest in traditional instalment warrant products. However, it has a significantly wider application than what was originally intended. The changes give you the opportunity to establish a structure that will allow your fund to borrow to purchase residential and commercial property as well as shares and other permitted fund assets.

These rules were amended from 6 July 2010 to provide further clarification.

Strict rules

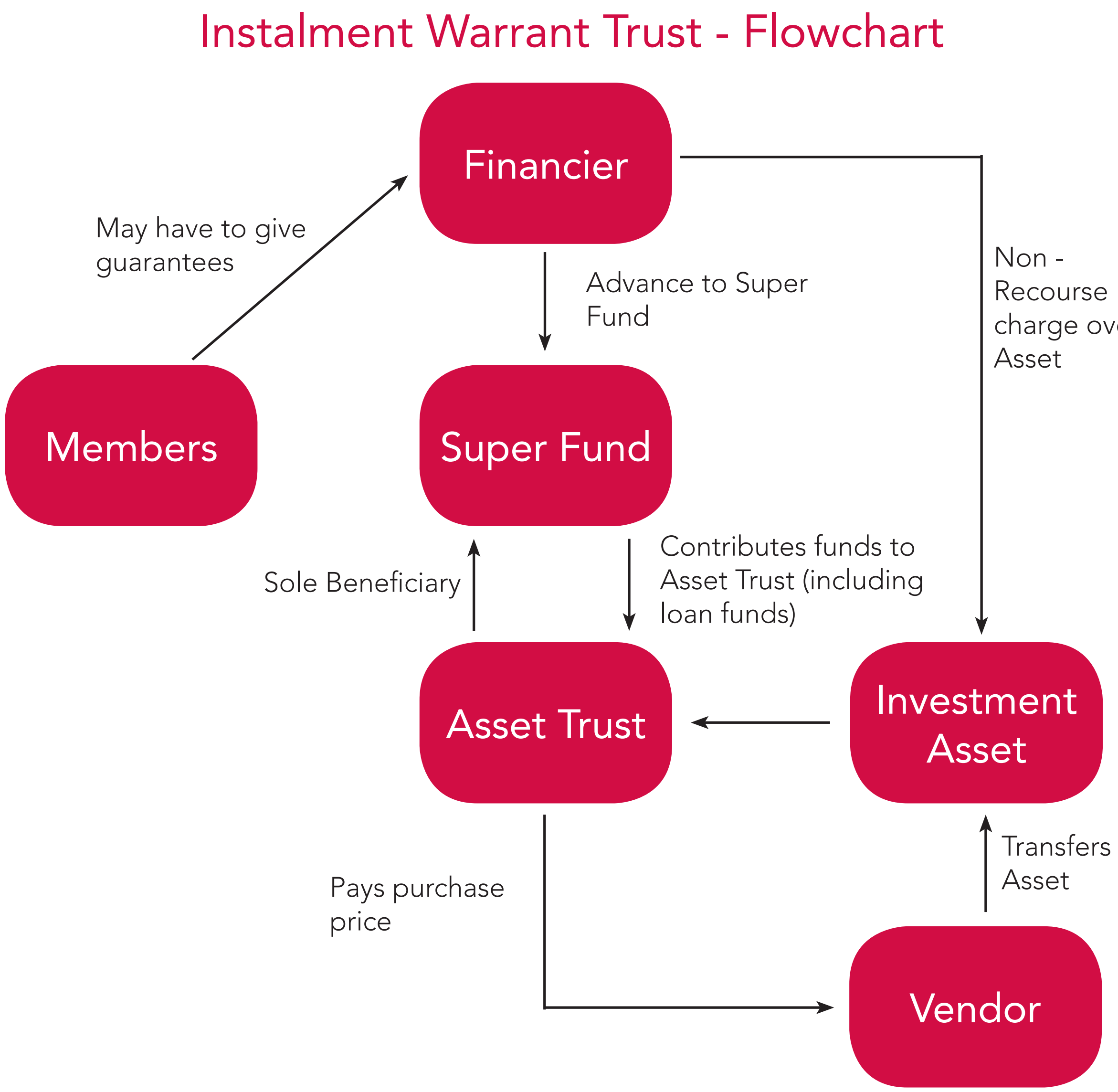
To do this, you must strictly adhere to the following:

1. the asset must be an asset the super fund can acquire;
2. the borrowings must be applied to acquire the asset and some limited associated costs;
3. the asset is held on trust (Asset Trust);
4. the trustee of the fund has a right to acquire legal ownership of the asset after making one or more payments;
5. the lender's rights are limited to the asset; and
6. the fund must be absolutely entitled to the asset.

The basic structure

Cooper Grace Ward has advised a number of clients (including financial institutions) on these transactions, and prepared documents to allow your super fund to borrow. The Asset Trust is a single asset, special purpose trust designed to comply with these borrowing rules.

The typical structure for these transactions is:



This diagram represents the basic flow of money for purchase of assets via a special purpose trust deed to use borrowings to fund the purchase of an asset through a superannuation fund. This flow chart may vary or require adding to depending on the circumstances of the client.

Frequently Asked Questions

You should discuss your personal circumstances with your financial advisors before borrowing in super. We have listed some frequently asked questions below that highlight some factors to take into account:

1. What can the super fund use the borrowed funds for?

   The borrowed funds can only be used to acquire an asset in the Asset Trust that the super fund is allowed to acquire.

   The borrowed funds can also be used to pay expenses:

   a. relating to the acquisition of the asset (eg. conveyance fees, stamp duty, loan fees etc); and

   b. to maintain or repair the asset (but not to improve the asset).

   However the borrowed funds cannot be used to:

   c. fund the construction of an asset; or

   d. develop or acquire an existing asset held by the fund.

2. Can I refinance the borrowing by my super fund?

   Yes. The amendments to the borrowing rules in July 2010 confirm that you can refinance a borrowing used to acquire an asset in the Asset Trust.

   It is also possible to refinance a borrowing by a super fund that was advanced before July 2010. However, the borrowing and the Asset Trust must comply with the amended borrowing rules (as at July 2010) at the time of the refinance.

3. Can the fund acquire more than one asset?

   It is only possible to acquire one asset in each Asset Trust.

   However, the rules allow you to acquire a 'collection of assets' in one Asset Trust if:

   a. they are identical; and

   b. have the same market value.

   An example of assets that would be allowable are 100 shares of the same type in a single company. However, a property on multiple titles will generally no longer be acceptable.

4. Can the fund borrow from a related party?

   A related party can lend to your super fund, however, the terms of the loan must be the same as those offered in the commercial marketplace. This means you must:

   a. have proper loan documentation; and

   b. register the mortgage.

   Also, the term, interest rate and amount of the loan must be commercially justifiable. We recommend you obtain evidence from independent financiers to ensure that you can justify the terms of the related party loan.

5. Can I provide a guarantee?

   Some lenders require guarantees from related parties when lending to a super fund.

   Cooper Grace Ward has always advised that related parties (including the members of the super fund) can give a guarantee provided the rights of the guarantor against the trustee of the fund are limited to the asset acquired by the Asset Trust. The amendments to the rules in July 2010 confirm this is correct.

6. Do I have to transfer the asset to the super fund when the borrowing is repaid?

   The ATO has indicated that once the loan is repaid, the asset must be transferred from the Asset Trust to the super fund. Cooper Grace Ward disagrees with this position.

   However, if the asset is transferred to the super fund:

   a. there should be no capital gains tax consequences as the trustee of the fund is absolutely entitled to the asset; and

   b. it is likely stamp duty will be payable on the transfer (in Queensland). However, we do prepare documents to provide an argument that no duty is payable.

Be cautious

1. You must not sign a contract to purchase an asset under these provisions until the Asset Trust has been established.
2. Your investment strategy will most likely need to be re-written to contemplate the borrowing and acquisition of the asset using this structure, and in particular, the risks associated with it.
3. It is important that the loan documents are checked carefully to ensure it complies with the borrowing rules. In the past we have found errors in the loan documents from some of the major banks and financial institutions that would affect the compliance of your super fund.

Alternatives

It is also important to discuss the alternatives as another option may be more appropriate for your circumstances. The other options include:

1. two unrelated parties investing in a unit trust (uncontrolled unit trust) equally and the unit trust borrowing to acquire the property;
2. the trustee of the fund and a related party acquiring a property as tenants in common; and
3. using your pre-'99 unit trust to acquire a property.

Our work

For a standard fee, we perform the following work to establish this structure:

1. review the trustee for your superannuation fund to ensure that it has the necessary power to enter into the structure;
2. establish the Asset Trust;
3. provide other necessary documentation to comply with the SIS Act;
4. prepare loan documentation if you are borrowing from a related entity; and
5. provide an advice in relation to the structure's compliance with the SIS Act.

It is our preference, and that of the majority of financial institutions, that a company with no other activities be established to be the trustee of the Asset Trust.

From our experience, it is often necessary to:

- Amend the trust deed for your superannuation fund to allow the investment in this structure. The Cooper Grace Ward Trust Deed allows the Fund to invest in this structure (but banks sometimes have special requirements).
- Change the trustee of the Fund to a corporate trustee. This is required by most financial institutions.

We can also assist in helping you with these issues. Also, if you don't already have a self managed superannuation fund, we can assist with establishing one for you.

Assistance

If you have any further questions in relation to this structure or other possible structuring options regarding your superannuation fund, please contact the following members of our team:

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