

Self-managed superannuation funds and borrowing

Key points

- Self-managed superannuation funds can only borrow in limited circumstances
- The rules regarding self-managed superannuation fund borrowings are complex and there are many issues to consider
- Care must be taken when setting up and maintaining this type of arrangement

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

Opportunity

1. In 2007 the *Superannuation Industry (Supervision) Act 1993* (SIS Act) was amended to allow self-managed superannuation funds to borrow in certain circumstances.
2. The amendments were intended to allow a superannuation fund to invest in traditional instalment warrant products. However, they have 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 in order to purchase residential and commercial property as well as shares and other permitted fund assets.
3. The ATO has clarified their interpretation of the rules in SMSFR 2012/1.

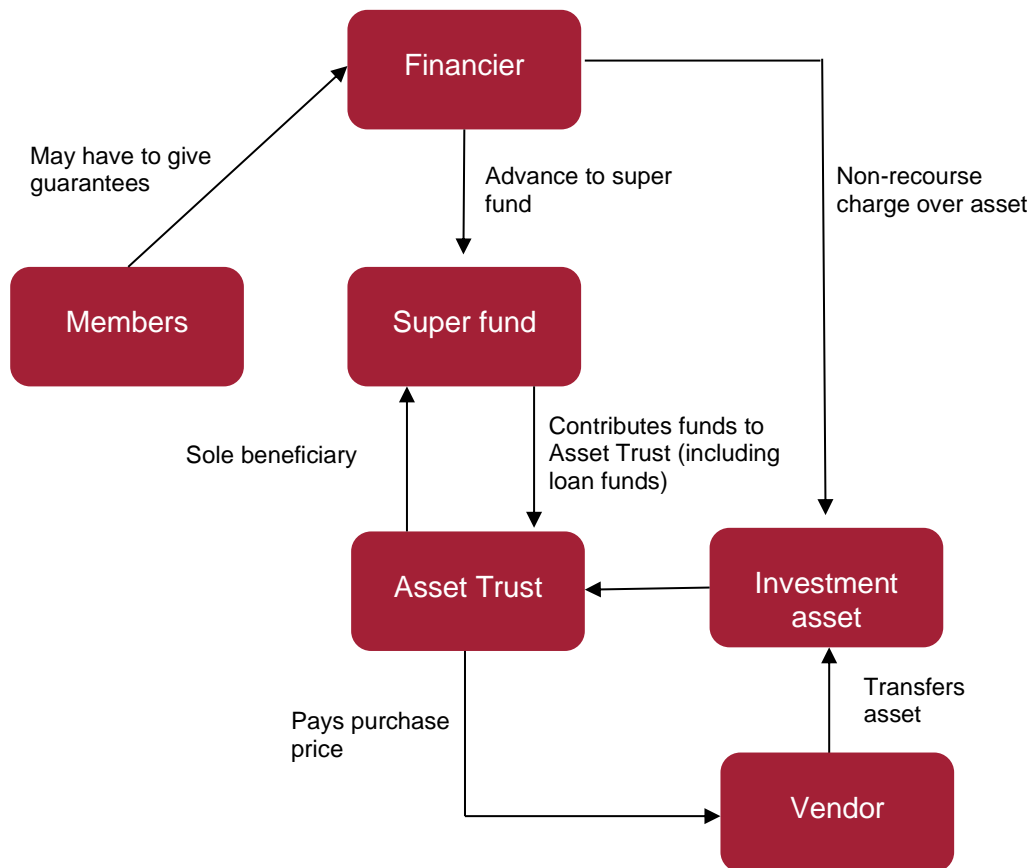
Strict rules

4. Superannuation fund borrowing arrangements must strictly adhere to the following:
 - (a) The asset must be one the super fund can acquire.
 - (b) The borrowings must be applied to acquire the asset and some limited associated costs.
 - (c) The asset must be held on trust (Asset Trust).
 - (d) The trustee of the fund must have a right to acquire legal ownership of the asset after making one or more payments.
 - (e) The lender's rights must be limited to the asset.

The basic structure

5. Cooper Grace Ward has advised numerous clients (including financial institutions) on these transactions, and prepared documents that allow super funds to borrow. The Asset Trust is a single asset, special purpose trust designed to comply with these borrowing rules.
6. The typical structure for these transactions is outlined in the following flowchart:

Instalment Warrant Trust - flowchart



7. 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

8. 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:

What can the super fund use the borrowed funds for?

9. The borrowed funds can only be used to acquire an asset in the Asset Trust that the super fund could acquire in its own name.
10. The borrowed funds can also be used to pay expenses:
- (a) relating to the acquisition of the asset (e.g. conveyance fees, stamp duty, loan fees etc.); and
 - (b) to maintain or repair the asset (but not to improve the asset).
11. However, the borrowed funds cannot be used to:
- (a) fund the construction of an asset; or
 - (b) develop or acquire an existing asset held by the fund.

Can I refinance the borrowing by my super fund?

12. Yes. However, care must be taken to ensure any refinance complies with the rules.

Can the fund acquire more than one asset in a single Asset Trust?

13. No. It is generally only possible to acquire one asset in each Asset Trust.
14. However, there are some limited exceptions. 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.
15. An example of assets that would be allowable are 100 shares of the same type in a single company.
16. One property on multiple titles is generally not considered one asset for these purposes. However, the ATO accepts in SMSFR 2012/1 that one asset can include multiple titles with one building across all of them (subject to a few requirements), or multiple titles that must be sold together by law (for example a strata lot and its separately titled car park). Care must be taken when looking at multiple lots to ensure they will constitute one asset.
17. If you want to have your super fund borrow to buy more than one asset in other situations, you will generally have to establish separate Asset Trusts for each asset.

Can the fund borrow from a related party?

18. A related party can lend to your super fund, however, the terms of the loan must be the same as those available in an arm's length dealing (what would be offered in the commercial marketplace). This means the term, interest rate, repayment requirements, security and amount of the loan should be commercially justifiable, and you should:
 - (a) have proper loan documentation; and
 - (b) register the mortgage.
19. In Practical Compliance Guideline 2016/5, the ATO provides guide loan terms that can be used for related party loans (safe harbour terms). If the related party loan is not consistent with the safe harbour terms, you will need to establish that the loan is consistent with an arm's length loan. In this case, we recommend you obtain evidence from independent financiers to ensure that you can justify the terms of the related party loan. Failure to do so could result in tax and compliance issues.

Can I provide a guarantee?

20. Some lenders require guarantees from related parties when lending to a super fund.
21. 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.

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

22. The Self Managed Superannuation Funds (Limited Recourse Borrowing Arrangements - In-house Asset Exclusion) Determination 2014 confirms the asset can remain in the Asset Trust, even when the loan is repaid. However, if the asset remains in the Asset Trust, there are still some limitations (for example, you cannot develop the property without first transferring it to the trustee of the super fund).

Be cautious

23. In most states, you must not sign a contract to purchase an asset under these provisions until the Asset Trust has been established.
24. 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.
25. It is important that the loan documents are checked carefully to ensure they comply with the borrowing rules.

Alternatives

26. It is also important to discuss the alternatives as another option may be more appropriate for your circumstances. The other options include:
- (a) two unrelated parties investing in a unit trust (uncontrolled unit trust) equally and the unit trust borrowing to acquire the property;
 - (b) the trustee of the fund and a related party acquiring a property as tenants in common; and
 - (c) using your pre-'99 unit trust to acquire a property.

Our work

27. We can:
- (a) review the trust deed for your superannuation fund to ensure it has the necessary power to enter into the structure;
 - (b) establish the Asset Trust;
 - (c) provide other necessary documentation to comply with the SIS Act;
 - (d) review purchase contracts and other documents to ensure compliance with the SIS Act;
 - (e) prepare loan documentation if you are borrowing from a related entity; and
 - (f) provide an advice in relation to the structure's compliance with the SIS Act.
28. Our fees will be tailored to your individual circumstances and we can provide you with an estimate for the work.
29. It is our preference, and that of the majority of financial institutions, that a company with no other activities is established to be the trustee of the Asset Trust.
30. From our experience, it is sometimes necessary to amend the trust deed for the superannuation fund to allow the trustee to borrow. The Cooper Grace Ward trust deed allows the Fund to borrow and acquire assets in an Asset Trust (but banks sometimes have special requirements).
31. We can assist with appointing a corporate trustee and any necessary amendments to the trust deed. Also, if you don't already have a self-managed superannuation fund, we can assist with establishing one for you.

Assistance

32. If you have any further questions in relation to this structure or other possible structuring options regarding your superannuation fund, please contact us.

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