



## BORROWING IN SMSF | FINANCIAL PLANNING

### BORROWING TO INVEST IN SMSF

Also referred to as Instalment Warrants

### GREAT WAY TO BUILD RETIREMENT SAVINGS

Way to build retirement savings with SMSF

**Self Managed Superannuation Funds are allowed to borrow to invest in direct property or shares. This is known as Limited Recourse Borrowing.**

Section 67(4A) of the Superannuation Industry Supervision Act was amended in September 2007 allowing SMSF to borrow to acquire assets, subject to certain conditions being met, these being:

- The borrowing is limited recourse – the lenders only security is the asset GAP purchased (no personal guarantee permitted unless structured so that there is never any call on SMSF assets)
- The SMSF could ordinarily acquire the asset without borrowing; and
- A third party (security trustee) holds legal title to the asset on trust for the SMSF trustee. The SMSF trustee then has a beneficial interest and a right to call for a transfer of legal title when the loan is repaid and the mortgage discharged.

### What is a Limited Recourse Borrowing?

A Limited recourse borrowing is a financial instrument which enables a SMSF to purchase property or shares partly with borrowed money.

Typically the SMSF will contribute a sum of money to the purchase (called the 'first instalment' and arrange for a lender to contribute the balance (which is equal to the 'second instalment')

The SMSF then has a beneficial interest in that property or shares, and as a result will receive all rent paid by the tenants or dividends generated by the shares. Tax is payable on the income at the concessional rate of 15%.

The SMSF will pay all interest on the loan and fees to the lender. It would also pay all associated holding costs in respect to property investments.

### What are the options at the end of the term?

The Limited Recourse Borrowing will usually have defined maturity date (typically 1-20 years). At the end of the term the SMSF can:

- Pay the second instalment and acquire full ownership of the asset
- Sell the instalment warrant on a secondary market
- Roll over the warrant for another term
- Do nothing, in which case the asset will be sold and the proceeds applied to the outstanding loan amount, with any leftover going to the SMSF.

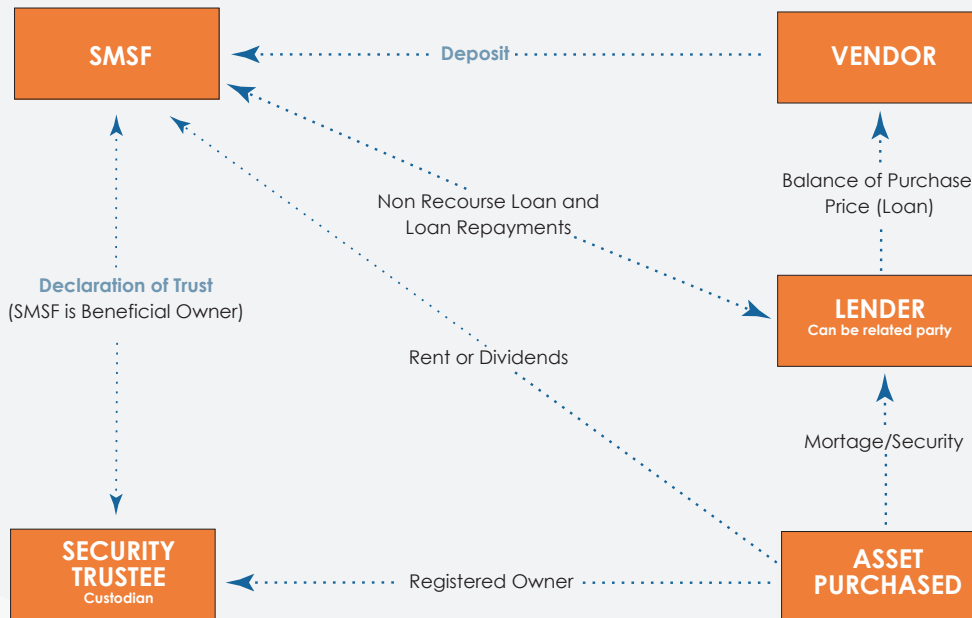
### Who should use limited recourse borrowing arrangements?

Ideally suits those members of SMSF's who meet the following criteria:

- Need to build their retirement savings sooner
- Want to hold a key property (i.e. business premises) inside the Concessional tax environment of superannuation.



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## SMSF Trustee Considerations

- The sole purpose test
- The investment strategy for the SMSF
- In house asset rules – will they apply
- Related party acquisitions – CANNOT acquire asset from related party unless Business Real Property or Direct Shares
- Cash flow – the fund must have sufficient cash flow to meet interest and holding costs.

## SMSF Trustee Requirements

- A SMSF Trustee borrowing funds on behalf of the SMSF must ensure that:
- The loan complies with the SIS Act, including
    - the lender's rights against the SMSF trustee for a default on the loan being limited to the underlying asset only
    - The fund has sufficient cash flow to repay the principal and interest (without relying on contributions)
  - The SMSF Deed allows the SMSF trustee to borrow and acquire the relevant asset;
  - A declaration of trust is executed between the security trustee and fund trustee; and
  - The structure of the transaction and the investment is signed off by the fund auditor as being compliant with the SIS Act.

## Documentation Required

- SMSF Deed Establishment/Upgrade
- Custodian Trust
- Loan Documentation (bank lending versus related party)
- Mortgage Documents
- Lease Documents

## Establishment Costs

- Stamp duty (property) and conveyancing
- Lender Fees
- Professional advice from your financial planner including a written statement of advice, along with advice from your accountant
- Legal advice, documentation (creation of trusts) and lending documents
- Insurance – personal and general
- Accounting and taxation advices (GST, Capital Gains Tax, Stamp Duty)

*Actual figures have not been included as each transaction will have varying levels of services required to fulfill requirements.*