

Borrowing Through an SMSF

How to do it?

Yes, SMSF's can now borrow to acquire certain assets. This permission is detailed in Section 67(A) of the Superannuation Industry Supervision Act (SIS). Basically, this sections says that the trustee of a super fund can borrow to acquire an asset providing that the asset is held on trust until such time as the borrowings are paid and that the only asset to be provided as security for the borrowing is the asset being purchased.

Some important things to consider when looking to purchase an asset are:

1. You can only purchase an asset that you would otherwise be allowed to purchase anyway. This means that the trustee must still comply with the sole purpose test and also the in house asset rules.
2. You must be borrowing to purchase an asset so you may not borrow against an asset you already own. Therefore you may not borrow to put a building on a block of land that you already own or to make improvements on an asset that you already own.
3. The preferred method for purchasing the asset is by using a bare trust. This is to ensure that when you finally pay for the asset and transfer it back to the name of the SMSF trustee you do not incur stamp duty, GST or capital gains tax.
4. It is possible for the clients to borrow in their own names and then on-lend that money to the SMSF. It is important in this situation that neither the client nor the SMSF makes a non-arms length financial gain from the transaction.
5. You should also make sure that the bare trust documents that you are going to use are acceptable to your lender. Some lenders may wish to use their own documents and others will accept documents prepared by other solicitors. You should also confirm the costs of these documents where the bank wants to use their own supplier.
6. Because the relationship between the SMSF trustee and the company holding the property is a bare trust there is no actual name given to the trust relationship.
7. the banks have shown that they will be very pedantic when it comes to names. If there are middle names on the title deed of a property but not on the SMSF trust deed the banks may ask for the documents to be re-drawn.
8. Conveyancing will now become an area that accountants will be inadvertently thrown in to. It is very important that the conveyancing be done correctly as small errors can cost your clients double or even triple stamp duty and the errors may not be picked up until you go to unwind the bare trust relationship. We suggest that your clients use solicitors who are conversant with these arrangements and not just property transfers.

The following process should be adopted by your clients if they wish to borrow to purchase a property in their SMSF:

1. The client should make an appointment to come and see their adviser about them wanting to borrow in their SMSF. It is important here that you, as an accountant, contact your clients and explain the importance of them coming to see you first. You don't want your clients hearing from their mate at the pub that they can borrow in their fund because you can be certain that the first you will hear is two days before settlement when they can't get their loan.
2. The trustees of the fund will need to prepare a new investment strategy to provide for borrowing to acquire a particular type of asset. The requirements of an investment strategy can be found at Section 52 of SIS.
3. The trustee should then seek a pre approval of a loan for a particular amount of money. It is important that the trustees know that they can borrow the money before they lock in to purchase a particular property. There have already been cases of trustee's exchanging contracts only to find out that they were not able to get a loan as lending criteria are different for SMSF's instalment loans. You should also confirm with the lender at this time whether they require a corporate trustee of the SMSF.
4. You will almost certainly need to prepare an update of the SMSF's rules. Lenders have very specific requirements for the wording of the borrowing and asset charging ability of the trustees of the SMSF's. A simple borrowing clause in your rules will usually not be accepted. Some lenders are also charging a fee for each reading of your trust deed so you will want to have it right the first time.
5. Once the trustee has a pre approval of a loan they can go about finding a property.
6. After they have found a property they need to set up their Security Trustee to hold the property on their behalf. This will need to be a separate entity to the trustees of the SMSF. The reason for this is that you can't hold an asset in trust for yourself and section 67(A) clearly requires the asset to be held on trust. Some lenders are also showing that they will only lend to a corporate security trustee and also only to SMSF's with corporate trustee's. You MUST ensure that the security trustee is set up BEFORE you enter into a contract to purchase the property as the Security Trustee will need to be the purchaser on the contract.
7. Once you have set up the Security Trustee you can formally apply for the loan and also set up your Security Deed and Instalment Deed. In addition to these documents and depending on your own state laws you may also need a Statutory Declaration by the SMSF trustees stating that they are the real purchaser of the property even though it is held by the Security Trustee. This is to assist in evidencing the real purchaser when you eventually want to transfer the property back after repayment of the instalment loan.
8. Contracts can now be exchanged with the purchaser of the property being the Security Trustee in trust for the SMSF Trustee as trustee of the SMSF. It is important that your conveyancing is done correctly having regard to stamping the Bare Trust documents. Poor conveyancing will lead to stamp duty concerns in the future if you have difficulty proving the real purchaser. You also need to ensure that the timing of the documents does not create a double conveyance of the property.

9. It is now just a case of settling the loan and the purchase. The asset is then shown as an asset of the SMSF. It is not an investment in a trust (where a bare trust is used). The bare trust deed can be used to provide evidence of ownership to the fund's auditor.
10. It is vitally important that all the bare trust documentation be correctly stamped according to your own state laws and that the documentation be stored safely. A loss of these documents will almost certainly mean that you will incur stamp duty when transferring the property back to the SMSF trustee.
11. The Bare Trustee need not apply for a TFN or ABN. All financial transactions are direct with the SMSF trustee. All rent is received direct into the account of the SMSF Trustee and all expenses are paid direct by the SMSF Trustee. The property is to be treated as a direct asset of the SMSF Trustee. The property is shown as an asset of the SMSF in the fund's accounts. It is not an investment in a trust that then holds the asset.

To establish your SMSF with a Corporate Trustee and to set up a Bare Trust arrangement, call David Garry on 1300 880 963

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