



Improve the borrowing capacity of **your super fund**



TOWNSENDS BUSINESS
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What do I need to know about

Borrowing by my self-managed super fund

A self managed super fund (SMSF) can borrow to buy an investment, but there are a lot of rules to follow and traps to avoid.

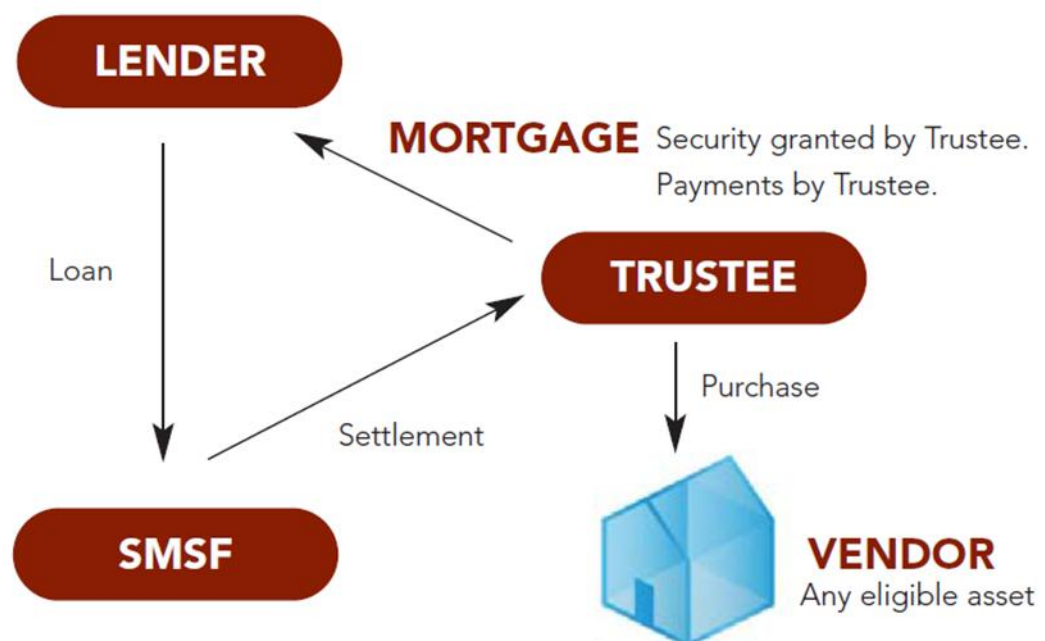
Borrowing can be a viable investment strategy for an SMSF. Loans to an SMSF:

- ✓ get around contribution limits
- ✓ magnify returns
- ✓ provide more superannuation for those who can't meet contribution eligibility rules
- ✓ are not caught by work tests
- ✓ are not subject to tax going in or out of the fund
- ✓ transfer value
- ✓ are not subject to preservation rules

Borrowing by an SMSF must meet the following criteria:

- the borrowing must be used to acquire an investment asset
- the asset must be held on trust for the fund by a holding trustee
- the fund must have the right to acquire the asset once the loan is repaid
- the lender's recourse must only be against the asset and not against any other fund asset
- the asset must be one that the SMSF would normally be permitted to acquire

The diagram below outlines the mechanics of the borrowing process:



The 15 Steps in a typical SMSF limited recourse borrowing

There are 15 steps in a typical borrowing transaction by an SMSF.

1. Determine (often with the help of the fund's accountant or financial planner) that borrowing would be an appropriate strategy to leverage investment.
2. Check the fund's trust deed to ensure the SMSF Trustee has power to borrow, grant security and allow an asset to be held by a holding trustee and, if not, then amend the trust deed.
3. Check the investment strategy to ensure it allows for the acquisition of the investment asset and permits borrowing for that purpose and, if not, amend the investment strategy.
4. Source the asset for purchase and ensure that the asset meets the definition of 'single acquirable asset' in the superannuation legislation. Negotiate the price and reach an agreement with the seller.
5. Source the loan funds and get in-principle loan approval from the lender.
6. Determine who is to be the holding trustee – if a new company, purchase the new company.
7. Arrange for the holding trustee to resolve in writing to hold the asset for the SMSF trustee.
8. Arrange for the SMSF trustee to resolve in writing to purchase the asset and to appoint the holding trustee to act for the SMSF trustee as trustee of the holding trust.
9. Arrange for the holding trustee (note: not the SMSF Trustee) to sign the purchase contract.
10. Ensure the SMSF trustee provides all the deposit money for the purchase directly from the SMSF's account.
11. Arrange for the holding trustee and the SMSF trustee to sign the holding trust deed. Signing of the holding trust deed must occur before exchange of contracts in Queensland and South Australia and after the exchange of contracts in NSW, Tasmania and the ACT. In Victoria and WA the holding trust deed can be signed before or after the exchange of contracts.
12. Arrange for the SMSF trustee to sign all loan documents with the lender.
13. Complete the purchase of the asset using only the SMSF's money and the loan by the lender.

14. Submit the holding trust deed to the stamp duty authority for payment of stamp duty.
15. When the loan is eventually repaid, transfer the asset from the Holding Trustee to the SMSF Trustee for nominal stamp duty, provided the holding trust deed was stamped previously.

8 Important points for limited recourse borrowing

1. The asset must be an asset which the SMSF is not prevented from acquiring by the laws relating to superannuation.
2. The asset must be acquired on commercial terms (ie arms length terms).
3. The asset cannot be acquired from a related party. (An exception applies to this rule if the asset is business real property or listed securities which can be acquired by the SMSF from a related party).
4. The asset, once acquired by the SMSF, cannot be used by the members of the SMSF (or their relatives or associates) even if they pay a commercial fee for their use of the asset. (An exception again applies if the asset is real estate and the use of the real estate by the member, relative or associate means that the asset qualifies as business real property.)
5. The acquisition of the asset must be consistent with the investment strategy of the SMSF and must be justified on its investment merits.
6. The asset must be used to generate income and or capital growth for the SMSF (subject of course to general market and economic conditions).
7. The asset cannot be redeveloped or improved. The asset can however be maintained and normal repairs undertaken.
8. The transaction to acquire the property must be properly undertaken, completely documented and all statutory requirements (including timely stamping of documents) satisfied.

These “Important points” are a brief summary of the more significant issues which must be borne in mind when an SMSF is considering entering into a limited recourse borrowing arrangement. The list is neither complete nor exhaustive. There may be limited exceptions which apply in particular situations.

The professional team at Townsends Business & Corporate Lawyers have dedicated themselves to understanding the intricate requirements of the gearing rules to assist accountants, and their SMSF clients.

To help the fund implement the borrowing in a way that is fully compliant with the law, our team can provide:

- sign-off confirming compliance with the law
- advice letter for clients explaining the process and the precise steps
- holding trust deed
- current superannuation deed review to ensure it is appropriate
- necessary investment strategy review and documentation
- loan agreement for related party loans
- mortgage documentation for related party loans
- SMSF trustee minutes
- holding trustee minutes
- stamp duty advice
- free help desk for implementation of the transaction

Townsend's Business & Corporate Lawyers offers 30 years extensive experience in providing legal assistance to the superannuation, estate planning and financial planning industries. The firm's Superannuation Division advises clients on all aspects of superannuation, including compliance and regulatory issues, deed amendment and modification, fund reconstruction and winding up, pensions, investment structures and investment strategy compliance, amongst others.

Disclaimer: The information in this document is general information only and cannot be relied upon as a substitute for professional advice. No action should be taken until (and we will not be liable to anyone unless) we have provided specific advice relevant to the particular circumstances.