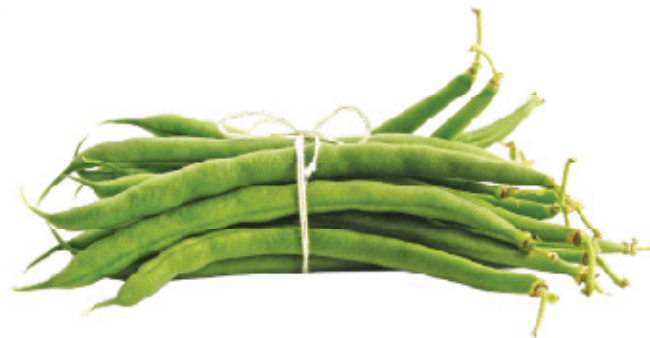


# Making the most of your SMSF “Borrowing”



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**Michael Garrone**

# Background

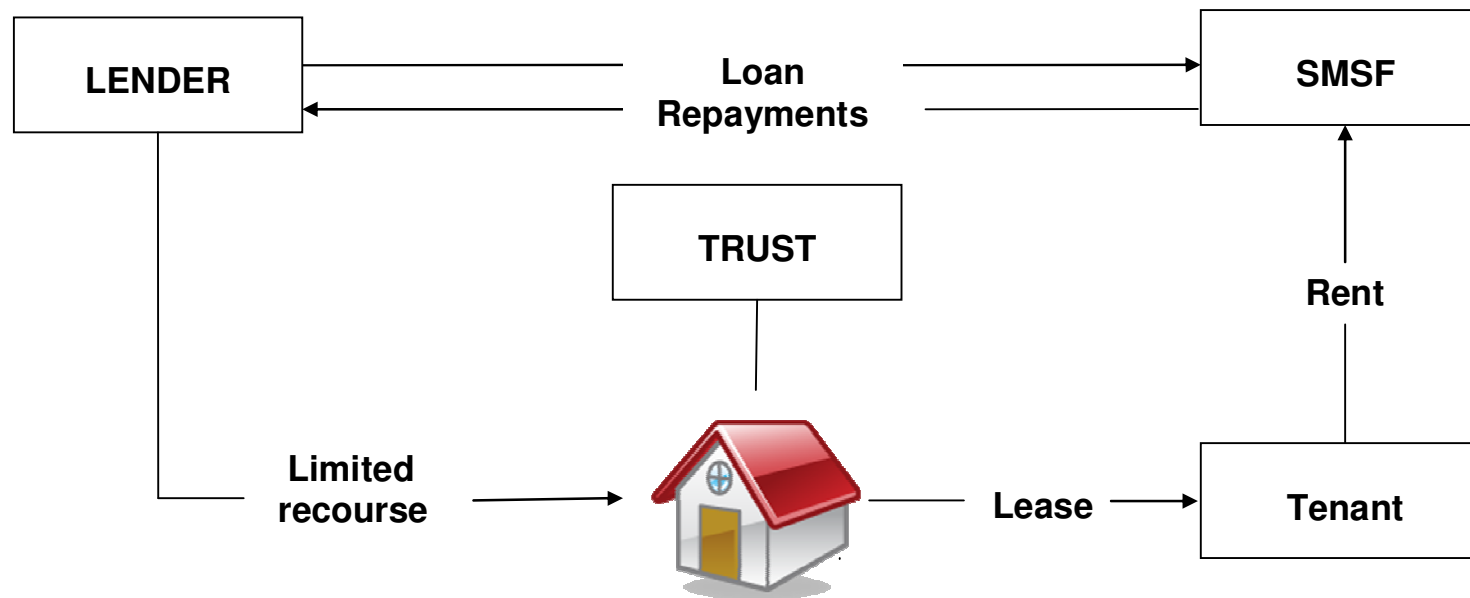
- How
- When
- Why

# Background

- Sep 2007 borrowing allowed - “Instalment Warrant Structure”
- Jul 2010 – “Limited Recourse Borrowing”
- Here to stay – ATO and Cooper review again in 2 yr’s)

# The Borrowing Structure

The basic borrowing structure is (detailed):



# Must haves

- > A SMSF – only for SMSF's
- > A Corporate Trustee for the SMSF
- > A Bare Trust
- > A Corporate Trustee for the bare trust (must not be a trustee for any other entity)
- > SMSF Deed must allow borrowing

**Be organised ! You cannot sign a contract before the SMSF and Bare trust are all set up.**

# How it works

- **Bare trust** contracts for or purchases the asset  
Eg, Property and Shares  
“Corporate Trustee P/L atf Bare Trust”
- **Settlement**  
SMSF pays instalment (eg, the deposit),  
SMSF gets loan from bank

# How it works

## ➤ **Loan**

Must be “limited recourse”

Security only over asset being purchased.

Personal guarantees - Yes

# How it works

## ➤ **Loan**

SMSF members cannot seek recourse from SMSF if guarantee called except to value of asset

Super fund's assets cannot be at risk

Is it that different to a normal loan

# How it works

- Accounting – SMSF accounts only
- Use SMSF ABN & TFN
- No stamp duty on transfer from Bare Trust to SMSF
- No CGT on transfer from Bare Trust to SMSF
- No GST on transfer from Bare Trust to SMSF

# What type of Assets?

- > **“Single asset”** – since Jul 2010
- > Most common asset will be property
- > Can only be over one title. ie. Cannot buy a 6 pack of units with strata titling.

# Common Questions???

- Cannot use an existing SMSF asset
- Use a related party asset – only if Business Real Property
- Cannot borrow against an asset when loan paid out
- Can refinance existing debt
- Can borrow to do repairs
- Cannot borrow to make improvements

# Common Questions???

- Cannot do a development
- Can buy a parcel of identical shares  
eg, 1000 BHP shares  
cannot dividend re-invest  
if sell one share must sell all shares

# Bank Lending Requirements

- All major banks – except CBA
  - Similar LVR's and servicing requirements
  - LVRs & Term
    - 60% - 70% Commercial, 10 – 15 yr's
    - 70% - 80% Residential, 25 – 30 yr's
  - > Specialty assets possible, eg, Farm, Child care centre
  - Personal guarantees are almost always required.
  - Interest only possible
- Super Fund must have a deposit available.**

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# What are the Tax Savings!

- Interest & holding costs deduction
- Income on asset
- Net Income – can use negative gearing loss
  - 15% tax
  - 0% pension phase > 55 or > 60
- > Capital gains
  - 10% tax
  - 0% pension phase

# Tax Treatment & Benefits

- Greater exposure to market, therefore get the advantage of higher returns within the super fund. (i.e. can grow your fund faster)
- Long term – more in super will last longer in retirement

# Tax Treatment & Benefits

- Example: SMSF \$1 million comm property  
Extra Net cash inflow after all costs \$100k to \$140k  
Tax saved on sale \$130k  
= \$165k to \$205k better off

## Main Assumptions:

1. Pension phase at sale after 10 yr's with min P&I payments
2. 5% pa capital growth & 50% LVR
3. 15% v 46.5% tax rates

# Tax Treatment & Benefits

- Example: SMSF \$500k rental property  
Extra Net cash outflow after all costs \$125k to \$150k  
Tax saved on sale \$75k  
= \$50k to \$75k worse off (gearing at 15% v 46.5%)

## Main Assumptions:

1. Pension phase at sale after 10 yr's with min P&I payments
2. 5% pa capital growth & 80% LVR
3. 15% v 46.5% tax rates

# Tax Treatment & Benefits

- Example: SMSF \$500k rental property
  1. Be Careful with over gearing
  2. 50% LVR would break even long term on sale
  3. But bad for cashflow for first 10 yr's
  4. But does not show benefit of more in super long term

# Disadvantages

- Gearing risk – potential to increase losses
- Not always the best structure from a tax perspective
- May be more tax effective to simply purchase a negative geared property outside of super
- Complex & Expensive
- Funds locked up in super
- Pension phase – No gearing benefit
- ATO, Government & Cooper review

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# SIS Compliance Issues

- Sole Purpose Test
- Investment Strategy –  
Diversification
- Related party acquisitions
- Related party tenants
- Breaches of lending rules

# Other Issues to Consider

## ➤ Cash flow of SMSF & Members

Member ages

Ability to contribute to super

Retirement plans

Diversification within SMSF

Contingency plans for loss of a tenant

Death – Insurance funding – if Deed allows

# Costs Involved

1. Bare Trust
  2. Corporate Trustee
  3. Bank review costs
  4. SMSF review costs – can it borrow
  5. SMSF corporate trustee
- 
- > \$8,000 to \$12,000 for a standard borrowing structure
  - > There must be a payoff to balance the costs!

# Who?

- > Those with equity outside super
- > Mid 40's to mid 50's
- > Businesses wanting to own bus property
- > Retirement strategy to boost super
- > Sell bus property into super tax free to boost savings?

# Other structures?

- > Non geared unit trusts – no borrowings
- > Unrelated Unit Trust – can borrow
- > Tenants in common

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Issues to consider  
*Pre-Investment*  
*Investment*  
*Risk Mitigation*

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- 🌐 Investment strategy
- 🌐 Diversification
- 🌐 Finance
- 🌐 Repayment

- 🌐 Investment Return
- 🌐 Commercial v Residential
- 🌐 Fees
- 🌐 Tax
- 🌐 Liquidity & cash flow (care with pensions)
- 🌐 Maintain but not renovate
- 🌐 Need new Bare trust & trustee per property
- 🌐 Insurance (members)

- Gearing
- Rising interest rates
- Property values can fall
- Loss of tenant
- Replacement Asset via Insurance Proceeds