

Borrowing by Superannuation Funds

SUPER RETIREMENT SOLUTIONS

Specialists in Self Managed Superannuation
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In September 2007 laws enabling self managed superannuation funds to invest by means of an *instalment warrant* were passed. This provides an exception to the general prohibitions on borrowing by a superannuation fund and the placing of a charge over an asset of the superannuation fund.

What are Instalment Warrants?

An instalment warrant is an investment in which an instalment payment is made to acquire an asset with the outstanding balance being financed through a limited recourse loan. The terms of the loan agreement are such that the investor immediately receives the beneficial rights of asset ownership (namely, any income arising by way of interest, distributions, dividends or rent). However, while there remains an outstanding loan the asset is held in trust for the investor. Full legal ownership is only conferred once all amounts owing have been paid in full.

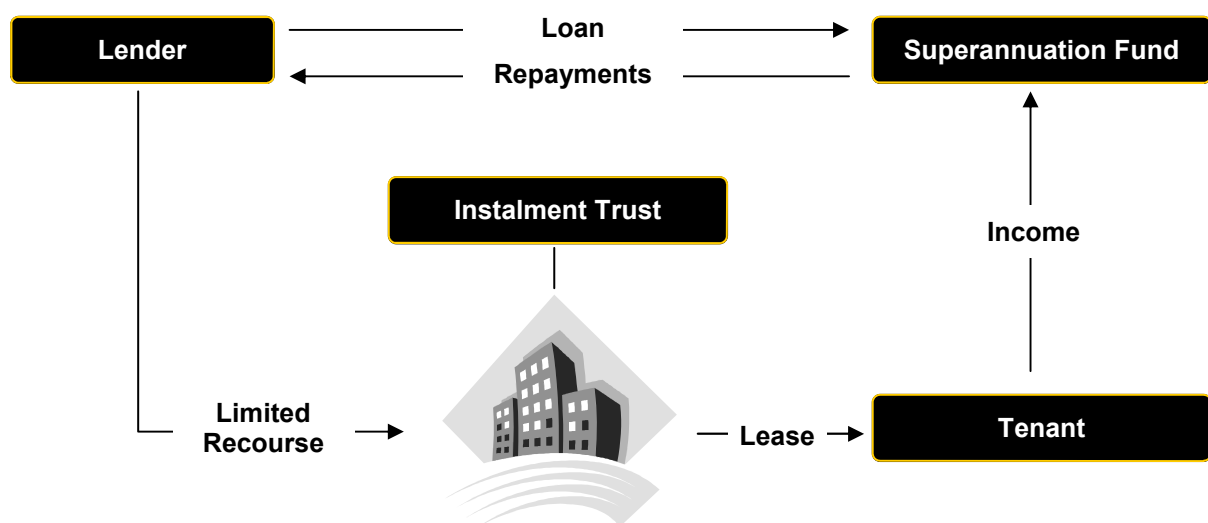
Key features of an Instalment Warrant

The *Superannuation Industry (Supervision) Act* [SIS Act] was amended to allow superannuation funds to borrow and place a charge over fund investments so long as the correct structure is used.

The key features of the instalment warrant structure are:

- Any type of investments, as allowed by the SIS Act, may be used
- The beneficial owner of the investments will be the superannuation fund
- The lender has no recourse to other assets of the superannuation fund
- The trustees can deal with the investment however and whenever they like, in the same way as investors can deal with 'normal' investments (subject to the terms of the loan agreement)
- All income payments are paid directly to the superannuation fund.
- Loan repayments are made in the usual way by the superannuation fund
- The superannuation fund can pay out or reduce the mortgage at any time (subject to the terms of the loan agreement)
- When the mortgage is paid out in full, title to the investment can be transferred to the superannuation fund or the investment trustee can continue as registered proprietor.

Lending Structure Diagram



The benefits

- A maximum 10% capital gains tax is payable on any capital gain if the property is sold after a minimum of 12 months and no capital gains tax is payable if sold during pension phase
- A maximum of 15% income tax on rental income
- As the interest costs are tax deductible, they can be offset against the rental income
- As the asset is held in a superannuation fund, in the event of bankruptcy, creditors have limited if any claim against the asset
- As the loan must be 'limited recourse', in the event of default the lender can only sell that particular asset and cannot access the other investments of the superannuation fund
- Gearing helps magnify returns

The concerns

- You must ensure that your loan structure complies with superannuation rules so that the superannuation fund does not become non compliant
- You must ensure that the superannuation fund has sufficient cash flow to support the investment if it is negatively geared
- Superannuation legislation may change again in the future
- The instalment trust must be structured such that stamp duty liability does not arise when the property is transferred from the trust to the superannuation fund
- The additional costs associated with establishing and maintaining an Instalment Trust
- The higher interest rates that apply due to the limited recourse nature of the borrowings
- Borrowing in a superannuation fund may not be the most tax effective option. Acquiring a property outside the superannuation structure can often provide greater tax savings for interest deductions and capital gains concessions for small business assets do not apply to assets owned by a superannuation fund.

The process

- Review the current position of the superannuation fund – *Does the trust deed need to be amended?*
- Review the borrowing capacity of the superannuation fund
- Review funding options available
- Source a suitable investment property
- Establish an Instalment Trust
- Complete a loan application
- Advise your Solicitor that the property is to be purchased in the name of the Instalment Trust
- Ensure an agreement is entered into between the Instalment Trust and the Superannuation Fund

This process should be completed in consultation with your Accountant, Financial Planner, Solicitor and Financial Institution.

To find out more information, please contact our Super Retirement Solutions staff.



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