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ARM Insights – Series 3

Property & Self Managed
Super Funds

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Disclaimer

This presentation has not been prepared to provide recommendations for any particular individuals. The examples used are for the purposes of illustration only. Individuals should seek expert financial planning advice to determine suitable recommendations for individual circumstances.

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Agenda

- Background – What's Changed
- What could this mean for you
- Case Study
- What is a Instalment Warrant
- The Structure (Lending/Underlying/Ongoing/Transfer)
- Other Structures
- Other Considerations
- Questions

What's changed?

- Nothing – Super Funds cannot borrow
- Section 67 of the Superannuation Industry (Supervision) Act 1993 (SIS Act) states;

“A trustee of a Regulated Superannuation Fund (RSF) must not:

(a) Borrow money or

(b) Maintain an existing borrowing of money

What's changed?

Question:

Why can't super funds borrow?

Answer:

If super funds could borrow, they may not be able to protect the funds assets from risks associated with borrowing

What's changed?

- Sept 2007 – Amendment to the SIS Act
- Insertion of Section 67 (4A) titled Exception-Instalment Warrants

“(4A) Subsection (1) does not prohibit a trustee (the RSF trustee) of a regulated superannuation fund from borrowing money, or maintaining a borrowing of money, under an arrangement under which:

(a) the money is or has been applied for the acquisition of an asset (the original asset) other than one the RSF trustee is prohibited by this Act or any other law from acquiring;

(b) is held on trust so that the RSF trustee acquires a beneficial interest in the original asset or the replacement;
and

What's changed?

- Sept 2007 – Amendment to the SIS Act
- Insertion of Section 67 (4A) titled Exception-Instalment Warrants

(c) the RSF trustee has a right to acquire legal ownership of the original asset or the replacement by making one or more payments after acquiring the beneficial interest; and

(d) the rights of the lender against the RSF trustee for default on the borrowing, or on the sum of the borrowing and charges related to the borrowing, are limited to rights relating to the original asset or the replacement;”

What could this mean for you?

- Self Managed Superannuation Funds (SMSF) can now 'indirectly' borrow to acquire an asset, including (and most commonly) real estate.

Can my SMSF purchase real estate from myself?

- Residential – No
- Business Real Property – Yes

What is Business Real Property?

Defined by ATO as;

“the underlying land must satisfy the business use test, which requires the real property to be used ‘wholly and exclusively in one or more businesses’ carried on by any entity”

Can I (or a related party of mine) occupy the property owned by my SMSF?

- Residential – No
- Business Real Property – Yes (provided use is business use)

Case Study – ABC Pty Ltd

- Renting Commercial Property for \$40,000 pa
- SMSF Balance - \$250,000
- Purchased 'Like' property for \$570,000
- Borrowed \$370,500 (Currently 7% pa)
- Contributed \$240,000 of SMSF funds to purchase
- Their business pays \$40,000pa in rent to the super fund
- 2 x Directors both contribute \$25,000 pa to super via salary sacrifice
- Directors both 50 years of age

Case Study – ABC Pty Ltd

Benefits

- Business cash flow has remained constant
- Rent income + Contributions used to pay loan
- Loan paid off in 5yrs 9 months
- When Directors/Members turn 55, rental income is tax free
- If property sold after Directors/Members turn 55 then CGT is nil
- Based on 4% growth in 5 years 9 months the property is worth \$714,300
- Provides asset protection
- Less Volatile than Other Investments

Case Study – ABC Pty Ltd

Devils Advocate

If \$250,000 in super was left instead of purchasing property, based on contributions and earnings of 8%pa

- o Super Balance after 5 years 9 months worth \$652,800

The Loan – ‘Instalment Warrant’

- The types of lending vehicle’s used for SMSF borrowing are known as Instalment Warrants. They could also be described as a ‘Lay-By’ with interest.
- These lending facilities effectively work like any other loan. It has a loan term, interest is charged and repayments are made.
- Some banks offer this type of lending – NAB leading the way with ‘Business Real Property’ transactions.
- It is important to note also that if your SMSF utilises a bank to lend money for investment, that it cannot change banks (i.e. Refinance).

The Loan – ‘Instalment Warrant’ (cont..)

- An alternative to utilising banks and other lenders, is for the SMSF to take out a loan with a ‘related party’. This can be yourselves as trustee’s or a company of which you have an interest in.
- The advantages of doing this (if capacity exists) is that
 - * Interest rate options
 - * Loan Term Options

The Structure

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The Borrowing Structure



Owned by



Mr Vendor

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The Borrowing Structure



Owned by



ABC Property
Holdings Pty Ltd
ATF ABC Property
Trust



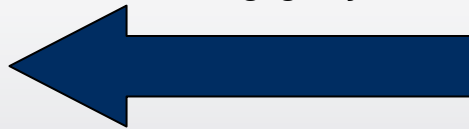
Sold to

Mr Vendor

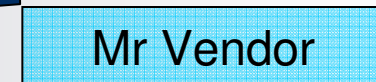
The Borrowing Structure



Who are provided a mortgage by



Owned by



Sold to



What's changed?

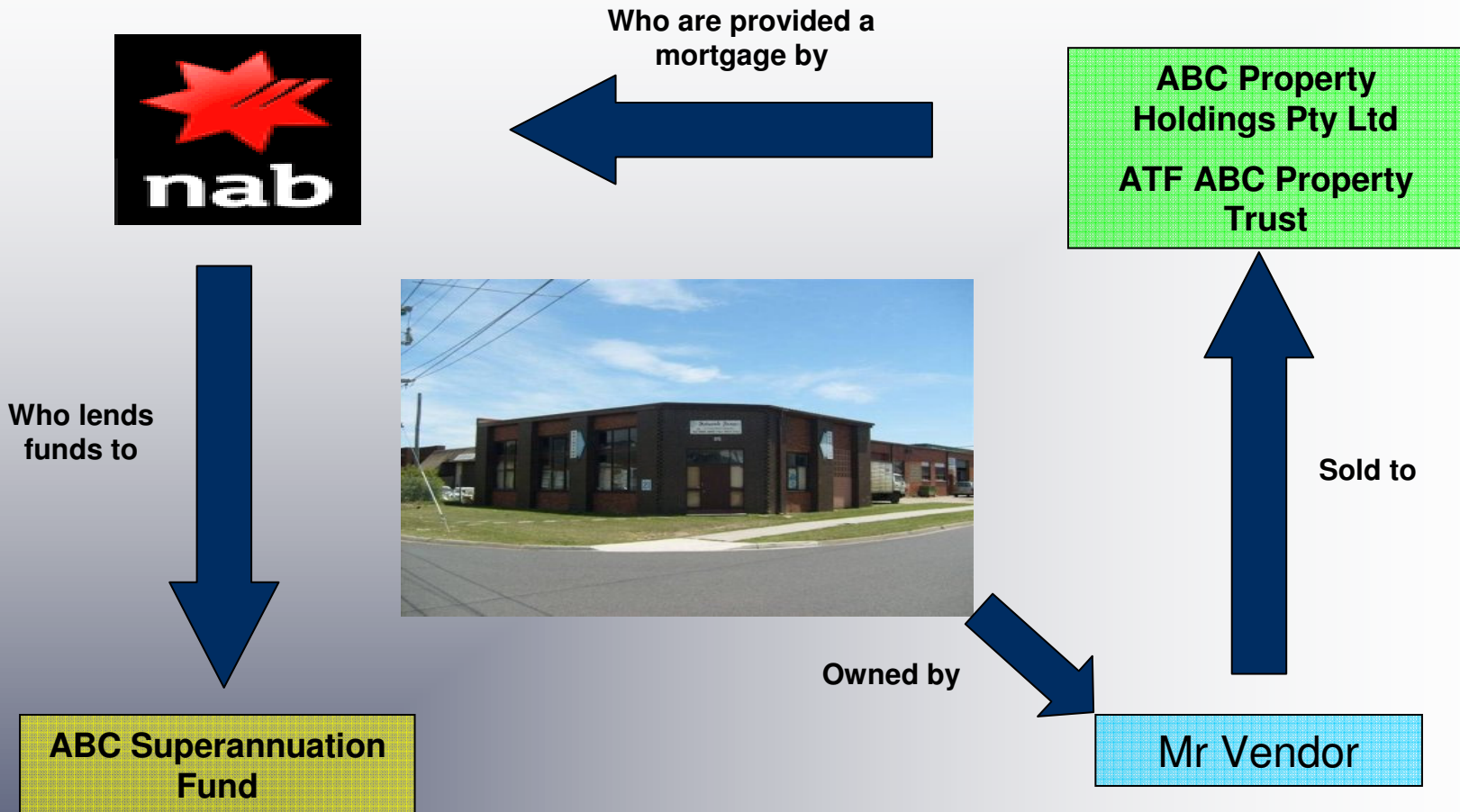
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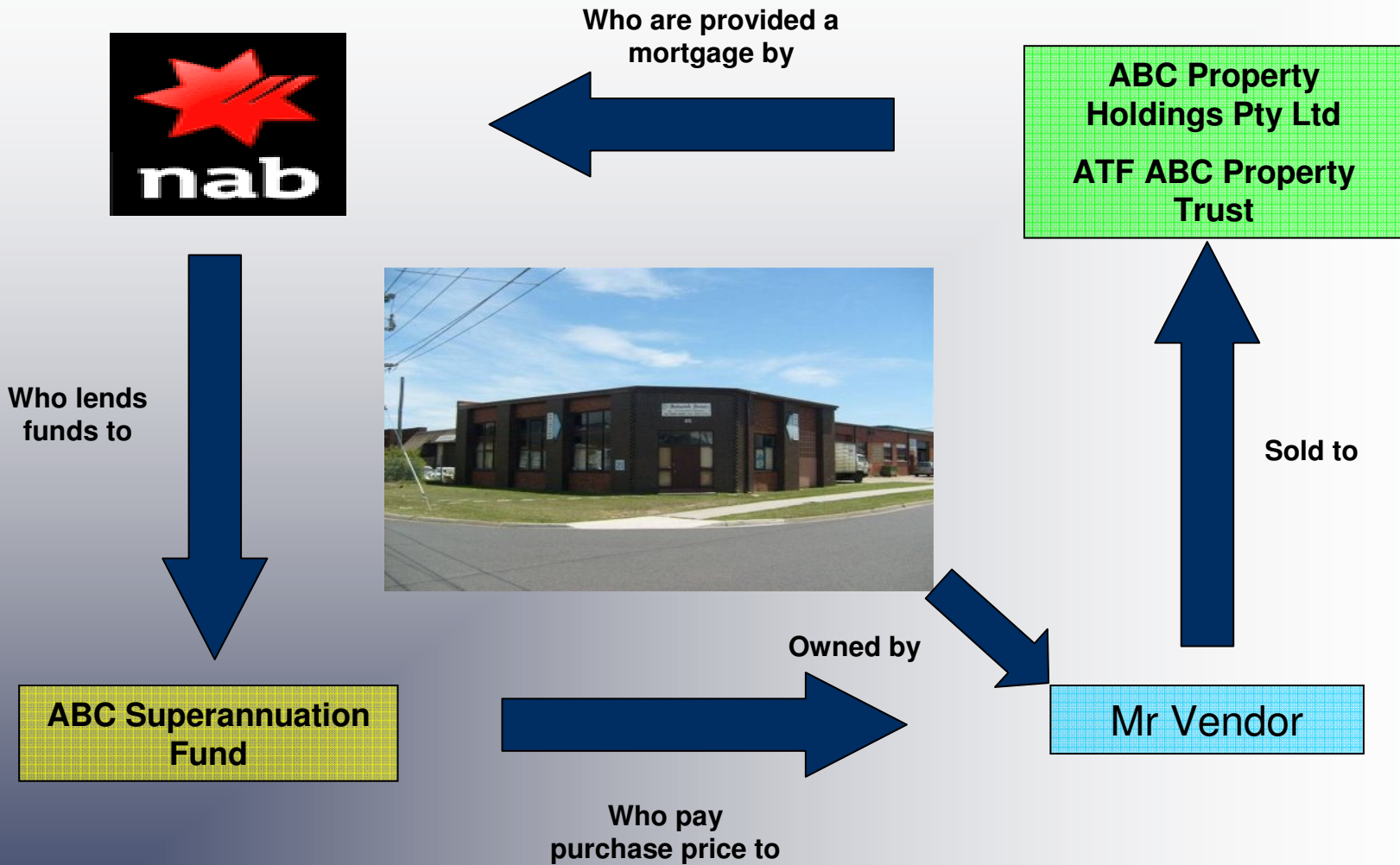
The Borrowing Structure

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The Borrowing Structure

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The Underlying Structure

ABC Property Holdings Pty Ltd
ATF ABC Property Trust



ABC Superannuation Fund

The beneficial owner of the assets held by the ABC Property Trust is the SMSF

The Ongoing Structure



**ABC Property
Holdings Pty Ltd
ATF ABC Property
Trust**

The Ongoing Structure

- Commercial Lease
- Market Rent



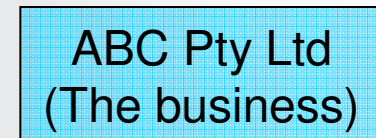
Has lease with



The Ongoing Structure



Has lease with



•Rights as 'Beneficial Owner'

Who pays rent to



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The Ongoing Structure



Has lease with



Repayments come from;

- Rent Received
- Other Funds Income
- Member Contributions

Who pays Interest and Principal to

ABC Superannuation Fund

Who pays rent to



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The Transfer Structure



ABC Property Holdings Pty Ltd
ATF ABC Property Trust

ABC Superannuation Fund

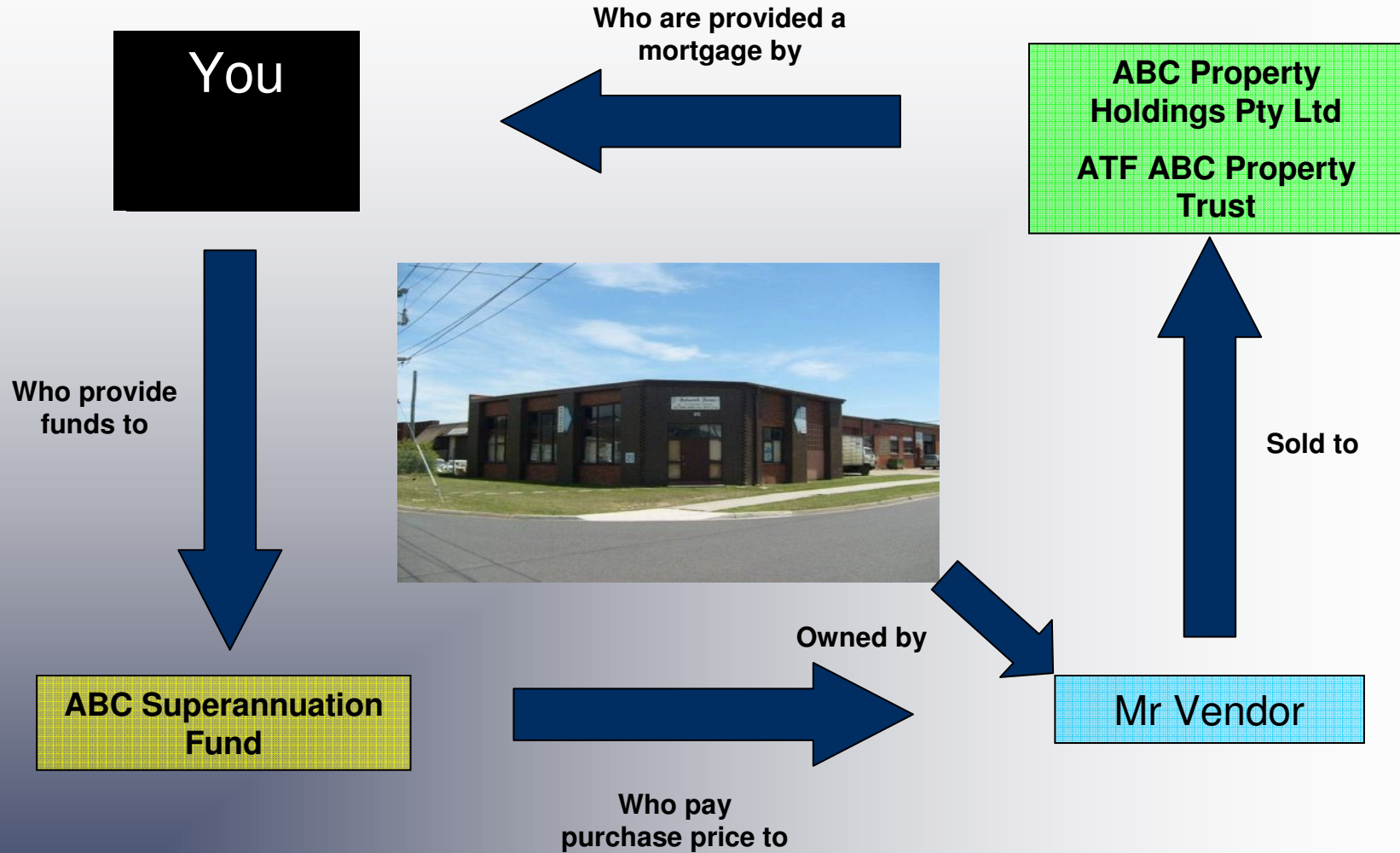


Loan is paid off.

Property is transferred to the name of the SMSF with no stamp duty or CGT

Other Structures

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Other Structures

(More than 1 super fund – Nil Borrow)

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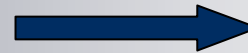
XYZ Superannuation Fund



ABC Superannuation Fund



Unit Trust



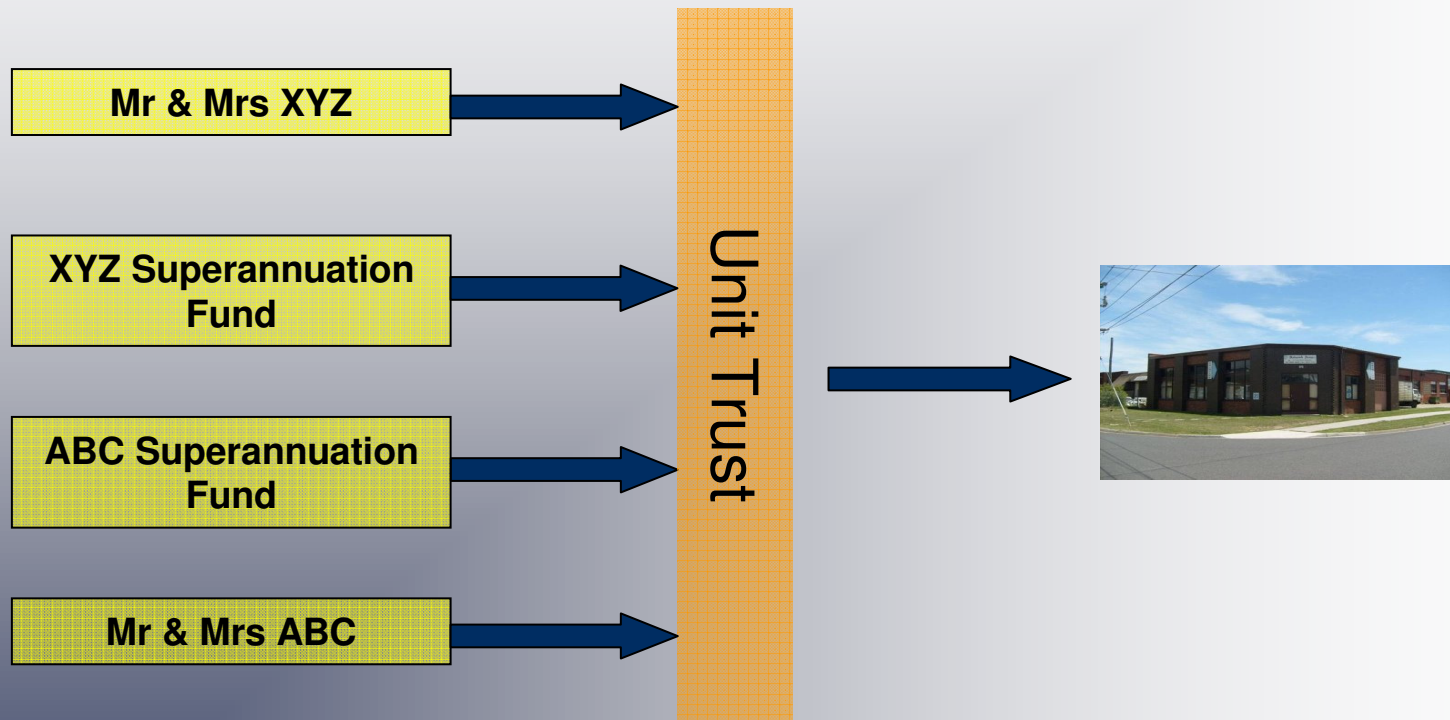
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Other Structures

(Combo of Super/Individual/Business – Nil Borrow)

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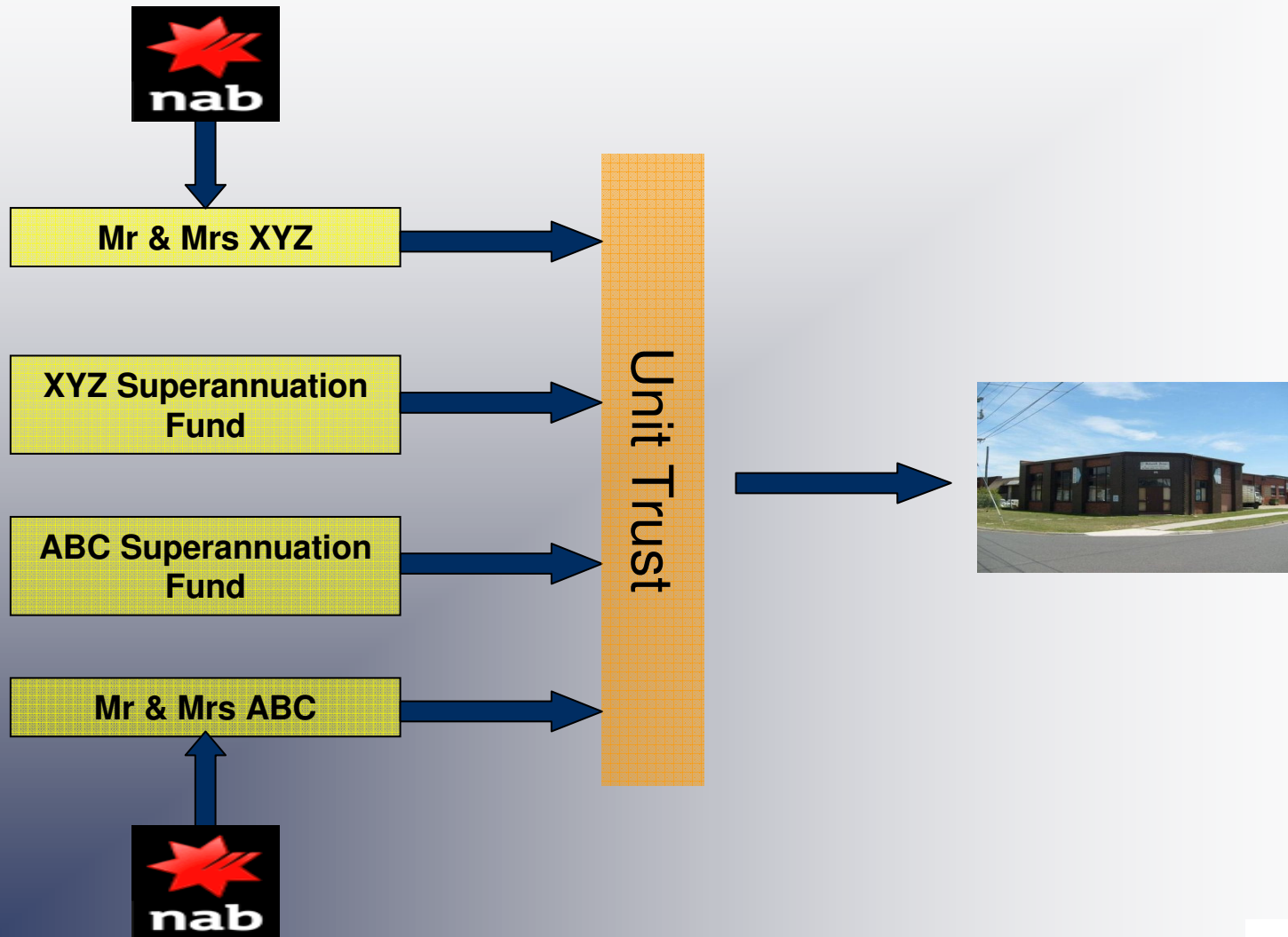
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Other Structures

(Combo of Super/Individual/Business – With Borrow)

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Other Considerations

Do you or your business' already own Commercial Property?

- You can transfer this property into your SMSF free from Stamp Duty however such a transfer would be regarded as a CGT event so tax may be incurred
- This CGT may be offset (fully or partially) by the business owner being able to claim a tax deduction for part of the transfer (up to the deductible contribution limit).

Can I take advantage of this opportunity?

- For a SMSF to borrow through instalment warrant, the trust deed for your SMSF needs to allow for borrowings. We can check this for you. If the deed does not allow for borrowing, the deed can be amended appropriately to allow it.
- ARM Financial Advisors can assist in determining your SMSF's capability to meet any lender criteria.
- If you do not have a SMSF, ARM Financial Advisors can assist you in establishing whether a SMSF is appropriate for you.

Questions?