Borrowing in your SMSF

Borrowing within a Self-Managed Superannuation Fund (SMSF) can be a useful strategy for investing retirement savings, allowing an SMSF to acquire significant assets like property or shares. SMSF borrowings are subject to strict rules and regulations that are important to understand. In this fact sheet, we will explore different considerations and factors with borrowing in an SMSF to help trustees make informed decisions about borrowing in their SMSF.

Benefits of borrowing in an SMSF

The use of Limited Recourse Borrowing Arrangements (LRBA) allows SMSF Trustees to leverage their superannuation to purchase large value assets. Common asset types purchased via an LRBA include property and listed shares.

This leveraging effect of the LRBA enables Trustees to increase the value of the assets in the SMSF and access certain types of assets such as property that they may not otherwise be able to purchase. Like with assets held directly, the assets held under an LRBA are subject to the same capital gains tax rules.

Key rules

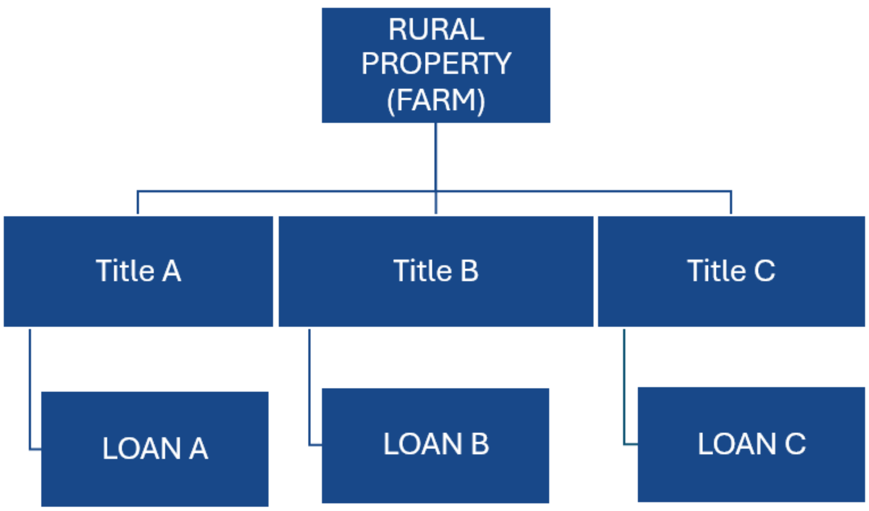
- The loan must be for a single acquirable asset.
- The asset must be held on trust for the fund.
- The SMSF must have beneficial ownership of the asset.
- The fund has the right to acquire legal ownership of the asset after one or more loan repayments.
- The rights of the lender against the trustee (either directly or indirectly) are limited to the rights relating to the acquirable asset.
- The acquisition of the asset must meet the criteria of the sole purpose test – that the purpose of the investment is to provide retirement benefits for the fund members.
- The acquisition must satisfy the acquisition rules.

What is a single 'acquirable asset?'[1]

- A collection of shares that are identical and have the same market value as each other.
  - Eg. a collection of the same class of shares in a single company bought at the same time.
- A collection of units in a unit trust that are identical.
- A collection of economically equal and identical commodities.
  - Eg. a collection of gold bars.
- A property with one title.
- Farming land over multiple titles may be considered as a single asset if there is a unifying object spread over both objects (ie. a shed).

What is not a single 'acquirable asset?'

- A collection of shares in a single company that have different rights.
  - Eg. ordinary and preference shares.
- A collection of shares in a single company that have different purchase details (eg. shares purchased on different dates).
- A collection of units in a unit trust or different classes that have different rights attached to them or are potentially subject to differing trustee discretion.
- A collection of shares in different entities.
- A collection of buildings each under separate strata titles (irrespective of whether the buildings are substantially the same at the time of acquisition).
- Farming land over separate titles will not be considered a single 'acquirable asset': even if there is an inability to access one title, other than through the other title.



Borrowing in shares

- A collection of shares must be acquired and disposed of as a collection and cannot be sold down over time.
- All the shares attached to the loan must be sold together.
- Shares acquired under a dividend reinvestment plan would need to be transferred to the fund and invested in its name. They cannot be included under the single acquirable asset.

[1] SUPERANNUATION INDUSTRY (SUPERVISION) ACT 1993 - SECT 67A

Example:

LOAN A	LOAN B	LOAN C	LOAN D
100 BHP shares purchased 1 August 2024	100 BHP preference shares purchased 1 August 2024	100 WBC shares purchased 1 August 2024	100 ANZ preference shares purchased 1 August 2024

Borrowing in property

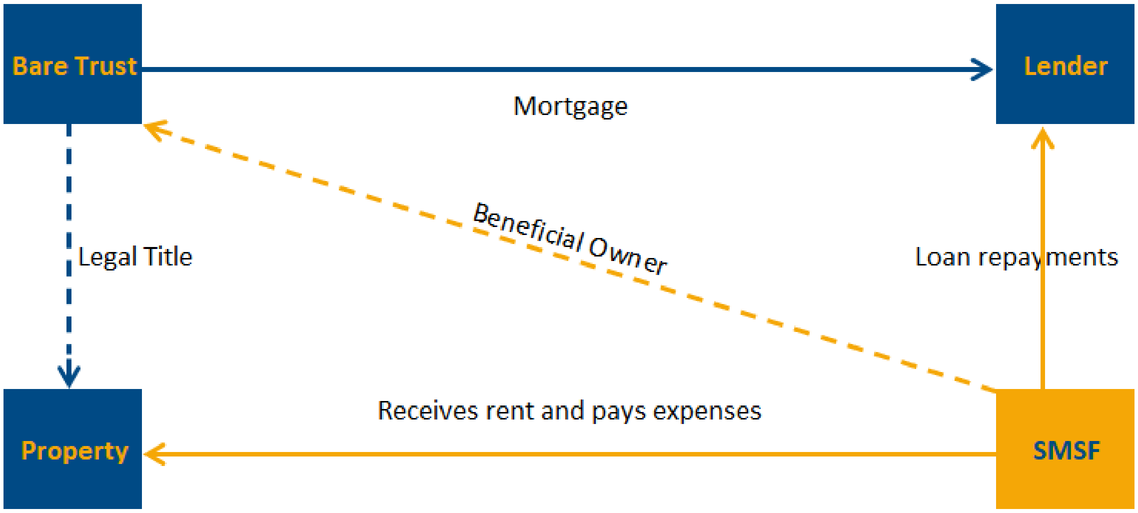
There are key rules relating to borrowing to invest in property:

- Multiple titles under one borrowing arrangement are prohibited even if managed as a block.
  - Eg a single loan cannot be utilised to purchase property, and a car park attached to it if the car park is on a separate title.
- Real Estate on a single title cannot be subdivided while the loan is still outstanding.
- Off the plan (OTP) purchases using borrowings are permitted if the building's construction and the title registration happens before settlement. The balance of payment under the contract must also be due at settlement.
- Repairs and maintenance can be carried out on the property, and money borrowed via the LRBA can be used to fund this. Improvements can be made to the property, but they cannot be funded by the borrowings, nor can the improvement fundamentally change the asset's nature. Therefore, improvements must be funded by contributions or other SMSF monies. Improvements include (but are not limited to) a second storey, extensions, addition of a swimming pool and installing a home security system. However, you must be careful not to improve the asset so much as to change the fundamental nature of it, as this is not permitted.
  - Eg, a vacant block subdivided into 2 separate blocks is a fundamental change, as is the conversion of a residential home into a restaurant.
- You cannot purchase a property in your SMSF from a member or related party as this breaches the acquisition rules.

Investing in Managed Funds/Trusts

- Units in a specific trust (eg. a managed fund) would be permitted if they all had the same rights attached.
- It is not possible to acquire units in a range of managed funds.
- It is not possible to acquire assets via a conventional wrap structure as the embedded cash management trust would fail the definition of a single acquirable asset.

How to structure an LRBA



- The acquirable asset must be held on trust for the SMSF until the debt has been extinguished. The SMSF may then assume full legal ownership.
- The acquirable asset must be the only property of the bare trust (holding trust).
- Complex trusts, including discretionary trusts and unit trusts, cannot be used as they are unlikely to satisfy the requirement that the SMSF trustee has the necessary interest in a particular asset of the trust, nor can the SMSF trustee be one of several unit holders in a unit trust.
- The trustee of the bare trust should not be the same trustee as the SMSF.
- If renting property, the trustee of the bare trust is to be named as the landlord.
- The statement of financial position shows the acquirable asset at market value and the loan's outstanding balance.
- Any depreciation costs should appear in the fund's financial statements.
- Keep records to evidence the fact that the asset is held on trust for the fund.

Which Lenders can you use?

The Lender can be a related party or a commercial bank.

A related party includes:

- Members of the SMSF who loan the funds to the SMSF.
- One or more members' family trust or companies.

Related party loans need to maintain either a floating interest rate or fixed interest rate as specified and agreed by the parties, which should meet the safe harbour rules set out by the ATO.

*NOTE: Where the lender is a related party, the fund must adhere to the safe harbour rules to avoid Non-Arms' Length Income or Expenditure penalties.

A Commercial Lender includes:

- Banks.
- Financial Institutions.
- Any other Individuals, trusts or companies not related to the fund.

Commercial lenders are more likely to charge or impose commercial, or arm's-length rates and terms, and this may differ from the ATO's safe harbour rules.

Important things to consider

LRBAs carry complex rules around them. Some important rules set out by the SIS Act include:

- The sole purpose test (s62).
- Investment strategy considerations (s62(2)(f)).
- Related party acquisition rules (s66).
- The in-house asset rule (s71).
- The arm's-length requirements (s109).

Summary

LRBAs can be a highly effective tool for SMSFs, but it is important that Trustees understand the compliance requirements, and risks surrounding these arrangements. SuperGuardian recommends speaking to a financial adviser when considering the use of an LRBA in the SMSF investment strategy.

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