SMSF BARE TRUST EXPLAINED

Limited Recourse Borrowing Arrangements (LRBA)

Amendments to superannuation legislation in September 2007 provided trustees of SMSFs with the opportunity to borrow for the purpose of acquiring a single asset.

Trustees of SMSFs are now in a position to buy a commercial or residential property through their SMSF.

Providing the SMSF has a deposit that meets the lenders loan valuation ration (LVR) requirements the lender will provide the balance of the purchase price. Banks may require a minimal deposit but trustees should be aware that negative gearing in a super fund is not tax effective due to the reduced tax rate applicable to super funds.

Legislation requires that the loan must be a Limited Recourse Borrowing Arrangement (LRBA). This facility allows the lender to hold the property as security however any existing or other assets held by the SMSF cannot be used for additional security. Subsequently the lender may insist that the members provide personal guarantees.

Trustees can either borrow from a financial institution e.g. a bank or from a related party e.g. the members or an entity controlled by the members.

Structure

Regulations require that the property acquired with borrowed monies must be held by a bare trust with the SMSF being the beneficiary of the trust.

The bare trust is merely the registered holder of the property until the loan is repaid. The SMSF will receive rental income from the lessee and will pay interest to the lender.

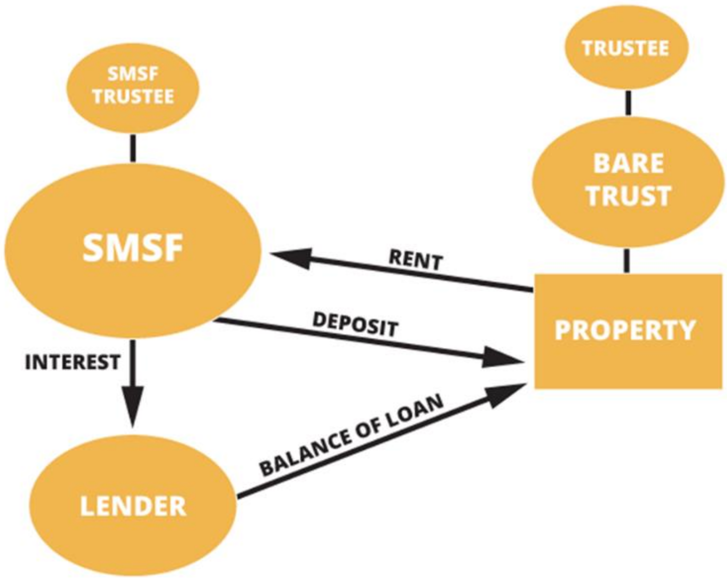
If and when the loan is repaid the legal ownership of the investment property will revert to the trustee of the SMSF.

The trustee of the SMSF cannot be identical (the same) as the trustee of the bare trust, this may in some instances require a corporate trustee for both entities, again dependent on the lenders requirements.

Ownership

When trustees enter into a contract of sale to purchase a property they should be aware that the purchaser must be the trustee of the bare trust as this entity will be the registered owner upon completion of the property settlement.

Limited Recourse Borrowing Structure



Common mistakes

- Properties purchased with or on multiple titles may need a separate bare trust for each property or title e.g. inner city apartments with a unit and car park on separate titles may require a bare trust for each title if they can be sold independently.
- Properties purchased using an LRBA cannot be significantly changed e.g. major renovations etc.
- Borrowings cannot be used to refinance an existing super fund property or improve / change an existing property held within the super fund. Trustees sometimes do not understand that any borrowing must be utilised only to acquire a new single asset.
- Believe incorrectly that super funds can borrow using the same strategies when borrowing personally or within a family trust structure (e.g. using existing unencumbered properties as security).
- Often sign a contract to purchase then seek advice.
- Execute the contract in the wrong name. As some states do not allow 'and / or nominee' clauses, this has the potential for additional stamp duty.
- Do not understand that the super fund must have cash to pay its share of the purchase price i.e. deposit.
- Want to borrow with little or no deposit.
- Do not understand that negative gearing does not work in a low tax (i.e. superannuation) environment.
- Forget that as trustees, investments are for the benefit of the members (not for the convenience of their business).

Getting professional help

Always talk to an advisor prior to purchasing a property using a Self Managed Super Fund

For more information about the changes, you can also contact our SMSF Specialist Team on **1300 27 28 29**

RJ Sanderson & ASSOCIATES PTY LTD PUBLIC ACCOUNTANTS

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