DBA Butler Pty Ltd Lawyers

NEWS March 2008

SMSF Borrowing Update

The new laws which now permit super fund trustees to borrow (refer to our October 2007, December 2007 and February 2008 newsletters) continue to be a major planning topic for advisers. Interest in these arrangements is growing steadily and clarification from the regulators on a number of technical issues is expected soon. We summarise the latest news below.

Can a guarantee be given?

Current indications are that guarantees give rise to several technical issues. Section 67(4A) provides that the rights of the lender against the SMSF's trustee for a default on the loan must be limited to the underlying asset only. This does not expressly preclude the lender from obtaining security against a third party. Therefore, some borrowers have been requesting a guarantee from members. However, the alternative or conservative view is that the giving of a guarantee provides the lender with additional security and therefore infringes s 67(4A).

Generally, a guarantor has a right to take legal action against the borrower if the borrower defaults and the guarantor is then called upon by the lender to satisfy the debt. The SMSF's trustee is therefore exposed to more than just the underlying asset (ie, it can be sued by the member guarantor for any shortfall). As discussed, this appears to contravene the spirit of s 67(4A), the intention of which is to limit the recourse available against SMSF trustees.

Some have suggested that a waiver of the guarantor's right to sue the SMSF trustee could be given. However, we understand that the ATO will deem this to be a *contribution* by the member. Accordingly, even if an SMSF trustee never defaults and the guarantor is never called upon, the guarantee carries some risk.

Similarly, some have suggested that the SMSF could provide payment to the member guarantor (to compensate the guarantor for any loss) to ensure the arm's length requirement is satisfied. Again, this also appears to entail risk as the SMSF is utilising its own assets to effectively provide further security for the borrowing.

The guarantee issue is a hot topic and with the entry of further finance providers into the SMSF market, the extent to which security can be offered is a question which requires some clarification by the regulatory authorities.

In the meantime, DBA urges caution on the giving of guarantees and other third party collateral. All borrowing-related documentation should be carefully reviewed by the fund's legal advisers. We understand that there are currently financiers who do not require guarantees. Finance can generally be obtained without third party security by way of a higher interest rate and restricted loan-to-value ratio.

Can my SMSF borrow to develop land?

The new borrowing laws clearly allow for money to be borrowed provided it is used to acquire an asset. Many SMSF trustees now wish to borrow in order to finance the purchase and development of new land.

An SMSF undertaking property development must ordinarily take extreme care to comply with the raft of superannuation rules. Further, while there are arguments that the improvement of an asset could be part of its 'acquisition' and that the expression 'acquire' should be interpreted broadly in s 67(4A), this issue has been raised by the ATO as a potential concern. DBA recommends that SMSF trustees planning to use borrowed money to develop property seek advice before doing so in order to ensure that their borrowing does not conflict with any law.

Consider obtaining insurance

SMSF trustees must consider the long-term implications of meeting loan repayments. While it is true that a trustee can 'walk away' from a borrowing, there are probable CGT consequences of doing so and the SMSF will likely lose its equity in the asset. Insurance against the death of members can help minimise the risk of default, particularly where the SMSF is reliant on contributions to meet repayments.

A Deed Is A Deed Indeed — SMSF Trust Deeds

This is an extract of a paper that was delivered on 13 March 2008 by Daniel Butler and Bryce Figot at the SPAA National conference in Brisbane.

Introduction

A good SMSF trust deed is the backbone to everything that an SMSF does. It provides legal certainty and empowers the trustee to undertake day to day activities as well as crucial planning strategies.

This paper seeks to educate on several key issues regarding SMSF deeds:

- what can a deed do for me?
- what is a deed?
- what to look for in a good deed?
- should I obtain deeds from the web?

What can deeds do for me?

Deeds are vitally important.

The SISA , the SISR and general trust law rarely empower trustees. Instead they usually only specify what trustees may not do. For example, the SIS legislation often provides things like:

- **Account-based pensions:** 'Rules for the provision of a benefit meet the standards of this subregulation if the rules ensure that payment of the pension is made at least annually, and also ensure that:...' (SISR reg 1.06(9A)).
- **Borrowings:** ' ... a trustee of a regulated superannuation fund must not ... borrow money [but this does not prohibit a trustee] from borrowing money ... under an arrangement under which ...' (SISA s 67)

Accordingly, in order for a trustee to have the power to do something (eg, borrow, pay an account-based pension, etc), the deed needs to contain that power.

A good deed will have strategies built into it and will empower trustees in situations such as:

- converting an AP to an ABP;
- segregation of pension assets and allocations from one pension account to another;
- SMSF borrowing arrangements;
- Self-dealing (eg, selling property to a trustee/member);
- succession planning; and
- bankruptcy.

For example, consider succession planning.

CASE STUDY – SUCCESSION PLANNING

Mum and Dad happily married with children. They have an SMSF with a total value of $1.2 million. Mum dies.

Dad is lonely and then makes a new 'lady friend' whom he grows very fond of. Dad wants $200,000 of his assets to go to her upon his death and balance to go to his kids.

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The full text of the paper can be downloaded from http://www.dbabutler.com.au/download/(dba)_deed_seminar_paper.pdf

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Improved pension kits!

DBA's pension kits provide template documentation to commence SMSF pensions. These kits have recently been improved — they are now even easier & quicker for advisers to complete. Naturally, the kits' high level of legal quality remains uncompromised.

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*Transition to Retirement Income Stream ($440)** ☐

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