

ATO clarifies certain SMSF borrowing queries

Introduction

The new SMSF borrowing rules introduced with effect from 7 July 2010 raised a number of queries. The ATO has recently responded to these which are summarised below.

Loans for real estate with multiple titles

Many apartments comprise more than one title (eg, the apartment and car park may each have a separate title). Similarly, many farms are spread over multiple titles. Whether separate borrowing arrangements are needed for each title has been a query since the introduction of the new laws in July 2010.

The ATO state that where assets are for practical purposes inseparable or where they are an 'incident ancillary asset of a very small value' the assets may be treated as one asset. However, they then state that a 'strata title with an accessory car park and commercial premises over more than one title' do not necessarily fall within this category. The ATO say they would need to consider the facts of a particular case to make a decision.

Thus, unless a trustee has received positive SMSF specific advice from the ATO, the conservative approach would be to treat each title as a separate asset. Accordingly, a separate loan would be needed for each asset.

Before signing any purchase contract, SMSF trustees should check whether the property involves multiple titles and — if it is — be sure that they are comfortable with the implications before proceeding.

No subdivision of land

Many SMSF trustees want to borrow to acquire real estate and then subdivide the land. However, the new borrowing provisions allow assets to be replaced in very specific circumstances. None of those circumstances apply to real estate. The Explanatory Memorandum states that subdivided land would be a replacement asset and therefore this would not be permitted.

The question was put to the ATO as to whether a single title to real estate that has been purchased

under an SMSF borrowing may subsequently be subdivided while the loan is still on foot.

The ATO adopted the view set out in the Explanatory Memorandum. Accordingly, for as long as the borrowings are still on foot, the real estate should not be subdivided.

The implication is that if an SMSF trustee wants to borrow to acquire land they wish to subdivide, they must first fully pay off the loan before engaging in any subdivision.

Borrowing to acquire an off the plan ('OTP') apartment

The ATO were asked how they view the purchase by a superannuation fund of an OTP apartment. An OTP apartment is usually purchased under a contract where the purchaser acquires the right to the apartment in the future (eg, in 12 to 18 months time, the subdivision has occurred and the apartment is built and on settlement the purchaser obtains a separate title with a completed apartment).

Under the new law, borrowing for expenditure incurred on improving the acquirable asset is not permitted. It appears the reason for asking this question was to provide comfort that the purchase of an OTP apartment would not be considered an improvement but rather the purchase of a completed apartment for s 67A purposes.

The ATO indicated that the answer depends on the OTP arrangement. One of the ATO's main concerns here appears to be whether the borrowing was after the apartment was completed and the land was subdivided. It is also understood that a number of financiers will generally only lend on the security of OTP apartments after the apartment is substantially completed.

Accordingly, those wanting to undertake OTP purchases via the SMSF borrowing arrangement should consider obtaining SMSF specific advice before proceeding to ensure their particular OTP arrangement will satisfy the ATO's criteria for the new law.

Trust not a bare trust — separate GST registration might be required

The new law (like the old law) required the asset being acquired with the borrowings to be held on trust. The law does not specify what type of trust. It

has been very popular for the trust to be structured as a bare trust. One advantage with a bare trust is administrative savings for GST.

The GST administrative savings comes from the fact that sometimes bare trusts do not need to be registered for GST, but rather the ABNs etc of their beneficiaries can be used instead. See GSTR 2008/3.

However, the ATO have expressed the view that the trust on which the property is held can never be a bare trust. This view has wide reaching implications. The most immediate implication is that all 'bare trusts' for borrowing arrangements with commercial properties turning over more than \$75,000 must be separately registered for GST.

Can an asset remain in a 'bare trust' after the loan is repaid?

The view that the 'trust' is not a bare trust raises questions as to whether the asset can remain in trust after the borrowing is repaid. The concern is whether — once the loan is repaid — the trust creates an in-house asset risk. The ATO have stated that they will discuss this matter with APRA and Treasury and in the meantime they will not take compliance action if it involves purely a custodial arrangement through a bare trust.

If the ATO do determine that assets can not remain in trust once the borrowings are repaid, this may give rise to stamp duty implications for many SMSFs. On its face, any such transfer gives rise to a duty liability because it is a transfer of dutiable property. Many jurisdictions have exemptions provided that a number of hurdles can be met. A typical hurdle is that the

SMSF trustee can demonstrate that it provided all of the purchase monies and was the real purchaser.

However, many SMSF trustees might lack documentation to evidence this to the satisfaction of the relevant state revenue office. This is especially the case where the deposit was paid by a related entity and journalised as a contribution. Other implications could also arise such as CGT and GST.

Care obviously should be taken prior to the purchase to ensure the deposit and all further consideration is paid by the SMSF trustee.

Moving forward — further ATO clarification

Although some clarification has been received, a number of grey areas remain. SMSF trustees should be familiar with the remaining uncertainties before entering into borrowing arrangements.

The ATO has convened a workshop scheduled for early November to discuss the issues arising from the new law. We hope that the outstanding issues will be clarified shortly after that meeting.

We plan to discuss the latest outcomes in the 'update' portion of our next Quarterly SMSF Seminars to be held in November. We will be monitoring these developments and reflecting any necessary changes in our documentation.

DBA Lawyers is experienced in the preparation of SMSF borrowing documents and the provision of legal advice concerning the above. We are also able to assist with applications to the ATO for SMSF specific advice, if applicable.

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