

SMSF borrowing clarifications

The recent release of SMSFR 2011/D1 provides some much anticipated guidance on SMSF borrowing. While the ruling outlines a practical approach to many issues, it is still only in draft.

Single acquirable asset

It is common for SMSF trustees to acquire real estate comprising multiple titles. However, a separate borrowing is needed for each 'single' asset being acquired. If multiple titles constitute multiple assets, then multiple borrowings will be needed: one borrowing for each title. This can be impractical.

This issue often arises where the trustee acquires farmland, commercial premises or an apartment with a car park. The ATO has provided clarification as to whether they constitute one asset or multiple.

Apartment and car space on separate titles

The ATO confirms that an apartment and a car park on separate titles will be considered a single asset if they cannot legally be sold separately.

Commercial property spread over multiple titles

If a commercial building, such as a factory, is spread over multiple titles, the ATO considers the multiple titles to be a single asset.

Farmland

The ATO generally considers that if farmland involves multiple titles, each title represents a separate asset.

Improvements and replacements

Improvements

SMSF trustees may not use borrowed money to improve an asset. However, the ATO confirms that money from other sources can be used to improve an asset. Thus, improvements can be made with money other than from borrowings (eg, money from contributions).

Examples of allowable improvements include adding a garage or pool to a residential property.

Replacement assets

There is a risk, however, that if an asset subject to a borrowing is improved too much it may become a different asset. This results in the borrowing

exception ceasing to apply and thus a contravention of the borrowing prohibition.

An example of a replacement asset is where a four bedroom house burns down and the proceeds of the insurance policy are used to build two townhouses on the land. The original asset has changed and therefore contravenes the borrowing exception. However, if the proceeds were to rebuild a similar four bedroom house, this would be allowable.

Off the plan purchases

Consider an SMSF trustee borrowing to acquire an apartment off the plan. Typically the SMSF trustee pays the deposit with its own money. Then once the apartment is built and 'strata titled', the SMSF trustee enters into the borrowing arrangement. The ATO state the trustee can enter into a borrowing to acquire this, as it is a single acquirable asset.

Conclusion

The ATO have now provided greater certainty regarding a number of aspects to do with SMSF borrowing.

However, SMSF borrowing transactions must continue to be carefully implemented and documented. SMSFs are at risk of adverse tax consequences if there is a lack of planning, or ineffective or out of date documentation.

SMSF succession planning

The aging population and the ATO's recent draft pensions ruling (TR 2011/D3) highlight the need to review clients' overall succession planning.

Succession planning strategies

Advisers should look at formulating an SMSF succession planning strategy that can be applied across their client base.

DBA Lawyers has distilled an 11 step process that covers succession planning for all SMSFs. These steps are set out in *The Complete Guide to SMSFs and Planning for Loss of Capacity and Death*.

Recent succession planning issues

Some of the recent issues to do with pensions highlight the importance of having the right documentation in place.

BDBNs v auto-reversionary pensions

In recent months, advisers have been divided as to whether a BDBN takes precedence over an 'auto-reversionary' pension, or vice versa.

DBA Lawyers' view is that:

- a BDBN will usually validly bind a trustee (ie, it is a fettering (or limiting) of a trustee's discretion that is usually authorised by the governing rules of the SMSF); and
- an auto-reversionary pension, under most SMSF deeds, is merely a request by the member of the SMSF trustee or a trustee resolution.

Therefore, if there was a conflict, the BDBN will ordinarily win.

However, the conflict can easily be avoided. BDBNs and auto-reversionary pensions should be consistent, as well as align with the SMSF member's other estate planning documentation (eg, wills, enduring power of attorney, etc.).

TR 2011/D3

The ATO in TR 2011/D3 outlines its view of when a superannuation income stream (eg, a pension) will cease upon a member's death.

The ATO's view is that a pension will generally instantly cease upon the SMSF member's death. However, the pension will continue if a 'dependent beneficiary' is automatically entitled to receive the pension.

There are a number of adverse tax risks that may arise as a result of a pension ceasing — if only for a day — upon a member's death.

As such, TR 2011/D3 highlights the need for appropriate succession documentation to be in place for each pension.

Required action

Advisers should review all clients with pensions to see if they are exposed by not having an auto-reversionary pension. This review should encompass a comprehensive review of each client's SMSF and succession planning documents, including wills, BDBNs and enduring powers of attorney.

Advisers could also use this review as the opportunity to ensure that a smooth succession plan regarding the control of the SMSF is in place. Successor director and successor trustee documentation can be implemented to help achieve this.

The 11 steps detailed in *The Complete Guide* provides a structured framework through which to conduct such a review.

DBA Lawyers' SMSF succession planning documentation

DBA Lawyers offers a number of kits and documents that can assist advisers and SMSF members with a 'total SMSF succession planning solution'. This offering includes:

- **Pension kits** — our new pension kits have recently been updated to take into account the ATO's requirements for a pension to continue upon a member's death as an auto-reversionary pension.
- **Reversionary nominations** — The importance of a reversionary nomination has been highlighted by the ATO in TR 2011/D3. We have especially developed a service for this purpose. In this service we draft documentation to amend existing pensions so that an auto-reversionary beneficiary is locked in.
- **BDBNs** — DBA Lawyers can tailor BDBNs to fit into an SMSF member's overall succession planning. A tailored BDBN also can be used to lock in an auto-reversionary pension.
- ***The Complete Guide to SMSFs and Planning for Loss of Capacity and Death*** — DBA Lawyers publishes a 140+ page book that is dedicated to SMSFs planning for death and loss of capacity. The book details the 11 key steps necessary for proper SMSF succession planning for all SMSFs. It contains 90+ examples, detailed case studies and much more.

For more information on our SMSF succession planning documentation, please visit our website — www.dbalawyers.com.au/smf-succession-planning. The website also has order forms for these products.

For further information please contact:

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