

SMSF related party lending

Some SMSF trustees may find the benefits of a related party lender more appealing.

Key tips

Ease of set up

A loan agreement can generally be set up between the trustee of the SMSF and the related party lender for a fixed fee. Once this agreement is in place, the money can then be drawn down and the actual borrowing arrangement (under s 67A) can commence.

Further, some banks require trustees and guarantors to obtain independent financial and legal advice before a loan is approved. This is a further cost with certain bank lending.

Makes financial sense

If lending from a related party is done in the right manner, the SMSF and the related party may together be in a better financial position than if the SMSF borrowing from a bank.

The advantage lies in the fact that there is generally a premium on bank interest rates for SMSF borrowing as compared with interest rates for home loan lending.

As such, related party lending can often be a more effective option.

Key traps

Arm's length

There are however traps associated with related party lending. A compliance trap is that investments of a superannuation entity must be made and maintained at arm's length (s 109 SISA). One practical way to assist in evidencing this is to obtain several bank quotes and benchmark these.

Arm's length is not defined in the SISA, but implies a dealing that is carried out on commercial terms. A useful test to apply is whether a prudent person, acting with due regard to his or her own commercial interests, would have agreed to the terms (*APRA v Derstepanian* (2005) 60 ATR 518, 524 [18]).

Where the parties are uncertain as to whether the related party loan would be at arm's length, we recommend that legal advice be sought.

Practical consideration – interest rates

How an interest rate is expressed in a loan contract between related parties can often suggest whether the contract itself is at arm's length.

We generally recommend that the interest rate be certain (e.g., 'RBA cash target rate + x%') which is capable of being worked out by a third party.

Personal guarantees

The new SMSF borrowing legislation requires that recourse for default on borrowing is limited to the single acquirable asset which is the subject of the borrowing.

Practical advantages of an SMSF corporate Trustee

The report "A Statistical Summary of Self-managed Superannuation Funds" released as part of the Cooper Review in April 2010 disclosed that over 70% of SMSFs have individual trustees. Further, the report revealed that in recent years nearly 90% of SMSFs have been established without a corporate trustee.

These statistics start ringing alarm bells considering the great advantages that flow from having a corporate trustee. The high rate of SMSFs with individual trustees is probably due to the perception that individual trustees are cheaper than corporate trustees. However, we believe that individual trustees can prove more expensive in the longer-term.

Liability advantage

Many SMSF trustees overlook the potential liabilities that may arise in relation to their role.

DBA is aware, for instance, of an SMSF with individual trustees that invested in a property development that suffered a number of problems that has the potential to not only wipe out their entire super savings but also result in claims against the trustee's personal assets.

The above case highlights that personal liability can easily inflict individual trustees and also highlights the attraction of corporate trustees. A corporate trustee will provide individuals associated with the fund with the peace of mind that relates to limited liability protection.

Estate Planning

Another saving of corporate trustees relates to estate planning. Smoother succession planning can be put in place so that a successor director can more readily step in for a director who dies or loses capacity, eg, who suffers a coma after an accident. Otherwise, the interests of that person may be entirely in the hands of the other director (who may be the second spouse).

In comparison, costly paperwork is required to change individual trustees upon the death or loss of capacity of an individual trustee. This is on top of the considerable paperwork that is usually associated with administering a person's estate and obtaining probate of their will, etc.

Administrative Efficiency

A corporate trustee also gives single member funds the flexibility to be controlled by one individual who can be the same sole director/shareholder. In comparison, a single member fund with individual trustees still requires two individual trustees.

Corporate trustees also provide an SMSF with other administrative savings. For example, if mum and dad were individual trustees and wanted to add (or subtract) a child as a member of their fund, they would generally require a deed of change of trustee

and would also need to transfer all fund assets into the joint names of the three individual trustees.

If they instead had a corporate trustee of their SMSF, they would only be required to add (or subtract) their child as a director.

Naturally, a corporate trustee allows for a much more simpler and efficient process.

Conclusion

Corporate trustees are recommended as a better and more efficient option. Moreover, a sole purpose corporate trustee is preferred as this overcomes the risks that may relate to the company's other activities and obtains the lower annual Australian Securities and Investment Commission fee of \$41 (compared to \$218 pa for an ordinary company).

Note that a feature of DBA's company constitution is that there are built-in SMSF succession provisions. These features allow directors of the corporate trustee to take advantage of appointing a successor director to step in on death or incapacity to protect that person's interests.

Online SMSF Borrowing Seminar

After the successful August borrowing seminars, DBA Lawyers will be running an online SMSF borrowing seminar. The seminar will be held on 30 September from 3pm – 4.30pm and delivered via a webcast online. The topics covered include:

- all the implications from the new laws and the latest from the ATO
- the key taxation and stamp duty issues
- key planning tips and traps
- how to practically implement a borrowing
- advanced topics including, borrowing for shares, property development, vendor terms, arrangements

To register online, visit:

http://www.cpdlive.com/dbalawyers/training/displaySeminar.html?Seminar_seminar_id=689&Series_series_id=939

For more information regarding this seminar, please call Marie on 03 9092 9400.

For further information please contact:

DBA LAWYERS PTY LTD (ACN 120 513 037) Level 1, 290 Coventry Street, South Melbourne Vic 3205

Ph 03 9092 9400 Fax 03 9092 9440 dba@dbalawyers.com.au www.dbalawyers.com.au

DBA News contains general information only and is no substitute for expert advice. Further, DBA is not licensed under the Corporations Act 2001 (Cth) to give financial product advice. We therefore disclaim all liability howsoever arising from reliance on any information herein unless you are a client of DBA that has specifically requested our advice.