

# Common Traps: SMSF BORROWING ARRANGEMENTS

In this article we set out a couple of common borrowing scenarios relating to self-managed superannuation funds (SMSFs) which we are frequently asked about. Borrowing by SMSFs, known as limited recourse borrowing, is heavily regulated.

## TRAP 1 BUYING & RENOVATING PROPERTY

David is the trustee for the DJ Smith Super Fund, which is a SMSF. David wishes to purchase a commercial property through his Fund, which will then be leased out to David's business.

The Fund does not have the cash to purchase the property, so David will arrange for the Fund to borrow from a bank under a limited recourse borrowing arrangement.

David intends to renovate the property and do the fit out for the business using the funds borrowed.

### IS DAVID ABLE TO DO THIS?

This strategy would not comply with section 67A(1)(a)(i) of the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act), as amounts borrowed under a limited recourse borrowing arrangement cannot be used to fund improvements to a property.

This strategy could comply with the SIS Act, provided the following conditions are met:

1. money from other sources is used to renovate the property. Note that if the funds are not sourced from the SMSF, the value of the improvement will need to be recorded as a contribution to the SMSF (and will count towards the contribution caps); and
2. the improvement does not create a significant change to the nature of the asset therefore resulting in a different asset. This tends to occur when the function of the asset is changed, for example by converting a house into a coworking space. It can also occur where there are legal changes made to a property, such as subdivision.

### WHAT DOES THIS MEAN FOR YOU?

If you are purchasing a property through your SMSF under a limited recourse borrowing arrangement and intend to renovate the property, we recommend you discuss this with us prior to doing so to ensure that you comply with the SIS Act. A failure to comply may result in the transaction having to be undone which will have significant adverse financial and tax consequences.

## TRAP 2 FARMLAND ACROSS SEPARATE TITLES

Sarah and John are trustees of the SJ Super Fund. Sarah and John want to purchase a large farm that is split across four separate titles, through their SMSF and using limited recourse borrowing.

The arrangement notes that vendor requires a deposit on the property with a final payment due at a later stage.

### ARE SARAH AND JOHN ABLE TO DO THIS?

This strategy would not comply with the section 67A(1)(a) of the SIS Act as the money is being applied for more than a single acquirable asset.

The SIS Act states that limited recourse borrowing may only be used to acquire one single asset. The ATO considers that where a single property spans across two or more titles and cannot be sold or dealt with separately, the property will be deemed to be a single acquirable asset. For example, a warehouse that spans across two lots would likely be treated as a single asset.

In the case of rural or farm land, each title is generally able to be dealt with separately and therefore would not meet the requirement of being a single acquirable asset.

### WHAT ARE THEIR OPTIONS?

There are a couple of options available to Sarah and John in this case to get around this rule. They could either:

1. arrange for the vendor to consolidate all titles into one title (although this will be time consuming and costly); or
2. hold each individual title (property) in a separate custodian trust, with a separate limited recourse loan.

### WHAT DOES THIS MEAN FOR YOU?

If you are arranging to purchase a property through your SMSF and are obtaining a limited recourse loan, you should seek our advice to confirm whether the property is likely to be considered by the ATO to be a "single acquirable asset" or separate assets. Depending on the situation, we can assist with obtaining a private ruling in order to give you certainty as to the way the ATO will treat the matter.

There are other considerations when using SMSFs to buy or borrow and specialised advice should be sought before committing.

In the event that you wish to discuss SMSF Borrowing arrangements, please contact one of our team members.