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Money

Property investing gets easier

MAKE IT

Self-managed super can be boosted by gearing — just be wary of the loan arrangements.

Trustees of self-managed superannuation funds (SMSFs) are turning more to gearing arrangements as they adjust to the lower contribution caps announced in the federal budget.

High net worth individuals have had their plans for large contributions into super disrupted by the lower caps and are looking for other ways to maximise their tax-effective investment in super.

Rules covering the use of warrants and other gearing mechanisms were made less restrictive in late 2007 and a number of lenders and warrants issuers have put together products for the trustees of SMSFs. But the area is still new and subject to ongoing review by the Australian Taxation Office.

Trustees need to have good advice if they are planning a gearing strategy for their fund.

On July 1 the maximum amount of concessional contributions super fund members can put in their account was cut from $50,000 to $25,000 a year for people under 50 and from $100,000 to $50,000 for the over 50s. The higher contribution cap for the over 50s lasts only until the 2011-12 financial year, after which all super fund members will have the same cap – $25,000 – irrespective of age.

Concessional contributions are payments made out of pre-tax salary. These attract a low 15 per cent contribution tax.

One way to maintain an ambitious asset accumulation plan without breaching the cap is to use gearing.

In September 2007 legislation was amended to clarify the law in relation to geared structures, such as **instalment warrants**, in super funds. The amendment went further than expected and established the right of funds to borrow to invest in any asset they would otherwise be allowed to borrow outright.

Since then the ATO has cautioned trustees of SMSFs to be careful about the types of loan arrangements they get into.

The ATO says trustees have to ensure that in entering into a loan contract they do not breach provisions of the Superannuation Industry (Supervision) Act that prohibit the acquisition of in-house assets or that require that the sole purpose of super investment is to accumulate benefits for use in retirement.

The ATO is also fussy about the way gearing is arranged (see below).

Assets acquired with borrowed funds must be held in a separate security trust until the loan is paid. The super fund has a beneficial interest in any income, interest or capital gains from the asset. When the loan is paid out ownership can be transferred to the super fund.

The existing assets of the fund have to be protected from loss if the loan goes bad. Loans must be non-recourse, which means that if the borrower defaults the lender can take possession of the property being offered as security but no other assets of the fund.

Lenders can ask the members of the fund to give personal guarantees, which means the lender could recover assets held outside super if the loan goes bad. Trustees cannot gear against assets already in the super fund.

Quantum Warrants national sales manager, Michael Kolikias, says his group has set up warrants for more than 300 SMSFs to gear into property over the past 18 months.

Kolikias says the ATO is still looking at a number of issues relating to these structures, particularly the practice of lenders asking for personal guarantees.

“What the ATO is looking at is whether it is consistent to offer a non-recourse loan and then ask for a guarantee,” Kolikias says.

The technical services manager at ING Australia, Graeme Colley, says he has come across some trustees who think that because the asset is held outside the super fund until it is paid for, the normal investment rules do not apply. Colley says rules such as the in-house assets test and sole-purpose test still apply.

Colley says ING has arranged about 100 loans for SMSFs through its division, Super Concepts. Most of the investments are commercial buildings in which the trustees of the fund operate their business. There are also some residential properties. “Trustees have to recognise that even though the geared asset is held outside the fund, it is accounted for as if it were an asset of the fund. Income from the asset comes into the fund and loan payments and maintenance fees are made out of the fund,” says Colley.

Need to know — how the rules apply

* In-house assets. A maximum of 5 per cent of a fund's assets can be used as a loan, lease or investment with a related party — a family member or business associate. Business real property is exempt.

* Sole purpose. Super savings can't be used to provide pre-retirement benefits to members and related parties.

* Geared assets must be held in a separate trust, usually referred to as the security trust, and can only be transferred to the super fund when the loan is fully paid.

* Loans must be non-recourse. In a normal mortgage contract, the lender has recourse to any of the borrower's assets to get its money back if the borrower defaults. When the loan is non-recourse, the lender can only have security over the asset being financed. Existing assets of the DIY fund are

protected from loss if the loan goes bad.

* Personal guarantees. Some lenders ask for a personal guarantee, taking a charge over assets held outside super. The ATO has expressed concern about this practice and has it under review.