

What is the rule on *borrowing to invest in Self Managed Super?*

Self Managed Super Funds (SMSF) are now allowed to borrow to invest in direct property or shares – as long as an *instalment warrant* is used for the transaction.

What is an instalment warrant?

An instalment warrant is a financial instrument which enables an SMSF to purchase a property or shares partly with borrowed money.

Typically the SMSF will contribute a sum of money to the purchase (called the 'first instalment') and arrange for a lender to contribute the balance (which is equal to the 'second instalment'). The lender could be a financial institution or a member of your SMSF.

The SMSF now has a beneficial interest in that property or shares, and as a result will receive all rent paid by the tenants or dividends generated by the shares. Tax at the concessional rate of 15% is payable on this income by the fund.

In addition, your SMSF pays interest on the loan and fees to the lender. In the case of a property it also pays for repairs, maintenance and property management expenses. These are deductible to the fund.

At the end of the term, the purchaser can choose whether or not to pay back the second instalment.

What are the options at the end of the term?

An instalment warrant over an asset will usually have a defined maturity date (typically 1 – 20 years). At the end of the term, the SMSF can:

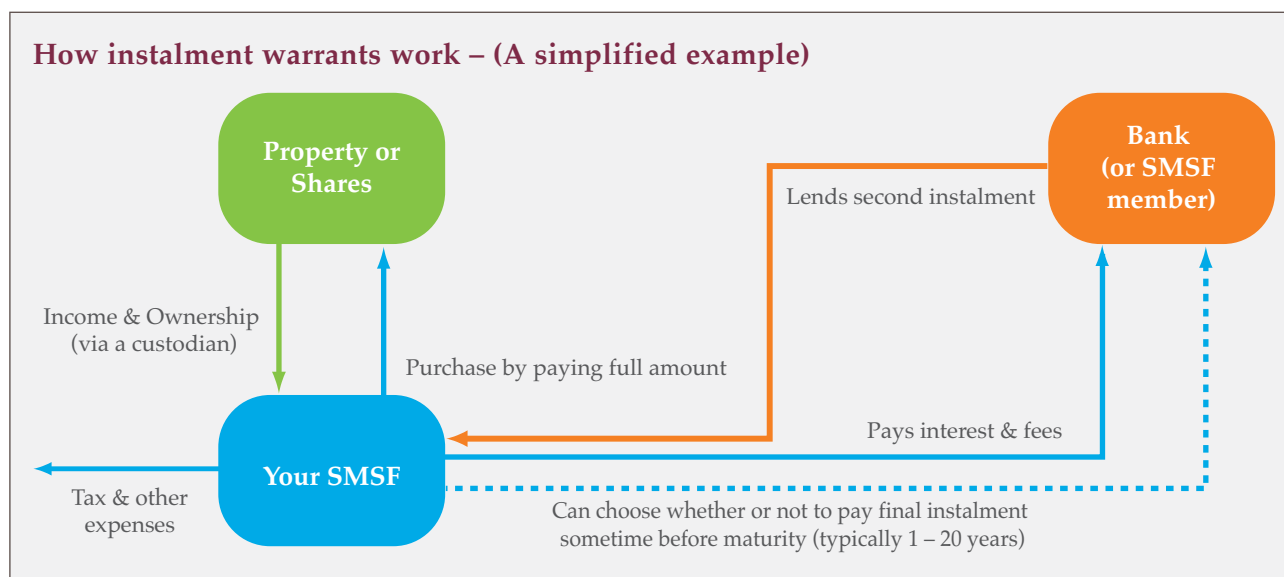
- Pay the second instalment and acquire full ownership of the asset, or
- Sell the instalment warrant on a secondary market, or
- Roll over the warrant for another term, or
- Do nothing, in which case the asset will be sold and the proceeds applied to the outstanding loan and other associated costs, with any leftover going to the SMSF.

Who should use instalment warrants?

Instalment warrants will suit those members of SMSFs who meet one or both of these criteria:

- Need to build their retirement savings faster
- Want to hold a key property inside the low tax super environment (e.g. their business premises).

How instalment warrants work – (A simplified example)



Some important points

Using instalment warrants inside your SMSF is not a simple process and professional advice is required. Some points you need to be aware of include:

- Your SMSF can only invest in assets which meet SIS regulations
- Your SMSF can only use instalment warrants if the trust deed allows them – this may require a modification to your SMSF trust deed
- You'll also need to establish a security custodian to facilitate instalment warrants
- The new limits on super contributions do not apply to the loan amount
- The loan used to purchase the asset can only be a 'limited recourse' loan which means the lender has no claim on any other assets in your SMSF other than the asset purchased with their money. The lender may, however, require security over assets outside of your SMSF.

PROS

- ▶ Your SMSF has more money invested than if it hadn't borrowed – and therefore your SMSF could potentially benefit from higher investment income and capital growth
- ▶ Investment income is taxed at just 15% maximum (compared to up to 46.5% outside of superannuation)
- ▶ Capital gains tax is only 15% maximum (compared to up to 46.5% outside of superannuation)
- ▶ The asset is fully protected from future litigation & bankruptcy you or your business may face (as long as it was not placed in your SMSF for protection against a specific litigation or bankruptcy you were aware of)

CONS

- ▶ Increased level of risk due to the investment of money which isn't yours
- ▶ The cost of borrowing is deductible at only 15% (compared to up to 46.5% if borrowing used outside of superannuation)
- ▶ Additional administration for SMSF trustees
- ▶ There is a cost to set up an instalment warrant facility
- ▶ Possible additional capital gains tax consequences if asset is sold prior to payment of second instalment

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- Superannuation
- Wealth creation
- Investments
- Home loans

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- Personal risk insurance
- Investment loans
- Car finance
- Business estate planning
- Business risk insurance.

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Because knowledge is the first step to creating a secure financial future.

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