



Smart gearing will help cover your assets

The tax benefits are agreeable, but it's important to know what you're getting into when meddling with super

THE advantage of gearing inside the super regime is that you access its tax benefits and potential asset protection and distribution advantages that aren't necessarily available elsewhere.



Tony Negline

The types of assets that can be purchased using super gearing include any asset that a super fund can own directly. The family home, any property you or your relatives intend to live in, even if the resident will pay your super fund a market rent, are automatically excluded. Also excluded are any assets you intend to use in a personal capacity. It's unlikely the bare trust — which is used to hold the loan while it is outstanding — would be able to own any significant shares in your business enterprise.

You may see bare trusts called a warrant trust, simple trust or even security trust. The bare trust's only beneficiary should be the super fund. This means that the bare trust's trustee cannot be the same as the super fund's trustee. (When there is no difference between the trustee of a trust and beneficiary of that trust, then you don't have a trust relationship.)

The key to the bare trust is that its governing rules should be simple. It's vital that under the bare trust's governing rules the super fund's trustee (as the bare trust's sole beneficiary) is able to take immediate possession of the asset at any time they choose. In effect the bare trust's trustee will have no independent role in respect of the trust property.

The super fund's trustee is unlikely to ask for the asset before the loan is repaid because this would result in the super fund breaching other super fund rules, but nevertheless the super fund's trustee must have the ability to make this demand.

Some financial institutions are insisting that the bare trust's governing

rules allow the super fund to take full possession of the asset only once the loan has been repaid.

Vince Scully, technical adviser at SMSF Finance Specialists, believes that this type of provision may give rise to capital gains tax when the asset is

transferred from the bare trust to the super fund. The transfer may be capital gains tax-exempt only if the super fund is "absolutely entitled" to the asset in the bare trust.

Townsend's Business & Corporate Lawyers principal Peter Townsend says the timing of when segments of the purchase transaction occur can be important. "In NSW, Victoria, Tasmania and the ACT, the contract to purchase the property must be signed before the bare trust is created. However in Western Australia, Queensland and South Australia this process has to be reversed; you create the bare trust before signing the contract to purchase the property," he says.

If you get this process wrong, then ad valorem stamp duty may be payable twice. "If the super fund is based in one state and the property in another, then you follow the rules in the state where the property is located, not where the super fund is domiciled," Townsend says.

When exchanging the property sale contracts it's important to make sure they are done in the right names otherwise stamp duty problems can arise. Townsend says he has seen people use private money to pay the initial deposit, not super fund money.

Let's look at the loan and the lender. If an investor has sufficient spare capital in their own name or related entity, then it's possible to lend that money to the super fund. This can be a great way to escape the maximum concessional and non-concessional contribution restrictions.

Most super gearing arrangements now being set up involve third-party



Australian
Wednesday 10/6/2009
Page: 8
Section: Wealth
Region: Australia Circulation: 137,000
Type: National
Size: 491.68 sq.cms.
Frequency: MTWTF

Brief: CHRIS HOCK
Page 2 of 2



Warning: SMSF Finance Specialists adviser Vince Scully says transferring assets can have capital gains implications

lending. After a slow start, most of the banks appear to be offering super gearing loans.

Some banks are demanding the super fund's members provide a personal guarantee or additional security. Lenders like the guarantee or security because without it they can protect themselves only by selling the asset purchased with the loan.

Chris Batten, Macquarie Group Services managing director, has obtained an opinion from Ernst & Young in relation to the super fund member providing "personal property as security and-or a personal guarantee to the lender in respect of the loan in consideration for the lender providing additional loan funds and a lower interest rate". These

personal guarantees, or security, can create substantial tax problems for the super fund.

A more valuable property may be purchased and the rental income is likely to be more than that expected from a lesser value property. Similarly, where a property of greater value is purchased because of the guarantee, then the net capital gain may be more than expected from a lesser-value property.

Ernst & Young says the income and capital from additional security or personal guarantees may not be seen as non-arm's length income. The income tax laws contain a provision that says that if a super fund receives non-arm's length income or capital, then penalty tax rates (46.5 per cent)

may apply to that income and capital.

This penalty tax would apply even if the super fund were paying a pension when it is meant to have a zero per cent tax rate on its income and capital gains earned on those assets.

Next week we conclude our discussion on super gearing by looking at how the asset is transferred out of the bare trust, and other important tax and stamp duty issues.

Disclosure: Tony Negline provides services to SUPERCentral Pty Ltd. Peter Townsend is its managing director. Negline may be contacted at



www.atcbiz.com.au