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**SELF MANAGED SUPER FUNDS (SMSF)**

**A TAX EFFECTIVE STRUCTURE TO SAVE FOR YOUR FUTURE RETIREMENT**

 Mark Neaverson and Associates 1

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**ALTERNATIVES AVAILABLE TO SAVE FOR YOUR RETIREMENT**


1. NEGATIVE GEARING OF PROPERTY
2. PERSONAL MARGIN LENDING OF STOCKS & SHARES
3. CASH SAVINGS
4. PERSONALLY DEVELOP A SHARE & STOCK PORTFOLIO
5. DOWNSIZING YOUR HOME ON RETIREMENT
6. SUPERANNUATION



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**What is the tax effect of each Saving Alternative now and on retirement**


	• Individual	• Super Fund
• Negative Gearing	• Always assessed on income & CGT at Marginal Rates	• Assessed at 15% on income & CGT – Nil When Pension Fund
• Margin Lending of Stocks & Shares	• Always assessed on income & CGT at Marginal Rates	• Assessed at 15% on income & CGT – Nil When Pension Fund



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**What is the tax effect of each Saving Alternative now and on retirement**

	• Individual	• Super Fund
• Cash Savings	• Always assessed on income at Marginal Rates	• Assessed at 15% on income - Nil When Pension Fund
• Personally Develop a Share & Stock Portfolio	• Always assessed on income & CGT at Marginal Rates	• Assessed at 15% on income & CGT - Nil When Pension Fund

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**REGULATION OF SMSF**


1. All super funds are regulated by the SIS legislation.
2. Self managed funds are controlled by the Australian Taxation Office.

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**Changes to SIS**

- Tax Law amendment Bill No.5, 24 September 2007 two amendments to SIS Act section 67 & 71
  - Sec 67...borrowing prohibition clause.....has new clause 67(4A)
  - Sec 71(8).....definition of in-house assets..... specifically excludes warrant trust as in-house asset

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SMSF's Borrowing to buy Property – MN & Assocs

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### New Section 64 (4A)

- So what does it mean?
  - Trustee must borrow for purpose of acquiring an asset, not against an existing asset
  - Asset must not be prohibited (ie.. Acquiring an asset from a member)
  - Asset must be held on trust
  - SMSF Trustee can acquire the asset after it has paid for it
  - Lenders rights against the trustee are only against the asset purchased



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### New Section 71 (8)

- So what does it mean?
  - Without this section an investment in the warrant trust would be an in house asset and therefore not allowed
  - This section does not allow the SMSF Trustee to take up units in a Unit Trust (ATO Instalment Warrants and super funds – questions and answers)
  - Other problems is unwinding a unit trust as this could trigger
    - Capital Gains Tax
    - Stamp Duty
    - GST
  - May not be able to unwind if a related trust (can acquire residential real estate from a related party)
  - Because of these issues a unit trust is not recommended



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### Bare Trust Structure


- The recommended structure is a bare trust
  - This effectively makes the original asset an asset owned directly by the SMSF
  - Only used to satisfy s67(4A) requirement that the asset be “held in trust”
  - If structured correctly will mean no CGT, Stamp Duty or GST upon unwinding the arrangement



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### What Is A Bare Trust


- What is a bare trust?
  - An asset is held by the trustee for the absolute benefit of a beneficiary.
- Who can be the trustee?
  - Anyone except the trustee of the SMSF (you can't hold an asset in trust for yourself).



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### Current Lending Requirements


- Banks have been very slow to develop a product that complies with SIS regulations
- The Bank will only lend 70% of the property Value
- Bank only has security over the property
- Banks Require Corporate Trustee of SMSF & Bare Trust
- Interest Rate Approx 7% (2% margin)



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### Potential Problem with 30% Deposit & Purchasing Costs

- Funds need to come from existing funds in superannuation
- The member or employer sponsor can lend funds to the superannuation fund to make up the shortfall
- Potential problem with member or employer sponsor needing to have security against the loan



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**ATO Concerns TA 2008/5**

*"monies advanced by a member or related party at zero or less than a commercial rate of interest could be characterised as a contribution to the SMSF. This may result in the trustee/member having to pay excess non-concessional contributions tax under Division 292 of the Income Tax Assessment Act 1997"*

*So you can lend to the fund yourself but it must not be at a discounted interest rate*



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**Limit on Contributions to SMSF**

- Members Aged over 50 - \$50,000
- Members Aged under 50 - \$25,000
- All Contributions under the limit are taxed at 15%
- If Contributions to super funds exceed the limit the excess contribution is taxed at 46.5%



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**Protection of Super Fund Assets**

- Under Current Legislation if the member or their business goes broke the creditors cannot get access to Superannuation Fund Assets.
- The Asset Portfolio that you have created in your SMSF is protected.




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**TA 2008/5**

– *“monies advanced by a member or related party at greater than a commercial interest rate of interest may result in:*

- *a breach of the sole purpose test outlined in section 62 of the SIS Act, on the basis that the excessive interest rate may mean that the SMSF is not being maintained solely for the purpose of providing superannuation benefits, and/or*
- *the trustee breaching paragraph 65(1)(b) of the SIS Act, which prohibits the trustee from giving financial assistance to a member of the SMSF or to a relative of such a member using the resources of the SMSF;”*

*So you can lend to the fund yourself but you must not profit from the fund by charging excess interest*



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**Case Study – Transfer of Business Premises to Super Fund**


- Sam's Electrical Services Pty Limited (SES) currently has business premises used to store equipment & materials
- SES wants to transfer the property to a SMSF
- SES is required to get a market valuation on his property and the market rental
- The bank will lend the Super Fund 70% of the value of the property. The Super fund needs the 30% balance and the costs of purchase.



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**Case Study SES Continued**


- The market valuation comes in at \$400,000
- The Super Fund needs funds of 30%  
Deposit = \$120,000 plus Stamp Duty \$13,000 plus legals of \$1,200 plus setup costs of \$3,000 plus borrowing costs \$2,500.... TOTAL COSTS \$140,000



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### SES Case Study – Points to Consider

- Transfer of Property from SES to Super Fund may Trigger CGT Liability
- Member may need to transfer super funds from other accounts & lock in book loss to get deposit & setup costs
- If the member loans the Super Fund the funds for deposit has he/she got security to borrow funds
- The Super Fund will incur stamp duty for purchase.
- The sale of the property by the employer sponsor will create cash for the equity held in the property
- The Property will now be protected if the business fails.
- IF the Super Fund holds the property until the members retires and converts the fund to a pension fund will not have to pay CGT if the property is subsequently sold.
- If the Super Fund holds the property for more than 12 months CGT will be limited to 10%.
- The Super Fund maybe able to use the Super contributions to reduce the loan principal.




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### Case Study - Purchasing a property in a Super Fund

- Fred Stevens decides to purchase a property in Paradise Palms Queensland for \$450,000
- Deposit 30% @ \$450,000 = \$135,000
- Stamp Duty \$ 14,000
- Legal \$ 1,200
- Bank Fees \$ 2,300


TOTAL	<u>\$152,500</u>
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### Case Study – Purchasing A Property in A Super Fund

- Expected Rental @ 6% = \$27,040
- Less Expenses
- Rates, Insurances, Fees \$ 6,551
- Interest Paid \$315 k @ 7 % \$22,050
- Total Cash Expenses 28,601
- Net Cash Deficit -\$1,561
- Depreciation \$12,156
- Total Deductions \$40,757
- **Net Tax Loss** -\$13,717



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**Case Study – Purchase a property  
in a Super Fund**

- Tax Saving on Contribution of \$13,717 is \$2057.55
- Member Decides to make a contribution of \$50,000 and claims a tax deduction.
- Super Fund pays tax on 50,000 – 13,717 = \$5,442.45
- Net Cash in Super Fund of \$42,996.55 can be either used as principal loan repayment or deposit for further investment



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**Advantages & Disadvantages of  
Buying Property in Super Fund**

- |   |  |
|---|--|
| <ul style="list-style-type: none"><li>• <b>ADVANTAGES</b></li><li>• Asset Protection</li><li>• No CGT &amp; Income Tax When you retire</li><li>• Tax Deduction of Contributions used to Reduce Loan Principal</li><li>• Lower income tax rate on earnings &amp; CGT</li></ul> | <ul style="list-style-type: none"><li>• <b>DISADVANTAGES</b></li><li>• Can't access funds until you retire</li><li>• Cost of setting up Super structure</li><li>• Cost of complying with SIS regulations</li></ul> |
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