

Borrowing by Super Funds

As many would be aware, recent changes to the superannuation laws now enable super funds to borrow money to purchase assets and thereby gear up their holdings - a concession likely to appeal to many clients.

The major banks are currently launching new products designed to meet the expected demand.

However, in the rush to take advantage of these changes, there is risk that critical requirements will be missed, some less obvious than others, with potentially disastrous results.

Until recently, the circumstances under which a super fund could borrow were very restricted. Now, with the addition of sub-section 67(4A) to the *Superannuation Industry (Supervision) Act 1993*, super funds may borrow from any source, whether a third party financier such as a bank, or a related party, to finance the acquisition of an asset.

Although apparently drafted with instalment warrant products in mind, the new rules operate broadly and open a number of possibilities, including:

- the super fund borrowing directly from a financial institution to enable purchase of an asset on the open market;
- a loan from a member of the fund or related entity who has funds available, but due to the contributions cap is unable to contribute them;
- borrowing to enable purchase of business real property at market value from a related party.

Certain requirements must be met, the two main ones being that:

(a) the asset, and any replacement asset, must be held by a "bare trustee" on behalf of the trustee of the super fund;

(b) the loan must be limited recourse - that is, permitting the lender to recover for non-repayment of the loan only against the asset itself, and not from other assets of the super fund.

In addition, the normal restrictions on the purchase of an asset by a trust fund will apply, such as:

(c) the requirement for arm's length dealings - this means that the terms of the loan, such as the interest rate, should be based on normal commercial terms;

(d) the restriction against acquiring assets, other than listed securities and business real property at market value, from a fund member or related party.

It will also be necessary to check that the trust deed establishing the super fund actually allows borrowing by the trustee, and that the proposed investment is consistent with the super fund's existing investment strategy.

Warnings have already been issued by the Tax Office, and each client's affairs will need to be reviewed on their own circumstances to ensure that not only the criteria set out in the SIS Act but also the less-obvious requirements have been met. Non-compliance can lead to serious consequences, with both civil and criminal penalties applying. In the case of a loan from a member not being properly documented, it might result in the contributions cap being exceeded and penalty tax rates being applied.

In response to strong enquiry, we have developed a new product designed to establish a bare trust (or "security trust", as it is also called) to enable clients to comply with the new rules. If the lender requires third party guarantees from fund members or anyone else, other documentation may also be required.

As an add-on service, we can also prepare trust deed variations if the current deed does not permit the proposed borrowing, and can prepare the loan agreement itself if the borrowing is from a related party.

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