eBook

NO.002

PROPERTY

P U L S E

PROPERTY INVESTMENT
:INVESTING THROUGH SUPER

Contents

INTRODUCTION

It is a common belief among wealth advisers that setting up a 'Self-Managed Super Fund' (SMSF) is the most fruitful and successive way to secure your retirement plan. A way of using the SMSF as a tool is to buy property.

A risky and complex, what it looks at first, but if it is managed and properly supervised, it might come out the one decision for a lifetime.

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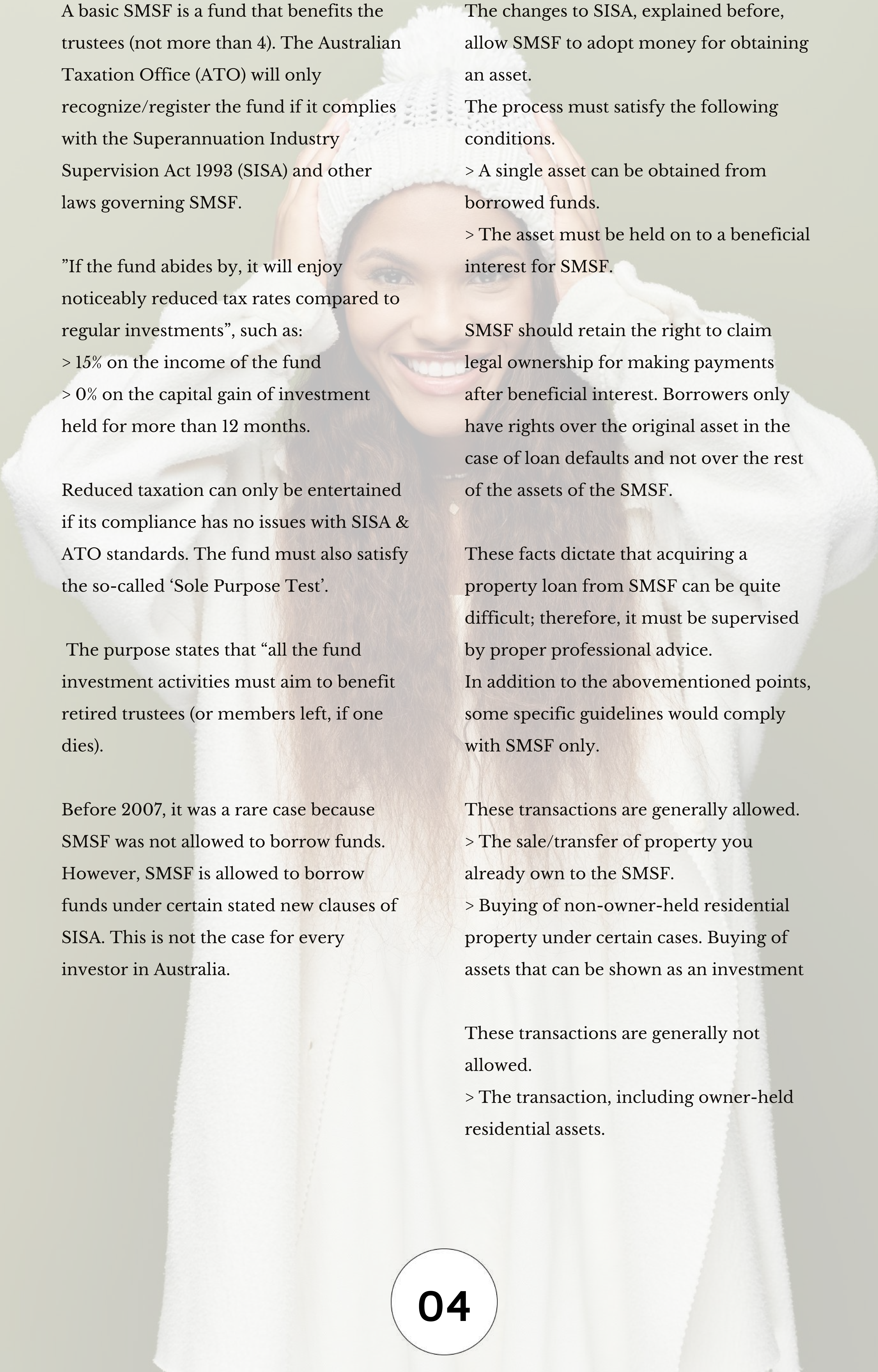
This little effort aims to make you aware of the benefits and pitfalls of buying a property with SMSF, plus it would also look into managing finance and your investment. We believe the information provided in this guide will help you decide whether the above option was a good decision.

Specifically, the eBook will focus on matters covering investment properties inside the SMSF

PROPERTY IN SMSF: FUNDAMENTALS



A basic SMSF is a fund that benefits the trustees (not more than 4). The Australian Taxation Office (ATO) will only recognize/register the fund if it complies with the Superannuation Industry Supervision Act 1993 (SISA) and other laws governing SMSF.

”If the fund abides by, it will enjoy noticeably reduced tax rates compared to regular investments”, such as:
> 15% on the income of the fund
> 0% on the capital gain of investment held for more than 12 months.

Reduced taxation can only be entertained if its compliance has no issues with SISA & ATO standards. The fund must also satisfy the so-called ‘Sole Purpose Test’.

The purpose states that “all the fund investment activities must aim to benefit retired trustees (or members left, if one dies).

Before 2007, it was a rare case because SMSF was not allowed to borrow funds. However, SMSF is allowed to borrow funds under certain stated new clauses of SISA. This is not the case for every investor in Australia.

COMPULSORIES AND FORBIDDEN IN SMSF

The changes to SISA, explained before, allow SMSF to adopt money for obtaining an asset.
The process must satisfy the following conditions.
> A single asset can be obtained from borrowed funds.
> The asset must be held on to a beneficial interest for SMSF.

SMSF should retain the right to claim legal ownership for making payments after beneficial interest. Borrowers only have rights over the original asset in the case of loan defaults and not over the rest of the assets of the SMSF.

These facts dictate that acquiring a property loan from SMSF can be quite difficult; therefore, it must be supervised by proper professional advice.
In addition to the abovementioned points, some specific guidelines would comply with SMSF only.

These transactions are generally allowed.
> The sale/transfer of property you already own to the SMSF.
> Buying of non-owner-held residential property under certain cases. Buying of assets that can be shown as an investment

These transactions are generally not allowed.
> The transaction, including owner-held residential assets.

BANK CRITERIA AND EXCLUSION FOR THIS TYPE OF LOAN

> Property purchases adhering to SISA loans for building and renovation are not currently being provided. The same is the case for empty land.

> Most lenders ask for the loan to value ratio of up to 70% for residential property.

> Some lenders may ask for certain authorities in the SMSF Trust deed, so they may ask you to amend it.

> Some may ask for written proof of expert advice sought, and then they may begin the process.
> Some may ask for an insurance policy so they can be excluded from the risk of default. It is due to an increased focus on adequate insurance.
> Some lenders may ask for a personal guarantee from SMSF members. Lenders are generally interested in assessing the process of debt servicing by the rent and the track record of the member's contribution to the asset.

So it is highly recommended that you try to achieve a loan free of these requisites. Once the fund is managed, the debt can be paid as normal.
> Differ mortgage terms
> Set up offset accounts
> Create additional payments
> Pay loan anytime

It is advocated that you must use expert advice to deal with these complex matters, which can easily handle through skill and practice.

DISTINCTIVE TRANSACTIONS

Two distinctive transactions can greatly enhance the strength of your SMSF, including following the inclusion of the commercial fund into the SMSF that you already own. With advanced knowledge about governing laws and legislation, thus it is highly recommended to attain professional services from fiscal advisers. The two transactions in the discussion are 'Business real property transfers' & 'Investing a Tenant in common'.

BUSINESS PROPERTY REAL TRANSFERS:

According to the exemption in section 66-(2) of the Superannuation Industry Supervision Act, the Trustees are allowed to obtain profits in the real business properties without lease-back to related parties falling foul of related party rules. If all the relevant rules are taken care of, members' business premises can be transferred to the SMSF.

This approach acknowledges substantial benefits:
> The ability to move business property into SMSF in a way that reduces Tax Liabilities.
> The ability to reconstruct non-deductible debt into deductible one.

BUSINESS PROPERTY REAL TRANSFERS:

Business Real property is any freehold or the leasehold interest of an entity in the real property, where the interest can be transferred, and the property can be used in one or more businesses as either a part or a whole.

QUESTIONS RAISED WITH SMSF INVESTMENTS

These are the main issues related to SMSF property deals:
> An SMSF, including property investments, will have to be properly managed. You have to ensure there are no ambiguities; otherwise, the laws are very strict, and you may have to pay a lot for them.

> Trustees are held responsible for making investment strategies. So as a trustee, you may have to set definite strategies and solid groundwork before doing it. This is the main point on which most people are challenged.

> The fiscal arrangements for buying property in SMSF are somewhat more difficult than normal investments. So you have to be precise and accurate when making decisions. It looks fine but can be quite complicated at times.

The reasons mentioned above are insufficient to discourage you from investing using SMSF, but they enlighten the fact to get the best possible financial advice.

BUILDING PROPERTY INVESTMENTS IN SMSF

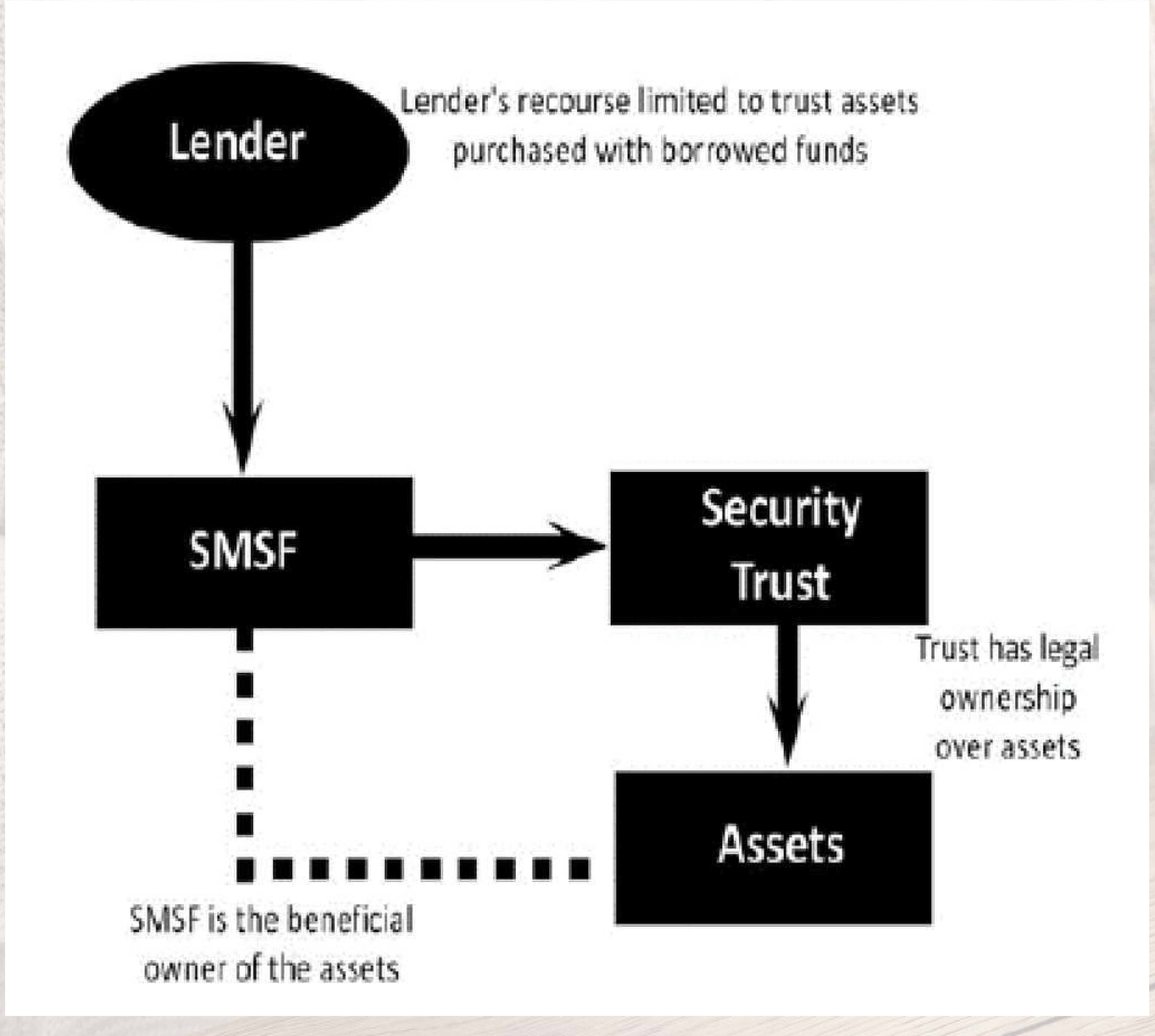
SMSF is an investment tool with a set purpose: To give retirees income according to the laws and tools guiding SMSF. Therefore, SMSF funds are verified by the regulators. The trustees of SMSF should know this fact and must have a serious attitude toward adhering to those procedures which guide SMSF. Some basics of these procedures are explained below.

The mechanism governing SMSF property investment structure is called 'Installment Warrant Structure'. It deals with the activities of a super fund in the property business that is then placed in trust. SMSF will have ownership of the asset, but it will be legally of the trust.

Borrowing funds must also adhere to the legislation; it must be a limited recourse borrowing arrangement (LRBA). The borrower has no recourse to the other assets in the funds. He has only access to the asset for which funds have been borrowed.

All the profits and capital growths will be paid off to the SMSF as it is the beneficial owner.

The pictorial representation of the structure of SMSF makes it clearer:



INVESTING IN THE PROPERTY AS 'OWNER IN COMMON.'

An 'owner in common' agreement can allow SMSF to co-invest in a real business party with an investor. 'Owner in common' bears shared rights to an asset - generally a set percentage of the total. The OIC's share can be considered a single acquirable investment, such as a property.

Its benefit includes:
> Power to invest in business property with a related party without breaking the rules governing SMSF
> Power to invest in more expensive properties
> A commercial asset can be obtained from the owner over time.

Possible disadvantages related to OIC Arrangement.
> The laws regarding borrowing funds to acquire a stake in OIC are complex and may be subject to change ATO Issues.
> A gradual transfer of residential property to SMSF cannot be done via OIC arrangement.
> It can create hurdles in the pension drawdown phase.

REQUISITES AND RULINGS

A document named ATO ruling on managing SMSF was released to clarify the ambiguities in SMSF. All the fund members must keep a copy of it. Some areas where special attention is required are:
Adhering to the laws about 'Single obtainable asset.'
SMSF rules require you to establish security trust to control Single Obtainable assets.

A strict interpretation states with 'one asset, one title'.
The recent ATO draft ruling clarifies the ambiguity stating that an asset cannot be viewed as a single asset if irreparable.

A complex area where the trusts would be advised to seek proper advice to ensure their activities stick to the rules.

Administering transparent differences between maintenance and improvement
Superannuation laws allow SMSF trustees to borrow funds for the maintenance and repair of their assets but not for their improvement.

This ambiguity has also been clearly stated in the ATO Draft ruling. Maintenance and repair of an asset are done on the same asset, but improving an asset means an addition to the asset, which is not allowed in any case.

The difference is more clarified in the example:
If a fire substantially damages a kitchen, repairs to bring it up to its previous standard would be allowed. If, however, the trustees decide to extend the kitchen simultaneously, this will be deemed an improvement and not allowed under SMSF rules.

REPLACEMENT ASSETS

Trustees of SMSF are allowed to use their existing funds if they desire to improve the assets. It is permissible to add some features, but completely changing an asset is not allowed.

ATO WARNING ON GETTING MAINTENANCE COMPLIANCE

The ATO issued a taxpayer alert comprising the following !
“The ATO is concerned that some of these arrangements if structured incorrectly, cannot simply be restructured or rectified; and unwinding the arrangement may involve a forced sale of the asset, which could cause substantial loss to the fund.”

FAULTY LRBA ARRANGEMENT

Purchases within an SMSF rely on LRBA. The ATO has serious issues: numerous funds do not comply with it, thus making the fund ineligible.

Some of the most common mistakes are mentioned in the alert, but it is also clear that those who deliberately or without notice out of the legislation would not be relaxed. Non-compliance can lead to serious issues regarding personal tax refunds.

FAULTY LRBA ARRANGEMENT

The ATO is unhappy with the improper use of a related unit trust. His concerns in this area are rather technical than personal; therefore, this clarifies the need for basic homework here.

There can be very unpleasant tax implications when the ATO finds out that the related Unit trust fails to pass the ‘Sole Purpose Test’.

MISTAKES IN SMSF PROPERTY, TO AVOID

1. Being careless.
2. While it can be a very fruitful process, it can have negative consequences if not used correctly. Some important points must be considered:
3. People with a small amount in their funds
4. Closer to retirement people
5. People who are against taking risks
6. Naming the buyer.
7. This one can be extremely difficult to amend. You have to buy in the name of a fund; if you do not, you may deem non-compliant by the ATO.
8. More than one title.
9. SMSF allows a 'single obtainable asset'. This does not allow for a different name for your asset.
10. Legal ownership Transference.
11. The trustee and security trust must be functional when signing the asset-buying contract. If not adhered to, this can be a costly mistake.
12. Purchase through a related party.
13. SMSF has simple and straight rules regarding residential property, you cannot buy from yourself, and you cannot buy from any related party.

THE STEPS AHEAD

It may look like we are repeating the same point in different words, but we want to ensure that we have informed you about every aspect. SMSF provides benefits to retired members. However, there are rigid rules for the 'drawdown.'

Drawdown can range from 5% yearly at 65 to 14% yearly at 95. Trustees must ensure they have sufficient funds to meet drawdown demands. If not, it may lead to quick steps like selling the property held in the fund to meet drawdown criteria, which is not desirable.

Drawdown requirements make serious consideration when trustees make plans to decide on investing or not!

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CONCLUSION

Property investments can be immensely profitable and an excellent way to create wealth. However, there are some associated risks. Predicting profits and guessing taxation is highly complicated, and it requires expertise when you are planning for negatively geared investments.

It would be best if you relied on a professional financial advisor who can understand your financial position and guide you according to them to maximize your profits and make a successful wealth-generating plan. You will make progress on your road to financial independence with the support of the right advisor.

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Our team members are specialist investment planners in property, and what we do is different to that of a financial planner. We are licenced to deal in real estate, not financial planning.

Financial planners and accountants often buy into us to assist their clients in starting a successful property portfolio. We have no specialist skills in family succession, shares, or testaments. We do not hold an Australian Financial Services or Credit Licence. Until we learn more about your uniqueness, the opinions published here can only be general.

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The data in the following graphs and tables are from third-party authoritative sources, all listed at the rear of this document.
These use historical data. Of course, past performance is not necessarily indicative of near- future results. We use this data to highlight long-term trends.

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We believe that any financial commitment is a big step in your journey, so we strongly recommend obtaining independent advice before making financial decisions arising from this document.

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The law compels us to state that we make no warranty as to the accuracy, completeness, or reliability of the information, including the tools used to compute the information, nor do we accept any liability and responsibility arising in any way from omissions or errors contained in this document.
All arguments herein are made in good faith, and all data has been obtained in good faith from the most accurate sources we could find, much from government agencies

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Feel free to contact us to set up an initial complimentary meeting and find out how we can help you on your quest to develop your property portfolio that can change your future.

The steps include:
Step one. Relationship.
Step two. Knowing the numbers.
Step three. The choices.
Step four. Recommendations.
Step five. Plan into action.
Step six. Working together as a team.

CONTACT US TO START YOUR RELATIONSHIP WITH OUR LICENSED TEAM MEMBERS