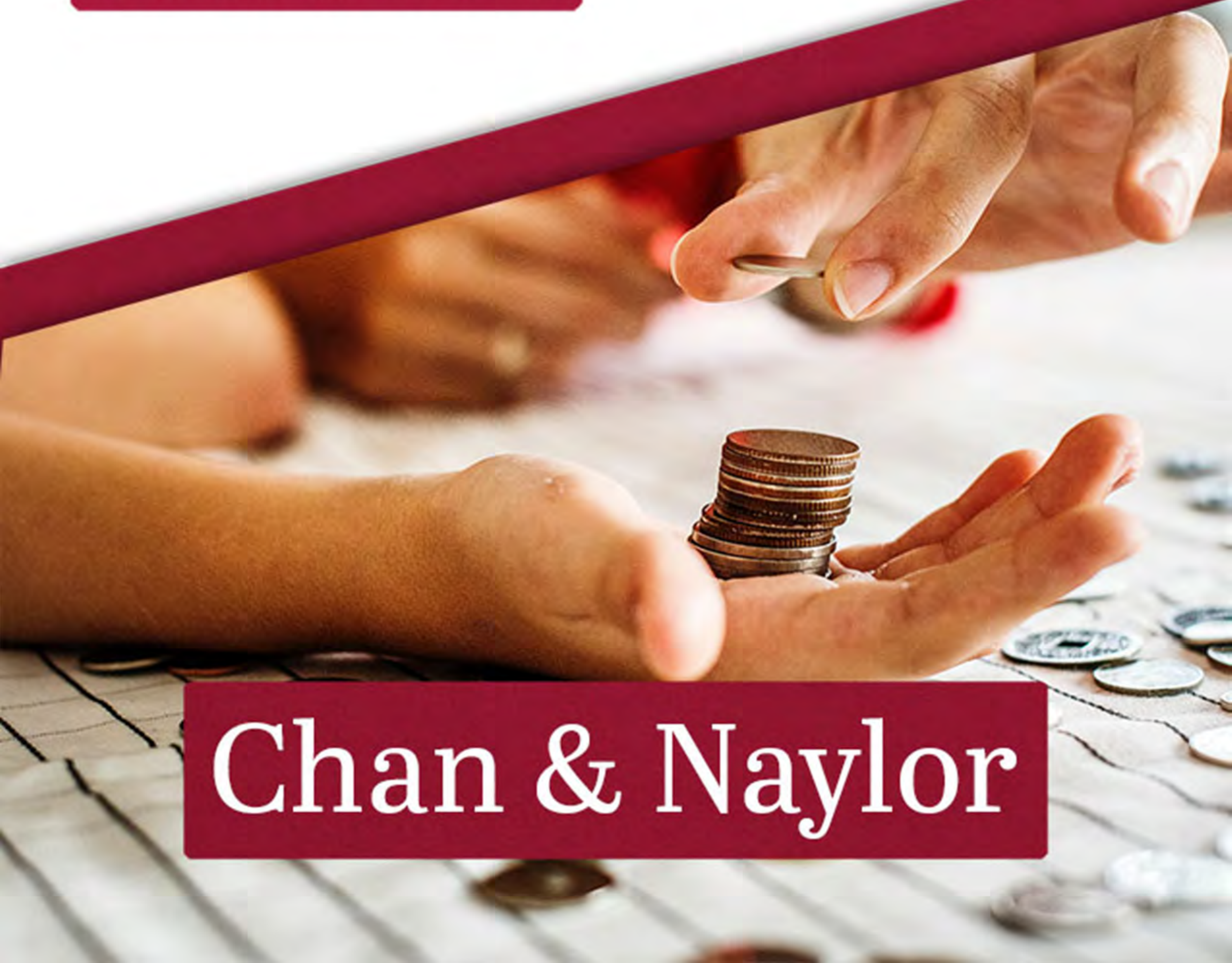
Get Smart with Property Series!

How to Use Your *Super* to Purchase *Property* with Debt

DOWNLOADABLE E-BOOK



Chan & Naylor

WARNING

Disclaimer - This e-booklet contains general information only

This information has been prepared as a general guideline, and is not intended to be an exhaustive or a complete analysis of the topics in question or issues raised in this e booklet. There are many particular legal, taxation and accounting matters which have not been dealt with in this e booklet and readers are urged to discuss any aspect of the operation of any of these matters discussed herein with their professional advisers. In particular asset protection, estate planning and superannuation are potentially very litigious areas of law and you will need specific advice before you take any actions if you want your wishes complied with. Before taking any action or implementing any strategy you should seek professional advice from your lawyer, accountant and or financial planner who will take into account your specific circumstances and objectives. Please note that the complementary 10-15 minute consultation will not be giving you specific advice as there is not enough time to review your specific circumstances and is only aimed at providing a general idea of what the law allows. If you require specific advice you will need a more detailed consultation.

Whilst reasonable care has been taken in preparation of this information, subsequent changes in circumstances (including legislative changes) may occur at any time and may impact on the accuracy of this information. Chan & Naylor Australia Pty Ltd nor its directors, officers or associated and related entities including the author take no responsibility for any omissions or inaccuracies in this information and will not be held liable for any losses or damages that may result in the use of this information.

The information contained is accurate at the time of publication being 28th April 2014.

Using your Self-Managed Superfund to purchase property with debt – Holding Trust

Table of Contents

1. General Overview of Superannuation

In today's aging population and ever increasing demands on the public purse, it is becoming increasingly necessary for individuals to prepare themselves for their own financial security in retirement.

Superannuation has become a growing component of peoples retirement and with the introduction on 1 July 1992 of the super guarantee system, most people (over 86%; Source: Superannuation Australia ABS) now have a compulsory method of superannuation. The rate of the superannuation guarantee now stands at is 9.25% (9.5% from 1 July 2014), and together with the recent abolition of tax for super funds in pension stage, the benefits of superannuation are significant. Yes you read correctly, in today's taxation environment zero tax and you do not go to jail. Total funds invested in superannuation is approximately $1.8 trillion as at 31 December 2013 with 30% or $532 billion of these funds in a self-managed superannuation fund (SMSF).

Given the above taxation benefits of superannuation, in pension stage and concessionally taxed superannuation environment in pre-pension stage, many Australians have increased their superannuation balances. The superannuation industry is governed by APRA for the retail and masterfunds and by the ATO from 8 October 1999 for SMSF. The SMSF industry has increased significantly over recent time as people seek to gain a greater control over their investments or are seeking to contain costs. The current assets per member in a SMSF now stands at over $534,000 (Source: ATO Statistical Report December 2013) and compares to approximately $30,000 per member in a non SMSF (i.e. retail, industry or masterfund) fund (Source: Annual Superannuation Bulletin APRA June 2013 revised 5 February 2014).

2. Self-Managed Super Fund Borrowing

The following takes the reader through the various ATO guidelines and rulings chronologically. The reader needs to read the total section to take them to the ATO views as at 23 May 2012 in SMSFR 2012/1 as different treatments have eventuated for the same set of facts over time. Do not despair about the number of ATO changes as time has allowed the ATO to adopt a more pragmatic and investor beneficial view.

<u>11th August 1999</u>

Legislation was introduced 11th August 1999 that effectively stopped allowing SMSF to borrow when using superannuation and as such, notwithstanding the attractive taxation benefits many people secured assets outside of superannuation to avail themselves of the leveraging benefits of using debt.

24th September 2007

On 24th September 2007 the Federal Government introduced new legislation to allow superannuation funds to borrow under certain conditions. This borrowing procedure is referred to as a Limited Recourse SMSF Loan (LRSMSFL), but it can be called anything. The ATO refers to it as Limited Recourse Borrowing Arrangement (LRBA). Its name is of less importance than what it is doing. This is similar to the process used when Telstra first floated where payment for the shares was made with two instalments.

In plain English, a LRSMSFL is a structured loan where there is a first instalment and a latter (or a series of) instalment/s. While there is a loan and the asset acquired is used as security the asset must be held outside of the superfund in a Holding Trust with a Company acting as Trustee. The underlying asset which is secured does not pass over to the SMSF until the final instalment is paid at which time the legal title passes on; normally without capital gains tax or stamp duty (care needed as some states charge stamp duty on the transfer to SMSF if the paperwork at purchase date is not correct). The ATO requires the property to be transferred when all the debt is repaid or imposes severe penalties which could be as high as 50% of the SMSF assets. Correctly structured no stamp duty will be due on the transfer and no capital gains tax will be levied.

Under a LRSMSFL the loan agreement is drawn up to specify that if the instalments are not paid then the asset does not pass over to the SMSF and there is no liability or requirement by the borrower (i.e. the SMSF) to pay any outstanding sums. In essence, it is a loan without any requirement to repay and no litigation or credit rating impact on the borrower for non-payment, they simply do not get “ownership” of the asset. The legislation was written in such a way that prescribed the exact methodology required if borrowing were to take place. Banks will typically require someone to offer additional security or guarantee to ensure the bank does not lose out in the event of a default. It is perfectly allowable under the super legislation for this additional security or guarantees to be given. The only stipulation is that in the event of a default no other SMSF asset can be taken by the bank, only the asset purchased and held in the Holding Trust.

7th July 2010

The ATO issued additional guidelines on 7th July 2010 explaining what they interpret the borrowing arrangements apply to including the definition of what constitutes an asset (which the ATO has called the single acquirable asset) and how a loan structure needs to be set up and administered. These new rules apply to limited recourse borrowing arrangements put in place on or after 7 July 2010, and arrangements put in place after 24 September 2007 and before 7 July 2010 if the loan is refinanced on or after 7 July 2010. These guidelines are designed to ensure compliance with the relevant statutes as they relate to the use of limited recourse borrowing arrangements by superannuation funds.

As part of the new guidelines it is critical to keep in mind that any refinancing of a pre 7th July 2010 loan will now need to comply with the requirements of a post 7th July 2010 loan and so you will need to consider the impact on what assets can be held by the loan and what if any improvements to the asset can be undertaken once a refinance takes place.

One of the significant items in the 7 July 2010 guidelines was that you could not do a renovation on a property “held” in the SMSF that was subject to a loan as the renovation changes the single acquirable asset into something different to create a new single acquirable asset. As such, the borrowing exemptions would no longer apply to that single acquirable asset. This was a very confusing concept and a lot of industry submissions were put to the ATO to revisit their interpretation of the borrowing rules. Unlike guidelines the ATO released a ruling in 2012 after extensive consultation which confirmed renovations with debt was allowable.

14th September 2011

From 14th September 2011 additional guidelines (SMSFR 2011/D1) were released by the ATO to further explain the ATO position on borrowings and in particular clarify some of the uncertainties coming out of the 7 July 2010 guidelines. Of significant benefit is the ATO revised position on renovations. The latest guidelines now allows renovations and even complete demolitions and rebuilding but in both cases this can only occur with non-borrowed funds i.e. funds within the SMSF and not additional borrowings. Subsequent to this draft the ATO released a final ruling in 2012 after extensive consultation which confirmed renovations with debt was allowable and also clarified many issues the industry and SMSF members had raised.

23rd May 2012

The ATO release SMSFR 2012/1 which now confirms renovations are possible and with borrowed funds. In summary this ruling identifies what is:

a. a repair and maintenance (allowable with borrowed funds)
b. an improvement (allowable with cash reserves of the fund)
c. a change to the underlying asset (allowed with cash reserves but only after all debt has been repaid).
d. a replacement asset and when it is allowed within the borrowing regime.

In summary these changes impact the SMSF as follows:

1. Repairs and Maintenance
   In line with the ruling a repair restores the function of the asset without changing its character and may include restoration to its former appearance, state or condition. This includes correcting something that is already there that has become worn out or dilapidated through ordinary wear and tear. Therefore cosmetic renovations to a kitchen or bathroom are a repair and so can be funded with debt. For tax purposes scrapping schedule and depreciation schedule would be initiated. Costs cannot be expensed so the use of the word repair can be misleading but ATO has chosen to define repair differently for super and for tax.

2. Improvement
   In contrast to a repair an asset is improved if the state or function of the asset is significantly altered for the better. This includes demolishing walls to extend a kitchen or bathroom, adding a granny flat, adding a second storey etc which does not change what the SAA is i.e. it is still a single dwelling. Funds for improvement cannot be borrowed so only internal SMSF resources can be used.

3. A substantial improvement which alters the asset (single acquirable asset) i.e. changes the asset substantially so it is not longer the same asset such as the purchase of land under a contract and then a subsequent construction of a dwelling (e.g. demolish one building and build a duplex etc.,) cannot be done while there is a loan. However, if there is no debt then it can be done but it must be funded by internal cash. Note properly documented and financed off the plan or single contract to buy land and build, as part of one contract, where a deposit is paid and then financed on completion is OK.

3. Superannuation Borrowings

What do all these changes mean? In summary your SMSF:

A. Can borrow to purchase an asset including all purchase costs. Multiple loans for the purchase is allowable.
B. Can borrow to finance repairs/maintenance including cosmetic renovations and to capitalise interest
C. Can use SMSF funds to do improvements even while borrowings exist
D. Cannot fundamentally change the asset if it creates a new asset (i.e. creates a new single acquirable asset) while debt exists against the asset but you can if no debt against the asset exists. E.g. buy land and then under separate contract build a property or demolish a property and build a duplex etc
E. Can replace the asset (destroyed) as long as it replaces what was there before i.e. one house on one land title.
F. Can borrow from a Member (no limit). Any Interest rate is allowable even as low as 1% (refer SMSF NTLG minutes June 2012) but in any borrowing arrangement there must be formal documentation in the prescribed format.
G. Can refinance loans as long as the new loans are no more than the original borrowings.

4. Leveraging Superannuation

For arrangements entered into on or after 24 September 2007 and before 7 July 2010, more than one asset may be acquired under a particular limited recourse borrowing arrangement. The assets acquired need not be all of the same form or type. Thus, if the arrangement was put in place after 24 September 2007 but before 7 July 2010, a portfolio of shares in different companies can be acquired under a single arrangement.

However, for arrangements put in place on or after 7 July 2010, the trustees of a regulated superannuation fund are only permitted to borrow if the borrowed funds are applied for the acquisition of a single acquirable asset including expenses incurred in connection with the borrowing or acquisition, or maintaining or repairing the acquirable asset. It is also a requirement that the asset acquired under these arrangements is held on trust so the superannuation fund trustee acquires a beneficial interest in the acquirable asset and right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest.

To avail yourself of this leverage strategy in your superfund, you need to have control. You cannot go to the trustee of a retail or masterfund and tell them to buy XYZ and certainly not if you also ask for a leverage strategy for a specific asset such as property. To do this you need to control your own fund i.e. you need to have an SMSF. Professional advice from a licensed financial planner should be sought before starting a SMSF or reviewing your investments. The licensed planner will take into account all your individual needs and circumstances including your funds asset allocation.

For many, the ability to leverage in the SMSF to purchase assets i.e. a property, may have major benefits especially when coupled with the favourable taxation situation for superannuation. It is now possible to use your SMSF to purchase residential property with debt.

The potential benefits using warrants are as follows:

1. Uses debt to create wealth
2. Provides the benefit of compounding (assuming your asset increases in value);
3. Allows leveraged investment in your preferred asset class, i.e. property.
4. Utilises the concessional taxation rates (15% on income and 10% on capital) during the period where your superannuation is in accumulation phase.
5. Zero taxation for both income and capital once super fund is in pension stage

6. Allows for debt repayments with concessionally taxed dollars thereby allowing the use of 85 cents to 90 cents (depending on non-cash items such as depreciation) in the dollar to repay principle. Normally paying down principle if the asset is outside of the super is at marginal tax rate of up to 46.5%. This is almost like getting up to 30% discount on the cost of the asset.

The types of assets that your superfund can acquire using the Holding Trust and the LRSMSFL are any asset that the super fund could normally purchase. Furthermore the documentation must ensure that the superfund only need make instalments at its discretion. The lending institution can take as security the asset being purchased but cannot take any other superfund assets as security or guarantees by the super fund. The loan is therefore of a limited or non-recourse nature. If the superfund is in default of payment either interest or as to principle then the only loss to it is the asset acquired and the funds paid to date. The super fund cannot be forced or litigated against for any payments or shortfall between the asset value (if reposed and sold by the lender) and the outstanding debt.

There are many places where the Holding Trust documentation can be arranged including your lending bank or lawyer. The bank will want to review any document you present. From our experience, the banks are currently pricing their warrant loans with the superfund in mind. Our experience to date has shown that the terms and conditions are not normally as favourable as if the loan was direct to the individual/s or trust excluding the fact that a superfund is involved. These additional costs are in the form of:

1 Higher interest rate
2 Lower Loan to Valuation Ratio thereby requiring a higher deposit
3 Shorter time periods for the loan

The above three cost imposts, can greatly add to the ongoing costs and while sometimes the banks documentation appears relatively cheap compared to external documents, the additional ongoing costs far outweigh the difference in document costs. The banks traditionally argue that the loans are made without the normal security in that they are made on a limited or non-recourse basis (i.e. No other security or guarantees other than the asset being acquired is given) to the SMSF. In many instances however the bank is requiring the individual to give a personal guarantee effectively putting the bank back in the same position i.e. the super fund will not be required to make up any loss but the individual out of non super fund assets will be required to fund any loss.

There are several cash flows which the SMSF can access to fund the interest and or principle repayments. These include the super guarantee (currently 9%), any additional concessional contributions or salary sacrifice, non-concessional contributions (after tax contributions) or any other income that the SMSF generates from other investments. All or any of these can be used to assist in servicing the loan. This greatly reduces the risks of any defaults and as such the banks are in safer territory as opposed to other traditional loans where the SMSF moneys are not available.

At Chan & Naylor, we have recognised the issue of the banks higher costs and have developed our own Pension Trust documentation to be used instead of the Holding Trust. Our Pension Trust documentation allows you to borrow in your own right at potentially better terms and conditions and then pass the loan onto the superfund via a Holding Trust procedure. This is slightly more complicated than a straight Holding Trust purchase but can save you significant costs if you cannot borrow at reasonably favourable terms. Many of our clients will be more than adequately serviced by just the Holding Trust.

In essence within the Pension Trust you will borrow giving the bank the security and guarantees it would normally require but then on-lending to the superfund without the same level of the guarantee i.e. on a limited recourse basis .

In a nutshell you borrow giving the bank all the security it would require from you but you on-loan the funds to your SMSF on a limited recourse basis. Effectively the superfund will not guarantee the loan to you and as such if it defaults then you cannot force the super fund to repay but the bank can litigate you to pay. As you are in control of the SMSF and arrangements outside of the SMSF, this should not cause any undue uncertainty or problems as you are in control of both camps.

At Chan & Naylor we have gone an additional step as we have found that many SMSF do not operate in a family friendly environment and many SMSF are not written in a way that allows the members to avail themselves of all the practical and beneficial strategies allowed within a SMSF. To this end we have developed the Enduring Family Superannuation Fund that allows members to build wealth in a protected environment safe from creditors attack, safe from the tax man (in pension stage) and safe from unfriendly or capricious in laws. It allows true wealth creation for the family that can be passed on from generation to generation.

5. What is a Single Acquirable Asset

For arrangements entered into on or after 24 September 2007 and before 7 July 2010, more than one asset may be acquired under a particular limited recourse borrowing arrangement. The assets acquired need not be all of the same form or type. Thus, if the arrangement was put in place after 24 September 2007 but before 7 July 2010, a portfolio of shares in different companies can be acquired under a single arrangement.

However, for arrangements put in place on or after 7 July 2010, the trustees of a regulated superannuation fund are only permitted to borrow if the borrowed funds are applied for the acquisition of a single acquirable asset including expenses
incurred in connection with the borrowing or acquisition, or maintaining or repairing the acquirable asset. It is also a requirement that the asset acquired under these arrangements is held on trust so the superannuation fund trustee acquires a beneficial interest in the acquirable asset and right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest.

The term single acquirable asset ("SAA") is now the basis of what the superfund can borrow to buy. At its basic it still only allows the purchase of an asset which would normally be allowed to be purchased by a superfund. This concept of a SAA now restricts the asset being acquired to a purchase of one asset in a complete form. What does this mean? In essence you cannot change the asset to be another asset and the loan can only be for a single asset and not a basket of different assets. The practical issues with this are as follows:

a. Shares
   The SAA is the listed security being purchased for example ABC Ltd. You are allowed to purchase a number of ABC Ltd shares under the loan but they must be the same type of share in the company at the same price at the same time. You cannot purchase a basket of different share types or indeed different listed companies under the one loan. If you wish to secure multiple companies you will need a separate loan for each and a separate Holding Trust for each. The SAA then becomes the 100 ABC Ltd shares. This means if you want to sell say 10 you need to sell the whole asset being 100 shares and buy back 90 under the same SAA rules as previously described.

b. Real Estate
   The SAA definition when applied to property raises many issues that are not normally considered by an investor.

   i. The SAA concept allows the superfund to borrow to purchase the original property including costs and any additional funds for repairs and maintenance and capitalisation of interest. The superfund can refinance the loan amount if from multiple sources to the extent of the original LRBA.
   ii. The superfund can borrow to do cosmetic renovations. If you extend the size of say the bathroom then this moves from a repairs (no extension) to an improvement
   iii. The superfund cannot borrow to improve the property but it can use its own cash resources.
   iv. The SAA concept creates the need to have separate loans and holding trusts where split contracts are used to purchase real estate for example the apartment on one contract and a car space etc on another. While on the surface this may not be a problem the issue arises where the body corporate or other regulation does not allow the car space to be sold separate or leased to different parties to that leasing the apartment. In these situations the contract for the car space would be deemed to have no value and so why would the superfund buy it or indeed under borrowing legislation why would a lender finance an asset with no value and or no income.
   v. Off the Plan. It is acceptable to use super monies to pay a deposit and costs and then borrow the remaining after additional super money is used to complete the deposit and costs on settlement. As no SAA is there at the time of the deposit then on completion of construction and relevant strata titles etc have been issued then the borrowings at that time is for a SAA (subject to split contract issues as described above) and so this type of OTP purchase fits into the SAA definition.

5. Funding an Improvement

Only internal SMSF funds can be used to do an improvement such as additional rooms, extension of kitchen or bathroom, granny flat etc. This therefore may mean that the SMSF may need to retain internal funds to do the improvement that would have otherwise been used to pay for a deposit and costs. This could mean that the SMSF does not have enough funds so it will need to borrow additional monies. If the bank will not lend these funds (exceed loan to valuation criteria) then the SMSF can borrow from the member or an associate of the member. The member can use savings or draw down from equity from another asset. This means the SMSF will have two loans one from the bank and one from the member. Once the property value increases these two loans can be refinanced as long as the new loan is at or below the aggregated amounts of the original loans. The interest payable on the member loan cannot exceed a commercial rate or the difference will count towards that member/s concessional contributions.

6. Practical Operation of the Chan & Naylor Holding Trust

The following example is where you will borrow directly from the bank to purchase a property to be held in the Chan & Naylor Holding Trust for the benefit of your Enduring Family Superannuation Fund.

The Enduring Family Superannuation Fund (EFSF™) provides funds for the deposit (and any costs if appropriate). The EFSF™ injects funds into the Holding Trust to cover costs and required deposit. The EFSF™ borrows the balance using the property being purchased as security. Banks will normally take income of the EFSF™ such as member contributions, EFSF™ profits if other assets are held etc., to calculate serviceability they would normally be required to give for the loan. If there is insufficient serviceability the bank may require a higher deposit amount.

The loan from the bank is given as a limited recourse loan which means that the asset given as security is the only asset of the EFSF™ which the bank can take in the event of a default. It cannot access any other EFSF™ assets. For this reason we find banks usually charge some additional interest and require a higher deposit than on a normal property loan. For this reason banks will usually also require guarantees from you and or additional security over and above the asset being acquired. The banks are taking all necessary security and guarantees to approve the loan. The property (or other asset) being acquired is given as security for the loan plus any guarantees the bank requires from the individual/s. The name on the contract of sale is the name of the trustee of the Holding Trust i.e. ABC Pty Ltd. The Holding Trust does not mention or relate itself to the EFSF™. In reality it is still the EFSF™ which is taking on the loan.

The trustee of the holding trust arranges for rents (normally after costs which the agent will pay) to be paid to an EFSF™ bank account. The property must be managed by an independent agent and not the individual or EFSF™ to avoid triggering GST.

The superfund pays interest using these net rent and shortfalls if any are paid out of EFSF™ monies i.e. contributions into the fund by members and or other funds within the EFSF™. The tax effect of paying for negative gearing directly by the individuals if the property were not in the EFSF™ are the same as the individual salary sacrificed (remember salary sacrifice is a tax deduction to the individual and so the tax benefit of the salary sacrifice is at the individuals marginal tax rate) additional contributions into the EFSF™ and used via the holding trust situation to fund the negative gearing i.e. no difference. Funds being used by the EFSF™ to fund the negative gearing are also taxed at nil as they are used to absorb the losses (i.e. no 15% tax on these amounts). Obviously the EFSF™ needs access to sufficient funds. The EFSF™ can also use its own funds if sufficient or the individuals can top up their contributions via salary sacrifice. You will need to keep in mind the maximum concessional and non-concessional contributions for each member and any salary sacrifice will need to ensure you do not breach these limits. In the EFSF™ contributions from any members can be taken into account to fund the property and so multiple family members can effectively band together as long as they have the same investment strategy.

While you are working and in accumulation mode any “profits” are taxed at either 15% on income or 10% on capital. The tax rates fall to nil when you move to pension mode. Once the EFSF™ is in pension mode any income received by the EFSF™ either rent or capital gains (if the property is sold) is taxed at nil and when paid to the member as a pension component is taxed at nil in the members hands. If there are multiple members in the EFSF™ any profits of the EFSF™ from the rent or capital gains from the property (or other assets) will be apportioned between the members and their appropriate tax rates applied.

The holding trust would be set up to allow any funds needed to pay interest shortfalls to be paid over as an instalment and it would allow any principle repayments to be made in similar fashion.

An advantage of the Chan & Naylor Holding trust is that if the bank requires additional deposits which you do not have in super then you can borrow the funds from your line of credit as an example and then lend the money to the EFSF™ via a LRSMSFL. The terms would be in line with what it costs you i.e. not benefit to you individually. Once the property increases in value you can then refinance with the major bank and pay down your line of credit. If you had cash you could also loan the funds to the EFSF™ in the same manner and again refinance with the major bank at some later stage to pay yourself back. You will need to charge the EFSF™ and arm’s length interest rate or any deficiency will count towards your concessional contributions.

Assuming the holding trust period expired before the loan was paid out then the documents would allow the loan to be refinanced by the individual/s or other bank. The property can stay in the holding trust indefinitely as an EFSF™ asset and retain the taxation benefits of super or it can be transferred directly into the EFSF™ if required when the final instalment (loan is fully repaid) is made with no CGT or stamp duty even if the EFSF™ is still in accumulation mode.

If the EFSF™ has multiple members with some of them not wanting to be part of a property purchase with debt then the EFSF™ will need to have multiple investment strategies i.e. one that includes property with debt and another excluding property with debt. This will effectively differentiate the funds in super so that only the members wanting to purchase property with debt have their funds directed to this investment.

7. Associate Party Loan

If the EFSF™ does not have sufficient funds for a deposit and costs a member (associated party) can lend any shortfall to the EFSL. A formal loan document is required. Interest rate charged is as agreed and can be even 1%. Any apparent benefit to the EFSF™ will not be treated as a contribution by the ATO. Forgiveness of a loan will however constitute a non-concessional contribution so care is needed if debt is forgiven to not breach the contribution limits or heavy penalties will be applied by the ATO.

The EFSF™ can later (Property value increases) refinance both the associate party loan and the bank loan into one loan and pay back the member. Obviously the bank would need to be satisfied with serviceability and its loan to valuation requirements.

The associate party loan could even be used as part of the deposit which would allow the EFSF™ to retain funds which it would have otherwise used for a deposit to maybe complete an improvement.

8. Example

John aged 40 wishes to purchase a $500,000.00 investment property borrowing 80%. The following example assumes his capacity to borrow and fund any shortfalls.

a. Purchased Directly

If purchased directly he would need to save the say 20% deposit and costs $120,000. This saving would be from after tax dollars. If John is on a 30 cent marginal tax rate he would need to generate about $171,000 of pre-tax money or $218k if he is on 45 cent tax rate. John would then borrow the remaining $400,000 and since this would be borrowed for investment purposes the interest would be tax deductible. Any shortfalls in rent versus expenses would be paid by John with the appropriate tax deduction. Assuming he keeps the property into retirement. John would receive rental income which at that time should be positive and as such pay tax on the income or if he decides to sell would pay tax (after receiving a 50% CGT discount). Either way he pays tax.

b. Purchased in the Enduring Family Superannuation Fund via a Holding Trust

Alternatively John could save his $120,000 via additional super contributions or use funds that have been previously built up in the SMSF. Since his contributions are taxed at 15% (assuming his income is below $300,000 or the tax would be 30% in super as per the 2012 Federal Budget announcement) he would only require pre tax about $141,000 (compared to $171,000 above) a saving of $30,000. The EFSF™ would borrow the remaining $400,000 directly (note the potential additional costs which a bank may apply) or individually and then on loaned to the EFSF™. Any negative cash flow from the rental of the property would be funded by the EFSF™ as via salary sacrifice super contributions (to a maximum of the allowed contribution including any super guarantee i.e. $25k as John is under 50).

The tax impact of this salary sacrifice is the same as if John owned the property in his name and funded the negative gearing with a tax deduction. If the EFSF™ has sufficient funds from other sources then there may be no need for John to contribute any additional amounts. As above John keeps the property into retirement. If the property is now identified as in pension stage (i.e. after John reaches 60) any positive rental income or capital gains made by the EFSF™ would be at nil tax and any payments made from this account to John would be at nil tax. Any income pre age 60 would be taxed in the super fund at 15% and any capital gains would be taxed at 10%. This means while John is earning income any additional funds he needs to put into the transaction (up to his contribution limit) are tax deductible at his marginal tax rate and in pension stage income/capital paid to him is at nil tax. If John is under superannuation preservation age (employment status and age which determines access to super funds) the normal restrictions on withdrawing funds from super would apply.

***Diagram 1:** Purchasing a Property in Super*

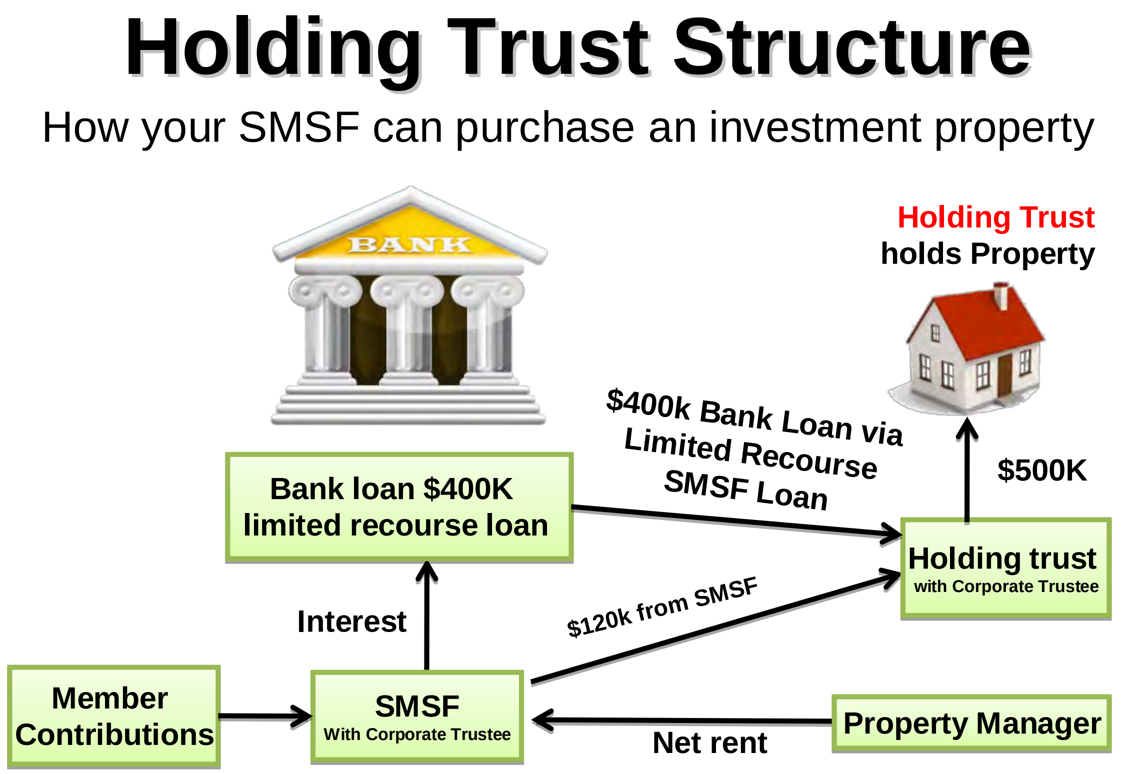


Diagram 2: Practical Example of a Property Purchase in Super

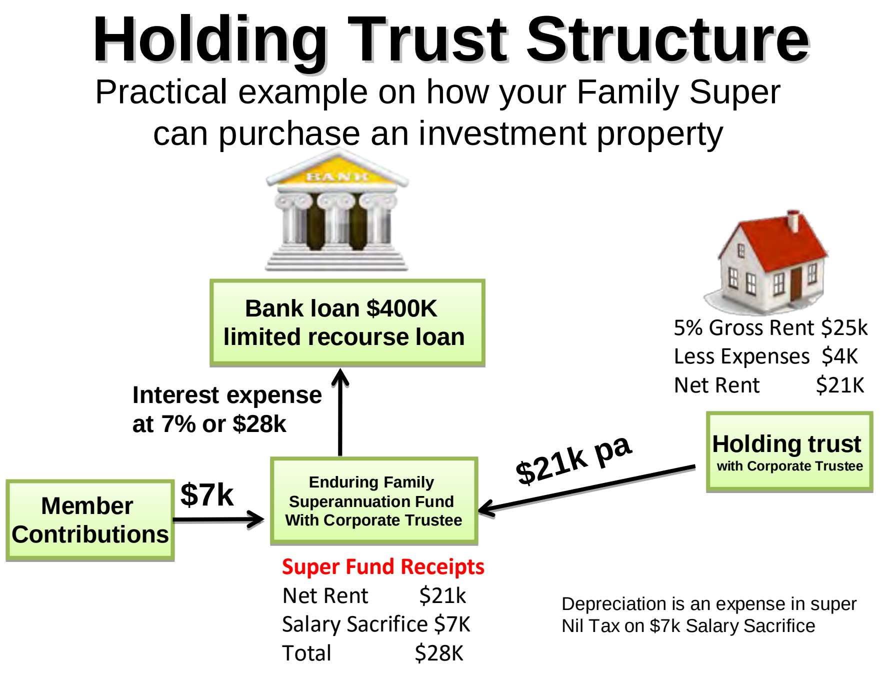
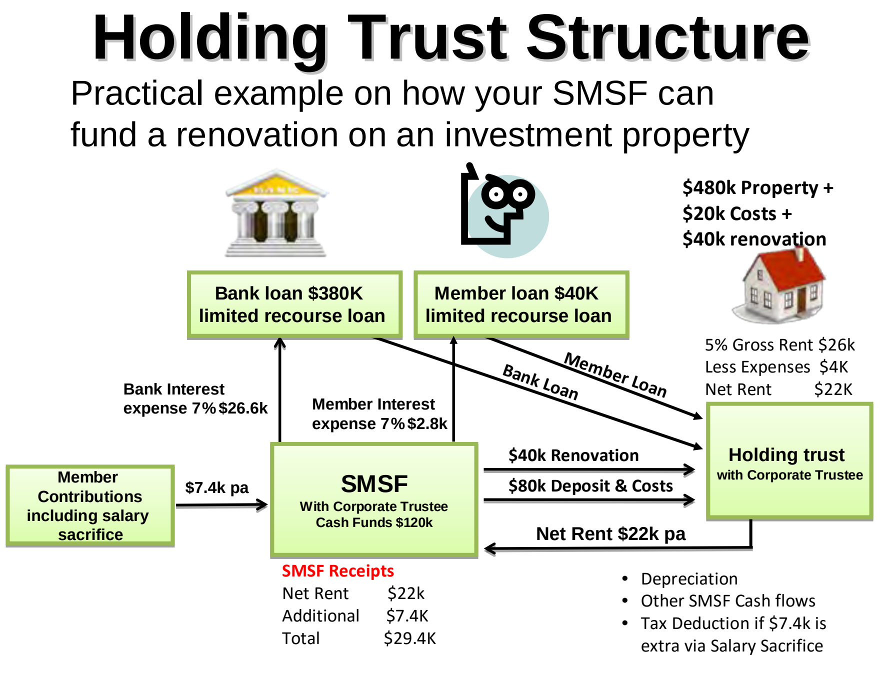


Diagram 3: Practical Example of Funding an Improvement in Super



9. The Enduring Family Superannuation Fund™ Overview

The Enduring Family Superannuation Fund (EFSF™)™ has many components that if used correctly and in conjunction with your other estate planning objectives can yield significant benefits to your family wealth and in some cases reduce the potential for family disputes on a member's death.

Some of the components are:

a. Proportional Voting. This gives trustees and or directors of a trustee company voting in line with the member's funds they are responsible for e.g. $1m gets 1 million votes compared to $10,000 and therefore 10,000 votes. This means you are less likely to be outvoted on a motion which could detrimentally impact your funds. This right effectively safeguards that particular member's rights/assets. It cannot be used to disadvantage another member's balance or rights under the SMSF deed or SIS Act.

b. Binding Death Nominations. A more practical process to reduce the possibility of being non-binding

c. Super Will. This component allows you to write a will within super thereby ensuring funds stay in super on your death and retain asset protection and lower tax

d. Anti-Detriment. Allows the fund to create an expense for funds it did not receive from a member if they died prior to age 65

e. Self-insurance and Children's Insurance

f. Improved and easier move to your legal Personal Representative in event of death or incapacity

g. Easier process to access lump sum payments which assist if you become bankrupt after age 60 and also allows controlled release of funds out of super for major expenses while retaining funds in a better tax environment.

h. The correct use of life insurance that could allow a property to remain in super after a members' death thereby allowing it to be effectively passed onto the next generation. Normal superannuation rules on withdrawals apply to remaining members.

i. The ability to continue a member's balance to remain in pension stage after their death instead of reverting to accumulation stage (ATO default) which would have the funds taxed.

10. Not sure if this strategy is right for you?

We provide a free 10-15 minute phone consultation with a Senior Partner of Chan & Naylor – they can answer your general questions and discuss what's possible.

www.chan-naylor.com.au/free-call

Chan & Naylor is Australia's leading property accounting group, ranked in the BRW Top 100 Accounting Firms Australia.

At Chan & Naylor you can count on our knowledge and expertise in the following areas:

- Property
- Small Business
- Asset Protection
- Self-Managed Superannuation Funds,
- Taxation
- Wealth Creation
- Estate Planning

Our motto is:

"To help our clients increase and protect their net worth from generation to generation"

If you want to arrange a specific consultation to discuss any of the strategies please contact Chan & Naylor via www.chan-naylor.com.au or on **1300 250 122** where you will be able to arrange a suitable time to meet with one of our team.