

## SMSFs & Borrowing Update

September 2011

SMSFs have been able to borrow for the purchase of assets since a change in legislation in September 2007.

This legislation was amended with effect from 7 July 2010. The amendments introduced at that time clarified some matters, but also introduced other areas of confusion.

The Australian Taxation Office released a draft ruling (SMSFR 2011/D1) in September 2011 confirming their view of how SMSF borrowing legislation works.

### Properties on multiple titles

An issue with the July 2010 amendments was that it was necessary for a single asset to be acquired under the borrowing. A group of assets was allowed provided they were identical, which allowed for 1,000 shares in a listed company to be purchased as a part of a borrowing.

Many inner city apartments have up to three separate titles attached to them which can include a car park and storage space. It is also common for commercial properties to be constructed on land that is in several different titles.

The ATO have taken a practical approach to this draft ruling in that provided the titles are bundled

For example, the car park cannot be sold separately to the apartment, the asset will be able to be acquired by an SMSF with a borrowing.

In contrast, farming land that is held over multiple titles will be unable to be purchased with one borrowing. It may be necessary for a separate borrowing to be established for each title.

### Improvement to a property

It is not possible for an SMSF to borrow for the purpose of improvement of a property. The ATO have noted that it is possible for improvements to a property to be undertaken, provided the SMSF is able to pay for the improvements from cash reserves rather than the borrowing.

SMSFs still need to take care in improving their properties to ensure the improvement does not create a new asset.

For example it is not possible for a SMSF to enter into a borrowing to purchase vacant land and then to use cash reserves to construct a building on that land. The construction of the building is considered a significant enough change to be a new asset.

### Repairs to a property

A SMSF is able to utilise borrowed funds for the purposes of undertaking a repair to a property acquired with borrowings. The ATO ruling confirms that it is possible for a SMSF to draw on a loan for the purpose of funding repairs to a property as well.

In undertaking repairs to the property, SMSF trustees will need to ensure that the expenditure does not amount to an improvement. One example given in the ruling is of a kitchen damaged in a fire. If the affected area is fixed to bring the kitchen back to its original functionality it will be a repair. In contrast if the kitchen is redesigned and extended it would be an improvement and the fund would not be able to borrow for these amounts.

Before undertaking any repairs with borrowed funds SMSF trustees should consider whether the expenses incurred may be an improvement.

## Destroyed properties

The question has been raised as a result of recent natural disasters damaging property, is it possible for a property to be reconstructed using the proceeds from the insurance policy?

The draft ATO ruling has confirmed that it is possible for these properties to be reconstructed after they were damaged.

In order for this to take place the newly constructed property needs to be of the same type as the property that was destroyed.

For example, if a four bedroom house was damaged in a fire to the point it was required to be demolished, the SMSF is able to construct a new house of similar size and functionality. If the SMSF trustee decided to build three townhouses on this land it would be considered a new asset and would not be able to have any borrowings against the property.

The release of this draft ruling does provide some welcome clarification in a number of areas, such as acquiring properties with multiple titles and improving properties with cash.

SMSF trustees will still need to carefully consider the impact of repairs and improvements and whether they may result in a breach of the borrowing rules.



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