

Instalment Warrants & SMSFs

- ❖ Instalment warrant purchases of “acquirable assets” are an exception to the general borrowing prohibition for SMSFs
- ❖ Acquirable assets include real estate, units/shares in an ungeared property holding unit trust/company, listed securities in a single company & a work of art
- ❖ Each instalment warrant contract must be limited to a single asset or a collection of identical assets
- ❖ Purchase subject to investment strategy & *SIS Act* rules
- ❖ Instalment warrant parties include **SMSF trustee** (as ultimate purchaser), (limited recourse) **lender & custodian trustee** (holding asset for duration of instalment payments)

Instalment Warrants – 2 Key Components

There are 2 key components for an instalment warrant that meets the requirements of sections 67A and 67B of the *Superannuation Industry (Supervision) Act 1993* (“the *SIS Act*”) being used to partly fund the trustee of a self managed superannuation fund (“SMSF”) purchasing real estate or other permitted assets for the fund, ie:

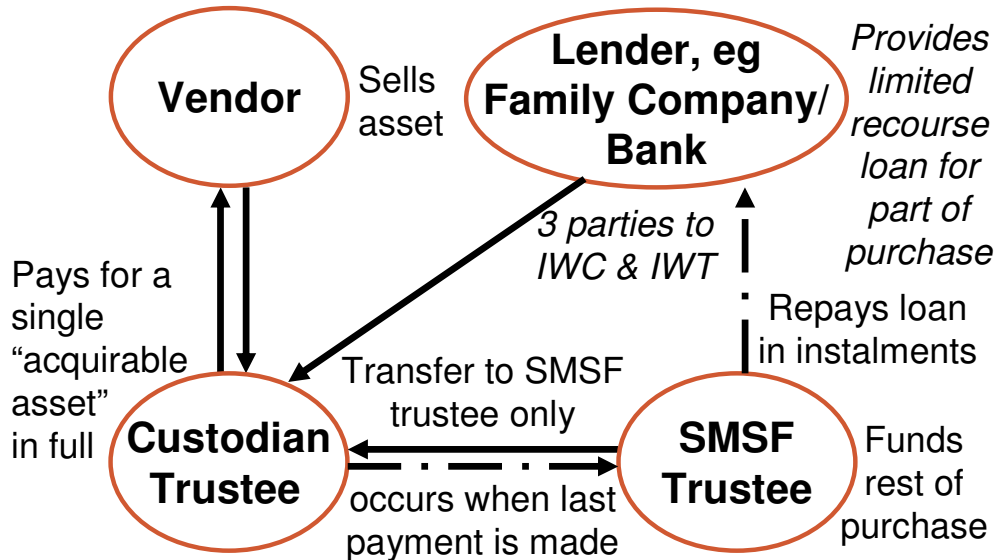
1. An instalment warrant contract (“IWC”). The obligations under this contract are concluded either once all of the instalment payments have been made or if the asset subject to the instalment warrant is sold and the sale proceeds have been distributed proportionately between the lender and the trustee of the SMSF.
2. An instalment warrant trust (“IWT”) appointing a custodian trustee to hold the asset being acquired for as long as the asset is subject to the terms of an IWC.

If the s 67A and s 67B requirements are not met, the general borrowing prohibition in s 67 of the Act would apply instead and the trustee of the SMSF would be in breach of the *SIS Act* and in danger of losing SMSF income tax concessions.

Instalment Warrants – 3 Funding Options for SMSFs

1. A limited recourse loan (ie the lender can only recover against the asset being purchased) is made by a bank (or finance company) for part of the funds needed to acquire the asset. In practice banks are loathe to make limited recourse loans to the current value of the asset, the balance of the acquisition price will need to come from the trustee of the SMSF.
2. A limited recourse loan is made by a party associated with the trustee of an SMSF with that loan in turn being wholly or partly funded by a full recourse loan from a bank.
3. A limited recourse loan is made by a party associated with the trustee of an SMSF (that party having contribution limit, Division 7A or need for liquidity issues) with no bank or other 3rd party finance.

Instalment Warrant Contract & Trust



Subsection 67A(1) – Limited Recourse Borrowing Exception

"... (a) the money is or has been applied for the acquisition of a single acquirable asset, including:

(i) expenses incurred in connection with the borrowing or acquisition, or in maintaining or repairing the acquirable asset (but not expenses incurred in improving the acquirable asset); and

(ii) money applied to refinance a borrowing (including any accrued interest on a borrowing) to which this subsection applied (including because of section 67B) in relation to the single acquirable asset (and no other acquirable asset); and

(b) the acquirable asset is held on trust so that the RSF trustee acquires a beneficial interest in the acquirable asset; and

(c) the RSF trustee has a right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest; and

(d) the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) default on:

(i) the borrowing; or

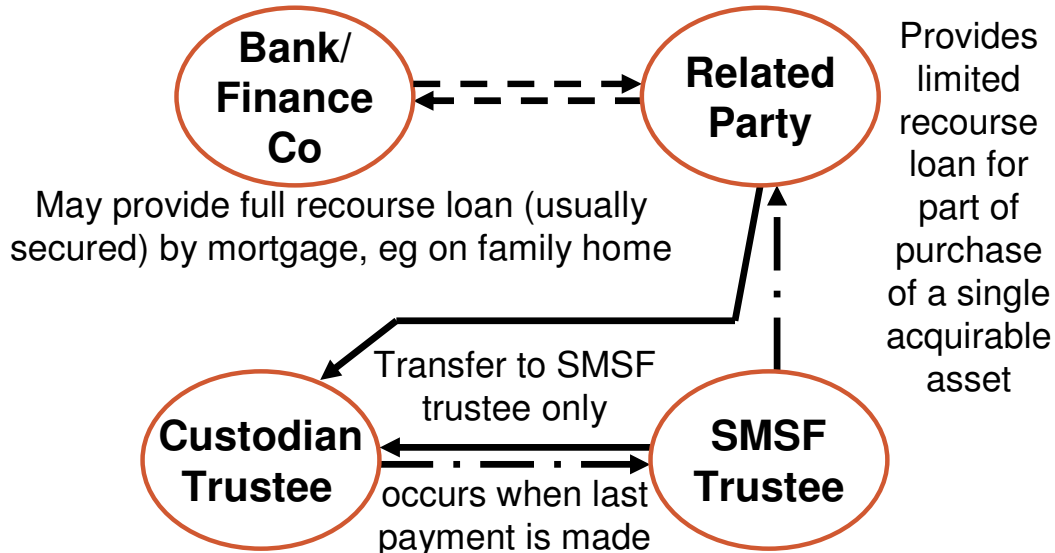
(ii) the sum of the borrowing and charges related to the borrowing; are limited to rights relating to the acquirable asset; and

(e) if, under the arrangement, the RSF trustee has a right relating to the acquirable asset (other than a right described in paragraph (c)) - the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) the RSF trustee's exercise of the RSF trustee's right are limited to rights relating to the acquirable asset; and

(f) the acquirable asset is not subject to any charge (including a mortgage, lien or other encumbrance) except as provided for in paragraph (d) or (e)."

IWC & IWT

Related Party Lending



Instalment Warrants – Documentation

The 2 documents needed for a s67A instalment warrant are an IWC and an IWT:

1. The IWC sets out the purchase terms, number of instalment payments, amounts to be paid, rights of the parties and the completion of the contract, ie either when all instalment payments have been made or the custodian trustee sells the asset.
2. The IWT sets out the appointment of the custodian trustee, the responsibilities of the trustee and the rights and obligations of the beneficiary SMSF. The custodian trustee usually is a person or entity associated with the members of the SMSF, but not the lender or the trustee (or a trustee) of the SMSF.

As the SMSF is subject to annual audits, the firm preparing the documentation will usually also provide a letter regarding compliance of the s67A requirements.

Instalment Warrants – Associated Documentation

Other documents that may need to be prepared include:

1. A new company may need to be established to act as the custodian trustee.
2. The SMSF itself may need to be established (a new company may also be required to act as trustee of the SMSF).
3. The governing trust Deed for an existing SMSF may need to be updated, eg to amend the borrowing restrictions to permit the use of an instalment warrant.
4. If the lender is the trustee of a trust, the trust deed powers may need updating.
5. Conveyancing documents for the purchase of real estate (and possibly the related party sale as well) or transfer documents for other assets such as units and shares.
6. If the asset purchased is real estate, the lease agreement between the tenant and the SMSF trustee for the lease of the property (if the parties to the lease are related, the terms of the lease should be commercially realistic).

Instalment Warrants & SMSFs – Further Reading

Australian Master Estate Planning Guide – Chapter 41 in the Premium Edition

The latest version of this Pocket Summary is at
www.mooreslegal.com.au/services/estateplanning/pocketsummaries

Further Reading

- *Australian Master Estate Planning Guide* – Allan Swan, to be published (in both a Standard and Premium Edition) by CCH in 2012.
- *Estate Planning Documents* – Allan Swan, Moores Legal (includes many of the Pocket Summary series).
- *You Can't Take It With You* – Andrew Simpson, Wrightbooks.
- *Tax Issues in Family Law Property Settlements* – Peter Szabo, Moores Legal.

Australia-wide Seminar, Workshop & other Presentations – Allan Swan

EPSTTAP Introductory: • Estate Planning – The A-Z • SMSFs – The A-Z (includes all pages of this Pocket Summary) • Trusts – The A-Z.

EPSTTAP Advanced: • Estate Planning – Case Studies • Estate Planning Masterclass (2) • Superannuation – Death Benefits & Binding Nominations (2-3) • Testamentary Trusts – Drafting the 6 Major Types • Trusts & Deceased Estates – Income & Capital Distributions • AMEPG Chapter Workshops.

Allan's local Moores Legal client, community & discussion group topics are:

- Estate Planning – Protecting & Enhancing Wealth • Estate Planning – Vulnerable Family Members • Family Trusts – Income & Capital Overview • Farm Succession – Avoiding Tax Pitfalls & Anticipating Disputes • Providing an Estate Planning Service for Clients • SMSFs – Instalment Warrants, Pensions & Binding Death Benefit Nominations (all) • Tax & Business Structures Overview (2) • Update – Estate Planning, Superannuation, Trusts, Tax & Asset Protection.

To book Allan for any of these topics, contact Lilian Bruère on 03 9843 2153. All Pocket Summaries are copyright and are for general information purposes only and should not be relied on as (or in substitution for) legal or other professional advice.