SMSF and Bare Trusts FAQs

Aintree Group Legal

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This is general advice only and has not been prepared with your situation and needs in mind. For individual and personalised advice, we highly recommend that you seek out proper professional advice from your accountant and lawyer.

Are you looking to invest in a property or asset through a Self-Managed Superannuation Fund (SMSF)?

Did you know you can borrow to purchase that asset?

If you want to borrow to complete the purchase, there are a few steps you need to take before you can make the purchase.

Superannuation law generally states that SMSFs cannot borrow money.

So, how do you purchase an asset through your SMSF if you need extra funds?

In good news, there is an exception to the prohibition on borrowing. This exception allows a SMSF to borrow money if it is part of a transaction known as a Limited Recourse Borrowing Arrangement (LRBA). A LRBA allows a SMSF to borrow money from a financial institution or related party to purchase an asset (generally real estate).

The borrowing arrangement must meet the following conditions:

- The borrowed money is applied for the acquisition of a single asset;
- The single asset is held on trust for the SMSF. This trust structure is commonly known as a Bare Trust (see below);
- The SMSF has the right to acquire legal ownership of the asset once the loan is repaid in full; and
- If the SMSF defaults on the loan repayments, the lender's recourse is limited to rights related to the single asset.

What is a Bare Trust?

A Bare Trust is a simple trust structure that holds an asset on behalf of its beneficiaries. The trustee of the Bare Trust holds the legal title to the asset but does not own the asset.

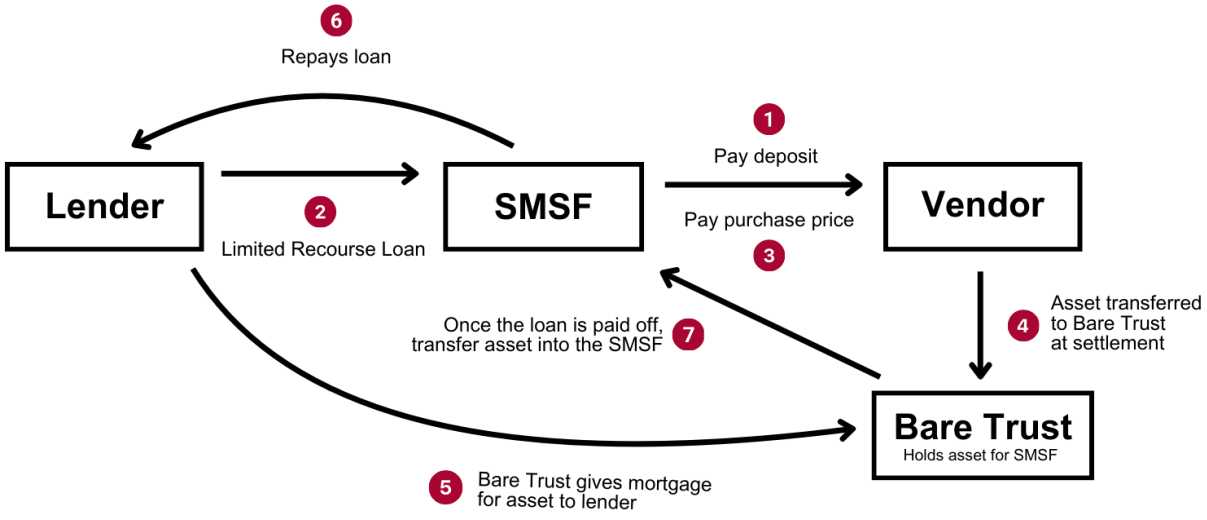
Under a LRBA, the sole beneficiary is the SMSF. The Bare Trust must deal with the asset as directed by the SMSF.

How does the process work?

The Bare Trust is brought into existence by a deed. This deed is usually signed by the trustee of the SMSF and a separate party as trustee of the Bare Trust. Institutional lenders generally require that both the SMSF trustee and Bare trustee are companies.

If your SMSF has individual trustees, they will likely need to retire as trustees with a company appointed as their replacement.

Note: Provided the arrangement is established and operates as a Bare Trust, the Bare Trust does not need to have an ABN or Tax File Number, operate its own bank accounts or be registered for GST. The SMSF is entitled to all income generated by the asset such as rent and is responsible for expenses relating to the asset.



1. The SMSF pays deposit to the asset vendor.

The SMSF needs to provide all the deposit monies to the asset vendor. The funds will come from a combination of the SMSF's assets and borrowings from a financial institution or related-party lender.

Professional advice should be sought regarding the payment of the deposit and the name of the contract purchaser.

Rules vary between states, and this will impact how the contract should be prepared as well as when the Bare Trust structure should be established. A review of the contract before purchasing is also an essential part of the due diligence process.

2. The SMSF borrows from a lender

The SMSF can either borrow from a financial institution or a related party lender.
The loan agreement must include provisions limiting the lender's recourse in the event of default by the SMSF. Where the SMSF borrows from a financial institution, the lender will attend to this requirement. Where the SMSF borrows from a related party, it is important that the loan agreement is correctly prepared so that it meets this requirement.

SMSF loans from financial institutions are generally less attractive than equivalent non-SMSF loans. They will typically have higher interest rates and require lower Loan-to-Value Ratios (LVR).

Where a related party lender is used, the loan terms (interest rate, LVR, term of loan, etc) must either be benchmarked against the market, or be in accordance with ATO guidance in which case the interest rate must be adjusted each year is required by ATO guidelines. SMSF trustees should seek advice on this point.

Note: The SMSF is the only borrower under the loan agreement.

3. The SMSF pays balance of the purchase price to the asset vendor.

The SMSF should also provide the balance of the purchase price for the asset. The funds will come from a combination of the SMSF's assets and borrowings from a financial institution or related-party lender.

The SMSF also pays stamp duty on the acquisition of the asset (if it is a dutiable asset such as property).

4. The vendor transfers the asset to the Bare Trust.

At settlement, the trustee of the Bare Trust is registered as the legal owner of the title for the asset.

The property remains in the Bare Trust while any amount of borrowing remains unpaid. It holds the asset in the trust for the benefit of the SMSF. The Bare Trust must deal with the property (such as leasing the property and redirecting rental payments) as directed by the SMSF.

5. The lender will register a mortgage over the asset.

As part of its suite of loan documents, the lender will require the Bare Trust to grant a mortgage over the property in favour of the lender.

6. The SMSF repays the loan in the set period of time.

The loan term for financial institutions will depend on the details of the transaction. Working with a mortgage broker will help you get the best deal available.
For related party loans the maximum loan term is generally 15 years.

7. Once the loan is paid off, the asset will be transferred to the SMSF.

As there is no longer any money owing (or borrowed), the SMSF can now take ownership of the asset and the Bare Trust can be wound up.

This is a formal transfer of property requiring the SMSF trustee to be registered as the new owner of the property with the Titles Office. The transfer of the property from the Bare Trust to the SMSF should be exempt from duty, although the specifics of the transfer will vary depending on which state the property is located in.

Who can set up the Bare Trust?

Your accountant or lawyer can set up the Bare Trust for you, as long as you already have a SMSF.

What if I don’t have an SMSF?

Your accountant or financial advisor can set up a SMSF for you. Before doing so, you should seek financial advice to determine if a SMSF is the right structure for you.

Do I need to set up a new Bare Trust for each asset?

Yes.

A Bare Trust is only allowed to hold one asset at a time. Therefore, if you intend to purchase more than one asset, you will need to set up a new Bare Trust for each asset if you're borrowing money to purchase it.

What happens if the SMSF doesn't pay off the loan?

Under a LRBA, the lender's rights will be limited. So, if the SMSF fails to pay off the loan, the lender can only enforce its rights against the asset and cannot touch any other assets held by the SMSF.

Because this rule limits the collateral available, lenders will seek additional security by asking for personal guarantees from each member of the SMSF. As part of this process, lenders will require the members to seek independent advice from a lawyer before signing the guarantee.

What can I buy using an LRBA?

Although there is no technical restriction limiting what can and cannot be purchased using a LRBA, in practice the overwhelming majority of LRBAs are used to purchase real property. This is because financial institutions are unwilling to offer SMSF loans for other asset classes.

Listed shares can also be purchased using a LRBA, although it is important to seek specialist advice before doing so. These types of LRBAs will generally require a related party loan in line with ATO guidelines, which mandate a particularly high interest rate for this type of asset.

Can I rent out the asset if it is a property?

Yes!

But you should note:

- The SMSF trustee will receive the rental income.
- The SMSF trustee will cover all costs associated with the property.

Can I rent a property to my business?

Yes! A SMSF can rent business real property to your related business. It is important that the property is genuinely business property. For example, a hobby farm that is only used for small-scale farming activities will not count as business real property.

Can I rent a property to a family member?

No! A SMSF cannot rent or provide access and use of a SMSF asset, such as residential property or a holiday home, to the members of a SMSF or their family members. This is a breach of superannuation legislation.

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