

CUSTODY TRUSTS

A QUICK GUIDE

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CUSTODY TRUSTS



What are custody trusts and why do we like them?
A Custody Trust is a legal document which is used to allow an SMSF to borrow money from a bank.

A CUSTODY TRUST ALLOWS YOU FINANCIAL LEVERAGE TO INVEST IN YOUR SMSF. IF THE INVESTMENT IS MADE WISELY, YOUR SMSF HAS THE POTENTIAL TO GROW SIGNIFICANTLY.



TREASURER WAYNE SWAN



On 24 September 2007, Treasurer Wayne Swan amended the Superannuation Industry Act to allow Self-Managed Superannuation Funds the ability to borrow money to purchase property. Custody trusts were born!

A custody trust is known by several different names. You may be familiar with some of these... **Bare trust, custody trust, custodian trust or property trust.** These are all different names for what is the same thing - a limited recourse borrowing arrangement. Simply put, a custody trust is established to enable you to borrow money to purchase property in your SMSF.

That's right; the SMSF is unable to borrow money unless it complies with Superannuation law requirements, so a custody trust is established to facilitate the loan.

There are advantages to establishing a custody trust and these include:

A custody trust allows you financial leverage to invest in your SMSF. If the investment is made wisely, your SMSF has the potential to grow significantly.

A custody trust offers protection. In the event of a loan default, the bank does not have any recourse on other assets within the SMSF. Your nest egg is safe!

All costs relating to the property can be paid by the SMSF. These costs include water, rates, maintenance and repairs. Likewise, rental income received by the property is deposited directly into the SMSF. The SMSF makes the loan repayments.

The Custody trust simply holds the property (or asset) for the beneficial owner (the SMSF). It does not require an ABN or TFN. When the loan is repaid, the property reverts back to the SMSF.

2%

Interest rates in Australia hit record low levels of 2% on May 6 2015.

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Some general info on custody trusts



Did you know the lender doesn't have to be a bank? The trustees can borrow the money and then on-lend to the SMSF.



There is no CGT or stamp duty payable upon transfer of the asset from the Custodian Trust to the SMSF because there is no change in the beneficial ownership.



A residential property which is acquired through the SMSF must not be lived in by trustees, members or any related parties. The asset is purely for investment purposes. And don't forget, all investments must pass the "sole purpose test". Sorry, but this means the property cannot be used as a holiday home!



Different rules apply for commercial property. This starts getting tricky, so please speak to your solicitor!

FREQUENTLY ASKED QUESTIONS

Clients always ask us, what name should appear on the contract of the property purchased in the SMSF? This is quite simple. The purchaser of the property is the trustee of the custody trust. So, if the trustee is a company, the company's name will appear on the property contract. If the trustee is an individual, then the individual's name will appear on the contract.

What structure should you use?

Another common query we get is, what structure do I use? A structure with individual trustees or corporate trustees? Our advice is simple - Check with your lender!

There are advantages and disadvantages associated with using individual trustees and corporate trustees. Here are just a few of them...

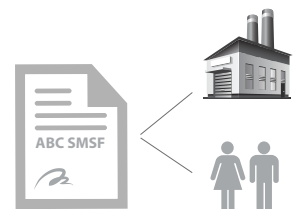
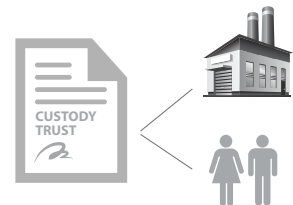
Briefly, establishing a company to act as a corporate trustee doesn't come cheap. The ASIC fee alone is over \$450!! On the other hand, appointing individual trustees for your SMSF is a lot less expensive.



Initially corporate trustees are more expensive to set up, however they allow for greater flexibility.



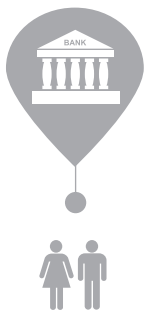
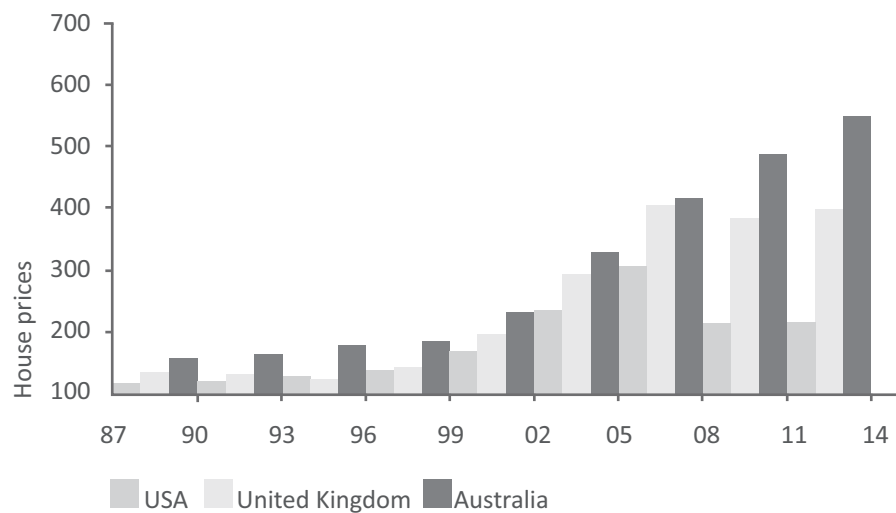
The death, divorce or resignation of members or trustees can cause all sorts of costly legal and administration issues for a fund with individual trustees.



CUSTODY TRUSTS



Figure 1.1: Graph detailing fluctuating house prices. USA, UK & AUS: 1987 - 2014



YOU NEED TO SPEAK TO YOUR LENDER BEFORE BORROWING IN YOUR SMSF. THE LENDER WILL HAVE SPECIFIC REQUIREMENTS WHICH WILL NEED TO BE FOLLOWED.

A RESIDENTIAL PROPERTY WHICH IS ACQUIRED THROUGH AN SMSF MUST NOT BE LIVED IN BY TRUSTEES, MEMBERS OR ANY RELATED PARTIES.

However, the advantage of establishing the corporate trustee can come in to play later on.... You see, the law requires the assets of an SMSF to be held in the names of the trustees of the Fund. In the event of death, divorce or resignations there is no requirement to change the name in which the assets are held. This is because all assets are held in the name of the company. This is the simpler option. You see, a company is an indefinitely continuing entity, it allows multiple generations of a family to come and go from a Fund. There is much greater fluidity. This means easier administration!

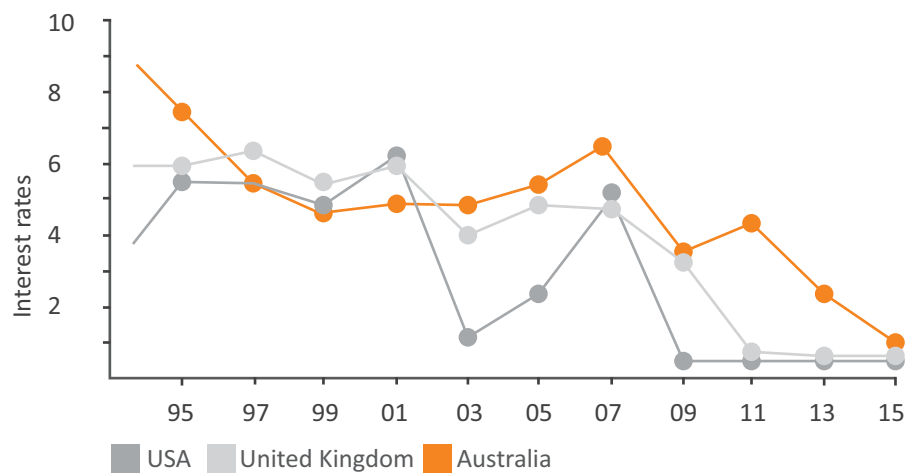
For a fund which uses individual trustees, the death, divorce or resignation of members or trustees can cause all sorts of costly legal and administration issues. This can be avoided by using a corporate trustee.

In summary, you should speak to your lender before deciding on the best structure to use for your SMSF and Custody Trust setup.

CUSTODY TRUSTS



Figure 1.2: Graph detailing interest rates. USA, UK & AUS: 1995 - 2015



CHECKLIST FOR ESTABLISHING A CUSTODY TRUST



Do you have an SMSF? If so, how old is it? Does it need to be updated? Updating your SMSF will ensure it stays compliant with current law requirements. If your SMSF is more than three years old then you should enquire about having it updated.



SPEAK TO YOUR LENDER to see what structure they require for your SMSF / custody trust setup.



If the bank requires corporate trustees, register the companies with ASIC. Set up a 'special purpose company' to act as the corporate trustee for the SMSF. Set up a regular company to act as the corporate trustee for the custody trust.



If you already had an SMSF with individual trustees and the bank requires corporate trustees, now is the time to perform a 'change of trustees' on your SMSF. This will remove the individual trustees

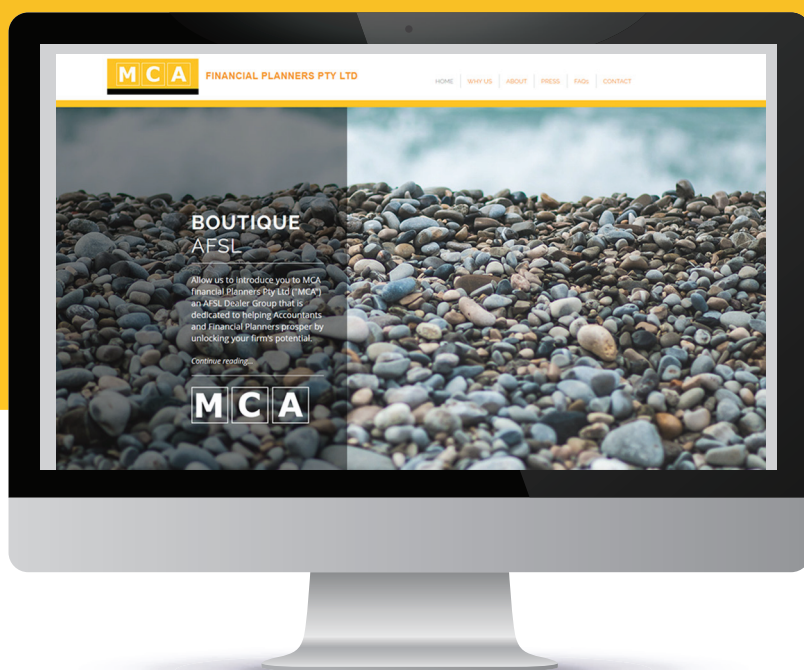


and replace them with the corporate trustee (special purpose company).

When signing the property contracts the name of the trustee of the custody trust will appear on the documents. If the trustee is a company, the company's name will appear on the contract. If the trustee is an individual, the individual's name will appear on the contract.



When the property has been purchased and the contracts signed, you will need to visit the state revenue office to enquire about the stamping requirements for your deed. Each state has different rules and charges for stamping deeds.



GENERAL ADVICE WARNING

The advice may not be suitable to you because it contains general advice which does not take into consideration any of your personal circumstance. All strategies and information provided on this website are general advice only.

