

SMSF BORROWING

– RULINGS AND RELEASES

In this article, we summarise some of the more pertinent rulings and releases from the ATO and the State Revenue Offices to provide you with a general overview of their respective positions.

Whilst SMSF Borrowing has been permitted under the superannuation legislation since September 2007, the regulatory interpretations regarding the very specific rules and limitations are still evolving. Over time, the regulatory bodies responsible for superannuation have released a number of rulings, draft rulings, alerts and publications clarifying their positions in relation to SMSF Borrowings.

ATO Alerts, Rulings and Draft Rulings

- Taxpayer Alert TA 2008/5
- GST Ruling GSTR 2008/3
- Taxation Ruling TR 2010/1
- Limited recourse borrowing arrangements by self-managed super funds – questions and answers
- Interpretative Decision ID 2010/162
- Interpretative Decision ID 2010/169
- Interpretative Decision ID 2010/170
- Interpretative Decision ID 2010/172
- Interpretative Decision ID 2010/184
- Interpretative Decision ID 2010/185
- SMSF Ruling SMSFR 2012/1

■ Taxpayer Alert TA 2012/7

Taxpayer Alert TA 2008/5

In this taxpayer alert, titled 'Certain borrowings by self managed superannuation funds', the ATO raises concerns about certain features that a Limited Recourse Borrowing Arrangement may exhibit. The features that are noted as raising concern for the ATO are as follows:

1. Rates of interest, especially in the case of related party loans

Summary: Loans to the Fund, especially from related party lenders, must be on commercial terms. Members risk having the difference treated as:

- a contribution, if at a low or zero rate, which could cause excess contributions tax issues; or
- if a high rate, a breach of the sole purpose test, financial assistance and early access provisions. (Also refer to ATO ID 2010/162 below)

2. Capitalisation of Interest on the borrowing

Summary: The capitalisation of interest may result in the SMSF Borrowing arrangement failing to meet the requirement of paragraph 67(4A)(a) of the SIS Act, which states

the loan proceeds must be applied for the acquisition of an asset.¹

3. A personal guarantee for the borrowing is given by a third party, particularly where the guarantee is given by a member or a related party of the SMSF

Summary: A personal guarantee given in the manner above may result in the lender having a recourse against assets of the super fund (other than the asset being acquired) which is "contrary to the intent that the exception in subsection 67(4A) of the SIS Act only applies to limited recourse borrowings".²

4. The asset acquired is one that a trustee is prohibited from acquiring under the SIS Act, or the SMSF's governing rules (eg, residential property, which is not business real property, from a related party)

Summary: The Asset being acquired by the Fund must be one that the Fund could acquire if purchased outright, as determined by the SIS Act and the Fund's Trust Deed.

Note that the Taxpayer Alert predates the changes to the SIS Act of July 2010 which, among other changes, repealed s 67(4A) and introduced s 67A and 67B.

¹ Capitalisation of interest was specifically permitted under s 67A. Some limitations apply to arrangements

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entered into prior to the July 2010 changes. (See reference to ATO ID 2010/184 below)

² The matter of personal guarantees was covered in s 67A, by limiting any recourse a guarantor, as well as the lender, may have to the extent of the actual asset acquired under the SMSF Borrowing. (Also refer to ATO ID 2010/170 below)

View this Taxpayer Alert in full
- [TA 2008/5](#)

GST Ruling GSTR 2008/3 - Goods and services tax: dealings in real property by bare trusts

This ruling applies to “supplies of real property involving bare trusts and similar trusts where the trustee has limited active duties and acts solely at the direction of the beneficiary or beneficiaries”.

The ruling states that it is the Super Fund Trustee, and not the Bare Trustee, that carries the liability for GST where the supply is a taxable supply in the following circumstances:

- There is a supply of real property.
- The trustee of a bare trust acquires the real property to be held in a bare trust.
- The trustee has limited active duties, acts solely at the direction of the beneficiary (SMSF) and has no independent role in respect of the trust property.
- The SMSF carries on an enterprise for GST purposes.
- The SMSF arranges for the real property to be used in its enterprise.

- The real property is therefore acquired by the trustee to hold upon a bare trust for the SMSF (subject to an obligation to transfer the legal title to the property to the beneficiary).
- The SMSF carries on an enterprise in respect of the real property even though the legal title to the property is registered in the name of the bare trustee.
- The SMSF makes supplies for consideration in relation to its enterprise.
- The consideration is received by the bare trustee who is bound to pay the consideration to the SMSF.
- Because the trustee of the bare trust holds the real property on behalf of a SMSF, the trustee does not carry on an enterprise for GST purposes as the trustee deals with the property at the direction of the SMSF.
- Therefore, the SMSF, as the beneficiary, and not the bare trustee, bears the liability for GST where the supply is a taxable supply.

View the full details of this Ruling
- [GSTR 2008/3](#)

Taxation Ruling TR 2010/1 - Income tax: superannuation contributions

This ruling is the finalised version of Draft Taxation Ruling TR 2009/D3, and relates to contributions to a superannuation fund. It is relevant to the issues of guarantees and SMSF Borrowing arrangements. The introduction of SIS Act s 67A which, as mentioned above, limited the

recourse of a guarantor to the actual asset acquired under the arrangement, has seen a significant change between the draft ruling and the final version.

Clause 180 of the ruling reads as follows:

“..the capital of the fund would not be increased when a lender exercises their right of recourse against the asset in circumstances where the value of the asset is less than the amount outstanding on the loan. This will be so even if the lender exercises both the right of recourse against the asset and requires a guarantor to satisfy any difference between the value of the asset and the outstanding loan amount.”

“

Note that the Taxpayer Alert predates the changes to the SIS Act of July 2010 which, among other changes, repealed s 67(4A) and introduced s 67A and 67B.

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Basically, if the guarantee is called upon because of a default on the loan by the SMSF Trustee, and the guarantor has been required to cover the amount owing to the lender, the payment by the guarantor to the lender will not be considered to be a contribution - **so long as the recourse of the guarantor is limited to the asset acquired under the arrangement.**

However, a contribution may be deemed to arise if the guarantor meets the obligations under the guarantee but does not seek recourse from the SMSF Trustee **to the extent any value remains in that asset.** Clause 149 of the ruling states:

“... a guarantor who satisfies a loan obligation of a superannuation provider may be taken to benefit the fund members in circumstances where the guarantor has no, or forgoes their right of, redemption against the superannuation provider. There may be a commercial reason for providing the guarantee (for example, the loan would not have been made to the superannuation provider without the guarantee) or indeed for satisfying the liability of the fund (the contractual requirements of the guarantee itself). However, the failure to deal with superannuation provider on a similar commercial basis in satisfying the fund's obligation means that it may be reasonably inferred that the guarantor's purpose is to provide benefits for the members of the fund.”

The effect of this part of the ruling is that, according to the ATO, if a

member makes a payment under a guarantee relating to an SMSF borrowing, for example under a borrowing arrangement (and guarantee) entered into prior to the introduction of SIS Act s 67A, and they forgo their right of indemnity to assets of the Fund, then the payment is regarded as a contribution to the Fund.

View this Ruling in full
- [ATO TR 2010/1](#)

Limited recourse borrowing arrangements by self-managed super funds – questions and answers

The ATO released this publication (Q & As), which it last updated in June 2012, to provide “general information on the Australian Tax Office’s (ATO) current views ... regarding the application of the superannuation law (specifically the Superannuation Industry (Supervision) Act 1993 and related super rules)” to limited recourse borrowing by self-managed super funds (SMSFs). The key points to come from the Q & As are:

Differing treatment for arrangements entered into either prior to, or from, 7 July 2010:

The document provides examples of a number of instances where permitted actions will differ, depending on whether the arrangement was entered into:

- after 24 September 2007 and before 7 July 2010; or
- on or after 7 July 2010.

Related Party Transactions:

- The laws which prohibit the acquisition of assets from related parties apply to limited recourse borrowing arrangements.
- A related party can borrow on a full recourse basis and on-lend the money to the SMSF under a limited recourse borrowing arrangement, at a higher rate of interest, provided the loan is appropriately documented and the SMSF is not charged higher than an arm's length rate of interest for the borrowing (i.e. what it would pay to borrow from a bank under a limited recourse borrowing arrangement).

Conditions of the Borrowing:

A limited recourse borrowing arrangement entered into on or after 7 July 2010 must satisfy the following conditions:

- “The borrowed monies are used to acquire a single asset, or a collection of identical assets that have the same market value (that are together treated as a single asset), which the fund is not otherwise prohibited from acquiring (called the 'acquirable asset'). The new law makes it explicit that borrowed money applied to expenses incurred in connection with the borrowing or acquisition (such as loan establishment costs or stamp duty), or expenses incurred in maintaining or repairing the acquirable asset, is allowed
- the borrowed monies are not applied to improving an acquirable asset

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- the acquirable asset is held on trust (the holding trust) so that the SMSF trustee receives a beneficial interest in the asset
- the SMSF trustee has the right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest
- any recourse that the lender or any other person has under the arrangement against the SMSF trustee is limited to rights relating to the acquirable asset. This limitation applies to rights directly or indirectly relating to a default on the borrowing and related charges or directly or indirectly relating to the SMSF trustee's rights in respect of the acquirable asset (for example, rights to income from the asset)
- the acquirable asset is not subject to a charge other than as provided in relation to the borrowing by the SMSF trustee
- the acquirable asset can be replaced by another acquirable asset that the SMSF is not otherwise prohibited from acquiring, but only in very limited circumstances as listed in the super law."

Single acquirable asset

A major change in recent versions of the ATO Q & As relates to a change in the interpretation of what constitutes a single acquirable asset. Prior to releasing the latest version of the Q & As, the ATO released a SMSF Ruling, SMSFR 2012/1 - Self-Managed Superannuation Funds: limited recourse borrowing

arrangements - application of key concepts. Rather than providing detailed responses in the Q & As, the ATO refers to the examples contained in SMSFR 2012/1 (see below for details).

Borrowing situations that are not compliant:

- The Trust that holds the asset on trust for the super fund cannot be a Discretionary Trust. It could be a Unit Trust, so long as the SMSF Trustee has full beneficial interest, and the asset must be the only property of the holding trust. Although permitted, this would appear to add other complications, such as Stamp Duty, CGT & GST issues.
- The Fund is not allowed to put an existing asset of the Fund into a limited recourse borrowing arrangement, or subject an existing Fund asset to a charge under the arrangement.
- Borrowing to make improvements to property is specifically prohibited under s 67A.

Related party guarantee of the Borrowing:

- The recourse of the lender or any other person against the SMSF trustee, as a result of a default on the borrowing, must be limited to rights relating to the asset that is being acquired.
- There is no contribution if the SMSF trustee has exercised a right to walk away from the arrangement (and has lost the acquirable asset to the lender)

and has no further liability, but the lender still exercises a right to call on the guarantee for a shortfall after disposal of the original asset.

Refinancing the Borrowing (also refer to ATO ID 2010/169 below)

- "Section 67A explicitly allows re-financing of a borrowing (including any accrued interest) under an arrangement if the new borrowing arrangement is over the acquirable asset from the first arrangement (including an asset from the first arrangement that is a replacement asset under section 67B of the SISA) and no other acquirable asset.

“

The Fund is not allowed to put an existing asset of the Fund into a limited recourse borrowing arrangement, or subject an existing Fund asset to a charge under the arrangement.

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- Where a new trust is created to hold the asset, SMSF trustees must ensure that the asset is transferred directly to that new trust and that the SMSF does not temporarily obtain title to the asset at that time, otherwise a contravention of the super law will occur.”
- Any arrangement refinanced on or after 7 July 2010 must meet the requirements of s 67A of the SIS Act.

Capitalisation of the Interest

(also refer to ATO ID 2010/184 below)

- “The super law ... explicitly provides that, under a limited recourse borrowing arrangement, the SMSF trustee can apply borrowed money towards expenses incurred in connection with the borrowing.”

Multiple drawdowns

- “The terms of a single limited recourse borrowing arrangement may allow multiple drawdowns by the investor
- Each drawdown must be reviewed to determine whether the borrowing meets the requirements of the super law applying to the particular arrangement.
- If a drawdown is put to a purpose that does not meet the requirements of the super law -

for example, the cash is put into a member's account - there is a contravention of the super law.

- Conversely, if the drawdown is put to a permitted purpose, such as the capitalisation of interest, then it does not result in a contravention of the super law.”

Other pertinent issues:

- Provided the borrowing arrangement complies with the superannuation law, the granting to the lender of a mortgage over the asset being acquired will not contravene the prohibition against giving a charge over a Fund asset.
- The Fund cannot enter into a limited recourse borrowing arrangement if its governing rules (usually the Trust Deed) do not specifically permit the borrowing.

View the full details of this publication - [ATO Q & As](#)

Interpretative Decision ID 2010/162 - Self managed Superannuation Fund: limited recourse borrowing arrangement - borrowing from a related party on terms favourable to the self managed superannuation fund

The ID states that there is no contravention (s 109 of SIS Act only) if the terms are more favourable to the SMSF, but adds that the terms cannot be more favourable to the related party than if the parties had been dealing at arm's length.

View this Interpretative Decision in full - [ATO ID 2010/162](#)

Interpretative Decision ID 2010/169 - Self managed superannuation fund: limited recourse borrowing arrangement - refinancing

This ID confirms that refinancing of an arrangement entered into before 7 July 2010 can occur after that date, provided certain rules are adhered to. Those rules relate to the application of the money borrowed, legal ownership of the asset, and ensuring the terms of s 67A of the SIS Act are met. Note - that includes the 'single acquirable asset' requirement.

View this Interpretative Decision in full - [ATO ID 2010/169](#)

Interpretative Decision ID 2010/170 - Self managed superannuation fund: limited recourse borrowing arrangement - third party guarantee

As the title suggests, the ID covers the provision of a guarantee by a related party of the SMSF, in respect of a borrowing arrangement entered into before 7 July 2010 (as the legislative change from that date specifically permits guarantees). The ID confirms the guarantee by a related party was permitted under the former subsection 67(4A) of the SIS Act.

View this Interpretative Decision in full - [ATO ID 2010/170](#)

Interpretative Decision ID 2010/172 - Self managed superannuation fund: limited recourse borrowing arrangement - joint investors

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This ID deals with the contravention of the SIS Act, in which two SMSFs entered into separate borrowing arrangements to purchase a single property, using one Bare Trust.

The ID states the requirement that the portion owned by each SMSF was required to be held by separate Bare Trusts.

View this Interpretative Decision in full - [ATO ID 2010/172](#)

Interpretative Decision ID 2010/184 - Self managed superannuation fund: limited recourse borrowing arrangement - capitalisation of interest

The ID confirms that interest on a borrowing entered into before 7 July 2010 can be capitalised without contravening subsection 67(1) of the SIS Act.

View this Interpretative Decision in full - [ATO ID 2010/184](#)

Interpretative Decision ID 2010/185 - Self managed superannuation fund: limited recourse borrowing arrangement - charge

ID 2010/185 confirms the contravention of subsection 67(1) of the SIS Act in the event that the Bare Trustee grants a charge over the asset under the borrowing arrangement other than to the lender.

View this Interpretative Decision in full - [ATO ID 2010/185](#)

SMSF Ruling SMSFR 2012/1 - Self Managed Superannuation Funds: limited recourse

borrowing arrangements - application of key concepts

SMSFR 2012/1, released in May 2012, details the ATO's view on three key concepts behind the SMSF borrowing legislation. The key concepts covered are:

- what is an 'acquirable asset' and a 'single acquirable asset';
- 'maintaining' or 'repairing' the acquirable asset distinguished from 'improving' it; and
- when a single acquirable asset is changed to such an extent that it is a different (replacement) asset.

The ruling indicates a willingness of the ATO to take a more practical approach to situations where the initial 'single acquirable asset' definition has proven to be impractical. Factories, certain farming properties and apartments with car parks on separate titles are examples of some of the investment issues covered in the ruling.

The ruling contains a number of examples explaining the ATO's view on each of the key concepts listed above.

A more detailed commentary of the ruling can be found on the Topdocs website - [here](#).

View this Ruling in full - [ATO SMSFR 2012/1](#)

Taxpayer Alert TA 2012/7 - Self managed superannuation funds arrangements to acquire property which contravene superannuation law

TA 2012/7 expresses the concern of the ATO in regards to two aspects:

- the structuring of a limited recourse borrowing arrangement which may not comply with the rules set out in the SIS Act; as well as
 - the incorrect use of a related unit trust to acquire property.
- The main concerns of the ATO, as detailed in the Taxpayer Alert, are that:
- the borrowing and the asset are incorrectly in the name of a related party, not the SMSF (borrowing) and Bare Trustee (asset); or
 - the SMSF signs the contract and/or holds title (including temporarily) to the asset.

View this Taxpayer Alert in full - [TA 2012/7](#)

Victorian State Revenue Office

The Victorian State Revenue Office (SRO) has published its view on the Stamp Duty exemptions available for property transactions under SMSF Borrowings on its website, under the heading 'Limited Recourse Borrowing Arrangements'. A summary of the Victorian SRO release is as follows.

The SRO bases its view on the 'more common structures' used to facilitate a limited recourse borrowing arrangement, which have as their basis:

1. "The SMSF provides all of the deposit monies and the balance of the purchase price for the land (the Property) from a combination of SMSF assets and borrowings from a financial institution (the Lender).
2. The SMSF trustee is the only borrower under the finance agreement.

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3. A person other than the SMSF trustee (the Custodian) acquires the Property using the money provided by the SMSF trustee, pays duty on the acquisition and is registered as the legal freehold owner on title. (Topdocs notes that the duty payable will be paid by the Custodian on behalf of the SMSF with the proceeds coming from the SMSF account)
4. The Custodian executes a declaration/acknowledgment of trust that the Custodian holds the Property on a fixed trust or bare trust for the SMSF.
5. The Custodian grants the Lender a limited recourse mortgage on the terms required by the Lender over the Property.
6. The Custodian retains legal title to the Property until the borrowing from and mortgage to the Lender is fully discharged by the SMSF and then the unencumbered title is transferred absolutely to the trustee of the SMSF."

Duty payable at the purchase of the Property

Summary:

The property will attract ad valorem duty payable by the Custodian on behalf of the super fund as per a normal property purchase.

The SRO requires the Custodian Trust Deed (declaration of trust) to be registered with the SRO. The Custodian Trust Deed will be exempt from duty if its structure shows that the Custodian is merely holding the property on trust for the SMSF under a fixed or bare trust structure. Part of this requirement is

demonstrating that the SMSF provided all monies for the purchase of the property. If the transfer of the property to the Custodian and the declaration of trust occurred 'contemporaneously' then the Custodian Trust Deed may be exempt from duty under section 17 of the Duties Act.

Duty payable upon transfer of the property from the Custodian to the SMSF Trustee

It should be noted that the SMSF Trustee has the right, but not the obligation, to request the transfer of title of the property from the Custodian to the SMSF Trustee. Should the SMSF Trustee wish to exercise its right to transfer, there are two possible exemptions that may apply:

1. If the Custodian Trust Deed was classified as exempt from duty when lodged with the SRO, on the basis that the Custodian is merely holding the property on trust for the SMSF Trustee under a fixed or bare trust structure, then the transfer of the Property from the Custodian to the SMSF Trustee will be exempt from duty.
2. Alternatively, the transfer will be exempt from duty if it can be evidenced that:
 - a. "duty was paid when the Property was acquired by the Custodian, and
 - b. for the whole period from the time the trust was declared by the Custodian to the time when the Property was transferred to the trustee of the SMSF:

- i. the trustee of the SMSF was always the only beneficiary, or
- ii. the beneficiaries (who are natural persons) of the SMSF were always the only beneficiaries of the SMSF."

View the full details of this publication - [SRO Victoria](#)

Other State Revenue Office Publications

A review of the websites of the State Revenue Offices in all of the States and Territories of Australia, for information on the required processes to ensure stamp duty exemptions are available in that relevant State or Territory, revealed only the Victorian publication referred to above.

As the process for obtaining exemptions from stamp duty on certain transactions differs from one State or Territory to another, it is vital that the requirements of the SRO/OSR, in the jurisdiction the property is to be purchased, are **ascertained before the contract to acquire the property is signed.**

More information

Should you have any queries or require more information, please contact the team at Topdocs on 1300 659 242.

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