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Limited Recourse Borrowing Arrangements

Presented By

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Advisers Digest

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History

- 2005 – PR 2005/27
- 2007 – SIS Section 67(4A)
- 2010 –
  - Section 67A & 67B introduced
  - Section 67(4A) repealed
  - Passed by the Senate 24th June 2010
- 2016 – Related Party Loan rules changed
- 2020 – Intermediary Loans approved
- 2026 – Definition of “Acquirable Asset” restricted to BRP

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Section 67A

- Trustee must borrow for purpose of acquiring a single "acquirable asset" or refinancing a loan used for that purpose (ss 67A(1)(a))
- Asset must be held on trust so that SMSF must have beneficial interest in underlying asset (ss 67A(1)(b))
- RSF Trustee has a right to acquire legal ownership after making one or more payments (ss 67A(1)(c) & (e))
- Rights of Lender or any other person limited to the asset purchased (ss 67A(1)(d))

Section 67A (continued)

- The asset is not subject to any charge except to the lender (ss 67A(1)(f))
- ss 67A(2) – Asset can not be cash and acquisition must not be prohibited
- ss 67A(3) – a collection of assets are identical and have the same market value – i.e. a parcel of shares

Section 67B – Replacement Assets

- Original asset can be replaced by a replacement asset where:
  - The original is a share or a unit in a unit trust
  - The new asset is a share or a unit
  - At the time of replacement both have the same market value
  - Instalment receipts converting to shares
  - Takeover, merger demerger or restructure
  - Scheme involving stapled securities

Section 71(8) – In-house Assets

- Section 71(8):
  - Fund invests in a related trust
  - Related trust is one described in ss 67A(1)(b)
  - The ONLY property of the trust is the acquirable asset
  - The investment in the trust is only an in-house asset if the acquirable asset is an in-house asset
- Be careful of trusts with multiple assets
- SPR 2014/1
  - Exempts the trust before, during and after the loan

ATO Q&A

- Can’t borrow to build on vacant land **
- Can’t borrow to make improvements
- Can borrow for repairs (must be subsequent draw downs)
- Can capitalise Interest
- Can’t buy & sell within parcel of shares
- Can make improvements

Single Acquirable Asset

- SMSFR 2012/1
- When can two titles be a single asset?
  - The existence of a unifying physical object, such as a fixture attached to the land which is permanent in nature and not easily removed and that is significant in value relative to the value of the asset
  - Whether under a law of a State or Territory the two assets must be dealt with together

What can you borrow or use cash to do?

- You can borrow to buy
- You can borrow to repair
- You can’t borrow to improve
- You can pay cash to improve
- But you can’t improve so much to change the asset

What can you do under an LRBA?

Permitted

✓ Knocking down a house and building a new much larger house

✓ Building a Managers residence on a sheep farm

✓ Adding a granny flat

✓ One bedroom converted into a home office

✓ Compulsory acquisition of part of the property

Not permitted

✗ Converting a residential property to a commercial property

✗ Subdividing a block of land into two

✗ Building on a vacant block

✗ House knocked down and replaced with strata units

Nominee/Custodian Versus Separate Trust

- **Investment in a trust**
  - Separate registration for TFN, ABN, etc.
  - Shown as investment in trust in balance sheet
  - May not need to unwind but if you do, see below – CGT now sorted
  - May attract stamp duty in some states
- **Mere custodian arrangement**
  - No mention of the trust in accounts
  - Asset & Liability of the fund
  - No need to unwind
  - What is a “Bare Trust” – GSTR 2008/3

GST

- Nominee makes agreement on behalf of beneficiary (SMSF)
- Use ABN of SMSF
- Do not register Bare Trustee for GST
- Special Conditions in Contract for Sale to include SMSF Trustee
- GSTR 2008/3 GST & Bare Trusts
- If you register Bare Trustee for GST, you may lose duty & CGT exemptions

Stamping A Bare Trust In NSW

- Evidence to obtain minimal duty
  - Bank statements to prove SMSF paid for property, not the Bare Trustee (be wary of deposits paid direct by members)
  - Loan agreement to show SMSF as principal borrower
  - Declaration of Trust
  - Statutory Declaration
  - Copy of Contract for Sale
  - SMSF Deed
  - Similar evidence when transferring the property back to SMSF trustee

Stamp Duty

- No need to stamp declaration of trusts in ACT, Vic, Qld & SA (but Vic & SA still should be lodged and assessed as nil)
- Stamping required in NT
- Must date Declaration of Trust BEFORE exchange of Contracts in Qld
- In Qld we recommend NOT to name the trust on title as it is not an operating trust (Section 130B has helped this)
- In Victoria we recommend that you enter into the contract under the name of the SMSF Trustee and/or Nominee. Transfer to Nominee before settlement
- Big duties issues in NSW – use good solicitors

Documentation

- Make sure your documentation is perfect before submitting to banks
  - All deeds are dated (not before incorporation)
  - Executed correctly
  - Check ACN‘s, spelling of names etc.
  - Check property details against contract and make sure it is only title
  - Updated deed (post June 2009)
  - Bank will ask for corrections too close to settlement
  - Big issue with older funds

Other Issues

- Accessing equity by selling a commercial property to a new fund
- Can use the same trustee for multiple arrangements
- Separate Land Tax Thresholds in some states
- Off the plan purchases where title changes
- Two lenders
- Holding trust does not need to be established before the contract date

Intermediary LRBAs

SPR 2020/1

Superannuation Industry (Supervision) In-house Asset Determination — Intermediary Limited Recourse Borrowing Arrangement Determination 2020

SPR 2020/1 – the determination

For the purposes of paragraph 71(1)(f) of the Superannuation Industry (Supervision) Act 1993, if at a time:

(a) an asset (the investment asset) of a fund is an investment in a related trust of the fund; and

(b) the related trust is one described in paragraph 67A(1)(b) in connection with the Intermediary LRBA under which the trustee of the fund is maintaining a borrowing that is covered by subsection 67A(1); and

(c) the only property of the related trust is the acquirable asset mentioned in paragraph 67A(1)(b);

Specific Requirements (1 of 4)

- a holding trust is established with members of a fund being the only trustees or shareholders and directors of the corporate trustee (Holding Trustee);
- the trustee of the fund is a beneficiary of the holding trust;
- the Holding Trustee holds an acquirable asset (Asset) on trust for the trustee of the fund, who is beneficially entitled to the Asset;
- the Asset is a single acquirable asset (as referred to in subsection 67A(1)) that the trustee of the fund is allowed to acquire under the Superannuation Industry (Supervision) Act 1993;

Specific Requirements (2 of 4)

- the Holding Trustee enters into a borrowing as principal with a lender with the borrowing secured by a mortgage over the Asset;
- the contract or deed of borrowing, referred to in paragraph (5), between the Holding Trustee and the lender may not limit the lenders right of recourse, under the contract or deed, to only the Asset in the event of default;
- the lender may require that personal guarantees are given as part of the Intermediary LRBA;

Specific Requirements (3 of 4)

- the arrangement is established by a legally binding deed(s) under which the trustee of the fund and the Holding trustee agree, for:
  - the trustee of the fund to maintain all borrowing obligations entered into by the Holding Trustee in respect of the borrowing referred to in paragraph (5);
  - the trustee of the fund is absolutely entitled to any income derived from the Asset, less fees, costs, charges and expenses incidental to the acquisition, holding or management of the Asset;
  - the trustee of the fund has the right to acquire the legal title of the Asset on completion of the borrowing referred to in paragraph (5);
  - the rights of the Holding Trustee or any Guarantors against the trustee of the fund in connection with default on the borrowing referred to in paragraph (5) is limited to the Asset.

Specific Requirements (4 of 4)

- The lender is fully aware of the intermediary nature of the loan

Related Party Borrowings

Backflip

- PBR 1012396819768
  - Is it a breach of s109? – No
  - Is it a deemed contribution – No
  - Is it non-arms length income? – No
- PBR 101258230106 (for shares)
  - Is it a breach of s109? – No
  - Is it a deemed contribution – No
  - Is it non-arms length income? – **YES**
- ATO ID 2010/162 even said it was OK

PCG 2016/5 Safe Harbour

- TD 2016/6
- Bring your loans up to speed before January 2017
- Consequences if you don’t have an arms length loan?
- You must have a loan on the equivalent terms to a commercial lender.
  - You basically need to get a loan approved

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PCG 2016/5 Safe Harbour (continued)

- Or else comply with the Safe Harbour
  - Loan agreement MUST be in writing
  - Must use the published rate (shares 2% higher)
    - Can be fixed for up to five years (three years for shares)
  - Repayments must be paid at least monthly
  - You must REGISTER a mortgage
  - Maximum LVR 70% for both residential and commercial properties
    - 50% for listed securities
  - Maximum term 15 years
    - Seven years for listed securities
  - Personal guarantees are not required

What You Can't Do

- Borrow for deposits
- Borrow for GST
- For both the above consider excess concessionals
- 2nd lender unless you comply with the PCG
- Borrow for units in a Reg 13.22C Trust (but why? Surely the banks lend unsecured)

Case Studies

Peter & Chloe

- Peter & Chloe have an SMSF with $200,000 in cash
- They want to buy their office that is $880,000 including GST
- They will have to pay $40,000 in stamp duty and other costs
- The bank will lend them 80% which is $640,000
- They are still $40,000 short and want to borrow the $80,000 GST until they receive back their GST
- They can borrow it off their related company
- They say that a bank will often lend $80,000 unsecured

The Issue

- They want to borrow off a related party
- TD 2016/16 and PCG 2016/5 give rules for borrowing
- You can't comply with the PCG because you won't get a mortgage
- You are also over 70%
- TD 2012/16 requires you to PROVE you could get a loan from a commercial lender under the same terms
- But NO commercial lender would lend you $80,000 unsecured AND on a limited recourse basis
- So if you borrow the money the property will be a non arms length investment

Solution

- The company makes a concessional contribution to the Fund of $80,000 being $40,000 for Peter and $40,000 for Chloe
- This will be an excess concessional contribution and will be added to Peter & Chloe's taxable incomes (but is still deductible to the company)
- So, Peter & Chloe need to reduce their incomes (wages) by $40,000
- The fund receives an extra $80,000 and can pay the GST
- In the new financial year Peter & Chloe receive their excess concessional contribution notices

Solution (continued)

- Peter & Chloe elect to release 85% of the excess contributions from the fund
- They receive $68,000 back from the fund
- They pay that back to the company

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Melissa & Matt

- Melissa & Matt have an SMSF and want their Fund to purchase a property – they are the only members of the Fund
- Establish LRBA with new standalone company as trustee and Melissa as sole director of the bare trustee company
- Bank refuses to lend to the Fund unless both Melissa and Matt are the directors of the bare trustee
- While the SIS Act imposes the requirement that each member is a director of the SMSF's Trustee, the same requirements don't apply to the bare trustee
- No issue with Melissa being sole director but prudent to have both members as director to save the argument with the bank

Melissa & Matt (continued)

- 3 years have passed and the Fund still holds the property and they accumulated more $ in the SMSF and decide to purchase another property
- Need to establish a second LRBA but to minimise costs, they want to use the same company as trustee for the second arrangement
- Legally acceptable but “what does the bank say”
- Asset protection issues, land tax aggregation issues
- Bank may request that the trustee be changed at an inopportune time (i.e. right before settlement)
- Happy Days Property P/L – contracts exchanged? Date of incorporation of company, double duty?

Charlie & Mary

- Brother SMSF and Sister SMSF would like to purchase commercial property to conduct Brother’s growing business operations. The property is essentially the warehouse adjacent to the current warehouse in use
- The negotiated price is $3m with the third party vendor
- It is envisaged that Charlie’s SMSF will acquire 60% of the commercial property, and Mary’s SMSF will acquire 40%
- Mary’s SMSF has sufficient cash in the SMSF to purchase its 40% share
- Charlie’s SMSF does not have sufficient cash in the SMSF and will require an LRBA
- The lender under the LRBA is a related party
- Received advice that it may be possible for a charge to be placed over the brother’s 60% interest in the real property if it is a related party lender
- Charlie’s 60% share needs to be seen as a single acquirable asset

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FAQ

- Members of Fund reside in Qld but the property is being purchased in NSW – since they reside in Qld, no need to have bare trust stamped?
  - Still needs to be stamped, duty liability arises in the state that the property is located – conveyancers should handle this and the order of dating of the bare trust
- Is a company legally required to act as trustee of the bare trust? **No** but bank will likely require a corporate trustee when lending
- What name should appear on the mortgage?
- What name should appear on the contract? Bare trustee ONLY unless NT or WA, conveyancers will be able to advise

Questions?

Please ask questions through the Q & A pod not on the chat pod.

Not Answered Questions will be emailed to you along with the **webinar recording**

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