



# Clarity – Re SMSF Limited Recourse Borrowing Arrangements – Prior to July 2010

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## Overview

The Australian Taxation Office has issued ID 2010/184 to clarify the capitalization of interest payments and the granting of charges by SMSFs under borrowing arrangements entered by the SMSF Trustee before the introduction of the new Limited Recourse Borrowing Arrangements provisions in 7 July 2010.

## Limited recourse Borrowing Arrangements Under former section 67(A4)

SMSFs are prohibited from borrowing money or maintaining a borrowing of money, by section 67(1) of the SIS Act, unless the borrowing arrangement satisfies one of the exceptions stipulated in the Superannuation Industry (Supervision) Act 1993 (SIS Act). One such exception was stipulated by former section 67(4A) of the SIS Act (now only applicable to limited recourse borrowing arrangements entered into before 7 July 2010).

Under this old legislative provision, a SMSF was only able to enter into a borrowing arrangement that had each of the following features (where all other relevant SIS Act conditions are met):

- (a) The borrowings are at all times applied to an Asset in which the SMSF would ordinarily be permitted to invest in directly;
- (b) The Asset (or a replacement Assets) is held on trust for the SMSF which initially acquires beneficial interest in the Asset;
- (c) The SMSF has the right to acquire full ownership of the Asset by making one or more instalment payments after acquiring beneficial interest; and
- (d) The lender's recourse to the SMSF in relation to the loan is limited to the Assets held on trust.

Current section 67A of the SIS Act, however, differs to the former section 67(4A) in a number of areas:

- (a) 'acquirable Asset' is defined in the singular whereas initial legislation could be interpreted as allowing for 'Assets' to be interpreted in the plural.



- (b) borrowing arrangements are limited to a single Assets or collection of identical Assets whereas initial legislation allows borrowing arrangements over multiple Assets.
- (c) any potential recourse against the super SMSF Trustee of a person other than the lender for default on the borrowing is limited whereas initial legislation extended only to the direct lender.
- (d) circumstances in which Assets can be replaced are defined rather than being at the discretion of the Trustee or lender.
- (e) trustees are expressly permitted to refinance an existing borrowing (emphasis added).

In this respect, current section 67A(1)(ii) expressly stipulates that "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)". For this reason capitalization of interests are currently allowed for Limited Recourse Borrowing Arrangements entered after 7 July 2010, but what about borrowing arrangements entered under the old section 67(4A) prior 7 July 2010?

### **Old borrowing arrangements and capitalisation of interest**

The Commissioner considered in SMSFR 2009/21 the nature of capitalisation of interest in respect to borrowing arrangements entered by the SMSF Trustee. For the Commissioner a drawdown to capitalise interest is a new borrowing under the terms of the arrangement.

However, ID 2010/184 confirms that if the limited recourse borrowing arrangement otherwise meets the requirements of former subsection 67(4A) of the SIS Act, then interest on the borrowing can be capitalised without contravening the general borrowing prohibition stipulated in section 67(1) of the SIS Act. In this respect, the old borrowing provision must meet the following requirements:

- (a) It meets the requirements of former subsection 67(4A) of the SIS Act;
- (b) The amounts capitalised is a cost related solely to the original borrowing under the borrowing arrangement;
- (c) The SMSF is permitted capitalise the interest under the terms of the original borrowing arrangement;
- (d) The ratio of the amount outstanding to the lender to the market value of the real property is within a stipulated maximum as at review date; and



(e) The capitalisation is for the purpose of acquiring the original assets and not a new one.

It is important to note that in order to take advantages of this decision, the original borrowing arrangement must permit the capitalisation of interest by the borrowing SMSF Trustee.

In addition, ID 2010/184 confirms that the lender's

right of recourse in respect of capitalised amounts remain limited to the real property held in the security trust.

Should you require further information in respect to SMSF Limited Recourse Borrowing Arrangements, or require an update as to the implications of SMSFR 2009/21 please visit the ili website [www.ili.com.au](http://www.ili.com.au).

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