Superannuation Borrowings LRBA

Superannuation funds are able to take out long-term loans to buy assets under the Limited Recourse Borrowing Arrangement (LRBA) rules in superannuation legislation.

The rules are very specific on how the arrangement must be structured. This includes:

1. The borrowed money must be used to purchase a single acquirable asset, or collection of identical assets. The loan can be used to pay expenses for the loan or asset purchase, or to repair or maintain the acquired asset. Borrowed money cannot be used to improve the asset.
2. The asset must be held in a custodial trust with the SMSF having a beneficial interest in the asset. The trustee of the custodial trust cannot be the same as the trustee of the SMSF.
3. The SMSF trustee must have the right to legal ownership of the asset once the loan has been repaid.
4. If the SMSF defaults on the loan, the lender will only have recourse to the asset purchased with the borrowed money.

However, the lender may have obtained personal guarantees from SMSF members.

The timing of transactions is important as the borrowed money must be directly applied to purchase the asset and the title must be put into the name of the custodial trustee.

Before entering into an LRBA the SMSF trust deed should be reviewed to ensure you are permitted to borrow. This may require amending the trust deed before proceeding with the acquisition. The acquisition should also fit into the SMSF's investment strategy.

The information below provides answers to some of the typical questions that arise in relation to LRBAs.

Single Acquirable Asset or Collection of Identical Assets

Whether the fund borrows or not, trustees of an SMSF can buy any asset that is appropriate to the fund but it can only be acquired from a member or related party if it is business real property, listed shares, units in a widely held unit trust or an in-house asset.

Each loan can only be used to buy a single asset. This means for example, that a property spread across more than one title deed is usually not a single asset. The acquisition of each title would need to be financed from a separate loan arrangement. An exception to the rule is where a property covers more than one title but it is legally impossible to sell them separately or there is a permanent and substantial fixture that is built across the titles.

A collection of assets will meet the rules for a single asset if the assets are identical, have the same market value and are purchased in one transaction. For example, a parcel of shares in a single company can be purchased provided they are all at the same price.

'Off the Plan' Purchases

It is possible to purchase a property 'off the plan' using an LRBA but only if the SMSF pays the deposit using accumulated savings and the loan is used to finance the balance of the purchase price at settlement.

Maintenance, Repairs and Improvements

Borrowed money can only be used to:

- Buy an applicable asset;
- Pay the costs associated with borrowing (e.g. loan establishment fees) and acquiring the asset (e.g. valuation fees, transfer duty, conveyancing and legal fees);
- Maintenance and repairs to the asset - maintenance is defined as work to prevent defects, damage or deterioration to the asset while repairs include remedying or making good defects in, damage to, or deterioration of an asset.

Improvements cannot be funded from borrowed money but may be paid with money from the SMSF provided the nature of the asset does not change.

Advice should be sought before money is spent on an asset that is subject to an LRBA.

Limited Recourse

The loan must be limited recourse. If the SMSF trustee defaults on the loan the lender can only recover what is owed from the asset that was purchased with the loan. This protects the other assets in the fund. But members may have needed to provide personal guarantees which puts assets held outside superannuation at risk.

Members who have been requested to provide a personal guarantee should seek appropriate legal advice to ensure they are fully aware of their rights and obligations.

Related Party Lenders

SMSF trustees can seek finance from a commercial lender. Alternatively, a member, relative or other related party could be the lender. In this case, appropriate legal advice should be obtained to ensure the borrowing arrangements are correctly structured from a taxation, superannuation and legal perspective.

The Australian Taxation Office has issued a number of Interpretive Decisions that indicate that where a trustee of a SMSF seeks to borrow from a related party, such loan arrangements should be arranged on commercial terms. In the event that trustees borrow on non-commercial terms, the ATO may treat the income derived from the underlying asset as non-arm's length income. Non-arm's length income is taxed at a current rate of 47%. When entering into a loan with a related party, the trustees should exercise care to ensure that other aspects of superannuation law are not breached and that the loan arrangement is properly documented.

In April 2016 the Australian Taxation Office released Practical Compliance Guidance 2016/5. This publication establishes 'safe harbour' terms for SMSFs seeking to borrow from a non-bank lender for the purposes of acquiring real property and listed securities.

Custodial Trust

The asset must be held on trust for the SMSF. The title should be registered in the custodial trustee's name and this should not be the same as the trustee of the SMSF. Many commercial lenders will require a corporate trustee.

The trust and the trustee will need to be established before the asset is purchased or before any purchase contract is entered into. Once the loan has been repaid, the title of the asset will need to be transferred to the SMSF trustee to avoid being treated as an in-house asset (that is subject to a 5% limit). Stamp duty may apply, with rules varying across the states.

LRBAs and the Transfer Balance Cap (TBC)

The TBC is the maximum amount a member of a superannuation fund may invest in superannuation income streams (pensions) (other than an income stream being paid under transition to retirement rules). The limit, which applies from 1 July 2017 is $1.6million. This figure is subject to indexing in future years.

Where a SMSF has a LRBA in place and has one or more members of the fund receiving income streams, repayments made under the LRBA may be counted against the member's TBC in certain circumstances. However, this only applies to LRBAs entered into on or after 1 July 2017.

An amount will be counted against a member's TBC (that is, counted as a credit against the TBC) where repayments made under an LRBA increase the value of interests that are supporting a retirement phase income stream. Generally, this will occur where a LRBA is held over assets that are in the pension phase of superannuation and repayments are being made from assets held in the accumulation phase of the same superannuation fund. Value is being shifted from the accumulation phase to the pension phase.

Where a LRBA is in place over an asset that is in either the accumulation or the pension phase, and the repayments are made from the same phase, then TBC reporting is not required.

By way of example, if a single member SMSF has both an accumulation account and a pension account and an asset of the pension account has a LRBA in place, and repayments of the loan are made from cash held in the accumulation account, the amount of each repayment will be reportable as a credit against the member's TBC as each repayment effectively transfer value from the accumulation account to the pension account (by reducing the debt held in the pension account).