

Changes to Superannuation Borrowing Rules

Borrowing from a Related Party

New legislation applying to borrowing by superannuation funds has been passed with an effective date of 6 July 2010. Sections 67A and 67B of the Superannuation Industry (Supervision) Act ("SIS Act") have replaced section 67(4A). The new legislation refers to "limited recourse borrowing arrangements" with "instalment warrants" being a thing of the past. The new legislation addresses Australian Taxation Office concerns around personal guarantees, borrowing to acquire multiple assets and replacement of assets subject to borrowing arrangements.

The new legislation applies to all future borrowing arrangements including purchases which are yet to be settled, and accordingly existing contracts should be reviewed.

Under the new provisions, a borrowing must have the following features:

- ▶ Borrowed funds applied to purchase a single acquirable asset;
- ▶ Acquirable asset is held on trust with the superannuation fund having a beneficial interest in the asset;
- ▶ Superannuation fund has the right to acquire the legal ownership (or replacement asset) after full repayment of the loan; and
- ▶ Rights of the lender against trustee are limited to the acquirable asset.

Furthermore, the following items can now be included with borrowing arrangements:

- ▶ Ability to refinance an existing borrowing; and
- ▶ Ability to borrow to fund repairs and maintenance.

In addition to the new legislation, there has been clarification around the following:

- ▶ What constitutes a single acquirable asset;
- ▶ When an asset can be replaced; and
- ▶ Limits on applying borrowings to repairs and maintenance.

Single Acquirable Asset

Generally speaking, the only time when more than one asset can be a single acquirable asset is where it is a collection of identical assets with the same market value (e.g. shares in the same company). This does not include identical apartments within a property development, even if the initial purchase price is identical, nor does it include apartments with car-parks on separate titles. The new legislation prohibits the acquisition of shares in two distinct companies under one borrowing arrangement.

Asset Replacement

Replacement assets rules have been significantly narrowed to apply to specific situations such as replacement listed company shares in the event of take-overs.

Repairs and Maintenance

The new legislation permits the use of borrowings to fund repairs to property. Borrowing to effect initial repairs where the purchase price of the property reflected the need for these repairs is prohibited. Borrowing to effect capital improvements is also prohibited. Current accepted law and rulings around what constitutes repairs as opposed to improvements should be used as guidance in this area.

Improvements to Assets Acquired under Borrowing Arrangements

Careful consideration should be given to if existing fund cash holdings are used to improve assets acquired under a borrowing arrangement, as this could be seen as subjecting existing assets of the fund to a charge which is prohibited under the SIS Act.

Borrowing from Related Parties – Short Cuts Can Be Costly

A superannuation fund borrowing from a related party rather than directly from a bank can be beneficial in the following situations:

- ▶ utilising surplus non-superannuation cash;
- ▶ transferring assets into superannuation; and
- ▶ accessing cheaper bank finance.

Appropriate advice and care needs to be taken when undertaking such an arrangement to ensure compliance with both superannuation and tax legislation.

Arms Length Requirements

Any transaction between a superannuation fund and a related party must be undertaken on commercial terms. In respect of borrowing arrangements, this includes the interest rate applied, the loan to value ratio and payment of establishment costs. Where borrowing arrangements are not undertaken on commercial terms, there may be deemed contributions (where the superannuation fund benefits) or failure of the sole-purpose test (where the member benefits).

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Mortgage over Property – Division 7A

Whilst there is no need to register the mortgage over the property, where a related party is the lender, registration of the mortgage may be required in order to comply with income tax legislation where the term of the loan exceeds seven years but is less than 25 years.

Where Division 7A legislation applies, the interest rate applicable to the borrowing arrangement must be equal to or greater than the relevant benchmark interest rate.

Documentary Evidence

The best way to demonstrate that the borrowing arrangement has been entered into on commercial terms is to fully document the transaction in much the same way as a financial institution would including registering the mortgage.