




ATO Interpretative Decision

ATO ID 2010/184

Superannuation

Self managed superannuation fund: limited recourse borrowing arrangement - capitalisation of interest

FOI status: may be released

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Issue

Can interest on a limited recourse borrowing arrangement entered into by a self managed superannuation fund (SMSF) trustee before 7 July 2010 be capitalised without contravening the general prohibition on borrowing in subsection 67(1) of the *Superannuation Industry (Supervision) Act 1993* (SISA)?

Decision

Yes. If the limited recourse borrowing arrangement otherwise meets the requirements of former subsection 67(4A) of the SISA then interest on the borrowing can be capitalised without contravening subsection 67(1) of the SISA.

Facts

An SMSF trustee has entered into a limited recourse borrowing arrangement under former subsection 67(4A) of the SISA (applying to arrangements entered into before 7 July 2010). The arrangement is to borrow to acquire real property from an unrelated party.

The arrangement was entered into on 1 June 2009.

Under the terms of the arrangement, provided the ratio of the amount outstanding to the lender to the market value of the real property is within a stipulated maximum as at a review date, the SMSF investor is permitted to elect to capitalise the interest on the borrowing for the relevant period. In these circumstances the interest liability for the period and associated charges are capitalised by a drawdown on the lending facility. The lender's rights of recourse in respect of capitalised amounts remain limited to the real property held in the holding trust.

The arrangement otherwise meets the requirements of former paragraphs 67(4A)(a) to 67(4A)(e) of the SISA.

Reasons for Decision

Regulated superannuation funds are generally prohibited from borrowing money or maintaining a borrowing of money, by subsection 67(1) of the SISA, unless the borrowing satisfies one of the exceptions provided for by section 67 of the SISA. One such exception is provided for by former subsection 67(4A) of the SISA (applying to limited recourse borrowing arrangements entered into before 7 July 2010).

In order to satisfy former subsection 67(4A) of the SISA the limited recourse borrowing arrangement must meet the following requirements set out in former paragraphs 67(4A)(a) to 67(4A)(e) of the SISA:

- The borrowed monies are applied to acquire an asset which the SMSF is not otherwise prohibited from acquiring. (paragraph 67(4A)(a))
- The asset is held on trust (the holding trust) so that the SMSF receives a beneficial interest in the asset. (paragraph 67(4A)(b))
- The SMSF has the right to acquire legal ownership of the asset by making one or more payments after acquiring the beneficial interest. (paragraph 67(4A)(c))
- Any recourse that the lender has under the arrangement against the SMSF trustee is limited to rights relating to the asset held in the holding trust. (paragraphs 67(4A)(d)&(e))

A drawdown to capitalise interest is a new borrowing under the terms of the arrangement, see *Self Managed Superannuation Funds Ruling SMSFR 2009/21* at paragraph 93:

93. The Commissioner also considers that each drawdown of funds from a loan facility or similar arrangement constitutes a separate borrowing, even if the facility or arrangement makes provision for redraws arising from earlier repayments.

Each drawdown under the arrangement must meet the requirement in former paragraph 67(4A)(a) of the SISA that the money borrowed is applied for the acquisition of the real property being acquired by the SMSF trustee under the arrangement.

A relevant meaning of 'apply' in *The Macquarie Dictionary*, [Multimedia], Version 5.0.0, 01/10/01 is:

4. to devote to some specific purpose: to apply a sum of money to pay a debt.

The Commissioner accepts that the drawdown representing the capitalisation is for the purpose of acquiring the asset under the limited recourse borrowing arrangement. That is, the requirement in former paragraph 67(4A)(a) of the SISA is met in respect of the drawdown if the amount capitalised is a cost related solely to the original borrowing under an arrangement that otherwise meets the requirements of former paragraphs 67(4A)(a) to 67(4A)(e) of the SISA. In this case all other aspects of the arrangement continue to meet the requirements of former paragraphs 67(4A)(b) to 67(4A)(e) of the SISA at all times.

Date of decision: 30 June 2010

Year of income: Year ended 30 June 2009

Legislative References:

Superannuation Industry (Supervision) Act 1993
 subsection 67(1)
 former subsection 67(4A)

Related Public Rulings (including Determinations)

Self Managed Superannuation Funds Ruling SMSFR 2009/2

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