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## Explanatory Statement

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

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### General Outline of Instrument

1. This instrument is made under paragraph 71(1)(f) of the *Superannuation Industry (Supervision) Act 1993* (SISA).
2. This instrument ensures that an investment by a self managed superannuation fund (fund) in a related trust that is in connection with an Intermediary Limited Recourse Arrangement (Intermediary LRBA) and that complies with section 67A of the SISA is excluded from being an in-house asset of the fund in the circumstances described in the instrument.
3. The instrument is a legislative instrument for the purposes of the *Legislation Act 2003* (LA).
4. Under subsection 33(3) of the *Acts Interpretation Act 1901*, where an Act confers a power to make, grant or issue any instrument of a legislative or administrative character (including rules, regulations or by-laws), the power shall be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to repeal, rescind, revoke, amend, or vary any such instrument.

### No guarantee of financial or commercial viability

5. This determination is being made to ensure consistent application of the SISA for arrangements that comply with section 67A of the SISA. The Commissioner does not sanction or guarantee Intermediary LRBAs. Further, the Commissioner gives no assurance that Intermediary LRBAs are commercially viable, that any charges are reasonable, appropriate or represent industry norms, or that any projected returns will be achieved or are reasonably based. Potential participants must form their own view about the commercial and financial viability of Intermediary LRBAs. The Commissioner recommends a financial (or other) adviser be consulted for such information.

### Date of effect

6. The instrument commenced on 24 September 2007.
7. The instrument commences retrospectively to ensure that a trustee of a fund that has entered into an Intermediary LRBA as defined in subsection 5(b) of the Legislative Instrument will not be disadvantaged. Under section 12(2) of the LA, this instrument does not adversely affect the rights or liabilities of any person other than the Commonwealth.

### **What is this instrument about**

8. The purpose of this instrument is to exclude an investment by a fund in a related trust from being an in-house asset of a fund under paragraph 71(1)(f) of the SISA in circumstances where the investment in the related trust is in connection with an Intermediary LRBA that complies with section 67A of the SISA.

### **What is the effect of this instrument**

9. This instrument determines that an asset (the investment in the related trust) covered by this Legislative Instrument is not an in-house asset of the fund.
10. Compliance cost impact: Minor – There will be minimal impact for both implementation and ongoing compliance costs. The legislative instrument is minor and machinery in nature.

### **Background**

11. A trustee of a fund is prohibited from borrowing money, or maintaining an existing borrowing of money, under section 67 of the SISA. An exception to this prohibition is where a trustee of a fund borrows money, or maintains a borrowing of money, under a LRBA that complies with section 67A of the SISA.
12. A central element of a LRBA is that the amount which has been borrowed is applied for the acquisition of an acquirable asset. Further, the acquirable asset is held on trust (a holding trust) in which the fund has a beneficial interest. Because the trustee of the fund controls the holding trust<sup>1</sup> in an LRBA, it is a related trust of the fund and, but for the operation of subsection 71(8) of the SISA, an in-house asset of the fund.<sup>2</sup>
13. The in-house asset rules contained in Part 8 of the SISA seeks to limit the risks associated with superannuation fund investments in related parties and imposes a 5% limit on the value of in-house assets that a fund can hold.
14. Subsection 71(8) of the SISA excludes from the definition of 'in-house asset' a fund's investment in a related trust (the holding trust) that is connected to a borrowing, by the trustee of the fund that is covered by section 67A of the SISA. That subsection provides that the investment is excluded from being an in-house asset if:
  - (a) the only property of the related trust is the acquirable asset mentioned in paragraph 67A(1)(b) of the SISA, and
  - (b) the acquirable asset would not have been an in-house asset of the fund if the fund held the asset directly.
15. The exclusion provided by subsection 71(8) of the SISA only covers circumstances where the borrowing, covered by section 67A of the SISA, is undertaken by the trustee of the fund. That is, to be excluded from being an in-house asset, the fund must borrow the amount directly.
16. However, section 67A of the SISA provides an exception to the borrowing prohibition in circumstances where the trustee of the fund borrows or maintains a borrowing.

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<sup>1</sup> Within the meaning of subsection 70E(2) of the SISA.

<sup>2</sup> See section 71(1) of the SISA.

17. Maintaining a borrowing of money includes circumstances where a fund trustee has become liable for obligations under a borrowing arrangement entered into by another party.
18. Therefore, while section 67A of the SISA may apply to circumstances where the trustee of a fund borrows directly or maintains the borrowing of a third party, subsection 71(8) of the SISA only applies where the trustee of a fund borrows directly.
19. Where the arrangement is undertaken as described below, this Legislative Instrument will apply to exclude a fund's investment in such a related holding trust from being an in-house asset of the fund.
20. This is consistent with the policy intent that an investment in a related trust that is part of an LRBA and that meets the requirements of the borrowing exception in section 67A of the SISA should only be an in-house asset under section 71 of the SISA where the underlying asset would itself be an in-house asset of the fund if it were held directly.<sup>3</sup>
21. The Legislative Instrument is limited to an investment in a related trust by a fund under an arrangement entered into by the parties that meets the requirements in subsection 5(b) of the Legislative Instrument.
22. In determining to exclude these assets from being an in-house asset of a fund, an important consideration was that the arrangement must comply with section 67A of the SISA. In particular, that the rights of the Holding Trustee, the lender and any other party against the trustee of the fund under the borrowing arrangement is limited to only the acquirable asset.
23. The ATO has reviewed the particular arrangement and is satisfied that where the requirements of subsection 5(b) of the Legislative Instrument are satisfied, it complies with section 67A of the SISA. Central to this conclusion is that the deed, which limits the rights of the Holding Trustee or any Guarantors against the trustee of the fund in connection with default on the borrowing, is disclosed to the lender.
24. This determination is specific to trustees of funds who have entered the Intermediary LRBA described in subsection 5(b) of the Legislative Instrument and described below. The Legislative Instrument cannot be relied on by other trustees of a fund even if they have entered into a similar arrangement.
25. Trustees of a fund who have or are proposing to enter into an LRBA arrangement where the trustee of the fund is maintaining the borrowing of a third party, other than the Intermediary LRBA covered by this Legislative Instrument, should seek advice from the Commissioner of Taxation to confirm;
  - (a) that the arrangement complies with section 67A of the SISA, and
  - (b) whether it is appropriate in the circumstances to exclude the investment in the related trust from being an in house asset.

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<sup>3</sup> See paragraphs 3.15 to 3.16 of the Explanatory Memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007 with respect to the introduction of subsection 71(8) of the SISA. Note that these paragraphs refer to the concept of an 'instalment warrant' under subsection 67(4A) of the SISA which operated before the introduction of section 67A of the SISA. However, the policy is still relevant to a LRBA that meets the requirements of section 67A.

## The Arrangement

26. The Intermediary LRBA is defined as an arrangement, entered into by the parties which meets the following requirements:
- (1) a holding trust is established with members of a fund being the only trustees or shareholders and directors of the corporate trustee (Holding Trustee);
  - (2) the trustee of the fund is a beneficiary of the holding trust;
  - (3) the Holding Trustee holds an acquirable asset (Asset) on trust for the trustee of the fund, who is beneficially entitled to the Asset;
  - (4) 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 SISA;
  - (5) the Holding Trustee enters into a borrowing as principal with a lender with the borrowing secured by a mortgage over the Asset;
  - (6) 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.
  - (7) the lender may require that personal guarantees are given as part of the Intermediary LRBA;
  - (8) the arrangement is established by a legally binding deed(s) under which the trustee of the fund and the Holding trustee agree for:
    - (i) the trustee of the fund to maintain all borrowing obligations entered into by the Holding Trustee in respect of the borrowing arrangement referred to in paragraph (5);
    - (ii) 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;
    - (iii) 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);
    - (iv) the rights of the Holding Trustee or any Guarantors against the trustee of the fund following the default on the borrowing referred to in paragraph (5) is limited to the Asset.
  - (9) the documentation referred to in paragraph (8) in connection to the borrowing referred to in paragraph (5), is disclosed to the lender at the time of the borrowing

## Consultation

27. Subsection 17(1) of the *Legislation Act 2003* requires, before the making of a determination, that the Commissioner is satisfied that appropriate and reasonably practicable consultation has been undertaken..
28. For this determination, broad consultation was undertaken for a period of 4 weeks commencing on 10 February 2020. The draft determination and draft explanatory statement were published on the ATO Legal database.

Publication was advertised via the 'What's new' page on that system and via the 'Open Consultation' page on ato.gov.au. Major tax and superannuation publishers and associations monitor these pages and include the details in the daily and weekly Alerts and newsletters to their subscribers and members. This ensures advice of the draft is disseminated widely across the tax professional community, and that they are in an informed position to provide comments and feedback.

29. Targeted consultation was also undertaken with more than 20 professional associates and professional firms.

- AMP
- ARC Super
- ASF Audits
- Auditing and Assurance Standards Board
- Australian Securities and Investments Commission
- BDO
- Chartered Accountants Australia and New Zealand
- Class Super
- Corporate Seminars Australia
- CPA Australia
- EY
- Financial Planning Association of Australia
- Heffron SMSF Solutions
- Institute of Public Accountants
- Legalwise Seminars
- National Tax and Accountants' Association
- Institute of Public Accountants
- Reliance Auditing Services
- SMSF Independent Superannuation Funds Association
- SMSF Association
- SMSF Auditors Association of Australia
- Super Concepts
- Super Sphere
- Tactical Super
- The Tax Institute of Australia
- Veritas Audit

31. The ATO received comments from four organisations in response to the request for feedback on this Instrument. Two feedback providers commented on the policy intent of the law and their comments were out of scope for inclusion in this instrument. Two other feedback providers made specific comments on the Instrument. The comments were taken into account in finalising this Legislative Instrument.

#### **Exemption from disallowance and sunseting regime**

30. Part 4 of the LA provides for the sunseting of legislative instruments. However, paragraph 54(2)(b) of the LA provides that Part 4 of the LA does not apply if the legislative instrument is prescribed by regulation. Section 11 of the *Legislation (Exemptions and Other Matters) Regulation 2015* (EOMR) provides a list of instruments that are not subject to sunseting. Item 6 of the table in section 11 of the EOMR lists instruments (other than regulations) relating to superannuation. As a result, Part 4 of the LA does not apply to this instrument. Therefore this instrument will not sunset.
31. Section 42 of the LA provides for the disallowance of legislative instruments. However, paragraph 44(2)(b) of the LA provides that section 42 does not apply to legislative instruments prescribed by regulation. Section 9 of the EOMR provides a list of instruments that are not subject to disallowance. Item 4 of the table in section 9 of the EOMR lists instruments (other than regulations) relating to superannuation. As a result, this instrument is not a disallowable legislative instrument under section 42 of the LA.

#### **Statement of compatibility with Human Rights**

As section 42 of the LA does not apply to this instrument, a Statement of compatibility with Human Rights in respect of this instrument is not required under section 9 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### **Legislative references:**

*Acts Interpretation Act 1901*

*Human Rights Parliamentary Scrutiny Act 2011*

*Legislation Act 2003*

*Legislation (Exemptions and Other Matters) Regulation 2015*

*Superannuation Industry (Supervision) Act 1993*

*Tax Laws Amendment (2007 Measures No. 4) Bill 2007*