

TAX TALKS

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A related party LRBA often involves money that sits in a bucket company. So you need to look out for Div 7A if you don't want to pay tax on a deemed or actual dividend.

Related Party LRBA

Most big banks have pulled out of the LRBA market by now. There are still some second-tier lenders who provide LRBAs, but the majority of new LRBAs now come from related parties. And the cash for these related party LRBAs often comes from bucket companies.

So how do you avoid triggering a Div 7A issue? That is the question we asked Andrew Henshaw of [Velocity Legal](#) in Sydney.

Here is what we learned but please listen to this episode as Andrew Henshaw explains all this much better than we ever could.

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The cash for related party LRBAs often sit in bucket companies. So the question is how do you get the cash out of the bucket company into the SMSF without triggering a Div 7A issue?

Question

Let's use an example. Easier that way. Image a company that runs a lucrative business. Shareholder is a family trust. Each year the trading company declares dividends to the family trust and the family trust then distributes these dividends to a bucket company.

There is also an SMSF. And this SMSF is to buy the business premises the trading company leases at the moment. The plan is to then get the SMSF to lease these premises back to the trading company.

The problem is that the SMSF does not have enough cash to buy the trading company's business premises. But the bucket company does. So how do they get the money out of the bucket company into the SMSF without triggering tax on a deemed (Div 7A) or actual dividend?

Answer

The answer is a Limited Recourse Borrowing Arrangement or LRBA. In essence, the bucket company would lend the money to the SMSF. But there are two important issues to consider.

To make sure the LRBA doesn't become non-arm's-length income, the LRBA must comply with the ATO's safe harbour rules for LRBAs.

The second issue is that the SMSF is likely to be an associate of a shareholder of the bucket company. So the bucket company lending money to the SMSF falls under Division 7A.

One Loan

Technically you could have the bucket company providing an LRBA directly to the SMSF. So just have one single loan. But that single loan would then have to comply with two sets of rules at once. The LRBA safe harbour rules and Div 7A.

The problem is that the two rules differ in significant ways. For instance each rule requires a different interest rate. So what do you do? Do you go for the higher one or you take the lower one?

Two Loans

The easier way to comply with both sets of rules is to make it two loans by putting another entity in between. An intermediary.

So the bucket company lends to the intermediary, which could be the shareholder of the bucket company or another discretionary trust or another entity altogether. This loan would require a Div 7A loan agreement.

And the intermediary then enters into an LRBA arrangement with the SMSF and on-lends the money to the SMSF. And that LRBA arrangement would then comply with the ATO's LRBA safe harbour rules to minimise the risk of the non-arm's length income rules to apply.

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