TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

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You don't have to follow the LRBA safe harbour rules. But many do.

LRBA Safe Harbour Rules

The LRBA safe harbour rules are there to give you certainty. Arm's length is a fuzzy word – what is arm's length for me might not be arm's length for you or the ATO. So to give you certainty whether your SMSF's LRBA is at arm's length, the ATO offers you the LRBA safe harbour rules.

In this episode, Kathy Evans of Findex will walk you through the 7 safe harbour rules listed in PCG 2016/5.

Here is what we learned but please listen in as Kathy Evans explains all this much better than we ever could.

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LRBA Safe Harbour Rules

Your SMSF can only borrow money through an LRBA – a Limited Recourse Borrowing Arrangement. But even when this LRBA is in place, you are not done yet.

You need to make sure that the LRBA is at arm's length. If it isn't, your SMSF has NALE (non-arm's length expenses). The entity providing the LRBA has NALI (non-arm's length income). And the underlying asset is NAL and hence any income or capital gain derived from this asset is taxed at the top marginal rate as NALI, even if the fund is fully in pension mode.

Top marginal tax rate isn't a good outcome, so NALE, NALI and NAL is something to avoid at all costs. But arm's length is a fuzzy concept. To make it less fuzzy, the ATO has issued the LRBA safe harbour rules in PCG 2016/5. Follow these for property and listed shares / units and you have certainty that you are well clear of any NALI, NALE and NAL.

Life Before PCG 2016/5

It took a while for the ATO to address the issue. It started in 2007 with an exception for instalment-warrants in the now repealed s67(4A)), but this still put a question mark on non-bank loans favouring the SMSF, hence the ATO Taxpayer Alert TA 2008/5.

In 2010, the ATO released ATO ID 2010/162, where the ATO took the very relaxed position that it is ok if the loan terms favour the SMSF. And confirmed this in their non-binding NTLG minutes in December 2012. So far so good.

But then in December 2014 the ATO changed its position with the release of ATO ID 2014/39 and ATO ID 2014/40 (now ATO ID 2015/27 and ATO ID 2015/28 respectively). The ATO now argued that favourable arrangements DO give rise to NALI. Putting the issue back on the table.

And so there came PCG 2016/5 (Practical Compliance Guidelines), giving SMSF trustees a safe harbour for property and listed securities.

Property and Listed Securities

The safe harbour rules only apply to property and listed securities. For anything else – for example unlisted shares and units – there is no safe harbour. But if you follow the safe harbour rules anyway, you have a strong argument that the terms are still at arm's length.

7 Rules

There are 7 safe harbour rules. They distinguish between real property and listed securities.

 # 1 Interest rate

Look for the Reserve Bank of Australia (RBA) interest rates. For property, use the RBA Indicator Rates for banks providing standard variable housing loans for investors. You find this via Google on the rba.gov.au website.
For listed securities you add 2%.

 # 2 Term of loan

The maximum term is 15 years for property and 7 years for listed securities. Any refinancing is included. So if the original mortgage was 10 years and then you refinanced it for another 10 years, you would have broken the rule.

 # 3 Loan-to-Value Ratio

The maximum LVR is 70% for property and 50% for listed securities.

 # 4 Security

For property you need to register a mortgage. For listed securities you need to register a similar charge, probably a registration in the Personal Property Securities Register (PPSR).

 # 5 Personal Guarantee

No personal guarantee is required – same for property and listed securities.

 # 6 Nature and frequency of repayments

You need to pay make monthly repayments of principal AND interest. This applies to property just as much as to listed securities.

 # 7 Written Loan Agreement

You need a written and executed loan agreement for property as well as listed securities. So handshake deals don't cut it.

Constant Monitoring

Written loan agreement, term of loan and security you set up, but then you can put it aside.

But interest, repayments and LVR are things you constantly need to monitor and take care of. So these three areas are most likely to cause issues further down the track.

This is a short overview of what we learned from talking to Kathy Evans, but please listen to this episode since Kathy Evans goes into a lot more detail.

MORE

LRBA

Related Party LRBA

Family Allowance Agreement

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