SMSFR 2009/2EC - Compendium

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Ruling Compendium – SMSFR 2009/2

This is a compendium of responses to the issues raised by external parties to draft SMSFR 2008/D4 – Self Managed Superannuation Funds: the meaning of 'borrow money' or 'maintain an existing borrowing of money' for the purposes of section 67 of the *Superannuation Industry (Supervision) Act 1993*.

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1	***Interaction between Ruling, particularly Example 9 at paragraph 69, and State legislation*** Section 75 of the *Property Law Act 1974* (Qld) provides a purchaser under an instalment contract the right to require conveyance of the land that is the subject of the contract to the purchaser provided certain conditions have been satisfied. The provision states that one such condition is the granting of a mortgage over the property in favour of the vendor. This is not a provision the parties can contract out of. No doubt other jurisdictions have similar provisions. The concern I have arises where the trustees of a superannuation fund embark upon an instalment contract for the purchase of land and one third or more of the purchase price has been paid and the vendor requires the trustees to take a transfer of the land and execute a mortgage in favour of the vendor to secure the unpaid balance. In such a case would that which was not at the outset a 'borrowing' under section 67 have become a borrowing at the option of the vendor?	***Material added to clarify (paragraphs 48 and 55)*** Paragraph 48 has been amended to make it clear that the existence of a borrowing of money depends on the existence of the two necessary features identified at paragraphs 10 and 39 of the Ruling. Paragraph 55 has been added to include a statement that where a fundamental aspect of the arrangement changes, then the arrangement may change in character. The issue in relation to the creation of a charge over the asset is outside the scope of the ruling.

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	If the trustees comply with their obligations under the Property Law Act then they would appear to be in breach of any inconsistent obligations under the *Superannuation Industry (Supervision) Act 1993* (SISA) or the Superannuation Industry (Supervision) Regulations 1994 (SISR) requiring they not give a charge over an asset of the fund.	
2	***Example 9 (paragraphs 69-70): instalment purchase agreement, deferred payment of purchase price*** It would be important that in negotiating such an arrangement the parties' intentions reflected a normal commercial reason for delayed payment of the purchase price. Under the draft ruling, the facts and circumstances of each transaction may be critical in determining when a contract which permits payment of instalments after title has been transferred. It would be preferable if the ATO could issue further guidance on this point. Bills of exchange are a common method of raising funds. Its features would result in it being considered a borrowing for the purposes of section 67. Debt factoring is another common method of raising funds. Depending on the terms of the arrangement it may contravene regulation 13.14.	***No change*** This comment correctly identifies that the determination of whether an arrangement is a borrowing depends on the features of the arrangement, in particular the two necessary features of a borrowing identified throughout the Ruling. This is consistent with paragraphs 10 and 39 to 47 of the Ruling. The purpose of the Ruling is to identify the principles upon which it will be determined whether a particular arrangement is a borrowing. In cases involving instalment purchase agreements or other deferred purchase arrangements, the detail of the facts and circumstances surrounding the arrangement are critical to the analysis. Further guidance beyond what is stated in the Ruling is best provided in the context of particular arrangements. Note also the response to issue 3.

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3	***Example 9 (paragraph 69-70): instalment purchase agreement*** My comment is that you might want to think a bit more about paragraph 69 and Example 9 relating to an instalment purchase agreement. I expect there will be players in the market who may seek to exploit this reasoning to do related party transfers on a vendor financed basis. There is then no need to do a mortgage and query whether interest would run. It is certainly possible between related parties it would not be charged. Unlike your facts you should expect that title would pass on payment of first instalment. This has potentially powerful applications which I wonder whether the regulator would be comfortable with though the point might be made that if it does not offend the SISA then so be it. Query whether non-charging of interest and unpaid price being unsecured gives rise to any other issues. I do not think section 109 of the SISA is activated because it is not a deal which is commercially favourable to the non super party. Query also whether any issue with sole purpose test because it can look as an eminently sensible thing for super fund to do in funding retirement benefits.	***Material added to clarify (paragraphs 51 to 53, 75 and 76 (previously paragraphs 69 and 70), footnotes 43 and 45)*** Paragraphs 51 to 53 have been added to provide further clarity regarding the distinction between borrowings of money on the one hand and other forms of debt or financial accommodation on the other. The changes to Example 9, at paragraphs 75 and 76 (previously paragraphs 69 and 70), which includes the addition of footnotes 43 and 45, in part reflect the material added at paragraphs 51 to 53. Footnote 43 makes clear that section 66 may apply if the asset that is the subject of the arrangement is acquired from a related party. The other issues raised are outside the scope of the ruling.

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4	***Excess Distributions from Related Unit Trust*** The first query is in relation to ATO ID 2002/660 which was withdrawn on 31 March 2006. This ATO ID concerned the situation where a SMSF received an excess distribution from a related unit trust and whether that resulted in a breach of section 67. Can you please confirm whether the ATO's conclusion to the question raised in ATO ID 2002/660 is still the same (that is, the excess distribution was a borrowing) and whether you would consider including a similar example in SMSFR 2008/D4 as we commonly come across this issue. *Reimbursements* The second query concerns example 7 at paragraphs 64 and 65 of the draft. In the example given, immediate reimbursement is sought and given. Could you please confirm whether it is the ATO's view that a borrowing does/does not exist in a situation with similar circumstances except reimbursement is not immediately sought and made (for example, where Gary perhaps does not realise he has paid an amount on behalf of the superannuation fund until later advised by his accountant and reimbursement is only sought and made at that later time). Could you also please confirm whether it makes any difference if the SMSF does not have sufficient monies available to make payment itself at the time Gary pays an amount on behalf of the fund.	***Material added to clarify (paragraph 75, footnote 43)*** The addition of footnote 43 in paragraph 75 (Example 9) clarifies that subsection 66(1) of the SISA will apply where an SMSF trustee acquires an asset from a related party by way of an instalment purchase contract. *Excess Distributions from Related Unit Trust* Consistent with the general principles expressed in the Ruling, the question of whether an excess distribution from a related unit trust is a borrowing of money turns on whether any part of the distribution is temporarily transferred with an obligation or intention on the part of the SMSF trustee to repay that amount to the unit trust. This can only be determined in light of the detailed facts and circumstances of each case. Given the nature of the analysis required in these types of cases, it would be potentially misleading to provide an example in the Ruling. Further guidance beyond what is stated in the Ruling is best provided in the context of particular arrangements. *Reimbursements* Similarly, the determination of whether money has been borrowed in the variations of the reimbursement example is made by reference to the facts and circumstances of the case. No definitive views can be provided in the absence of all of these facts and circumstances. Where a person acting in dual capacities (as an individual and an SMSF trustee) is not aware of the true basis of a payment he or she makes, as appears to be suggested in the comment raised, there is unlikely to be a borrowing. Generally speaking, at least one party to the arrangement must contemplate that a borrowing is taking place. It would ordinarily make no difference to the analysis whether the fund is in a position to make the payment at the time, although, as an evidentiary matter, this fact may point towards a borrowing having taken place.

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	Instalment Purchase Agreements The third query concerns example 9 at paragraphs 69 and 70 of the draft. Could you please confirm whether, in the ATO's view, a SMSF could acquire an asset from a related party vendor in similar circumstances without any issues?	*Instalment Purchase Agreement* The addition of footnote 43 addresses this comment. The acquisition of an asset from a related party under an instalment purchase agreement would trigger the operation of subsection 66(1). To avoid a contravention of section 66, one of the exceptions in the section (for example, if the asset is a listed security or business real property) would need to apply. Note also the response to issue 3.
5	*Refinancing (paragraphs 84, 86 and 95)* We would argue that it was not the intention of the legislature to restrict the trustees from being able to refinance an existing borrowing under subsection 67(4A) and that the omission of the word 'existing' from the section was intentional. If the intention of the legislation which is adopted by the Commissioner has the effect of restricting the ability of a superannuation fund trustee to refinance a borrowing, this places the superannuation fund in a weak position viz a viz the financier. Once the loan is in place, the financier usually has a discretion to increase charges and interest rates. Once in place the financier would be in a position to force the borrower to either accept whatever the bank proposes to charge or repay the loan. Where the superannuation fund has invested for the long term, repayment may not be possible without disposing of the asset. This may not be in the best interests of members.	***Material added to clarify (paragraphs 92 and 94 (previously paragraphs 84 and 86), footnote 55)*** The addition of footnote 55 in paragraph 92 identifies income tax rulings that either state or proceed on the basis that refinancing involves a new borrowing of money. Paragraph 94 (previously paragraph 86) clarifies that the question of whether an exception in section 67 applies to the new borrowing depends on the conditions in those exceptions being met. The Tax Office view expressed in these income tax rulings is considered to be better view of the application of the law to these facts. However, as identified in the changes made at paragraph 94, this view does not necessarily imply that section 67 will be contravened when the new borrowing is made. An exception in section 67 may apply, depending on the purpose of the borrowing.

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6	*Promissory notes* The question then is, what if a promissory note is used for the withdrawal and re-contribution process? This means the trustee of a SMSF writes a promissory note to a member representing their lump sum payment. The member then endorses the promissory note back into the SMSF. If the fund does not have sufficient assets to honour the promissory note, this can be considered a borrowing, in the same way that a bank overdraft is considered as a borrowing. As promissory notes are popular in the SMSF environment, the insertion of an example to illustrate how a promissory note could be used would be very beneficial from an administrative perspective.	***No change*** The use of promissory notes by SMSFs is outside the scope of this Ruling.
7	*Paragraph 40* More discussion on the difference between a 'borrowing' and a 'debt' would be beneficial.	***Material added to clarify (paragraphs 51 to 53)*** Paragraphs 51 to 53 have been added to provide further clarity regarding the distinction between borrowings of money on the one hand and other forms of debt or financial accommodation on the other.
8	*Paragraph 47* Treating the amount in question as a contribution raises timing issues, especially in determining whether or not the contribution caps are breached.	***No change*** This issue is outside the scope of this Ruling.