

# ***SMSFR 2011/D1 - Self Managed Superannuation Funds: limited recourse borrowing arrangements - application of key concepts***

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! There is a Compendium for this document: **SMSFR 2012/1EC** .



## Draft Self Managed Superannuation Funds Ruling

### Self Managed Superannuation Funds: limited recourse borrowing arrangements – application of key concepts

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**❶ This publication provides you with the following level of protection:**

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which provisions of the *Superannuation Industry (Supervision) Act 1993*, or regulations under that Act, apply to superannuation funds that the Commissioner regulates: principally self managed superannuation funds.

Self Managed Superannuation Funds Rulings (whether draft or final) are not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to you than the final version of this ruling indicates, the fact that you acted in accordance with the final version of this ruling would be a relevant factor in your favour in the Commissioner's exercise of any discretion as to what action to take in response to a breach of that law. The Commissioner may, having regard to all the circumstances, decide that it is appropriate to take no action in response to the breach.

### What this Ruling is about

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1. This draft Ruling explains key concepts relevant to the application of the limited recourse borrowing arrangement (LRBA) provisions, as those provisions apply to a self managed superannuation fund (SMSF) that enters into an LRBA. The LRBA provisions are found in sections 67A and 67B of the *Superannuation Industry (Supervision) Act 1993* (SISA).<sup>1</sup>

2. The key concepts explained are:

- what is an 'acquirable asset' and a 'single acquirable asset';
- 'maintaining' or 'repairing' the acquirable asset distinguished from 'improving' it; and
- when a single acquirable asset is changed to such an extent that it is a different (replacement) asset.

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<sup>1</sup> All legislative references in this Ruling are to the SISA unless otherwise indicated.

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3. Although the analysis and examples developed in this draft Ruling focus primarily on real property, the principles discussed can also apply to other types of assets.
4. This draft Ruling does not discuss other issues arising from an LRBA, such as the application of the in-house asset rules<sup>2</sup> if an asset remains in the holding trust once the borrowing has been repaid.
5. This draft Ruling does not provide the Commissioner's views on how other SISA and Superannuation Industry (Supervision) Regulations 1994 (SISR) provisions apply to any arrangement discussed, or examples given, in this Ruling.

## Ruling

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### The meaning of 'acquirable asset' and 'single acquirable asset'

6. An 'acquirable asset'<sup>3</sup> is any asset, other than money, that a trustee of an SMSF is not prohibited<sup>4</sup> from acquiring by the SISA or any other law.
7. An asset is defined in subsection 10(1) to mean any form of property. In the context of an LRBA, an acquirable asset is therefore any form of property, other than money, that the trustee is not otherwise prohibited from acquiring.
8. Money is Australian currency or currency of another country but does not extend to collectable banknotes or coins.<sup>5</sup>
9. The term 'property' is not defined in the SISA and therefore takes on its ordinary meaning. The phrase 'any form of property' has a very wide meaning.
10. The term 'property' can be used in different senses. It can describe:
  - proprietary rights, or
  - the (often physical) objects of proprietary rights, for example land or machinery.

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<sup>2</sup> Part 8. The in-house asset rules are discussed in Self Managed Superannuation Fund Ruling SMSFR 2009/4 Self Managed Superannuation Funds: the meaning of 'asset', 'loan', 'investment in', 'lease' and 'lease arrangement' in the definition of an 'in-house asset' in the Superannuation Industry (Supervision) Act 1993.

<sup>3</sup> Subsection 67A(2).

<sup>4</sup> See for example section 66 which, subject to some limited exceptions, prohibits the acquisition of assets from a related party. This provision is discussed in Self Managed Superannuation Fund Ruling SMSFR 2010/1 Self Managed Superannuation Funds: the application of subsection 66(1) of the Superannuation Industry (Supervision) Act 1993 to the acquisition of an asset by a self managed superannuation fund from a related party.

<sup>5</sup> This is consistent with the view in SMSFR 2010/1 (paragraph 28).

11. It is necessary to consider the meaning of property in both senses to determine whether money borrowed under an LRBA has been applied for the acquisition of a single acquirable asset. That is, it is necessary to consider both the legal form and substance of the asset acquired.

12. Having regard to both the object of the proprietary rights and the proprietary rights, it may be possible to conclude that a trustee is acquiring a single acquirable asset in the sense that the trustee is acquiring a single object of property notwithstanding that it is comprised of two or more proprietary rights. However, this will only be so where it is reasonable to conclude that the object of the separate proprietary rights is distinctly identifiable as a single asset.

13. If assets can be dealt with separately this will mean it is more than one asset for the purposes of the LRBA provisions. It is not the acquisition of a 'single acquirable asset' merely because the vendor wants to deal with the assets as a package or the lender will only lend over a group of assets. It would, however, be relevant if there are other laws of a State or Territory preventing the assets being dealt with separately.<sup>6</sup>

#### **Borrowings applied in maintaining or repairing but not improving the acquirable asset**

14. The money borrowed under the LRBA (and secured by the single acquirable asset) may be applied not only in acquiring the acquirable asset but also in carrying out repairs and maintenance to the asset whether necessary at the time of its acquisition or at a later time.

15. No amount that has been borrowed by the SMSF trustees under the LRBA may be applied to improve the single acquirable asset.<sup>7</sup> If a trustee of an SMSF expends borrowed money to improve a single acquirable asset, the exception in section 67A will cease to apply to the LRBA. If the borrowing is maintained the trustee will contravene section 67.

16. To determine if an asset has been repaired or maintained or whether it has been improved, reference is made to the asset's qualities and characteristics at the time when the asset is acquired under the LRBA.<sup>8</sup>

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<sup>6</sup> See also paragraphs 87 to 105 and Examples 1 to 7, paragraphs 43 to 57 of this draft Ruling.

<sup>7</sup> Subparagraph 67A(1)(a)(i).

<sup>8</sup> See also paragraphs 107 and 108 of this draft Ruling.

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## ***Distinguishing between maintaining, repairing and improving a single acquirable asset***

17. The concepts ‘maintaining’, ‘repairing’ and ‘improving’ an asset are often practically concerned with the physical form of an asset rather than its legal form. However, to the extent relevant to proprietary rights they similarly apply.

18. ‘Maintaining’, ‘repairing’ and ‘improving’ are given their ordinary meaning having regard to the context in which they appear in the LRBA provisions.

19. While the Commissioner’s views on the meaning of repair and improvement in Taxation Ruling TR 97/23 *Income tax: deduction for repairs* are informative they are not determinative in the LRBA context as in the income tax context the focus is on whether expenditure is of a revenue or capital nature for income tax purposes.<sup>9</sup>

## *Maintaining the acquirable asset*

20. The word ‘maintaining’ ordinarily means work done to prevent defects, damage or deterioration of an asset, or in anticipation of future defects, damage or deterioration provided that it merely ensures the functional efficiency of the asset is maintained in its present state.<sup>10</sup>

## *Repairing the acquirable asset*

21. The word ‘repairing’ ordinarily means remedying or making good defects in, damage to, or deterioration of, an asset and contemplates the continued existence of the asset.<sup>11</sup>

22. A repair is usually occasional and partial. A repair restores the functional efficiency of the asset without changing its character and may include restoration to its former appearance, form, state or condition. A repair merely replaces a part of something or corrects something that is already there and has become worn out or dilapidated through ordinary wear and tear, or is damaged whether accidentally or deliberately or by natural causes.<sup>12</sup>

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<sup>9</sup> See also paragraphs 111 to 115 of this draft Ruling.

<sup>10</sup> This is consistent with the explanation at paragraph 14 of TR 97/23.

<sup>11</sup> This is consistent with the explanation at paragraph 13 of TR 97/23.

<sup>12</sup> See paragraph 15 of TR 97/23.

23. In terms of whether the repair is partial it is the entire asset that is held under an LRBA that is relevant. For example, if it is a house and land in determining if the asset is maintained or repaired or whether it has been improved, it is necessary to consider the overall effect of the work (or expenditure) on both the house and the land.<sup>13</sup>

24. An asset may be acquired in a state in which a part of the asset is defective, damaged or suffering some deterioration of what would be considered to be its normal level of functional efficiency. Restoration of that part of the asset to its functional efficiency would be a repair for LRBA purposes.<sup>14</sup>

*Improving the acquirable asset*

25. In contrast to repair, an asset is improved if the functional efficiency of the asset or the value of the asset is substantially increased through the addition of new and substantial features or rights or bringing a thing or structure into a more valuable or desirable form, state or condition than a mere repair would do.

26. Determining if the functional efficiency of the asset is merely restored, or whether it is substantially increased, is a question of fact and degree in each case having regard to the appearance, form, state and condition of the asset that is subject to the LRBA at the time when the LRBA was entered into. Minor or trifling increases in functional efficiency or value as compared with the acquirable asset as a whole will not amount to an improvement.<sup>15</sup>

27. The following table illustrates circumstances of repair as compared with improvement.

*Table 1: repair or maintenance or improvement*

#	Repair or maintenance example	Improvement example
1.	A fire damages a part of the kitchen (cooktop, benches, walls and ceiling). Restoration of the damaged part of the kitchen would constitute repair of what is a subsidiary part of the asset being the house and land.	If the kitchen was also extended by extension of the house this extension would be an improvement.

<sup>13</sup> See also paragraphs 116 to 119 and Example 10, paragraphs 62 and 63 of this draft Ruling.

<sup>14</sup> See also paragraphs 127 to 130 of this draft Ruling.

<sup>15</sup> See also paragraphs 120 to 122 and Examples 8 and 9, paragraphs 58 to 61 of this draft Ruling.

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#	Repair or maintenance example	Improvement example
2.	The guttering on the house is replaced and the house is repainted. A fence is replaced. A fire alarm is installed to comply with new council requirements. This would be repair or maintenance.	The addition of a new pool or a new garage would be an improvement.
3.	A cyclone damages the roof of the house. Replacement of the roof in its entirety is a repair.	The addition of a second storey to the house at the time of also replacing the roof would be an improvement.
A farm (on a single title) is the single acquirable asset under an LRBA. At the time of entering into the LRBA the farm includes one set of cattle yards, four bores including windmills, tanks and troughs and three kilometres of fencing.		
4.	Replacing a section of the cattle yards or the existing fencing is a repair. Ensuring the bores, windmills, tanks and troughs continue working is repair or maintenance. This would include laying new pipes between the tank and trough.	Each of the following additions is an improvement: <ul style="list-style-type: none"> <li>• a new set of cattle yards;</li> <li>• a new bore, tank, windmill and trough;</li> <li>• a dam;</li> <li>• a further two kilometres of fencing.</li> </ul>

**Subsequent draw downs for repairs**

28. Subsequent draw downs<sup>16</sup> under an LRBA may be made for the purposes of maintaining or repairing an asset. If draw downs for the purposes of maintaining or repairing an acquirable asset are provided for as part of an LRBA, each draw down is a borrowing under an arrangement that is an LRBA if the arrangement as a whole continues to satisfy the LRBA provisions.<sup>17</sup>

**Repairs to an asset already owned by an SMSF**

29. If an asset is already owned by an SMSF, and thus not subject to an LRBA, a borrowing to fund repairs or maintenance for that asset would not satisfy the requirements of the LRBA provisions.<sup>18</sup>

<sup>16</sup> Each drawn down is a new borrowing: see paragraph 65 of Self Managed Superannuation Fund Ruling SMSFR 2009/2 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.

<sup>17</sup> See also paragraphs 131 and 132 of this draft Ruling.

<sup>18</sup> See also paragraph 133 of this draft Ruling.

**Money other than borrowings used to improve an asset**

30. Although borrowings under an LRBA cannot be used to improve a single acquirable asset that is the subject of the LRBA, money from other sources<sup>19</sup> could be used to improve (or repair or maintain) that asset. However, any improvements must not result in the acquirable asset becoming a different asset.<sup>20</sup>

**Whether an asset is the same asset or a different asset**

31. Consideration must be given to whether any improvements or other changes to an acquirable asset result in a different (replacement) asset being held on trust under the LRBA in circumstances not covered by section 67B.

32. Paragraph 67A(1)(a) requires that a borrowing under an LRBA is applied for the acquisition of a single acquirable asset and it is this asset that paragraph 67A(1)(b) requires to be held on trust so that the SMSF trustee acquires a beneficial interest in it.

33. The only exception to this is under section 67B which allows for the replacement of a single acquirable asset that is a share, a unit in a unit trust or an instalment receipt (or a collection<sup>21</sup> thereof) in the circumstances set out in subsections 67B(3) to (8).

34. Leaving aside the particular circumstances covered by subsections 67B(3) to (8), to determine if the asset presently held on trust is the acquirable asset that was subject to the LRBA at the time when the LRBA was entered into, it is necessary to consider both the physical object (assuming it is not an intangible asset) and the proprietary rights comprising the asset, to determine if the character of the asset as a whole has fundamentally changed. That is, it is necessary to consider both the qualities of the physical object and the attributes of the proprietary rights.

35. The following table illustrates when a change to a single acquirable asset results in a different asset(s).

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<sup>19</sup> If the source of funds is the SMSF the other provisions of the SISA must nonetheless be complied with.

<sup>20</sup> See also paragraphs 134 and 135 of this draft Ruling.

<sup>21</sup> Subsection 67A(3) provides that sections 67A and 67B can apply to a collection of assets in the same way as they apply to a single acquirable asset if the assets in the collection meet the requirements as set out in subsection 67A(3).

**SMSFR 2011/D1***Table 2: whether it is a different asset*

#	Single acquirable asset	Whether it is a different asset(s)
1.	Vacant block of land on single title	The vacant block of land is subsequently subdivided resulting in multiple titles. One asset has been replaced by several different assets as a result of the subdivision.
2.	Vacant block of land on single title	A residential house is built on that vacant land (still single title). The character of the asset has fundamentally changed from vacant land to residential premises. This is a different asset.
3.	A house and land	The house is demolished and is replaced by three strata titled units. The character of the asset has fundamentally changed along with the underlying proprietary rights. This has created three different assets.
4.	A house and land	Rezoning of the land is granted and the house is renovated and is now commercial premises. The character of the asset has fundamentally changed from residential premises to commercial premises. This is a different asset.
5.	A four bedroom house and land	A fire destroys the four bedroom house and a four bedroom house is constructed using insurance proceeds. Rebuilding a four bedroom house does not fundamentally change the character of the asset held under the LRBA. Rebuilding the house restores the asset to a house and land.

36. The improvements listed in column 3 of Table 1 at paragraph 27 of this draft Ruling, would not result in a different asset as the changes do not fundamentally alter the character of the asset or the proprietary rights held under the LRBA.

37. If the acquirable asset is changed (including by way of improvements) to such an extent that it fundamentally changes the character of the asset such that it becomes a different asset, the exception in section 67A will cease to apply to the LRBA. If the borrowing is maintained the trustee will contravene subsection 67(1).<sup>22</sup>

## Funds to which the Ruling applies

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38. This Ruling applies to Self Managed Superannuation Funds<sup>23</sup> (SMSFs) and former SMSFs.<sup>24</sup> References in the Ruling to SMSFs include former SMSFs unless otherwise indicated.

## Date of effect

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39. When the final Ruling is issued, it is proposed to apply to arrangements entered into on or after 7 July 2010 (including an arrangement that is a refinancing of a borrowing of money under an arrangement entered into before, on or after 7 July 2010).

40. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling.

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**Commissioner of Taxation**

14 September 2011

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<sup>22</sup> See also paragraphs 136 to 142 and Examples 11 to 15, paragraphs 64 to 74, of this draft Ruling.

<sup>23</sup> As defined in section 17A.

<sup>24</sup> A former SMSF is a fund that has ceased being a SMSF and has not appointed a registrable superannuation entity (RSE) licensee as trustee – see subsection 10(4).

## Appendix 1 – Examples

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❶ ***This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached.***

41. The following examples further illustrate the application of the principles discussed in this draft Ruling.

42. The following examples assume that the SMSF is not prohibited from acquiring the asset. Further, the application of other provisions of the SISA and SISR have not been considered and could, therefore, potentially apply depending on the particular circumstances.

### **Examples relating to the meaning of the terms ‘acquirable asset’ and ‘single acquirable asset’**

#### ***Example 1 – two adjacent blocks of land***

43. As part of the SMSF’s investment strategy, the trustees want to acquire two adjacent blocks of land under the one LRBA. The vendor will only sell the two blocks together, however, there are no physical or legal impediments to the two blocks of land being sold separately.

44. The two blocks of land are not a single acquirable asset. As a result, the two blocks of land cannot be acquired under one LRBA. However, each block could be acquired under a separate LRBA.

#### ***Example 2 – a factory complex on more than one title***

45. An SMSF trustee wants to enter into an LRBA to acquire a factory. The entire factory covers three separate legal titles.

46. The factory is a single acquirable asset and can be acquired under one LRBA.

#### ***Example 3 – farmland with multiple titles***

47. The trustee of an SMSF wants to enter into an LRBA to acquire a farm. While the farm has been conducted as a single primary production business it comprises two separate titles.

48. Although only one farming business is conducted on the land, there is no physical or legal impediment to the land represented by the different titles from being dealt with separately. That is, there is no obstacle to part of the farm (one of the titles) being sold off, leaving the farming business to be conducted on the remaining land. As a consequence, the farm is not a single acquirable asset and cannot be acquired under one LRBA.

49. If, however, the farming business concerned a piggery and the piggery is conducted in a large shed constructed over both titles then, similar to the approach with the factory in Example 2, it would be a single acquirable asset.

***Example 4 – completed ‘off the plan’ apartment***

50. The trustees of an SMSF pay an amount to secure the purchase of an apartment ‘off the plan’. This is not the subject of an LRBA.

51. Once the apartment is completed and strata titled the trustees are required to complete the purchase. The trustees can enter into an LRBA to facilitate its acquisition as it is a single acquirable asset.

***Example 5 – house built in situ***

52. An SMSF owns a vacant block of land. The trustees of the SMSF want to enter into an LRBA to construct a house in situ on the block of land.

53. The house cannot be a single acquirable asset under section 67A. As the house is built in situ it does not exist as an asset separate from the land that can be held on separate trust. Money lent to build a house effectively results in the acquisition of services and building materials and these acquisitions would not satisfy the LRBA requirement that the arrangement involves the acquisition of a single acquirable asset.

***Example 6 – apartment with separate car park***

54. The trustee of an SMSF wants to enter into an LRBA to purchase an apartment with a separate car park. The apartment and car park are each on a separate legal title. The laws of the State in which the apartment is located do not allow the two titles to be disposed of separately.

55. As the two titles cannot be assigned or transferred separately, the apartment together with the car park is a single acquirable asset.

***Example 7 – serviced apartment and furnishings***

56. The trustees of an SMSF want to enter into an LRBA to purchase a serviced apartment that will be leased to the provider of short-term residential accommodation. The vendor is an entity associated with the accommodation provider. The purchaser of the apartment is required by the vendor to also purchase a furnishing package.

57. The apartment without the furnishing package is a single acquirable asset and its acquisition could be funded under an LRBA. However, the apartment and the furnishing package together are not a single acquirable asset. The furnishing package is also not a single acquirable asset as it would include multiple furniture items.

## **Examples relating to repairs and improvements of assets using borrowings**

### ***Example 8 – purchase of land and construction of house using borrowings***

58. An SMSF wants to enter into an LRBA where the single acquirable asset is a vacant block of land. The SMSF intends for the borrowing to provide sufficient funds for the construction of a house on that block.

59. This arrangement would not satisfy the requirements of section 67A if money borrowed under the LRBA is used to construct the house and thus improve the acquirable asset (the land). Applying money borrowed under the LRBA to improve the asset is contrary to subparagraph 67A(1)(a)(i). Additionally, building a house on the land would result in it no longer being the same acquirable asset.

### ***Example 9 – renovation of property using borrowings***

60. An SMSF enters into an LRBA where the single acquirable asset is a three bedroom residential property. The SMSF renovates the property adding a bathroom using borrowings under the LRBA.

61. The addition of the bathroom improves the asset as compared with the asset as it was at the time when the LRBA was entered into. The arrangement will no longer satisfy the requirements of section 67A as money borrowed under the LRBA has been applied to improve the asset in contravention of subparagraph 67A(1)(a)(i).

### ***Example 10 – machinery***

62. An SMSF trustee enters into an LRBA where the single acquirable asset is a piece of machinery. Immediately after its acquisition money borrowed under the LRBA is used to fund repairs to the asset to return it to its full functionality.

63. The arrangement continues to satisfy the requirements of the LRBA provisions.

**Examples relating to whether an asset is the same asset or a different asset*****Example 11 – subdividing land***

64. The trustees of an SMSF enter into an LRBA to acquire a vacant block of land. Once the LRBA is in place that block of land is subdivided resulting in two separate titles.

65. The arrangement ceases to satisfy the requirements of the LRBA provisions as the original asset has now been replaced with two different assets and the replacement is not covered by section 67B. As the exception in section 67A ceases to apply to the LRBA, if the borrowing is maintained the trustee will contravene subsection 67(1).

***Example 12 – house built over two titles***

66. The trustee of an SMSF enters into an LRBA where the single acquirable asset is a house which is built over two titles. Subsequently the house is relocated so that it stands on only one of the titles.

67. The arrangement ceases to satisfy the requirements of the LRBA provisions. The relocation of the house results in the asset under the arrangement no longer being a single object of property. Following the relocation there are two separate assets, the block of land with the house and a vacant block of land, that could be dealt with separately. If the borrowing is maintained the trustee will contravene subsection 67(1).

***Example 13 – reconstruction of a house damaged by fire***

68. An SMSF trustee enters into an LRBA where the single acquirable asset is land on which a four bedroom lowset brick house had been constructed prior to the SMSF entering into the arrangement.

69. The house was severely damaged by fire and the local council required it to be demolished. As a result of an insurance policy, the four bedroom house was reconstructed using the insurance proceeds.

70. As rebuilding the house is restoring the asset to what it was at the time of entering into the LRBA (that is, a house and land) it does not result in a different asset being held under the LRBA. The arrangement continues to satisfy the requirements of the LRBA provisions.

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## ***Example 14 – construction of a different type of building***

71. Assume the same facts as in Example 13, however, insurance proceeds are used to construct two, two bedroom units on the land following approval for dual occupancy.

72. The construction of the two units on the land fundamentally alters the character of the land and house that existed at the time when the LRBA was entered into. Consequently, the original asset, being the land and the four bedroom house, has been changed to dual occupancy dwellings resulting in a different asset. The exception in section 67A will cease to apply to the LRBA and if the borrowing is maintained the trustee will contravene subsection 67(1).

## ***Example 15 – replacement arising from insurance claim***

73. An SMSF enters into an LRBA where the single acquirable asset is an item of equipment. The item of equipment is subsequently destroyed and a new item of equipment is provided by the insurer as a replacement.

74. The arrangement ceases to meet the requirements of the LRBA provisions as the item of equipment has been replaced in its entirety and that replacement is not covered by section 67B. If instead a cash payment is made by the insurer to the holding trust, the arrangement would also cease to meet the requirements of LRBA provisions. The exception in section 67A will cease to apply to the LRBA and if the borrowing is maintained the trustee will contravene subsection 67(1).

## Appendix 2 – Explanation

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**①** *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached.*

### Background

75. A number of provisions of the SISA place restrictions on an SMSF's investment activities. One of these is contained in subsection 67(1) which, subject to specified exceptions, prohibits a trustee of an SMSF from borrowing money or maintaining an existing borrowing of money. The borrowing prohibition is designed to limit the risk of superannuation fund investment as can be seen from the statement in the Explanatory Memorandum to the Superannuation Legislation Amendment Bill (No. 4) 1999:

Superannuation funds are generally not permitted to borrow in their own right. This is designed to reduce the risk to retirement income from gearing their assets.<sup>25</sup>

76. One specific exception to the prohibition on borrowing is provided by sections 67A and 67B.

77. Section 67A permits a borrowing arrangement (an LRBA) if the money borrowed is, or has been, applied for the acquisition of a single acquirable asset and that asset is held in a holding trust. Under such an arrangement the SMSF trustee acquires a beneficial interest in the asset and the lender's right of recourse in the event of default is limited to the acquirable asset held in the holding trust. By making one or more payments after acquiring beneficial ownership the SMSF trustee has the right to acquire legal ownership. Additional rules apply to treat a collection<sup>26</sup> of identical assets having the same market value in the same way as a single acquirable asset.

78. Section 67B contains the specific circumstances where the borrowing arrangement may be maintained in relation to a replacement asset rather than the asset originally acquired.

79. Sections 67A and 67B replace former subsection 67(4A). Former subsection 67(4A) was replaced as certain practices had developed that led to prudential concerns with the borrowing arrangements created to comply with its requirements.<sup>27</sup>

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<sup>25</sup> See page 4 under the headings 'Regulation Impact Statement', 'Problem Identification'.

<sup>26</sup> Subsection 67A(3).

<sup>27</sup> Second Reading Speech for, and paragraph 1.4 of the Explanatory Memorandum to, Superannuation Industry (Supervision) Amendment Bill 2010.

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80. By comparison with former subsection 67(4A), which applies to arrangements entered into before 7 July 2010, sections 67A and 67B have been enacted to ensure that the term 'asset' is read in the singular and is not interpreted as permitting one borrowing arrangement over multiple assets. The exception to this is if the assets comprise a collection of identical assets that have the same market value. This change removes the ability, available under former subsection 67(4A), to pool different assets in one arrangement and thus prevents a lender from choosing which assets are sold in the event of a default on the borrowing.<sup>28</sup>

81. A further concern under former subsection 67(4A) were assets that were the subject of the borrowing being replaced at the discretion of the trustee or the lender.<sup>29</sup> Section 67B addresses this concern.

82. The borrowing prohibition in subsection 67(1) is also complemented by other investment rules in the SISA and the SISR.<sup>30</sup>

## Contraventions

83. Section 67A provides a limited exception to the prohibition under subsection 67(1) of a trustee of an SMSF borrowing money.

84. Section 67 is a civil penalty provision and therefore contravening, or being involved in a contravention, of section 67 may have civil and criminal consequences.<sup>31</sup> Contravention places at risk the status of the SMSF as a complying superannuation fund under the SISA.<sup>32</sup>

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<sup>28</sup> Paragraphs 1.10 and 1.11 of the Explanatory Memorandum to the Superannuation Industry (Supervision) Amendment Bill 2010.

<sup>29</sup> Paragraph 1.4 of the Explanatory Memorandum to Superannuation Industry (Supervision) Amendment Bill 2010.

<sup>30</sup> For example, the restriction on acquiring assets from a related party in section 66. See a list of other restrictions at paragraph 80 of SMSFR 2010/1.

<sup>31</sup> Subsection 67(7).

<sup>32</sup> See subsection 42A(5) in relation to an SMSF. The status of an SMSF as complying or non-complying for SISA purposes will also have consequences for the SMSF under the income tax law and other parts of the superannuation law. Also see Law Administration Practice Statements: PS LA 2006/17, PS LA 2006/18 and PS LA 2006/19.

**Legislative context**

85. The most relevant elements of sections 67A and 67B are set out below:

67A(1) Subsection 67(1) does not prohibit a trustee of a regulated superannuation fund (the *RSF trustee*) from borrowing money, or maintaining a borrowing of money, under an arrangement under which:

- (a) the money is or has been applied for the acquisition of a single acquirable asset, including:
  - (i) expenses incurred in connection with the borrowing or acquisition, or in maintaining or repairing the acquirable asset (but not expenses incurred in improving the acquirable asset); and

Example: Conveyancing fees, stamp duty, brokerage or loan establishment costs.

- (ii) money applied to refinance a borrowing (including any accrued interest on a borrowing) to which this subsection applied (including because of section 67B) in relation to the single acquirable asset (and no other acquirable asset); and
- (b) the acquirable asset is held on trust so that the RSF trustee acquires a beneficial interest in the acquirable asset; and
- (c) the RSF trustee has a right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest; and
- (d) the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) default on:
  - (i) the borrowing; or
  - (ii) the sum of the borrowing and charges related to the borrowing;are limited to rights relating to the acquirable asset; and

Example: Any right of a person to be indemnified by the RSF trustee because of a personal guarantee given by that person in favour of the lender is limited to rights relating to the acquirable asset.

- (e) if, under the arrangement, the RSF trustee has a right relating to the acquirable asset (other than a right described in paragraph (c)) – the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) the RSF trustee's exercise of the RSF trustee's right are limited to rights relating to the acquirable asset; and

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- (f) the acquirable asset is not subject to any charge (including a mortgage, lien or other encumbrance) except as provided for in paragraph (d) or (e).

## **Meaning of *acquirable asset***

67A(2) An asset is an *acquirable asset* if:

- (a) the asset is not money (whether Australian currency or currency of another country); and
- (b) neither this Act nor any other law prohibits the RSF trustee from acquiring the asset.

67A(3) This section and section 67B apply to a collection of assets in the same way as they apply to a single asset, if:

- (a) the assets in the collection have the same market value as each other; and
- (b) the assets in the collection are identical to each other.

Example: A collection of shares of the same class in a single company.

67A(4) For the purposes of this section and section 67B, the regulations may provide that, in prescribed circumstances, an acquirable asset ceases to be that particular acquirable asset.

67B(1) Subsection (2) applies to:

- (a) a reference in paragraph 67A(1)(b), (c), (d), (e) or (f) to an acquirable asset (the original asset); or
- (b) a reference in subsection 71(8) to an acquirable asset (the original asset) mentioned in paragraph 67A(1)(b);

(including a reference resulting from a previous application of subsection (2) of this section).

67B(2) Treat the reference as being a reference to another single acquirable asset (the replacement asset) if:

- (a) the replacement asset replaces the original asset; and
- (b) subsection (3), (4), (5), (6), (7) or (8) applies.

86. The categories of replacement assets dealt with in subsections 67B(3) to (7)<sup>33</sup> deal exclusively with shares in companies, units in unit trusts and instalment receipts (as defined in subsection 10(1)).

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<sup>33</sup> Subsection 67B(8) provides for regulations to prescribe other circumstances (as at the date of issue there are no regulations).

**Explanation*****The meaning of ‘acquirable asset’ and ‘single acquirable asset’***

87. Subsection 67A(1) sets out the requirements of an exception to the borrowing prohibition in subsection 67(1).

88. Under the terms of subsection 67A(1), a borrowing of money may be made or maintained if the money is, or has been, applied for the acquisition of a ‘single acquirable asset’. That single acquirable asset must be held on trust so that the trustee of the SMSF acquires a beneficial interest in the acquirable asset.<sup>34</sup>

***The meaning of ‘acquirable asset’***

89. The term ‘acquirable asset’ is a key concept as the exception in section 67A can only apply to a borrowing of money if the money is, or has been, applied to acquire a single acquirable asset.

90. The definition of acquirable asset in subsection 67A(2) makes it clear that an acquirable asset is:

- an asset other than money, whether Australian currency or currency of another country,<sup>35</sup> and
- an asset that the trustee of the SMSF is not prohibited under the SISA or any other law from acquiring.<sup>36</sup>

***Exclusion of money from acquirable asset***

91. While money is specifically included in the definition of asset<sup>37</sup>, it is specifically excluded from the definition of acquirable asset.

92. Both relevant definitions refer to money in the form of currency, whether Australian currency or otherwise. However, the exclusion of money from the meaning of ‘acquirable asset’ does not extend to collectable bank notes and coins.<sup>38</sup>

***An asset the trustee is not prohibited from acquiring***

93. Paragraph 67A(2)(b) requires that the asset is one that the trustee of an SMSF is not prohibited from acquiring either by the SISA or by any other law.

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<sup>34</sup> Paragraph 67A(1)(b).

<sup>35</sup> Paragraph 67A(2)(a).

<sup>36</sup> Paragraph 67A(2)(b).

<sup>37</sup> Subsection 10(1).

<sup>38</sup> See paragraph 28 of SMSFR 2010/1.

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94. The SISA does not prescribe the types of assets that an SMSF may acquire as part of its investment strategy. However, it does, for example, contain a prohibition on acquiring assets from related parties of the SMSF.

95. Subsection 66(1) prohibits an SMSF from acquiring an asset from a related party of the SMSF subject to certain specific exceptions.<sup>39</sup> If the acquisition of the asset from the related party is prohibited by section 66 the asset cannot form part of an arrangement that meets the requirements of section 67A.<sup>40</sup> A related party<sup>41</sup> is a trustee of the SMSF, a standard employer-sponsor of the SMSF, or a Part 8 associate of either of the preceding entities.

96. Section 83 is a further example of a provision that is relevant in determining if the acquisition of an asset is prohibited. Section 83 is concerned with whether the asset that is acquired is an in-house asset<sup>42</sup> for the purposes of Part 8. An SMSF must not acquire an in-house asset if:

- the market value ratio<sup>43</sup> of the SMSF's in-house assets exceeds 5%;<sup>44</sup> or
- the acquisition of the asset would result in the market value ratio of the SMSF's in-house assets exceeding 5%.<sup>45</sup>

97. More broadly, the laws of the Commonwealth and the State or Territory in question must also be complied with. This includes compliance with the trust laws of the various States or Territories applicable to the SMSF.<sup>46</sup> Whether an acquisition is prohibited by a provision of the SISA, the SISR or any other law requires an examination of the facts of the particular case.

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<sup>39</sup> Subsections 66(2), 66(2A) and 66(2B). Subsections 66(2) and 66(2A) are further explained in SMSFR 2010/1.

<sup>40</sup> For example, residential property owned by a related party could not be acquired under an LRBA as the SMSF trustee is prohibited from making such an acquisition under subsection 66(1).

<sup>41</sup> See definition of 'related party' in subsection 10(1).

<sup>42</sup> As defined in section 71. This is further explained in SMSFR 2009/4.

<sup>43</sup> Section 82.

<sup>44</sup> Subsection 83(2).

<sup>45</sup> Subsection 83(3).

<sup>46</sup> Paragraph 67A(2)(b); paragraph 1.20 of the Explanatory Memorandum to the Superannuation Industry (Supervision) Amendment Bill 2010.

***Meaning of asset – any form of property***

98. The meaning of acquirable asset is clearly dependent upon the meaning of asset which, subject to any contrary intention, is defined in subsection 10(1) as follows:

asset means any form of property and, to avoid doubt, includes money<sup>[47]</sup> (whether Australian currency or currency of another country).

99. The meaning of ‘property’ is not defined in the SISA and as discussed in SMSFR 2010/1<sup>48</sup> and SMSFR 2009/4<sup>49</sup>, the phrase ‘any form of property’ has a very wide meaning. To summarise from those Rulings property can include ‘[a]ny type of right (that is, a claim recognised by law), interest, or thing which is legally capable of ownership, and which has a value...’.

***Property can refer to the proprietary rights or the object of those proprietary rights***

100. In the High Court case of *White v. Director of Public Prosecutions (WA)*<sup>50</sup> French CJ, Crennan and Bell JJ (at [12]) noted in their joint judgement:

The term ‘property’ used in a statute may take its ordinary meaning, its legal meaning, or both meanings. The interpretation of the term depends upon the context and purpose of the provision in which it is found.

101. Similarly, in *McCaughy v. Commr of Stamp Duties*<sup>51</sup> Jordan CJ discussed the meaning of property in the following terms:

The word ‘property’ is used in different senses. It may denote either objects of proprietary rights, such as pieces of land, domesticated animals, and machines; or the proprietary rights themselves ... In common parlance it is usually employed in the former sense, but in the language of jurisprudence in the latter ... Property, in the sense of proprietary rights, may exist in relation to physical objects, or to intangible things such as debts or patent rights. Each separate piece of property consists of a bundle of proprietary rights relating to a particular object, including rights of administration and rights of enjoyment, the totality of which may be vested in a single person, or may be divided amongst a number of persons, as for example when they are shared by several who together own them all, jointly or in common.

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<sup>47</sup> As discussed at paragraphs 91 and 92, money is specifically excluded from being an acquirable asset.

<sup>48</sup> Paragraphs 9 to 12 and 90 to 99.

<sup>49</sup> Paragraphs 7 to 9 and 38 to 45.

<sup>50</sup> [2011] HCA 20.

<sup>51</sup> (1945) 46 SR (NSW) 192 at 201.

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102. In the LRBA context it is relevant to consider the meaning of property in both senses to determine whether borrowed money has been applied for the acquisition of a single acquirable asset. That is, it is necessary to consider both the proprietary rights and the object of those proprietary rights.

103. In taking this approach it may be possible to conclude that a trustee has acquired a single acquirable asset in the sense that the trustee has acquired a single object of property that is comprised of two or more proprietary rights. However, this will only be so where there is something that, having regard to its physical characteristics, is distinctly identifiable as a single object notwithstanding that it is clear that two or more quite separate proprietary rights are present.

104. In determining if there is more than one asset the Commissioner will consider:

- whether the asset(s) could be sold separately even though the vendor and/or the purchaser may choose<sup>52</sup> not to do so – if the assets could be dealt with separately this will mean it is more than one asset for the purposes of the LRBA provisions;
- whether there is any law<sup>53</sup> (for example, a State or Territory law) that requires the assets to be sold together so that they cannot be sold separately without contravening that law – in this case it would be reasonable to treat it as the one asset for the purposes of the LRBA provisions.

105. However, if, for example, a mortgagor will only lend money to an SMSF for the acquisition of a group of assets rather than on the basis of a mortgage over each asset separately, this is a commercial consideration and would not support a view that these assets constitute a single acquirable asset for the purposes of the LRBA provisions. Similarly, that the vendor will only sell the assets as a package would not support a conclusion that it is the acquisition of a single acquirable asset.<sup>54</sup>

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<sup>52</sup> For example, the assets are contractually bound together but separate contracts could be executed for the acquisition of the assets if the parties chose to do so.

<sup>53</sup> This does not include for example a body corporate by-law that can be changed with the agreement of the voting members.

<sup>54</sup> See Example 7, paragraphs 56 and 57 of this draft Ruling.

**Borrowings applied in maintaining or repairing but not improving the acquirable asset**

106. A borrowing of money under an LRBA can be applied to expenses incurred in maintaining or repairing the acquirable asset that is held under the LRBA. However, this does not include expenses incurred in improving the acquirable asset.<sup>55</sup>

***The acquirable asset is identified at the time the LRBA commences***

107. Determining whether an acquirable asset has been repaired or maintained or whether it has been improved necessarily requires reference to the asset's qualities and characteristics at a particular point in time.

108. The acquirable asset (the original asset<sup>56</sup>) must be identified at the time when the asset is acquired and the LRBA is put in place, as it is this asset that is required to be held on trust under paragraph 67A(1)(b). Thus, to determine if an acquirable asset has been repaired or maintained or if it has been improved, it is necessary to refer to the acquirable asset's qualities and characteristics at that time.

***Distinguishing between maintaining, repairing and improving an acquirable asset***

109. As applying money borrowed under an LRBA for 'repairing' and 'maintaining' the acquirable asset held under the LRBA is permitted but applying money borrowed for 'improving' the acquirable asset is not, it is necessary to consider the meaning of each of these terms in the LRBA context.

110. As the terms are not defined in the SISA they take their ordinary meaning.

***Relevance of TR 97/23***

111. TR 97/23 explains the ordinary meaning of repair and to this extent reference is made to that Ruling. However, the views in that Ruling are not decisive of when something is a repair or an improvement in the LRBA context.

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<sup>55</sup> Subparagraph 67A(1)(a)(i).

<sup>56</sup> Section 67B makes it clear that the acquirable asset referred to in paragraphs 67A(1)(b) to (f) is the original asset.

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112. In the income tax context the distinction between repairs and improvements is often concerned with determining whether expenditure is on revenue account and thus immediately deductible or on capital account, in which case it may be deductible over time or included as part of an asset's cost base. Distinguishing between repairs and improvements for this purpose is not relevant in the LRBA context and thus the views in TR 97/23 have not been wholly adopted or relied upon in this draft Ruling.

113. In the LRBA context the relevant entirety for determining if something is a repair or an improvement is the single acquirable asset that is held under the LRBA. It is this acquirable asset that must continue to be held on separate trust under paragraph 67A(1)(b). For example, if the asset held under the LRBA is a three bedroom house and land, then both the house and the land is the relevant entirety.

114. This approach to determining the entirety for LRBA purposes is consistent with that taken in this draft Ruling in determining if what is acquired is a single acquirable asset. On this basis it is necessary to consider the physical characteristics of the asset and the proprietary rights.

115. To the extent that this approach differs from that taken in an income tax context is explicable by the difference in context. As explained in TR 97/23 (paragraph 37), the term 'entirety' is used by the courts in repair cases to refer to something 'separately identifiable as a principal item of capital equipment' and, in the LRBA context, such a distinction is not relevant.

### *Maintaining or repairing the acquirable asset*

116. It is immaterial in the LRBA context whether the expenditure is incurred in maintaining or repairing the acquirable asset held under the LRBA as, in either case, money borrowed under an LRBA may be applied for both purposes. While the ordinary meaning of each term is explained below, it is not necessary to categorise expenditure as such so long as it is either one or the other.

117. Maintain, when used as a transitive verb, is defined to mean, among other things, 'to keep in existence or continuance; preserve'; 'to keep in due condition, operation, or force; keep unimpaired'; and 'to keep in a specified state, position'.<sup>57</sup> Thus maintaining an asset typically involves work done to prevent or anticipate defects, damage or deterioration (in a mechanical or physical sense). For example, repainting a timber house to prevent deterioration is typically maintenance.

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<sup>57</sup> *The Macquarie Dictionary*, 2005, 4<sup>th</sup> edn, The Macquarie Library Pty Ltd, Sydney.

118. As explained at paragraph 13 of TR 97/23, and as relevant to this draft Ruling, repair ‘ordinarily means the remedying or making good of defects in, damage to, or deterioration of, property to be repaired (being defects, damage or deterioration in a mechanical and physical sense) and contemplates the continued existence of the property’.

119. As also explained in TR 97/23 (paragraph 15) a repair replaces a part of something or corrects something that is already there and that is damaged, has become worn out or dilapidated or has deteriorated. Repair may be necessitated through ordinary wear and tear, accidental or deliberate damage or by the operation of natural causes (whether expected or unexpected) during the passage of time.

#### *Improving the acquirable asset*

120. Improve, when used as a transitive verb, is defined to mean among other things, ‘to bring into a more desirable or excellent condition’; and ‘to make (land) more profitable or valuable by enclosure, cultivation, etc.; increase the value of (property) by betterments, as buildings’.<sup>58</sup>

121. As explained at paragraph 44 of TR 97/23, an improvement provides a greater efficiency of function in the property – usually in some existing function and involves bringing a thing or structure into a more valuable or desirable form, state or condition than a mere repair would do.

122. An improvement would therefore involve the addition of new and substantial features or rights to an acquirable asset that substantially increase the asset’s value or functional efficiency.

#### *Question of fact and degree*

123. It is a question of fact and degree whether something is merely maintenance or repair of the acquirable asset or whether it is an improvement to the acquirable asset.

124. Relevant considerations include:

- whether the acquirable asset’s efficiency of function is substantially increased, resulting in an improvement to the asset; or
- whether the acquirable asset’s value is substantially increased, resulting in an improvement to the asset.

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<sup>58</sup> *The Macquarie Dictionary*, 2005, 4<sup>th</sup> edn, The Macquarie Library Pty Ltd, Sydney.

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125. Determining whether the acquirable asset's efficiency of function or value has increased means having regard to the proprietary rights and the object of those rights and the qualities and characteristics of the acquirable asset at the time when the LRBA was entered into and the asset was acquired.

126. Minor or trifling increases in functional efficiency or value as compared with the acquirable asset as a whole will not amount to an improvement.

### ***Acquiring an asset in need of repair***

127. If deterioration of an asset occurred before the asset was acquired under the LRBA and that asset is subsequently repaired using borrowings under the LRBA, the use of borrowings for that purpose is nonetheless covered by subparagraph 67A(1)(a)(i).

128. However, the greater the state of deterioration of the asset at the time of its acquisition and the LRBA being entered into, the more likely it is that subsequent alterations or changes to that asset will be regarded as improvements.

129. For example, replacing some broken windows in a house immediately following the acquisition of the house and land, which is under an LRBA, is a repair for which borrowings can be used. It is of no consequence that the windows were in need of repair at the time of acquisition.

130. However, a substantial renovation of a run down house immediately following the acquisition of the house and land, which is under an LRBA, would improve the functional efficiency of the asset as well as substantially improve its value and thus would amount to an improvement for which borrowings under the LRBA could not be used.

### ***Subsequent draw downs for repairs***

131. Subsequent draw downs under an LRBA may be made for the purposes of maintaining or repairing an asset. Each drawn down is a new borrowing.<sup>59</sup>

132. If draw downs for the purposes of maintaining or repairing an acquirable asset are provided for as part of an LRBA, each draw down is a borrowing under an arrangement that is an LRBA if the arrangement as a whole continues to satisfy the LRBA provisions.

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<sup>59</sup> See paragraph 65 of SMSFR 2009/2.

***Repairs to an asset already owned by an SMSF***

133. If an asset is already owned by an SMSF, and thus not subject to an LRBA, any borrowings to fund repairs or maintenance for that asset would not satisfy the requirements of an LRBA under section 67A. This is on the basis that:

- paragraph 67A(1)(a) is not satisfied as the money is not applied for the acquisition of a single acquirable asset but is instead to be applied to repair an asset that the fund already owns;
- paragraph 67A(1)(b) is not satisfied as the asset that is the subject of the repair is not held on separate trust for the benefit of the SMSF. Rather it is held directly by the SMSF; and
- anything used in carrying out the repair is not subject to an LRBA in its own right.

**Money other than borrowings used to improve the asset**

134. Subparagraph 67A(1)(a)(i) only excludes borrowings being used to fund improvements. Therefore, money from other sources<sup>60</sup> could be used to improve (or repair or maintain) a single acquirable asset.

135. However, any improvements must not result in the acquirable asset becoming a different asset.

**Whether an asset is the same asset or a different asset**

136. Paragraph 67A(1)(a) requires that a borrowing under an LRBA is applied for the acquisition of a single acquirable asset. Paragraph 67A(1)(b) requires that the acquirable asset is held on separate trust so that the SMSF trustee acquires a beneficial interest in the asset. In effect the acquirable asset is to be held on trust for the duration of the LRBA.

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<sup>60</sup> If the source of funds is the SMSF the other provisions of the SISA must nonetheless be complied with.

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137. The requirement for the acquirable asset under the LRBA to continue to be held on trust is subject to the replacement asset exception in section 67B. Section 67B allows for the replacement of a single acquirable asset (the original asset) that is a share, a unit in a unit trust or an instalment receipt (or a collection<sup>61</sup> thereof) in the circumstances set out in subsections 67B(3) to (8). If an acquirable asset has been replaced in circumstances covered by section 67B, references to the (original) acquirable asset in section 67A are treated as references to the replacement asset.<sup>62</sup> Consequently, the LRBA may be maintained over a different (replacement) acquirable asset if the asset, and the circumstances of its replacement, satisfy the requirements of section 67B.

## ***Replacement of an asset not covered by section 67B***

138. If, however, the acquirable asset held under the LRBA is fundamentally changed, resulting in a different asset being held and that replacement is not covered by section 67B, the exception in section 67A will cease to apply to the LRBA. If the borrowing is maintained the trustee will contravene subsection 67(1).

139. Consistent with the view that the single acquirable asset is identified by both the proprietary rights and the object of those rights, the holding trust ceases to hold the original acquirable asset if the proprietary rights or the object of those rights changes to such an extent that it is fundamentally a different asset.

140. Whether a change to a single acquirable asset results in a fundamentally different asset being held in the holding trust is a question of fact and degree. While it must be determined on the facts of each case by reference to the legal and physical characteristics of the single acquirable asset as it was when the LRBA was entered into, the following considerations are relevant:

- whether the acquirable asset has been entirely replaced by another asset – the other asset would be a replacement asset;<sup>63</sup>
- whether the acquirable asset has been altered to such an extent that it now has a different function or purpose – this would indicate that the original acquirable asset has been replaced;<sup>64</sup>

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<sup>61</sup> Subsection 67A(3) provides that sections 67A and 67B can apply to a collection of assets in the same way as they apply to a single acquirable asset if the assets in the collection meet the requirements as set out in subsection 67A(3).

<sup>62</sup> Subsection 67B(2).

<sup>63</sup> See Example 15, paragraphs 73 and 74 of this draft Ruling.

<sup>64</sup> See Example 14 paragraphs 71 and 72 of this draft Ruling.

- whether the proprietary rights have changed – this would indicate that the original acquirable asset has been replaced;<sup>65</sup>
- whether the single acquirable asset has been altered so that it is no longer a single acquirable asset by virtue of a unifying object and part of the asset could be sold off separately – this would indicate that the original single acquirable asset has been replaced.<sup>66</sup>

141. However, a part of an acquirable asset might be destroyed. For example, a house, which is part of a house and land acquirable asset, is destroyed by fire, flood, cyclone, or similar. Restoration of the acquirable asset by reconstruction of a similar house would result in the restoration of the original acquirable asset rather than its replacement.<sup>67</sup>

142. If, however, the acquirable asset was land with a hayshed and following a cyclone in which the hayshed was destroyed, a house was constructed, this would result in a different asset that amounts to a replacement of what was previously held as the acquirable asset. The premises held as the acquirable asset are now residential premises serving a different function and purpose to that previously served by the land and hayshed.

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<sup>65</sup> See Example 11, paragraphs 64 and 65 of this draft Ruling.

<sup>66</sup> See Example 12, paragraphs 66 and 67 of this draft Ruling.

<sup>67</sup> See Example 13, paragraphs 68 to 70 of this draft Ruling.

## Appendix 3 – Alternative views

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❶ ***This Appendix sets out alternative views and explains why they are not supported by the Commissioner.***

143. It has been submitted that the reference to an ‘asset’ in sections 67A and 67B is concerned not with the physical properties of the object but only with the legal proprietary rights which are acquired.

144. Taking the legal proprietary rights approach, if borrowed funds are applied to acquire an estate in land under an LRBA, and subsequently a substantial improvement is made to that land, for example the erection of a building, this would not result in an improvement to the asset, nor a different asset, as the relevant asset is the proprietary rights which have not changed.

145. However, to apply this view consistently would mean determining what is a ‘single acquirable asset’ solely by reference to the legal proprietary rights recognised at law, and regardless of any limitations that might exist in dealing separately with those rights. That is, if an SMSF wished to acquire real property comprising several land titles, for example a factory built over three separate titles, each title would need to be held on a separate trust under a separate LRBA. Another approach put forward was to determine what is a ‘single acquirable asset’ according to accounting concepts.

146. While the alternative view has merit it is not the view that is preferred. The accounting approach to determining what is the single acquirable asset is also not preferred.

147. The view in the draft Ruling is that it is necessary to have regard to both the legal form and substance of what has been acquired in order to determine whether it is an acquirable asset as defined in subsection 67A(2) and whether it is a single acquirable asset. This view is open on the words of the law and in determining that it is the preferred view consideration has been given to the following:

- as compared with focussing only on legal title, the view in the draft Ruling takes account of the nature of the asset in determining if the asset is a single acquirable asset and if it remains the original asset that is held on separate trust under the LRBA;
- maintaining, repairing or improving an asset are typically more relevant to the object of the proprietary rights rather than the proprietary rights; and
- while the view in the draft Ruling may mean that an asset (taking account of both the object of the proprietary rights as well as the proprietary rights) has fundamentally changed even though it may not have changed if only the proprietary rights were considered, consideration of both the object and the proprietary rights is applied consistently for both purposes. That is, in first determining if it is a single acquirable asset and secondly in determining if it remains the same asset.

## Appendix 4 – Your comments

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148. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

149. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the ATO website at [www.ato.gov.au](http://www.ato.gov.au).

Please advise if you do not want your comments included in the edited version of the compendium.

<b>Due date:</b>	<b>28 October 2011</b>
<b>Contact officer:</b>	<b>Dennis Bird</b>
<b>Email address:</b>	<b><a href="mailto:dennis.bird@ato.gov.au">dennis.bird@ato.gov.au</a></b>
<b>Telephone:</b>	<b>(08) 8208 1157</b>
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<b>Address:</b>	<b>91 Waymouth Street Adelaide SA 5000</b>

## Appendix 5 – Detailed contents list

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- former SMSF
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- improvement to plant
- limited recourse loans
- arrangement
- SMSF related parties
- Repair equipment
- self managed superannuation funds
- superannuation

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NO: 1-2Z1H2KA

ISSN: 1835-2138

ATOlaw topic: Superannuation Entities ~ Self managed superannuation funds