

SMSFs & borrowing of money

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The ATO issued SMSFR 2009/2 in final form on 8 April 2009. The new SMSF Ruling discusses the meaning of the expressions 'borrow money' and 'maintain an existing borrowing of money' in section 67 of the *Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act)*. In this article, we outline the ATO's view of the meaning of these expressions and their application to various arrangements.

Prohibition on borrowing money

In general, the trustee of a SMSF must not do the following:

- borrow money; or
- maintain an existing borrowing of money (section 67(1) of the SIS Act).

There are certain exceptions to the above prohibition, which are found in sections 67(2) to 67(6) of the SIS Act.

In general, the prohibition is limited to arrangements related to borrowing **money**, rather than being a blanket prohibition on all types of borrowing (ie money or otherwise: SMSFR 2009/2, paragraph 10).

The expressions 'borrow money' and 'maintaining an existing borrowing of money' are not defined in the SIS Act. Accordingly, the expressions should have their ordinary meaning read against the background of the SIS Act (SMSFR 2009/2, paragraph 9).

Borrow money

A borrowing is an arrangement that exhibits the following characteristics:

- a temporary transfer of an amount of money from one entity (ie the lender) to another entity (ie the borrower); and
- an obligation or an intention on the part of the borrower to repay that amount to the lender (which may be satisfied by the provision of an asset) (SMSFR 2009/2, paragraph 10).

Money, for the purposes of section 67, is any generally accepted **medium** of exchange for goods, services or the payment of debts that confers **complete liquidity** on its holders. In the ATO's view, this includes both Australian and foreign currency (SMSFR 2009/2, paragraph 11).

Importantly, the final ruling differs from the earlier draft ruling in that the reference to cheques and other negotiable instruments in the draft ruling as being covered by the term "money" has been removed. (SMSFR 2009/2, paragraph 82 and SMSFR 2008/D4, paragraph 74). The final ruling emphasises the fact that money confers complete liquidity on the holder and states that "a promise to pay money at some time in the future is not actually money" (SMSFR 2009/2, paragraph 83).

In some cases, certain borrowing may limit the lender's right of recourse of the amount borrowed in the event of the borrower's default. The ATO maintains that this arrangement is nevertheless caught by the prohibition on borrowing as the nature of the arrangement is essentially borrowing since the obligation or intention to repay the amount of money lent still exists (SMSFR 2009/2, paragraph 12).

Maintaining an existing borrowing of money

The maintenance of an existing borrowing of money occurs where a borrowing arrangement previously entered into, directly or indirectly, by the SMSF trustee remains in place in circumstances where the SMSF trustee is required or intends to repay the money lent. Such arrangements include:

- where the trustee has borrowed money; and
- where the trustee has become liable for obligations under a borrowing arrangement entered into **by another party** (SMSFR 2009/2, paragraph 13).

Arrangements contravening section 67(1) of SIS Act

To determine whether a borrowing arrangement has been entered into by the parties, a careful analysis of all the circumstances surrounding the arrangement is required. In particular, an objective analysis of any documentation together with the actions of the parties may provide an indication of whether an arrangement exhibits the necessary characteristics of a borrowing thus contravening section 67(1) of the SIS Act (SMSFR 2009/2, paragraph 14).

The table below provides common examples of transactions and circumstances that are and are not borrowing (SMSFR 2009/2, paragraphs 15 and 16). However, the list is not exhaustive and each arrangement will require an analysis of all the facts of the case.

Borrowing	Not borrowing
A loan of money, whether secured or unsecured	Bona fide contributions to SMSFs accepted in accordance with the <i>Superannuation Industry (Supervision) Regulations 1994</i> (Cth) (SIS Regulations)
A margin lending account once drawn upon	The liability of a SMSF to pay benefits to members as they fall due
A bank overdraft once drawn upon	Arrangements under which expenses are paid on behalf of the SMSF trustee by an agent or any other person where reimbursement is immediately sought from and made by the SMSF
	Normal commercial delays in the payment of expenses incurred by a SMSF trustee

Exceptions to prohibition on borrowing money

Generally, there is a prohibition on the trustee of a SMSF to enter into borrowing arrangements unless the borrowing arrangement falls within one of the exceptions to the general prohibition. The specific exceptions to the general prohibition include the following:

- temporary borrowing to fund a payment to a beneficiary (section 67(2) of the SIS Act);
- temporary borrowing to cover settlement of certain securities transactions (section 67(3) of the SIS Act);
- the instalment warrants provision where the borrowing arrangement allows the SMSF to acquire an asset under certain limited recourse arrangements (section 67(4A) of the SIS Act); and
- borrowing to fund a payment of the superannuation surcharge (section 67(2A) of the SIS Act) (SMSFR 2009/2, paragraph 17).

Other considerations

In addition to considering whether an arrangement breaches section 67 of the SIS Act, the trustee of a SMSF also needs to consider whether there has been a contravention of any of the other provisions of the SIS legislation. In particular, the following provisions should be considered:

- the sole purpose test in section 62 of the SIS Act;
- the trustee's covenants contained in the governing rules of a SMSF in section 52 of the SIS Act; and
- the prohibition against granting a charge over an asset of the SMSF in regulation 13.14 of the SIS Regulations (SMSFR 2009/2, paragraph 18).

Conclusion

In general, SMSF trustees should be cautious of entering into arrangements that may result in borrowing or maintaining an existing borrowing of money. Even if a borrowing arrangement falls within one of the specified exceptions in section 67 of the SIS Act, SMSF trustees must also consider whether other provisions of the SIS Act or the SIS Regulations may apply.

This is particularly true if an arrangement entered into, though not involving 'money' or 'borrowing' in the ordinary sense, nevertheless could contravene other provisions of the SIS Act or the SIS Regulations (in particular, the sole purpose test and the prohibition against granting a charge over an asset of the SMSF).