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52 Goulburn Street  
SYDNEY NSW 2000

**RE: Look-through treatment for instalment warrants and instalment receipts**

Thank you for the opportunity to make a submission in regards to look-through tax treatment for instalment warrants and instalment receipts.

I support the look-through provisions for Instalment Warrants, Instalment Receipts and SMSF Limited Recourse Borrowing Arrangements (LRBAs). These measures will reduce uncertainty and align tax treatment with common practice.

However I would recommend that this opportunity be taken to further reduce the uncertainty of tax provisions as they apply to SMSF LRBAs. The issue is the potential for the Non-Arm's Length Income (NALI) rules to apply to low, or zero, interest rate loans to SMSFs.

During 2014 it came to the attention of superannuation professionals that the ATO was issuing Private Binding Rulings setting out an argument that zero or low interest rate LRBAs could result in NALI for SMSFs.

NALI is set out in section 295.550<sup>1</sup> of the Income Tax Assessment Act 1997, which says that:

“(1) An amount of ordinary income or statutory income is non-arm's length income of a complying superannuation fund... if:

(a) it is derived from a scheme the parties to which were not dealing with each other at arm's length in relation to the scheme; and

(b) that amount is more than the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length in relation to the scheme.

... unless the amount is consistent with an arm's length dealing.”

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1 [http://www.austlii.edu.au/au/legis/cth/consol\\_act/itaa1997240/s295.550.html](http://www.austlii.edu.au/au/legis/cth/consol_act/itaa1997240/s295.550.html)

Ordinarily SMSFs in accumulation phase pay 15% tax on income from an LRBA, with SMSFs fully in pension phase paying 0% tax on such income. The NALI rules mean that SMSFs may pay a tax rate of 45% on LRBA income, or 47% in years where the Temporary Budget Repair Levy applies.

Late in 2014 the ATO issued two rulings on the matter, ATO ID 2014/39<sup>2</sup> and ATO ID 2014/40<sup>3</sup>, which confirm the ATO's position that zero or low interest rate LRBAs could result in NALI.

I do not suggest that LRBAs should be used to artificially increase the income of an SMSF beyond what would be expected from an arm's length investment. The NALI rules should remain in place. However the current situation around zero and low interest rate LRBAs is causing uncertainty among SMSF trustees and professionals.

I therefore recommend the creation of a safe harbour provision from the NALI rules for SMSF LRBAs. This would be based on a benchmark interest rate, such as those published by the Reserve Bank of Australia. Provided the LRBA met the minimum interest rate, and other applicable conditions, the NALI provisions would not apply. Other conditions on the LRBA could include:

- Payment frequency
- Repayment of principal
- A requirement for security

Additionally, some provision would need to be made for fixed-rate and interest-only loans.

This is not to say that loans outside the safe harbour would automatically result in NALI, such arrangements would be dealt with under the current rules.

### **About the Author: Luke Smith**

I am a CPA and Tax Agent, have a background in public practice accounting for SMSFs and an interest in superannuation and retirement issues. I write for [SolePurposeTest.com](http://SolePurposeTest.com), an SMSF and superannuation news site for SMSF trustees and professionals.

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<sup>2</sup> <http://law.ato.gov.au/atolaw/view.htm?docid=%22AID%2FAID201439%2F00001%22>

<sup>3</sup> <http://law.ato.gov.au/atolaw/view.htm?docid=%22AID%2FAID201440%2F00001%22>