
TREASURY LAWS AMENDMENT (2017 MEASURES NO. 2) BILL 2017:
LIMITED RECOURSE BORROWING ARRANGEMENTS

EXPOSURE DRAFT EXPLANATORY MATERIALS

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DRAFT

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
Amending Act	<i>Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
IT(TP) Act 1997	<i>Income Tax (Transitional Provisions) Act 1997</i>
LRBA	Limited recourse borrowing arrangement
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>
SMSF	Self-managed superannuation fund

Superannuation reform package amending provisions - limited recourse borrowing arrangements

Outline of chapter

1.1 The amendments in Schedule 1 amend the transfer balance cap and total superannuation balance rules that were enacted through the *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016*.

1.2 The changes ensure that the transfer balance cap rules apply appropriately where there is a repayment of a limited recourse borrowing arrangement that transfers value from accumulation interests into retirement phase interests. The changes also ensure that where a fund has limited recourse borrowing arrangements in place, the total value of its assets is properly accounted for in working out individual members' total superannuation balances.

1.3 All legislative references in this Chapter are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise stated.

Context of amendments

1.4 The *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (the Amending Act) legislated the Government's superannuation reform package that was announced in the 2016-17 Budget.

1.5 The amendments contained in Schedule 1 relate to the transfer balance cap measure and the definition of total superannuation balance that were included in that package.

Transfer balance cap

1.6 The transfer balance cap was enacted through Division 294 and limits the total value of capital that can be transferred into the tax exempt 'retirement phase' of superannuation in respect of an individual.

1.7 It does this by requiring individuals to commute one or more of their superannuation income streams where they have ‘excess transfer balance’. An individual has excess transfer balance when the transfer balance in their transfer balance account exceeds their transfer balance cap (\$1.6 million for the 2017/18 financial year) (see section 294-30). Subdivision 136-A of Schedule 1 to the *Taxation Administration Act 1953* sets out the determination process that initiates a mandatory reduction of an individual’s retirement phase superannuation interests.

1.8 The transfer balance in an individual’s transfer balance account changes according to the transfer balance credit and transfer balance debit entries made to the account. A credit reduces the amount of available cap space that an individual has, whereas as a debit increases the amount available.

1.9 For superannuation income streams that commence on or after 1 July 2017, an individual will receive a ‘transfer balance credit’ equal to the value of the interest that supports the superannuation income stream when they start to be the ‘retirement phase recipient’ of the income stream (see item 2 of the table in subsection 294-25(1)). Individuals also receive a transfer balance credit equal to the value of the superannuation interest that supports a superannuation income stream of which they are a retirement phase recipient just before 1 July 2017 (see item 1 of the table in subsection 294-25(1)).

1.10 The transfer balance in an individual’s transfer balance account is reducible by ‘transfer balance debits’ (see section 294-80), which facilitate roll-overs and ensures that an individual’s transfer balance reflects the net amount of capital that has been transferred into the retirement phase in respect of them. Individuals receive debits for commutations of a superannuation income stream of which they are the retirement phase recipient, and for other events that reduce the value of superannuation interests they have in the retirement phase.

Total superannuation balance

1.11 The concept of ‘total superannuation balance’ was introduced by the Amending Act. The term is defined by section 307-230 and, with some modifications, is designed to reflect the total value of all interests that an individual has in the superannuation system.

1.12 To determine an individual’s total superannuation balance, the following amounts are added together:

- The accumulation phase value of all superannuation interests that are *not* in the retirement phase;

- The transfer balance in their transfer balance account, subject to certain modifications (but not where the balance is less than nil);
- The amount of each roll-over superannuation benefit that is not reflected in the individual's accumulation phase or transfer balance.

1.13 The total superannuation balance is used in the non-concessional contribution cap rules, the unused concessional cap carry forward rules, the definition of disregarded small fund asset rules, and in the spouse tax offset.

Limited recourse borrowing arrangements

1.14 'Limited recourse borrowing arrangements' (LRBAs) are an exception to the general prohibition on borrowing that applies to the trustees of regulated superannuation funds contained in subsection 67(1) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

1.15 The exceptions for LRBAs are also provided by sections 67A and 67B of the SIS Act. Section 67A relates to borrowing arrangements that the trustee of a registered superannuation fund uses to acquire an 'acquirable asset' and section 67B extends the exception to replacement assets.

1.16 The term, 'acquirable asset' is defined by subsection 67A(2) as a single asset that is not money. Subsection 67A(3) also extends sections 67A and 67B so that they apply to collection of identical assets in the same way as they apply to a single asset (for example, a collection of shares of the same class in a single company).

1.17 In addition to requirement about the rights and interest that a trustee has in an acquirable asset, subsection 67A(1) contains conditions about limiting any rights against the trustee for a default on the arrangement to rights in respect of the acquirable asset.

Summary of new law

1.18 Schedule 1 amends the transfer balance cap rules to create an additional transfer balance credit. This credit will arise where the repayment of an LRBA shifts value between accumulation phase interests and retirement phase interests in a superannuation fund that is a self-managed superannuation fund (SMSF) or a complying superannuation fund with less than 5 members. The amount of the credit that an individual member receives is equal to the increase in the value of their retirement phase superannuation interests.

1.19 Schedule 1 also amends the total superannuation balance so that it takes into account the outstanding balance of an LRBA that is entered into by the trustee of a regulated superannuation fund that is an SMSF or that has less than 5 members. As a result of these changes, an individual member's total superannuation balance is increased by the share of the outstanding balance of an LRBA related to the assets that support their superannuation interests.

Detailed explanation of new law

Transfer balance credit for LRBA repayments

1.20 An individual will receive a transfer balance credit where a superannuation provider makes a payment in respect of an LRBA that increases the value of a superannuation interest that supports a superannuation income stream of which they are a retirement phase recipient. *[Schedule 1, items 1 and 2, item 5 in the table in subsection 294-25(1) and subsection 294-55(1)]*

1.21 For the transfer balance credit to arise, the superannuation interest must be in a complying superannuation fund that is a self-managed superannuation fund or that has less than 5 members. *[Schedule 1, item 2, paragraph 294-55(1)(c) and subsection 294-55(4)]*

1.22 The transfer balance credit arises at the time of the payment, and the amount of the credit that the individual receives is the amount by which the superannuation income stream increased in value. *[Schedule 1, items 1 and 2, item 5 in the table in subsection 294-25(1) and subsections 294-55(2) and (3)]*

1.23 This credit ensures that the transfer balance in an individual's transfer balance account reflects shifts of value between a fund's retirement phase and accumulation assets. This treatment is consistent with the way transfers from accumulation phase assets are treated when a superannuation income stream is commenced.

1.24 A repayment of an LRBA increases the value of a superannuation interest that is supported by the asset acquired through the LRBA. A repayment sourced from assets that support the same superannuation interest will not increase the value of that interest because the reduction in the LRBA liability is offset by a corresponding reduction in cash. Therefore, repayments that are made under these conditions will not give rise to a transfer balance credit as they do not satisfy the requirement that there is an increase in value of the superannuation interest supporting a superannuation income stream.

1.25 However, if the repayment is sourced from other assets (for example, assets that support separate accumulation interests that the individual has in the fund), then there will be no offsetting decrease in the value of the retirement phase superannuation interest, meaning that its overall value will be increased by the amount of the repayment. In such cases, the transfer from the other assets would not result in a credit to the transfer balance account under the current transfer balance credit items. The new transfer balance credit addresses this gap by ensuring that the transfer balance cap takes into account the increase in value that has occurred through the repayment.

1.26 The restriction of the transfer balance credit in relation to superannuation interests in funds that are SMSFs or that have less than 5 members is consistent with the one taken for disregarded small fund assets (see section 295-387). Limiting the transfer balance credit in this way recognises that in larger superannuation funds, there is unlikely to be a direct connection between a specific asset of the fund and the superannuation interests of an individual member.

1.27 The condition in the new transfer balance credit about a payment being made in relation to an LRBA identifies the LRBA by reference to a borrowing under an arrangement that is covered by the exception in subsection 67A(1) of the SIS Act. [*Schedule 1, item 2, paragraph 294-55(1)(a)*]

Example 1.1 – repayment for assets solely supporting retirement interests

Bob is 65 and is the only member of his SMSF. Bob's superannuation interests are valued at \$3 million and are based on cash that the SMSF holds.

Bob's SMSF acquires a \$2 million property. This property is purchased after 1 July 2017 using \$500,000 of the SMSF's cash and an additional \$1.5 million that it borrows through an LRBA.

Bob then commences an account-based superannuation income stream. The superannuation interest that supports this superannuation income stream is backed by the property, the net value of which is \$500,000 (being \$2 million less the \$1.5 million liability under the LRBA). Bob therefore receives a transfer balance credit of \$500,000 under item 2 of the table in subsection 294-25(1).

In the first year, Bob's SMSF makes monthly repayments of \$10,000. Half of each repayment is made using the rental income generated from the property. The other half of each repayment is made using cash that supports Bob's other accumulation interests.

At the time of each repayment, Bob receives a transfer balance credit of \$5,000, representing the increase in value of the superannuation interest that supports his superannuation income stream.

The repayments that are sourced from the rental income that the SMSF receives do not give rise to a transfer balance credit because they do not result in a net increase in the value of the superannuation interest that support his superannuation income stream.

1.28 This transfer balance credit does not directly affect the borrowing arrangements that a fund can enter into, or the manner in which it repays any such arrangements.

1.29 While individuals whose transfer balance accounts are less than the transfer balance cap will have less unused cap space to commence any new superannuation income streams, this outcome appropriately reflects the assets that have been transferred into the retirement phase in respect of their superannuation income streams.

1.30 A transfer balance credit may result in an individual having an excess transfer balance. Where this occurs, an amount equal to the credit can be rolled-back through a commutation or partial commutation of the superannuation income stream. The commutation of the superannuation income stream will entitle the individual member to a transfer balance debit under item 1 in the table in subsection 294-80(1). The commutation of the superannuation income stream does not require any changes to the underlying assets in the fund, although the decrease in the current pension liabilities of the fund will appropriately affect the fund's access to the various earnings tax exemptions.

1.31 The transfer balance credit for repayments will not apply to the extent that a repayment is made in respect of asset supporting a superannuation interest related to a defined benefit income stream. This is because the right to payments that an individual has under a defined benefit income stream is unaffected by the assets or investments of a fund. As a result, the decrease in liabilities over an asset in the fund will not affect the value of the superannuation interest that supports the income stream.

LRBAs count towards total superannuation balance

1.32 An individual's total superannuation balance is increased by an amount if an asset that supports one or more of their superannuation interests is subject to an LRBA. *[Schedule 1, items 3 and 4, paragraph 307-230(1)(d) and subsection 307-231(1)]*

1.33 The amount by which an individual's total superannuation balance is increased is equal to a proportion of the outstanding balance of the LRBA. This proportion is based on the individual's share of the total superannuation interests that are supported by the asset that is subject to the LRBA. *[Schedule 1, item 4, subsection 307-231(2)]*

1.34 This increase to an individual member's total superannuation balance ensures that it more accurately reflects the overall values of the assets in a fund that support the individual's superannuation interests. This approach is appropriate because total superannuation balance is relevant in working out whether a fund can apply the segregated method, and the way in which an individual can increase the asset base of a fund through contributions (specifically by using the unused concessional cap carry forward rules and making non-concessional contributions).

1.35 As with the transfer balance credit for repayments, the addition to the total superannuation balance identifies an LRBA that a fund has by reference to a borrowing under an arrangement that is entered into by a regulated superannuation fund and which is covered by the exception in subsection 67A(1) of the SIS Act. [*Schedule 1, item 4, paragraph 307-231(1)(a)*]

1.36 Similarly, the increase to an individual's total superannuation balance will only occur where the LRBA was entered into by a superannuation provider of a regulated fund that is an SMSF or that has less than 5 members. [*Schedule 1, item 4, paragraph 307-231(1)(d) and subsection 307-231(3)*]

1.37 For the increase to apply to an individual's total superannuation balance, a regulated superannuation fund must have used the borrowing to acquire one or more assets, and any such assets must support the superannuation interests of an individual at the time at which the total superannuation balance is determined.

1.38 The connection between an asset of a fund and an individual member's superannuation interests relates to the way in which the fund has allocated its assets to meet its current and future liabilities in relation to the member's interests. The test requires a fund to determine which of its LRBA assets support which members' interests, as well as the extent to which those interests are supported. While this is a new requirement in respect of LRBAs, the assessment builds on the framework that already exists for funds in tracking the way in which income from its assets is allocated between the interests of its members.

1.39 The outstanding balance of an LRBA is the amount still owing under the LRBA. Where an individual has a superannuation interest that is supported by an asset that is subject to an LRBA, the increase to their total superannuation balance is based on their share of this outstanding balance.

1.40 While an individual's total superannuation balance can generally be measured 'at a time', it is only relevant at the end of a particular income year. This is because the non-concessional contribution cap rules, the unused concessional cap carry forward rules, the disregarded small fund asset rule and the spouse tax offset rule all use the total

superannuation balance ‘just before the start of the income year’ (see paragraphs 290-230(4A)(b), 291-20(3)(b), 292-85(2)(b) and 295-387(2)(c)). This means that the outstanding balance of an LRBA only needs to be identified at the end of an income year for the purposes of adding a share of that outstanding balance to an individual’s total superannuation balance.

1.41 Including this proportion of the outstanding balance in a member’s total superannuation balance prevents double counting of the outstanding balance from occurring where more than one member has an interest supported by an asset that was acquired through an LRBA.

1.42 Where only one member’s interests are supported by an asset, the proportion will be equal to 1, meaning that an amount equal to the outstanding balance is added to the member’s total superannuation balance.

Example 1.2– total superannuation balance where there is more than one member

Peter and Sue are the only members of their SMSF. The value of Peter’s superannuation interests in the fund is \$1 million. The value of Sue’s superannuation interests is \$2 million. All of the assets of the fund that support their interests are cash.

The SMSF acquires a \$3.5 million property. The SMSF purchases the property using \$1.5 million of its own cash and borrows an additional \$2 million using an LRBA.

The SMSF now holds assets worth \$5 million (being the sum of the \$1.5 million in cash and the \$3.5 million property). The fund also has a liability of \$2 million under the LRBA.

Of its own cash that it used, 40 per cent (\$600,000) was supporting Peter’s superannuation interests and the other 60 per cent (\$900,000) was supporting Sue’s interests. These percentages also reflect the extent to which the asset supports Peter and Sue’s superannuation interests.

Peter’s total superannuation balance is \$1.8 million. This is comprised of the \$400,000 of cash that still supports his superannuation interest, the 40 per cent share of the net value of the property (being \$600,000), and the 40 per cent share of the outstanding balance of the LRBA (being \$800,000).

Sue’s total superannuation balance is \$3.2 million. This is comprised of the \$1.1 million of cash that still supports her superannuation interest, the 60 per cent share of the net value of the property (being \$900,000), and the 60 per cent share of the outstanding balance of the LRBA (being \$1.2 million).

1.43 In contrast to the transfer balance credit for repayments of an LRBA, there is no requirement that particular superannuation interests be in the retirement phase for the increase to total superannuation balance to apply. This is because total superannuation balance assigns an appropriate value to all of an individual's superannuation interests in a fund, irrespective of whether those interests are in the retirement phase or not.

1.44 The amendments also extend the matters that may be included in the member contribution statement to include an LRBA amount that relates to an individual's total superannuation balance. [*Schedule 1, item 6, paragraph 390-5(9)(d) in Schedule 1 to the Taxation Administration Act 1953*]

1.45 Although the matters covered by subsection 390-5(9) in Schedule 1 to the *Taxation Administration Act 1953* do not limit the information that the Commissioner of Taxation can request in the member contribution statement, this amendment makes it clear that this will be information that a fund will be required to report.

1.46 Because the information relates to the liabilities that a fund has in respect of its assets, the outstanding balance of an LRBA is information that will be already known by the trustee of a regulated superannuation fund. However, although this information will now need to be identified on a member basis, trustees will only have to do so in respect of the end of a particular income year.

Application and transitional provisions

1.47 The amendments made by this Schedule apply in relation to borrowings that are entered into on or after the Schedule commences (being the first 1 January, 1 April, 1 July or 1 October that occurs after the day the Act containing Schedule 1 receives the Royal Assent). [*Schedule 1, item 7*]