

From: Ron Doig [mailto:rdoig@munrodoig.com.au]
Sent: Wednesday, 3 May 2017 7:28 PM
To: Superannuation
Cc: Yikai Hoe
Subject: FW: Scanned - Munro Doig Lawyers

Dear Sir/Madam,

A submission (attached) was sent in this morning.

We have been further considering the matter, in particular the "First Measure" as per point 2 (the payment of debt under an LRBA creating a transfer balance credit).

We now see an alternative way of reading the provisions which accords with the EM. That is to rely on the initial words of proposed section 294-55(1)(b) "as a result"

This suggests if the debt repayment of itself causes the interest to increase then a credit arises.

One could conclude that if pension asset cash was used to reduce the debt then "as a result" the interest did not increase. Pension cash reduces and pension debt reduces hence no resultant change to the value.

We remain of the view it is not clear, and are concerned debt repayment of itself is a trigger for a credit.

However reliance on the EM in understanding any ambiguity is one approach where legislative provisions leave some doubt. We believe it could be clearer.

We remain however very firmly of the view that measure two (as per point 3 of our submission) is ill-conceived.

Yours faithfully

Ron Doig
Director
Munro Doig LAWYERS

43 Richardson Street WEST PERTH WA 6005
(PO Box 1244, West Perth WA 6872)
Ph: 9426 6222 Fax: 9426 6211
rdoig@munrodoig.com.au



Our Ref: RAD:YH:

3 May 2017

By E-Mail: superannuation@treasury.gov.au

Manager
Melbourne Unit
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

**SUBMISSIONS FOR TREASURY LAWS AMENDMENT (2017 MEASURES NO. 2)
BILL 2017: LIMITED RECOURSE BORROWING ARRANGEMENT ("LRBA")**

We refer to you the exposure draft released on 27 April 2017 for the above bill and provide the following submissions in relation to Treasury's proposals outlined in the draft Explanatory and Bill.

1. Proposed Measures

1.1 The current proposed measures are to:

- (1) amend the transfer balance cap rules to create an additional transfer balance credit where there is a repayment of a LRBA sourced from other assets (First Measure); and
- (2) amend the total superannuation balance definition to take into account the outstanding balance of an LRBA that is entered into by the trustee of a regulated superannuation fund with less than 5 members (including self-managed superannuation funds) (Second Measure).

1.2 We understand that the purpose of the measures is to:-

"address concerns about the ability of SMSF members to use LRBAs to circumvent contribution caps and effectively transfer accumulation growth to retirement phase that is not captured by the transfer balance cap."

2. Our Submission – First Measure

2.1 We do not oppose the introduction of the concept outlined under the First Measure as it would be rational that the introduction of the transfer balance credit

for repayments of LRBA from sources other than assets used to support the payment of pensions in the retirement phase should result in a transfer balance credit.

- 2.2 However, we submit that the distinction between a repayment of LRBA using pension assets versus non-pension assets is not clearly made in the wording of the Exposure Draft legislation.
- 2.3 The new clause 294-55(1)(b) of the ITAA 97 refers to:
- “an increase in the *value of a *superannuation interest that supports a *superannuation income stream of which you are the *retirement phase recipient”*
- 2.4 With respect, our view is that this is ‘clumsily’ worded as all repayment of LRBA (whether it is from pension assets or non-pension assets resources) will result in an increase in the value of the superannuation interest.
- 2.5 It appears that the distinction as to the source of the LRBA repayment is made in the Explanatory Memorandum at paragraphs 1.24 and 1.25 (i.e. those comments appear to suggest that the source of the repayment of the LRBA is relevant).
- 2.6 However, it appears that the relevant test in the exposure draft is whether there is *“any increase in the value of the superannuation interest”* in pension phase.
- 2.7 This is premised on whether the LRBA repayment exceeds the pension payments made from the fund.
- 2.8 It would appear that the measures do not take into consideration the circumstance where the LRBA repayment amount (sourced from pension assets) exceeds the pension benefit payments from the pension account.
- 2.9 For illustration, if under Example 1.1 in the Explanatory Memorandum, assume:
- (1) the \$10,000 monthly LRBA repayment (i.e. \$120,000 per year) is sourced from the rental income that the SMSF receives from the Property; and
 - (2) Bob only takes the minimum pension (i.e. 5% of his \$500,000 pension account) being \$25,000 over 12 months.
- 2.10 Under the above facts, the LRBA repayments will result in a transfer balance credit of \$95,000 (i.e. \$120,000 repayment less \$25,000 benefit payment) notwithstanding that the full amount of the repayment is sourced from pension assets.
- 2.11 Surely, based on the commentary in the Explanatory Memorandum, the above is not the desired purpose of the measures.
- 2.12 It is also inconsistent with the transfer balance rules as they are currently enacted, which is investment earnings on pension assets do not create a transfer balance credit.
- 2.13 We recommend that the relevant test for the First Measure should not be based on an increase in the value of the superannuation interest, but on the source of the repayment of the LRBA (i.e. whether or not the repayment is sourced from assets supporting a pension).

3. Our Submission – Second Measure

- 3.1 With respect to the Second Measure, we submit that the changes unfairly target LRBA's for self-managed superannuation funds.
- 3.2 This is refusing, in effect, to recognise that a member's total superannuation balance (if supported by an asset on which there is an LRBA) takes into account the outstanding LRBA.
- 3.3 For example, a single member SMSF in accumulation phase with an property investment portfolio worth \$3.6M with \$2.52M LRBA liability to a third party bank (i.e. Net \$1.08M value fund) should not be prevented from making repayments to the LRBA using non-concessional contributions up to their yearly cap limits.
- 3.4 The only conclusion which can be derived, with respect, is that LRBA's (being a valid investment choice) are unfairly targeted and disadvantaged by these new measures.
- 3.5 LRBA's are one out of many investment options available to small funds and are currently highly regulated in the market place.
- 3.6 For example, Banks currently (based on their internal risk policies) only lend to SMSF's on an LVR which is around 60% - 70% and repayments to loans are strictly enforced.
- 3.7 For related party LRBA arrangements, the ATO has provided guidance as to what the Commissioner will accept as arm's length lending practices for tax purposes under *Practical Compliance Guidance PCG 2016/5*.
- 3.8 Under the above arrangements, the lending ratio and the repayment terms are not generally subject to manipulation.
- 3.9 Our view is that the LRBA investment is no different to any other valid SMSF investment (e.g. investment in a company or unit trust which has a similar debt risk).
- 3.10 Accordingly, we do not see the need to the Second Measure to apply in order to enforce the contribution caps and transfer balance caps.
- 3.11 Furthermore, we submit that the concepts introduced under the Second Measure (to take the gross value of the investment) do not accord with ordinary accounting standards and legal concepts for determining a member's superannuation interest.
- 3.12 We do not see how the loans created under LRBA's can be used to circumvent the contribution cap rules.
- 3.13 They do not result in an increase in the value of the assets (or trust fund) of the superannuation fund and, thus, cannot be taken to be a "contribution" as understood by the Federal Tax Commissioner's expressed view in Taxation Ruling TR 2010/1.
- 3.14 Similarly, we do not see how the Second Measure will add any value in preventing the circumvention of the transfer balance cap rules if the First Measure is properly worded to treat credit LRBA repayments from non-pension asset sources.

3.15 We submit that the Second Measure should be removed and a more carefully worded provision under the First Measure be used instead to achieve the purpose of the legislation to prevent aggressive repayment terms during the pension phase (from non-pension sourced funding).

In light of the above, we welcome any further consultation which your department wishes to have with us.

Yours faithfully



RON DOIG
Director



YIKAI HOE
Senior Associate