


Legal Update

Related Party Loans in your SMSF – Further Update

Safe Harbour Rules

Further to our recent update in relation to related party loans in your Self-Managed Superannuation Fund (SMSF), we confirm that the ATO has stated that limited recourse borrowing arrangements involving loans to a SMSF from a related party must be on arm's length terms by **1 July 2016** and must be compliant for the whole of the 2015/16 financial year.

The difficulty with this was how to ensure that the loan was actually on arm's length terms to the satisfaction of the ATO. We suggested that the only way to really ensure compliance was to seek an offer of finance from a bank or financial institution first, and then essentially mirror those terms.

Well now the ATO has released Practice Compliance Guideline PCG 2016/5 (you can read the complete guideline at https://www.ato.gov.au/law/view.htm?DocID=COG/PCG20165/NAT/ATO/00001) to provide further guidance on what it considers to be arm's length terms. The ATO will accept that the loan terms are consistent with an arm's length dealing if the terms of the borrowing comply with the 'Safe Harbour' terms set out in PCG 2016/5.

The 'Safe Harbour' terms are summarized in the following table:

	Real Estate	**Stock exchange listed shares or units**
Interest rate	Reserve Bank of Australia Indicator Lending Rates for banks providing standard variable housing loans for investors (5.75% for 2015-16 year).	Reserve Bank of Australia Indicator Lending Rates for banks providing standard variable housing loans for investors plus 2% (7.75% for 2015-16 year).
Fixed/Variable	This can be variable, or fixed for up to the first 5 years. After the fixed period, the interest rate must convert to variable.	This can be variable, or fixed for up to the first 3 years. After the fixed period, the interest rate must convert to variable.
Term	15 year maximum. For a refinance, 15 years including the elapsed term of the loan being refinanced.	7 year maximum. For a refinance, 7 years including the elapsed term of the loan being refinanced.

Loan to Valuation Ratio	70% of the value at the date of establishment or refinancing. For LRBAs in existence at 6 April 2016, the market value at 1 April 2015 can be used. Where there is more than 1 loan, the LVR is the total of all loans.	50% of the value at the date of establishment or refinancing. For LRBAs in existence at 6 April 2016, the market value at 1 April 2015 can be used. Where there is more than 1 loan, the LVR is the total of all loans.
Security	Registered mortgage.	Registered charge.
Personal guarantee	Not required.	
Repayments	Monthly principal and interest	
Loan agreement	Written properly signed loan agreement.	

How to comply

You should ensure that any borrowing arrangements are compliant with the above 'Safe Harbour' terms by 30 June 2016 and ensure that payments of principal and interest for the entire financial year ended 30 June 2016 are made on these terms.

If you wish to implement loan terms which do not comply with the 'Safe Harbour' terms, then the onus will be on you to show that the terms are nevertheless consistent with an arm's length dealing. If you cannot convert the loan to an arm's length dealing by 30 June 2016, then you will need to wind up the arrangement by 30 June 2016. This can be done by selling the asset and/or paying out the debt, having made principal and interest payments for the 2015/16 year consistent with an arm's length dealing.

Failure to comply with the above rules will mean the income from the arrangement may be taxed at the highest rate (47% in the 2016 year).

If you require assistance drafting the necessary loan documentation, please do not hesitate to contact Paul McHugh or Luke Steptoe of this office.

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