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

**Superannuation reform package amending provisions - limited recourse borrowing arrangements**

The SMSF Owners’ Alliance is an independent, not for profit advocate for the interests of one million Australians who are members/trustees of self-managed superannuation funds.

It has become routine in our submissions to Treasury on changes to superannuation to start by noting the unreasonably short time allowed for comment on complex legislation. We have to do so again as just four working days have been allowed for comment on the proposed Bill. It is not conducive to good policy making to allow such little time for comment on legislation.

Given the lack of time for us to analyse the effect of the proposed legislation and seek expert advice, we must confine our comments to general points.

The Explanatory Memorandum says the Bill will 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.

It is unclear how this will be done.

It seems the Bill is intended to prevent attempts by fund members to increase the value of their pension account and circumvent the total superannuation balance cap on non-concessional contributions. However, it is not known yet whether this will be a real problem and the Government has not produced any evidence of the need for it. This pre-emptive legislation will add another chapter to the complex changes to superannuation that were made at the end of last year and have yet to take effect.

One result of the Bill will be to make the rules for self-managed funds more complicated than they already are and increase compliance effort and cost for the funds that have borrowing arrangements. This will be particularly problematic for funds with multiple members in different phases of superannuation and with multiple assets.

It might be concluded that the Bill is designed to make borrowing so difficult for SMSFs that it will become untenable and effectively achieve a back-door ban on this method of building fund assets.

In 2015, in its response to the Financial System Inquiry, the Government did not accept a recommendation that borrowing by SMSFs should be stopped. Instead, the Government said it would ask the Council of Financial Regulators and the ATO to monitor SMSF borrowing and report back in three years. Has this monitoring been carried out? Have the regulators made any report to the Government? If not, this legislation is premature and lacks justification. If the regulators have made a report, it should be released so it can be seen whether the legislation is necessary.

**Meaning of the Bill**

It appears the intent of the Bill is to count borrowings as part of the assets of the fund and individual members’ accounts. The Explanatory Memorandum explains the purpose and workings of the Bill in a very complex way that is hard to follow. Even expert practitioners we have contacted in the past few days are still unsure of what the Bill means and what its practical effects will be. In particular, the wording of key sections 1.24 and 1.25 of the Explanatory Memorandum should be reviewed to give a clearer explanation of how the Bill is intended to apply.

**Consequence of the legislation**

Some self-managed funds may not be able to use limited recourse borrowing arrangements if they will be relying on non-concessional contributions to repay some or all of the loan interest and capital because the gross value of the asset(s) will take them over the $1.6 million total superannuation balance and they will be unable to make further non-concessional contributions to service the debt.

For example:

A member’s account has gross assets of $2.5m of which $1.2m is covered by borrowing. So the net value of the member’s account is $1.3m. At this level, under the existing legislation, an eligible member would be able to make a $300k non-concessional contribution from 1 July 2017.  The fund might then use the non-concessional contribution amount to repay some of the borrowing.

However, under the proposed legislation as we understand it, the $1.2m would be a ‘credit’ back to the member’s account, and therefore they will be deemed to have a total superannuation balance of $2.5M, which then means they are not eligible to make any non-concessional contributions as they are above the total superannuation balance cap.

This may then affect the borrower’s capacity to repay the loan and render the investment uneconomic. Assets covered by borrowing may need to be sold.

It should be kept in mind that this result may be compounded and further complicated by a member’s total superannuation account being determined by reference to amounts held in other funds, which may not be front of mind to a trustee or a lender when a new limited recourse borrowing is entered into by a fund.

In effect, some self-managed funds will be denied the opportunity currently allowed to borrow in order to build their assets and generate an adequate retirement income stream. This is likely to adversely affect small business owners who may use their self-managed fund to invest in the property used by the business.

Under the application and transitional provisions the legislation will take effect from the beginning of the next quarter after the legislation is passed, most likely 1 July if the legislation is passed in the budget sittings. We trust this means that it will not be retrospectively applied to funds that have existing borrowings. Specific assurance on this point should be included in the Explanatory Memorandum. Allowance should be made in the legislation so it does not disadvantage self-managed funds that have entered contracts to purchase assets before the legislation takes effect with settlement to be made at a later date. Such allowance should include the re-financing of borrowings as they fall due to avoid a retrospective impact on SMSFs that have entered borrowing arrangements.

It is also unclear how the proposed amendments will affect traditional instalment warrants for self-managed funds where underlying debt may not be as transparent as would be required in order to apply the new measures.

The Law Council of Australia has prepared a more substantial submission drawing attention to problems inherent in the draft legislation and we support the Law Council’s comments.

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