

Related party loan to SMSF - when is a loan not a loan?

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John is the sole member of his SMSF and is the sole director of the fund's corporate trustee. After seeking financial and tax advice on the benefits of owning a property in his SMSF, John decides to sell his investment property valued at \$1m to his SMSF.

As his SMSF's available balance is \$200k short of the market value, he enters into a contract with the SMSF for a loan of \$200k to fund its purchase using a limited recourse borrowing arrangement. In lieu of paying the loan amount to the SMSF, he received \$800k as the vendor from the SMSF on settlement, the \$1m sale price less his "loan" of \$200k to the fund.

But is that \$200k really a loan?

Borrowing options for SMSFs are becoming more limited with the withdrawal of major banks from SMSF lending, especially in respect of residential property. When it comes to related party borrowing, the importance of actually transferring the loan amount from the lender to the borrower (or to the vendor at the direction of the borrower) is sometimes overlooked, particularly in the circumstances where the same individual is the vendor, the lender and the fund trustee (or director of corporate trustee).

If you are considering a similar transaction, remember that having formal loan documents noting arm's length loan terms (i.e. ATO safe harbor terms) may not be sufficient. The ATO's current view is that there needs to be a transfer of money from the lender to the borrower as a necessary feature of a borrowing as referred to in the Superannuation Industry (Supervision) Act 1993 ("SIS Act").

Journal entries or set offs do not meet the requirements of a "borrowing". The ATO has relied on old rulings in other contexts to distinguish 'loans' from 'financial accommodation'.

Accordingly, in our example above, John should have actually transferred \$200k from his personal account to the fund as an advance of loan amount and received the whole \$1m on the settlement of the property sale contract.

If the transaction is deemed to be an arrangement other than a loan, the LRBA exception under the SIS Act will not apply and this may expose the SMSF trustee(s) to civil and/or criminal penalties and place SMSF's complying status at risk.

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