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Limited recourse borrowing arrangements and non-arm's length income

We have recently published [PCG 2016/5 \(/law/view/document?DocID=COG/PCG20165/NAT/ATO/00001&PiT=99991231235958\)](#) and [TD 2016/16 \(/law/view/document?DocID=TXD/TD201616/NAT/ATO/00001&PiT=99991231235958\)](#) which provide guidance to self-managed super fund (SMSF) trustees and their advisers on when the non-arm's length income (NALI) provisions apply to an SMSF's limited recourse borrowing arrangements (LRBA). It's important to recognise that it is a two-step process to determine whether the NALI provisions apply, based on the terms of the borrowing arrangement.

First, you need to determine whether:

- the terms of the LRBA are consistent with the safe harbours we have provided in PCG 2016/5
- the SMSF trustee can otherwise demonstrate that they are arm's length.

If the answer is yes, then trustees do not have to consider TD 2016/16 and are assured that we will not seek to apply the NALI provisions on the basis of the borrowing terms under the arrangement.

TD 2016/16 only needs to be considered if an SMSF has an LRBA on terms that are non-arm's length. This is because in these circumstances, trustees need to consider the second limb of the NALI provisions and whether or not the income the fund obtains under the arrangement is greater than it would otherwise have been.

TD 2016/16 does not have any application in instances where it is determined that an LRBA is consistent with an arm's length dealing.

Note that TD 2016/16 is not an alternative to the safe harbours set out in PCG 2016/5 and only applies if borrowing terms of an LRBA are non-arm's length.

Remember, SMSF trustees have until 31 January 2017 to review their LRBAs to ensure they are consistent with an arm's length dealing, or alternatively brought to an end if they are not.

Quick guide

Are borrowing terms consistent with safe harbours in Practical compliance guidelines (PCG), or other evidence that demonstrates they are arm's length?

Yes – trustee does not need to consider TD 2016/16.

No – trustee needs to consider TD 2016/16 to determine if income is NALI.

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