

Limited recourse borrowing arrangements

When can you use borrowed funds to do capital works and repairs?

<i>Work type</i>	<i>Is this work permitted?</i>	<i>Can you use borrowed money?</i>	<i>ATO explanation as expressed in SMSFR 2012/1</i>	<i>Examples</i>
Repairs	✓	✓	'... remedying or making good defects in, damage to, or deterioration of an asset and contemplates the continued existence of the asset. A repair is usually occasional and partial. A repair restores the function of the asset without changing its character ...'	<ol style="list-style-type: none"> Restoring kitchen affected by fire damage (including adding dishwasher that was not there previously) Replacing roof affected by cyclone damage A fire destroys a three-bedroom residential house. Rebuilding a broadly comparable house is not an improvement as it restores the asset to what it was before the fire. If superior materials, fittings or appliances are used it is a question of degree as to whether the changes significantly improve the state or function of the asset as a whole.
Maintenance	✓	✓	Work undertaken '... to prevent defects, damage or deterioration of an asset, or in anticipation of future defects, damage or deterioration, provided that the work merely ensures the continued functioning of the asset in its present state.'	<ol style="list-style-type: none"> Performing routine maintenance on apartment building including painting and replacing carpet Painting house Replacing fence (including adding gate) A residential house is acquired under an LRBA and is rented out for a number of years. As the area is now a real estate hot spot a decision is taken to renew the kitchen which, although functional, is significantly out of date and showing wear and tear. The design of the kitchen is improved and modern equivalent, rather than superior, materials and appliances are used. The changes made do not significantly improve the state or function of the asset as a whole.

Work type	Is this work permitted?	Can you use borrowed money?	ATO explanation as expressed in SMSFR 2012/1	Examples
Improvements	<p>?</p> <p>TAKE EXTREME CARE</p>	<p>X</p>	<p>An improvement occurs ‘... if the state or function of the asset is significantly altered for the better, through substantial alterations, or the addition of further substantial features ... to the asset.’</p> <p>Extreme care must be taken if undertaking improvements.</p> <p>Although it is possible to make improvement using the own cash resources of the SMSF (no borrowings allowed to fund improvements), the improvement must not be so great that it changes the nature of the asset. The ATO’s view is that is the nature of the asset is changed, you hold a different asset to the one originally acquired and therefore breach the superannuation borrowing rules. The only way to rectify such a breach is to sell the asset and wind up the borrowing structure.</p>	<p>ATO’s view on acceptable improvements (SMSFR 2012/1)</p> <ol style="list-style-type: none"> 1. One bedroom of a residential house is converted to a home office. 2. A fire destroys a three-bedroom residential house. Rebuilding a residential house that is not broadly comparable to that destroyed is an improvement. 3. An extension to add two bedrooms, a further bathroom or increase the size of the kitchen. 4. The addition of a swimming pool or a garden shed or a garage shed and driveway or a pergola is built to create an outdoor entertaining area. 5. An extension consisting of an outdoor entertainment area. 6. A 'granny flat' is to be constructed in the backyard of a property which already has a four-bedroom residence established on it. The granny flat will have two bedrooms, a family room, a kitchen and a bathroom and will be connected to utilities such as electricity, water and sewage. 7. An integrated home automation system is installed including electronically controlled lighting, multi room audio-visual distribution and security system. <p>ATO’s view on unacceptable improvements (SMSFR 2012/1)</p> <ol style="list-style-type: none"> 1. Building on a vacant block of land. 2. A house is demolished following a fire and is replaced by three strata titled units. 3. A residential house is converted into a restaurant by renovations which include fitting out a fully functioning commercial kitchen.

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