

Property in SMSFs – to have and to hold

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But first....what you need to know

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What we will cover today

1. Property & SMSFs – laying the foundation
2. What is the landscape – structure considerations
3. In specie transfers of property, in and out
4. Finance elements of property – practical issues
5. Finishing touches - obligations

The numbers

Top 10 Assets of SMSFs

1. Listed shares \$230,508 bn*
2. Cash and Term Deposits \$151,278 bn
3. Unlisted trusts \$102,477 bn*
4. Non-residential real property \$80,125 bn
5. LRBAs \$56,941 bn
6. Listed Trusts \$51,223 bn*
7. Other managed investments \$44,574 bn*
8. Residential real property \$43,334 bn
9. Other assets \$19,148 bn
10. Overseas shares \$11,550 bn

Source: ATO quarterly statistical report June 2021

Laying the Foundation

What does SIS have to say?

- Sole purpose test - operated exclusively for genuine retirement purposes
- Deemed covenants
 - Prudent person test
 - Investment strategy
- Acquisition of assets from related parties
- In-house assets

SIS Considerations

- Acquisition from related parties & in-house assets impact transactions with related parties

Impacts

- who we can acquire the property from,
- who we can invest with,
- who we can lease property to.

Investment strategy considerations

To **FORMULATE, REVIEW** regularly and **GIVE EFFECT** to an investment strategy that has regard to the whole of the circumstance of the fund including, but not limited to, the following:

The **RISK** involved in making, holding and realising and the likely **RETURN** from, the fund's investments having regard to its objectives and its expected **CASH FLOW** requirements;

The compositions of the fund's investments as a whole including the extent to which the investments are diverse or involve the fund in being exposed to risks from inadequate **DIVERSIFICATION**;

The **LIQUIDITY** of the fund's investments, having regard to its expected cash flow requirements;

The ability of the fund to **DISCHARGE** its existing and prospective **LIABILITIES**

SIS Considerations

A “related party” of an SMSF includes:

- Fund members
- A standard employer sponsor of the fund or
- An ‘associate’ of either a member or standard employer sponsor of the fund

Section 10(1) of the SIS Act

SIS Considerations

An "associate" (Part 8 Associate) is:

- any other member of the fund
- a relative of the member
- any trustee of the fund - single member fund
- any director of the trustee company - single member fund
- a partner in partnership with a member
- any spouse or child of that partner
- any entity controlled by any of the above

SIS Considerations

- Acquisition from related parties will permit purchase of
 - business real property, or
 - certain exempted unit trusts (13.22C)
- In house assets will permit
 - business real property to be leased to related parties,
 - certain property to be owned with related parties

Business Real Property

- Wholly and exclusively used in the conduct of a business
- Based on use of property not zoning
- Does not need to be a business related to fund members – can be anyone
- Limited exceptions for residential component where it is a necessity of the business activity



Super
Concepts

What is the Landscape - Structure Options

Structure options

- Outright ownership
- Tenants in common
- Using a unit trust
 - With related parties
 - With non-related parties
- Using an LRBA

Outright ownership

SMSF



- Property registered in name of SMSF Trustee – state laws
- SMSF corporate trustee best
- No charge over asset
- Restrictions on vendor if SMSF buys residential property
- Restrictions on tenant for SMSF with residential property
- No restrictions for business real property

Outright ownership

SMSF



- All rents paid to fund bank account
- All property expenses paid by SMSF
- How to pay out a benefit?

Tenants in common

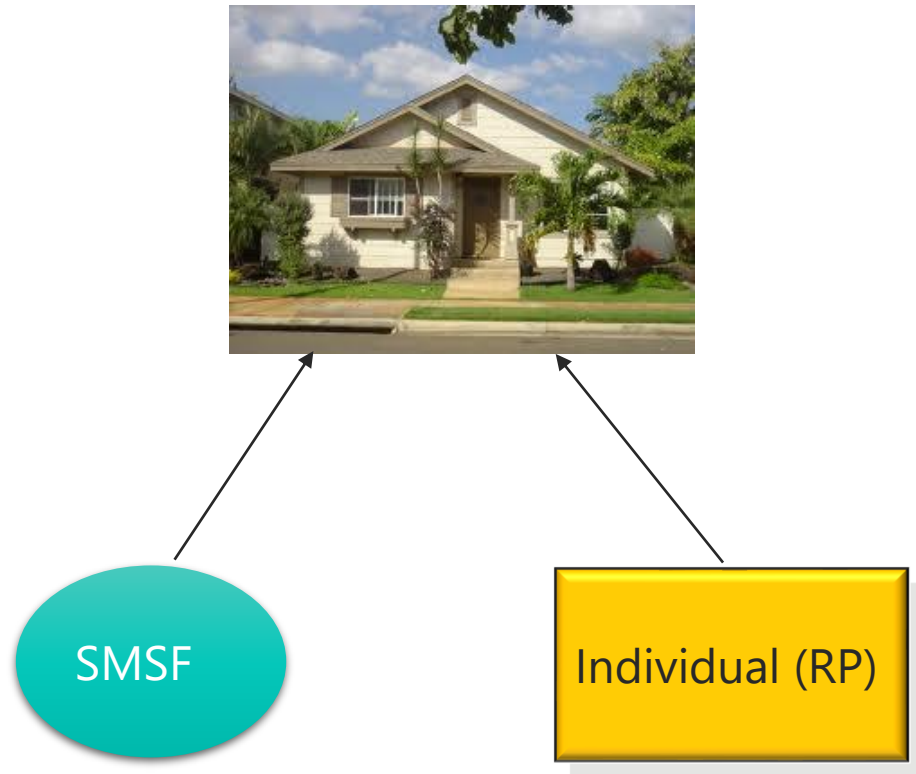


SMSF

Individual (RP)

- Tenants in common not joint ownership
- Restrictions on vendor if residential property
- Restrictions on tenant for residential property
- No restrictions for business real property
- Restriction on SMSF buyout of other interest

Tenants in common



- ABN for Tax Law P'Ship (GST rego?)
- Partnership agreement?
- Joint bank account for property
- Transfers of net income
- Income & Expense Statement
- How to pay out a benefit?

Unit trust with related parties

If 13.22C satisfied then

- Value of units excluded from 5% in house asset limit
- Additional units can be acquired from related parties

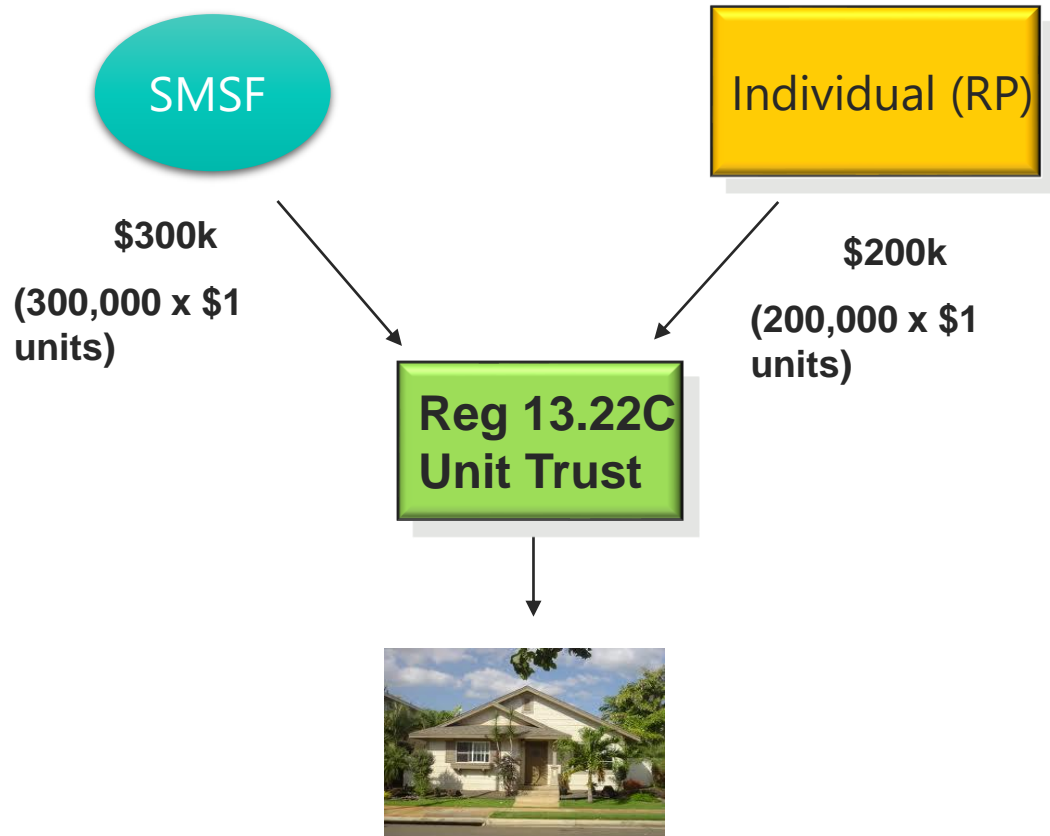
Generally done as unit trust but can also be a company

Breach of 13.22C rules results in units being in house assets and most likely results in disposal

13.22C conditions

- Does not borrow or have a charge over assets
- Does not invest in or through other entities
- Has an account with an approved ADI
- Has not acquired assets from a related party other than business real property, in the last 3 years
- Doesn't directly or indirectly lease assets to related parties other than business real property at arms length
- Doesn't carry on a business
- Conducts all other transactions on an arm's length basis

13.22C Unit Trust



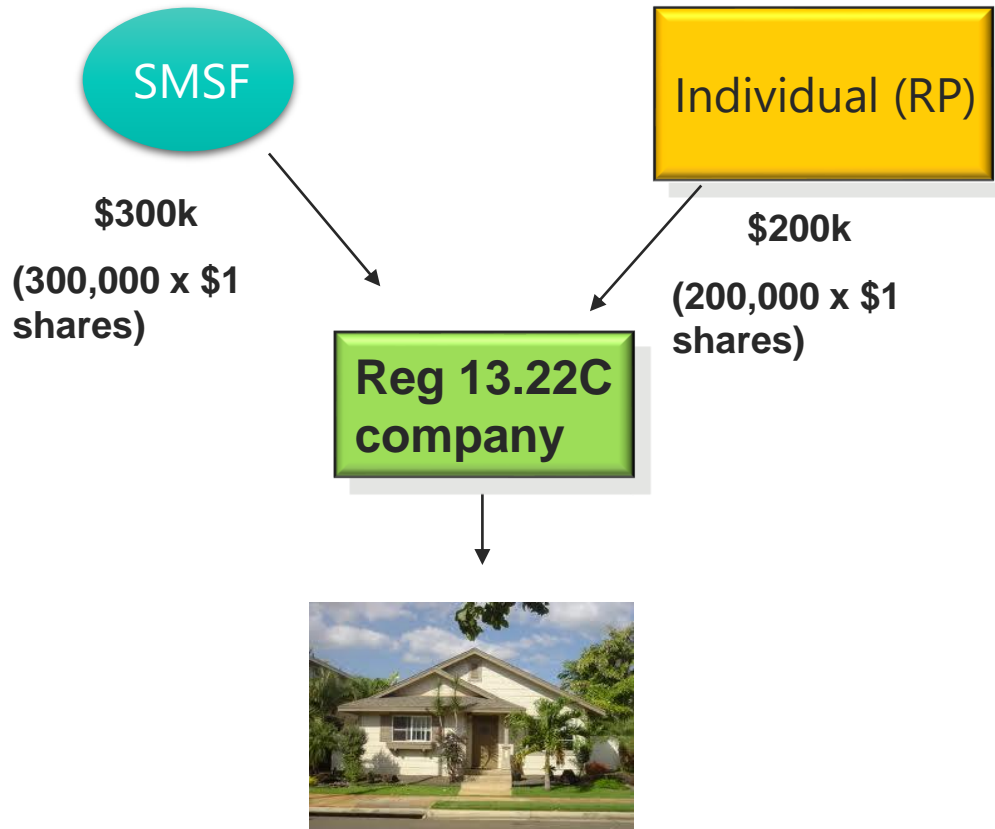
SMSF and related party property acquisition

Related party uses own funds or borrows to purchase units in the unit trust

Mortgages residence for loan

- Generally only Property and a bank account
- Restrictions on vendor and tenant if residential property
- No restrictions for business real property

13.22C Company



SMSF and related party property acquisition

Related party uses own funds or borrows to purchase shares in the company

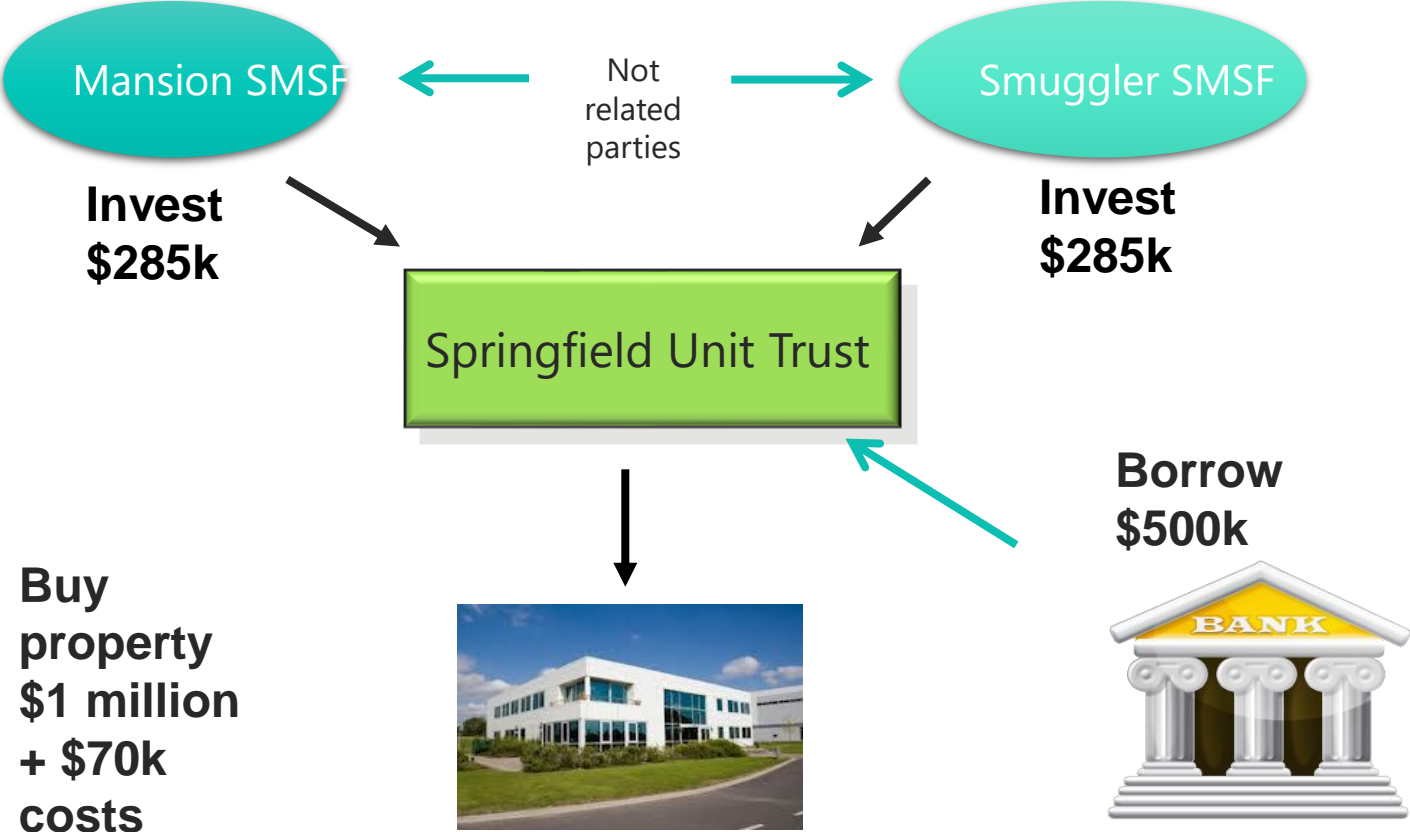
Mortgages residence for loan

- Often used if purchasing foreign property
- Beware foreign bank accounts
- Will have foreign tax obligations
- Moving income to investors?

Additional features

- Ability to acquire units from related party permits creeping acquisition
- Possible to improve/change property
- Must distribute income to unit holders but can do re-investment
- No need to declare dividends if a company is used
- More options available to pay out benefit
- No issues with Transfer Balance Cap and Total Super Balance

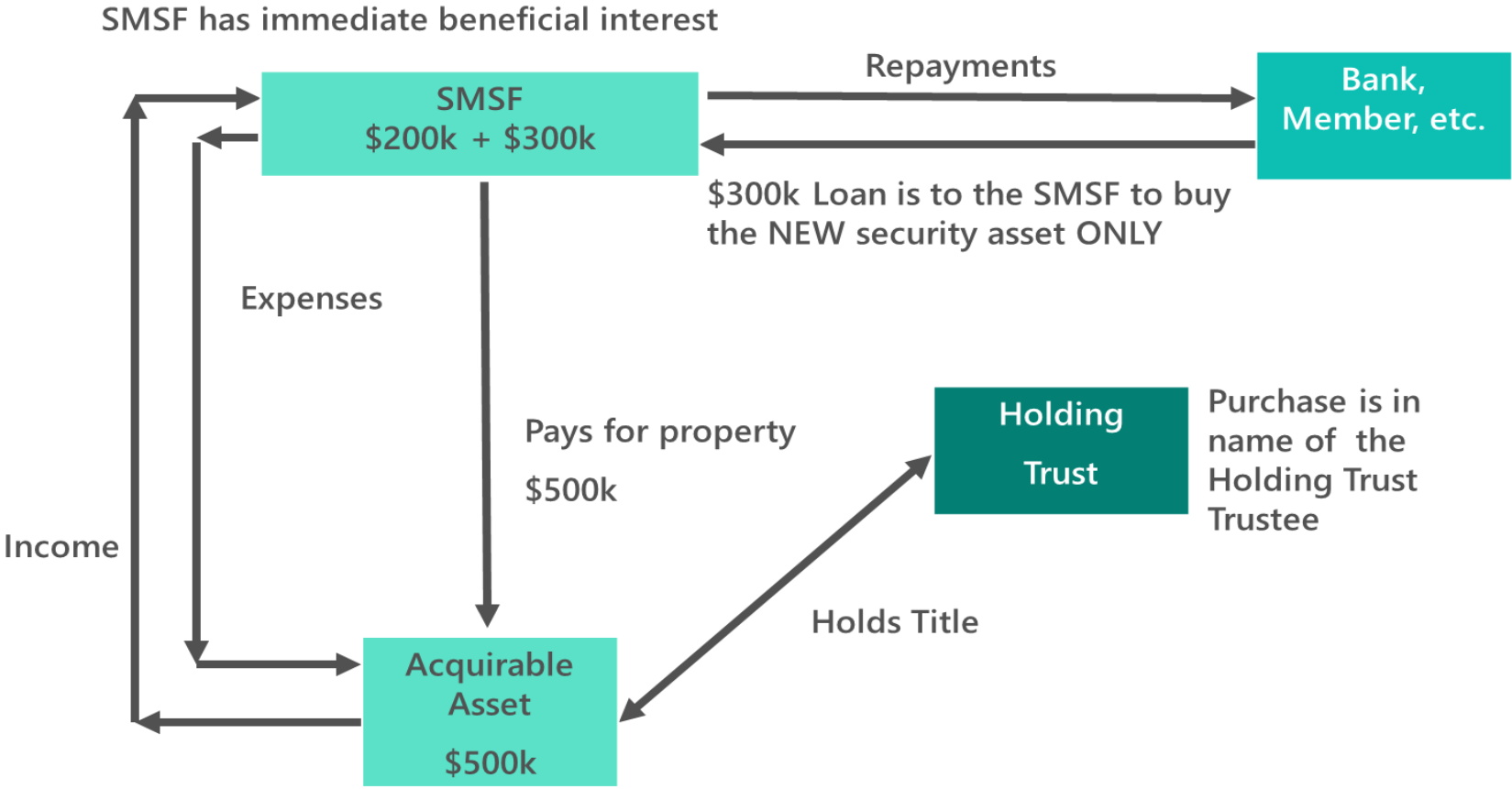
Unit trust with non-related parties



Considerations

- Needs to ensure no related group has control
 - Greater than 50% unit holding
 - Effective control the trustees
 - Power to remove or replace trustees
- Dead lock breaking powers in trust deed or company constitution need to be reviewed

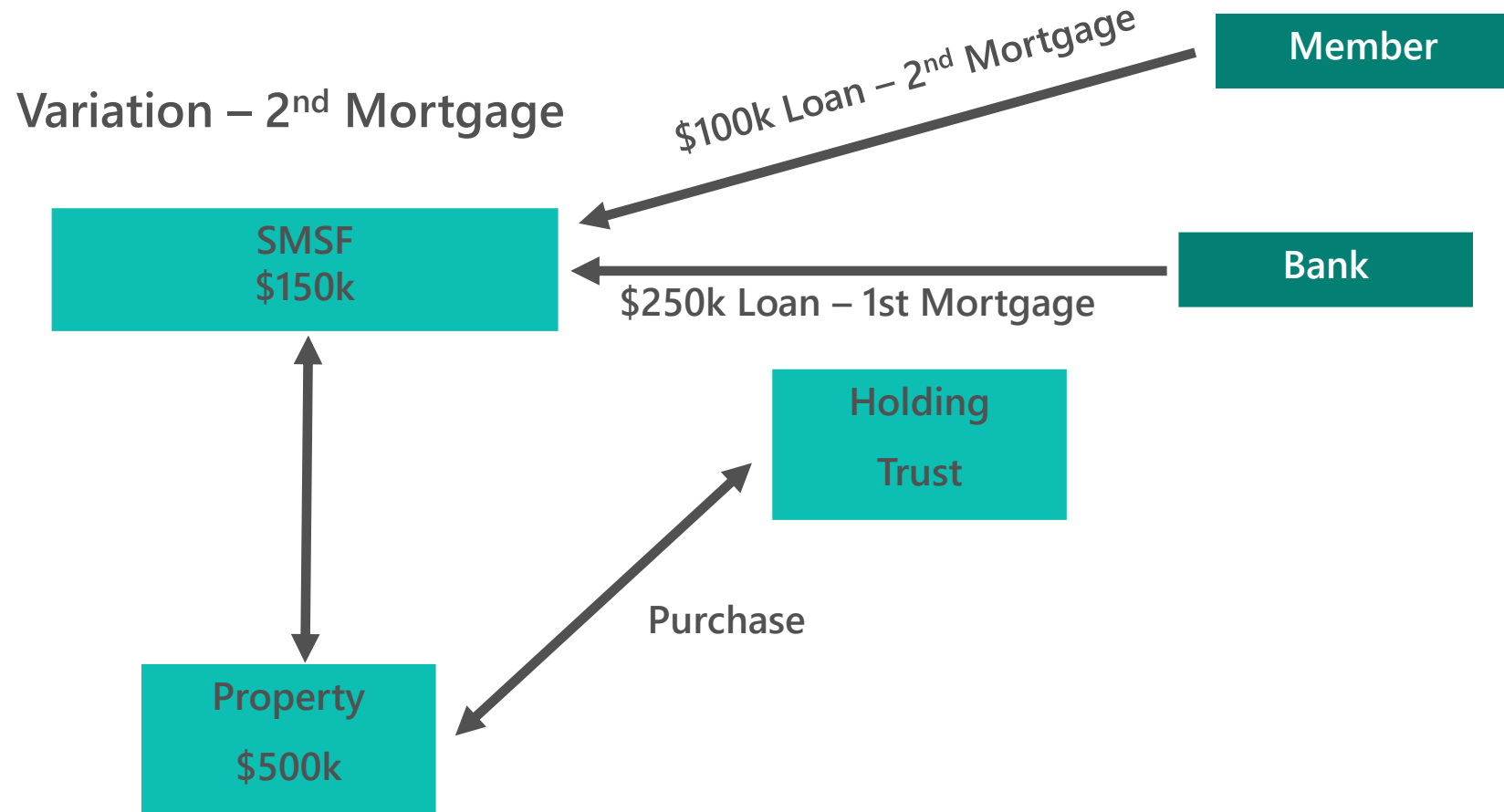
Limited recourse borrowing arrangement



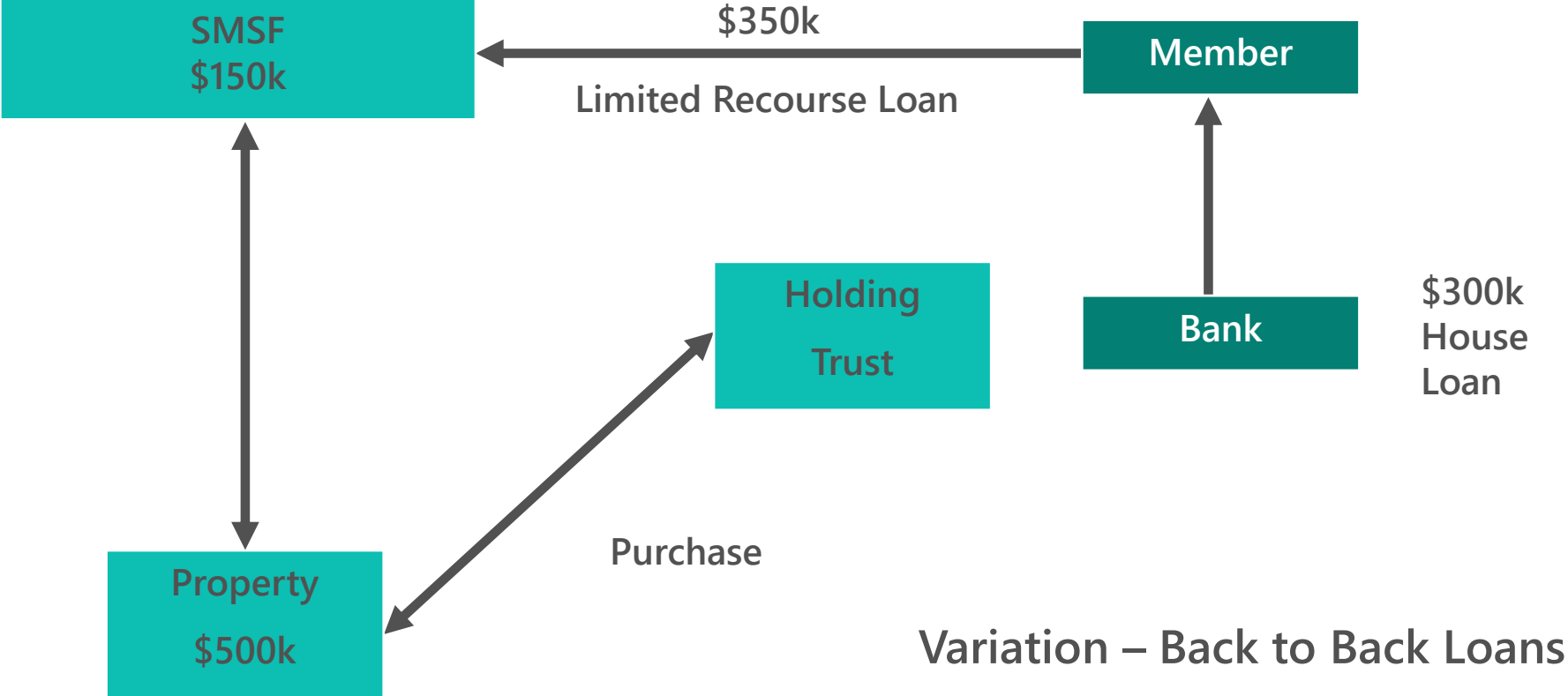
Considerations

- Borrowing to acquire a new single acquirable asset
- Asset is held on trust not in a trust
- Limitations on improvements using non-borrowed money
 - Does not change the fundamental nature of asset
- Recourse by lender and any other party limited to the acquired asset
- Lender may be a financial institution or a related party
- Transfer Balance Cap implications from 1 July 2017
- Total Super Balance implications from 1 July 2018

Limited Recourse Borrowing

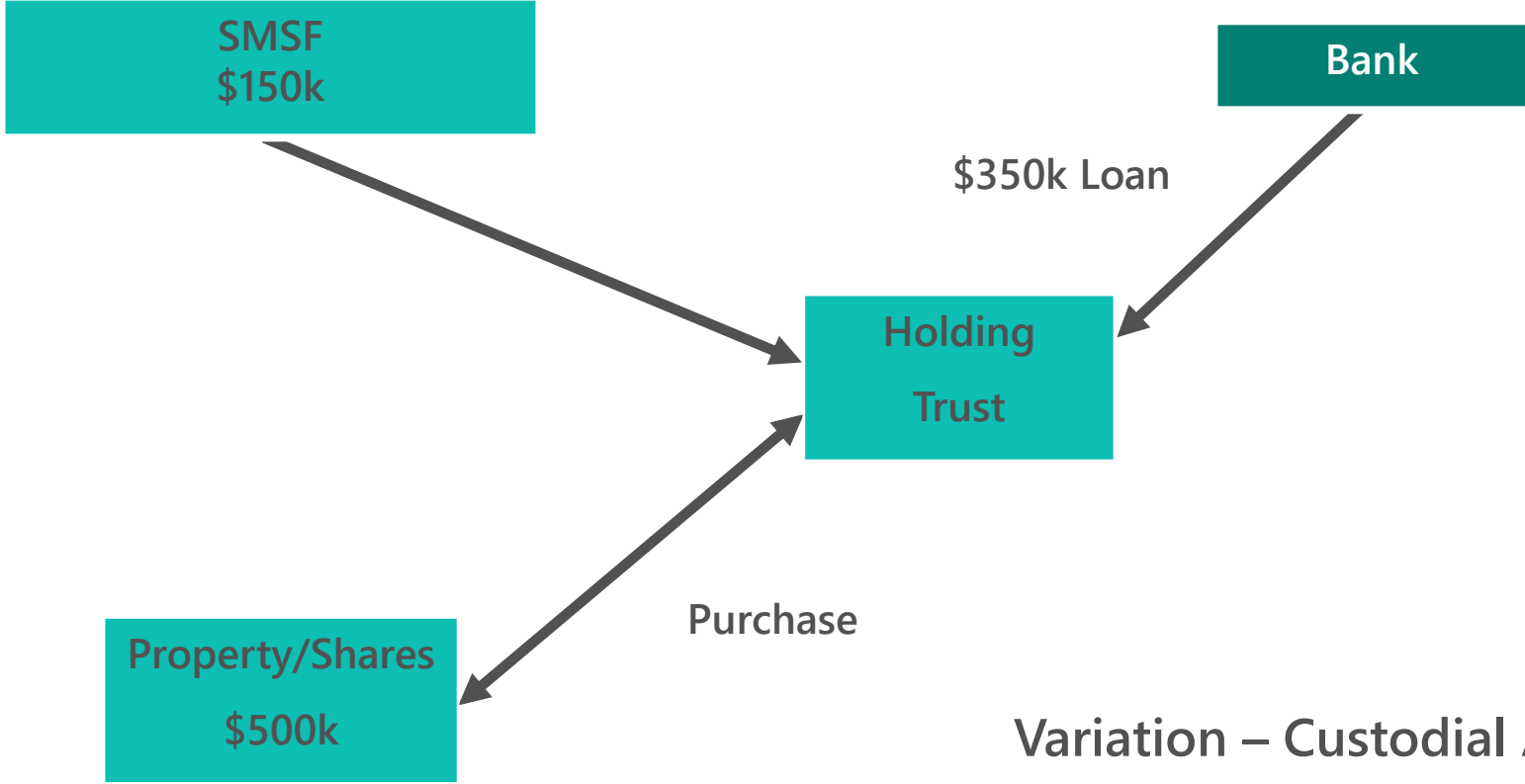


Limited Recourse Borrowing



Variation – Back to Back Loans

Limited Recourse Borrowing



Variation – Custodial Arrangement

Safe harbour – real property

Benchmark interest rate	RBA standard variable housing investor loan
Maximum LVR	70%
Maximum term of loan	15 years
Personal guarantee	Not required
Frequency of repayments	Monthly - Principal & interest
Security	A registered mortgage

In specie transfers of property

- in and out

Transfers in

- Related party
- Acquired from whom
- Rental property as business real property Denis Allan cases*
- SMSFR 2009/1 – what is business real property.

*Allzams Trust and Commissioner of Taxation (Taxation) [2021] AATA 2767
Allen and Commissioner of Taxation [2021] AATA 2768

Transfers out

- To whom
- Valuation of property
- CGT event
- Transfer of title to new owner

Strategy

- Partial commutation of pension to pay benefit
- Proceeds of non-commutable pension to pay benefit

Partial commutation of pension

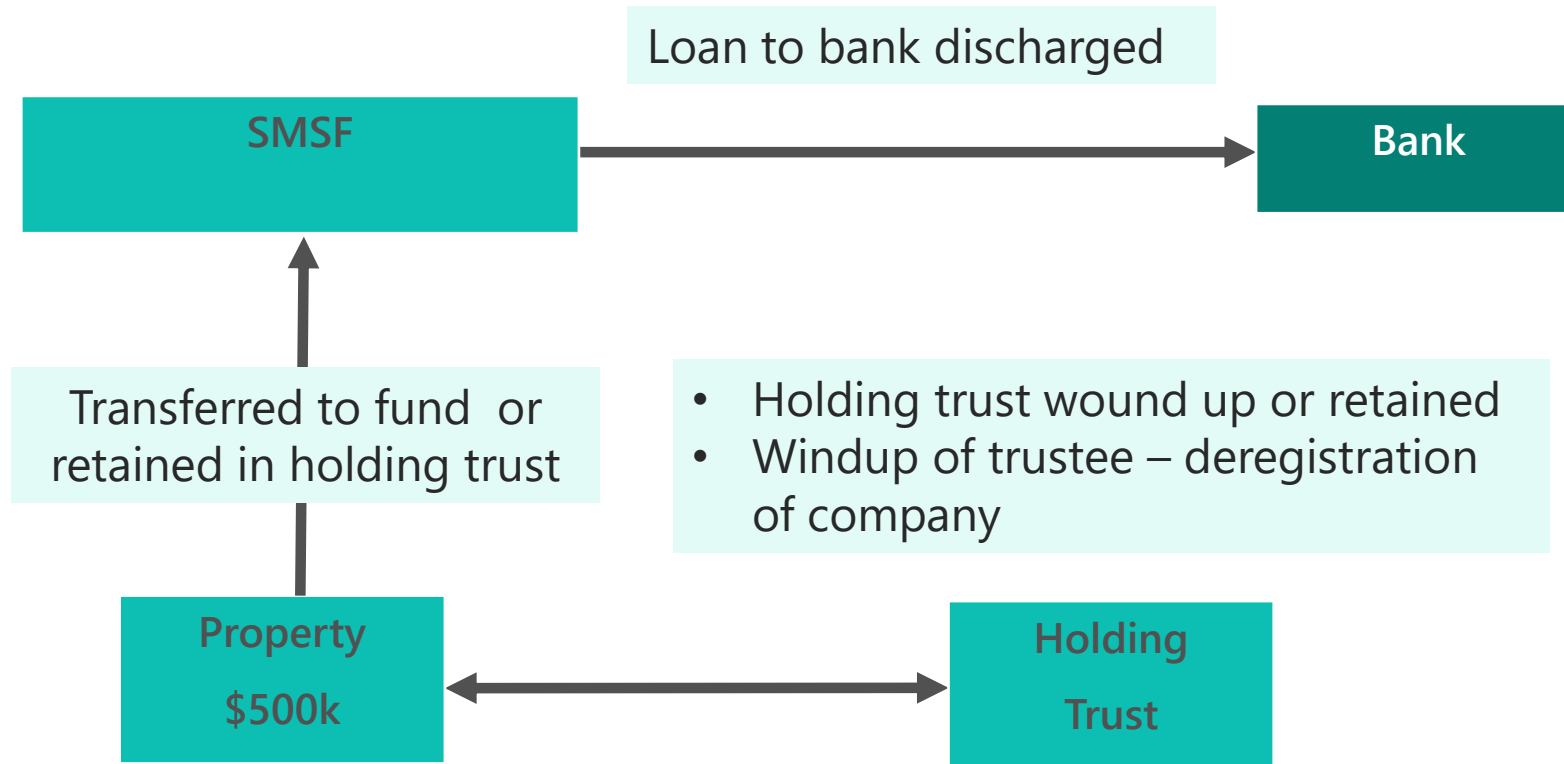


- Fund wholly in pension phase
- Current pension balance of member totals \$1.5 million for member
- Value of storage shed \$1.2 million
- \$1.2 million of pension commuted and storage shed transferred in specie to satisfy benefit.

Considerations

- No CGT if the transfer of the storage shed arises from
 - the fund being wholly in pension phase
 - partial commutation of a pension
 - partial commutation of a reversionary pension after the original pensioner's death
 - cessation of a non-reversionary pension on the pensioner's death
- Full commutation of a pension means the pension has come to an end and any transfer of the storage shed is liable to CGT
- Duty may not be payable where the transfer is made for no consideration in some states
- GST will depend on whether the fund is registered

Limited recourse borrowing arrangement – winding up



Considerations

- Whether to retain the property in the bare trust
- Whether to transfer to the fund
- Winding up of the company as bare trustee
- Issues with one company as bare trustee of two properties
- Documentation

Key ownership considerations

Key considerations

- Valuing the asset
- Revenue considerations - direct or indirect
- Expenditure considerations
- GST application
- SMSF taxation



Super
Concepts

Valuing the Asset

Valuing the property

- SIS regulation 8.02B requires every asset of the SMSF to be valued at market value
- Valuation is required
 - For annual financial statements
 - When commencing a pension
 - For any in specie transaction
- Different approaches if held directly or indirectly

Valuing the property

- ATO Valuation guidelines published May 2019
- Valuation can be undertaken by any party as long as its objective and based on supportable data required
 - Valuation can be unchanged if there are no changes in either market conditions or event that could affect valuation
- On-line services, real estate agent or property valuer can be utilised
- Auditors may “look through” certain structures
- 2020 FY and COVID – 19 valuation issues



Super
Concepts

Revenue and Expense Considerations

Leasing the property

- Primary source of revenue will be property rental
- Written lease with tenant outlining rental level, frequency, term of lease etc
- Lease is executed by title holder – who is this?
 - Directly held or via a trust or LRBA
- Considerations for commercial property
 - Provision of ABN for GST
- Rental level and terms need to “at market”

Leasing the property

- If tenant is related to the SMSF additional risks due to
 - Requirement to be arm's length transactions
 - Possible financial assistance
 - Non-arms length income/expenses
- In house asset triggered if not business real property
 - Could result in disposal of property

Property expenses

- Property is one of the few physical assets SMSFs hold
- As a physical asset property is subject to damage and wear
- Costs can be wide ranging from
 - Holding costs – land tax, utilities & rates
 - Maintenance costs – repairs & insurance
 - Finance costs – loan repayments for LRBA's
 - Taxation costs – depreciation or capital works

Final comments

- Property is a physical asset which results in different considerations to financial assets
- Ultimately the property needs to result in increasing the member's retirement savings
- Different structures may help mitigate some of the difficulties that are inherent with real property investments

Final comments

- What is the exit strategy – the SMSF may be forced to dispose of assets to pay a benefit
- Benefit payment is not just about retirement
 - Death – disability – divorce
- Death benefit pension will not automatically stop asset disposal depending on TBC restrictions

Summary

Structure	In house asset	Gearing	Construction	Business	Acquire from related parties
Outright ownership	No	No	Yes	No	N/A
Tenants in common	No	No	Yes	No	BRP only
Related trust – not 13.22C	Yes	Yes	Yes	Yes	Within 5% limit
Related trust – 13.22C	No	No	Yes	No	Yes
Non-related trust	No	Yes	Yes	Yes	widely-held trusts
LRBA	No	Yes	No	No	N/A



Questions?

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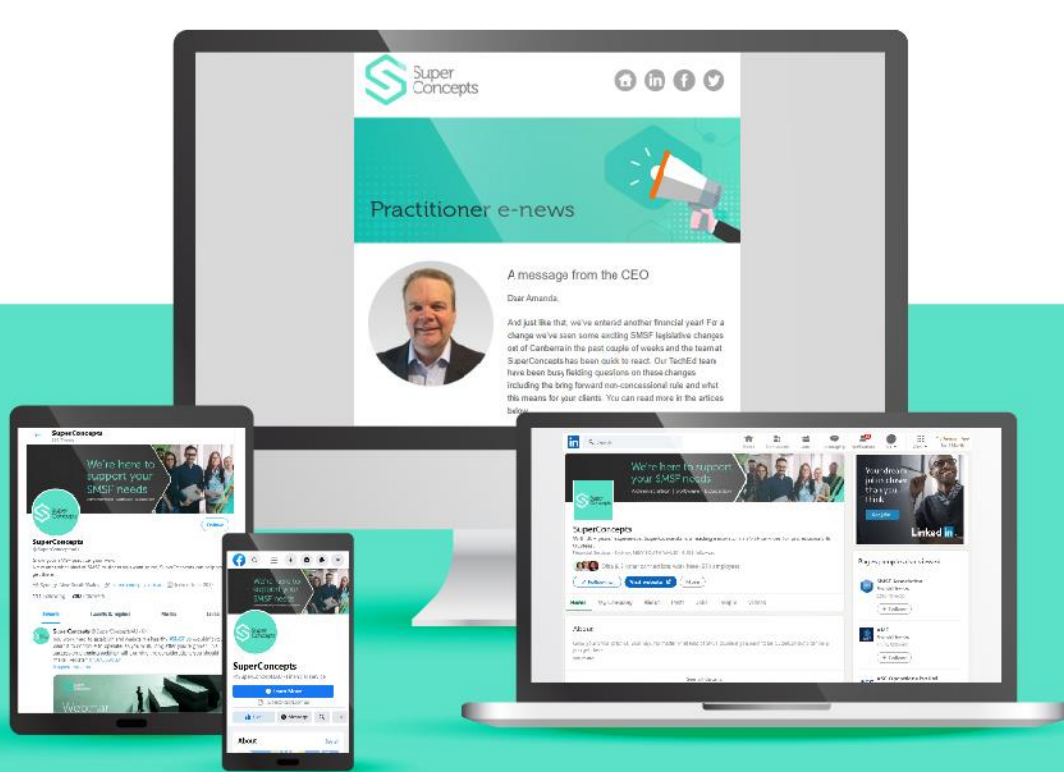
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