Six property potholes for SMSFs to avoid

I'm always concerned when I see advertisements such as, 'Convert your Super to a Self-Managed Fund and pay off your home in as quick as 10 years.' In my 28 years at the Australian Taxation Office (ATO), I saw many people caught up in these schemes, especially when in financial difficulties. To give you an idea on how to avoid some of these dodgy schemes, here are six things that you should always consider if you are entering into property investments using your SMSF.

1. **Does your SMSF's trust deed allow for property investments?** There are two main sources that provide details of what you, as trustee of your SMSF, can and cannot do. One is your SMSF's trust deed and the other is the *Superannuation Industry (Supervision) Act 1993*(SISA). An SMSF trustee is not able to undertake actions, regardless of whether it may be permitted by the superannuation law, if it is not also permitted by the SMSF's trust deed. If your SMSF needs to borrow money to purchase a property, you must ensure your SMSF's trust deed allows for security to be placed over its assets and allows for a separate trust to hold the asset while the loan remains outstanding.

2. **Is property part of your SMSF's investment strategy?** There is nothing in the SISA that requires an investment strategy to be in writing. However, SMSF trustees are solely responsible and accountable for the prudential management of their members' benefits. It is the trustees' duty to make, implement and document decisions about investing in assets and to carefully monitor the performance of those assets. Also the SISA provides a defence to trustees against any action for loss or damage suffered as a result of them making an investment. The defence is available if trustees can show that the investment was made in accordance with the investment strategy formulated for their SMSF. I recommend that your SMSF investment strategy is documented.

3. **Who is the owner of the property prior to the property being acquired by your SMSF**? Under the SISA, only properties that meet the definition of a 'Business Real Property' (BRP) can be acquired by an SMSF from related parties. A BRP is any land and building used wholly and exclusively in a business. It can be residential property as long as the property is used in a business at the time the SMSF acquired it from a related party. Examples of BRP, can be found in the ATO's publication SMSF Ruling 2009/1. You cannot use your SMSF's money to purchase the residential property that you live in unless

the property value does not exceed 5% of the total assets value of your SMSF. For most people, their SMSF is not worth enough to meet this requirement.

4. Does the purchase reflect market value? The SISA states that all investment transactions must be conducted at arm's length. Of course if the parties (i.e. the SMSF and the property owner) are related then they are not arm's length. ' However, the SISA allows sales of BRP between related parties by stating that if the parties are not at arm's length then they must act as though they are or on terms that do not disadvantage the SMSF. Therefore, the purchase price paid on properties should always reflect the true market value regardless of who the buyers and sellers are.

5. Has the SMSF accumulated enough money to purchase the property outright or would it need to borrow? If your SMSF needs to borrow to purchase the property, then the borrowings must be structured correctly in accordance with the requirements of a "Limited Recourse Borrowing Arrangement" (LRBA) under the SISA. If borrowing is required, it needs to be structured correctly, follow the correct process, have the correct wording on the loan document, and ensure the correct names are on the purchase and loan documents. A separate holding trust should be established by a qualified legal practitioner. Failure to properly execute a holding trust arrangement may lead to unnecessary stamp duty and/or capital gains tax implications. I recommend appropriate legal advice is obtained prior to any part of the purchase taking place. Also for more details on the application of the LRBA, refer to the ATO publication SMSF Ruling 2012/1.

6. Once the property is acquired by your SMSF, who is it going to be leased to? The SISA prevents properties that do not meet the definition of a BRP to be leased to related parties unless the property value does not exceed 5% of the SMSF's total asset value. So unless your SMSF has substantial wealth, beware of any claim that you can use your SMSF to pay off your mortgage. It cannot be done. If everything is done correctly and in accordance with the superannuation law, property may be a good investment for SMSFs. If things are done incorrectly, not only can your SMSF be penalised by the ATO, it may end up paying three times the stamp duty as well as incur additional capital gains tax.

By Monica Rule on March 7, 2014
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What you need to know
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