

# Who says your Self Managed Superannuation Fund can't build a property portfolio?

Almost since the introduction of compulsory superannuation contributions, frustration has existed among certain circles with regard to the constraints for investment opportunities given to superannuation funds.

Rightly so too, as the regulators have taken the conservative approach to ensure that superannuation contributions set aside to fund for people's retirement is exactly that – available for their retirement, and not entirely lost or significantly reduced as a result of volatile or poor investment strategies or decisions.

With the commencement of mandatory contributions, we each have some participation in a superannuation scheme, whether it's a large industry-type group scheme, medium-sized employer group schemes or, in the case of wanting control over our retirement savings, a Self Managed Superannuation Fund (SMSF). In the past, SMSFs have to a large degree invested in liquid assets such as cash, managed funds and direct shares. The regulators have overlaid SMSFs with strict compliance and investment strategy requirements to protect us – basically from ourselves!

Over the last two years there has been something of a relaxing of the restrictions placed on Self Managed Superannuation Funds to make them more attractive to the 'mum and dad' investors. The new superannuation rules

permitting SMSFs to borrow to purchase property present fresh opportunities for astute investors to maximise their overall entitlements to tax-free income and wealth accumulation with a focus on property.

But the emphasis and attention placed on these new regulations (created by the introduction of the new S674(A) borrowing rule in September 2007) have also brought an increase in focus and understanding of strategies that have been available for some years but perhaps appeared to be too complex to implement in the past. Now, compared to the opportunities arising from the new regulations, the 'Tenants in Common' or 'Non-g geared Unit Trust' arrangements seem more attractive to investors with SMSFs than ever before.

## **What is a Self Managed Superannuation Fund (SMSF) and why have they become so popular?**

A SMSF is a private fund set up for individuals or family groups to help them plan their retirement. It requires the establishment of a trust deed, the appointment of trustees and members who are usually the individuals or the family themselves, and is reasonably

inexpensive to set up and run. The fund must have no more than four members.

Ongoing compliance fees and establishment costs are paid out of the SMSF bank account, not your personal income, and are usually comparable with the fees you may currently be paying from your industry or other funds.

They are specifically designed for investors looking for greater control and choice over where and how their retirement savings are invested. Tax payable compares well with income generated outside a superannuation fund, that is, 15 per cent on income and 10 per cent on capital gains as opposed to 46.5 per cent and 25 per cent outside the superannuation environment.

There are many factors to consider and responsibilities to understand before establishing your own SMSF – and we recommend you discuss these with your accountant – but let's take a look at some realistic initiatives that investors can take using their own SMSF and real estate as an investment option, remembering that superannuation and investing in real estate have not gone hand-in-hand in the past:

### Case Study One

In this case Peter, aged 57, has an SMSF. The fund was established five years ago to purchase a rental property for \$340,000.

In 2008/09 Peter intends to sell the property (now worth \$550,000) to fund his retirement.

The capital gain on the property is \$210,000 (which would be reduced by a one-third discount in an SMSF, for assets owned more than 12 months).

The tax payable would therefore be \$21,000 (i.e. capital gain \$210,000 x two-thirds assessable net gain x 15 per cent SMSF tax rate).

This is less tax than Peter would pay if had owned the property personally, due

to the higher tax rates on individuals.

Had the asset been in Peter's name the tax payable would be \$43,575 (i.e. assuming 50 per cent discount for assets held by individuals for more than 12 months and a marginal tax rate of 41.5 per cent).

Tax saving to Peter in holding the asset in a SMSF is \$22,575.

Furthermore, if Peter had commenced an account-based pension in his SMSF (i.e. he had switched his SMSF to 'pension phase'), Peter would have paid no tax at all on income or capital gains – a saving of \$43,575!

The ability to manage Capital Gains Tax and Income Tax within an SMSF highlights the distinct advantages

of these types of savings funds, particularly for assets that cannot be accessed from the larger employer schemes or retail funds, such as direct ownership of property.

### Case Study Two

Geoff Ball (55) and Helen Park (51) are business partners in a successful restaurant. They currently lease the business premises; however there is an opportunity to purchase the property from the current owner at a market value of \$535,000.

Geoff has \$300,000 and Helen has \$350,000 in their respective family SMSFs.

Rather than take on additional debt, they use the SMSFs to acquire the property.



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Geoff and Helen each speak to their spouses (who are members of each family's respective superannuation funds) and it is agreed by all parties the property will be a good investment.

Each family SMSF draws a cheque for \$267,500 and the property is purchased by the SMSF, which then leases the property to the business on normal commercial terms.

The investment strategy for the SMSF reflects that the purchase of the business premises is for retirement purposes and takes into account the estimated rental income and capital growth (all compliance matters have been satisfied).

There is now greater certainty for Geoff and Helen as owners (thanks to their SMSFs), as they do not need to be concerned with lease renewals.

The lease payments are deductible to the partnership (at up to 46.5 per cent) but taxable to the SMSF at only 15 per cent.

Furthermore, capital gains on the property will accrue in a low tax environment; and in the event the property was sold at retirement, no Capital Gains Tax will accrue, provided both Geoff and Helen had commenced pension funds.

#### Two points to note:

The use of superannuation (as a low-cost source of financing) is an important advantage of an SMSF for business owners, particularly when looking to acquire business real estate.

When you accumulate assets in your SMSF, the aim is to not sell until you reach retirement and certainly not before you commence a pension fund.

#### Case Study Three: Tenants in Common

Greg (aged 51) has current superannuation benefits of \$150,000 and his wife Marie (aged 49) has super benefits of \$100,000 – both with AMP.

Greg decides to purchase a property for \$500,000 (from an unrelated vendor) and wishes to utilise the family's superannuation fund money.

Accordingly, he sets up The Greg and Marie Family Superannuation Fund and arranges for a rollover of his and Marie's \$250,000 superannuation benefits from AMP into this new fund.

Having a total of \$250,000 in the fund, Greg proposes to borrow in his own name the balance of \$250,000 from the bank and purchase the property as 'tenants in common' with the Greg and Marie Family Superannuation Fund.

The Greg and Marie Family Superannuation Fund will therefore own 50 per cent of the property and Greg and Marie will own the other 50 per cent.

To comply with the regulations, Greg will need to offer other property, such as his residence, to the bank in order to obtain the \$250,000 loan, as property that is partly owned by a SMSF cannot be used as security for a bank loan.

Greg receives approval for the bank loan and settles the investment property.

#### Case Study Four: Non-Geared Unit Trusts

Apply the same circumstances found in Case Study Three.

Instead of buying the \$500,000 property as 'Tenants in Common', a 'non-geared unit trust' is set up to purchase the property.

The name of the unit trust is The Greg and Marie Unit Trust.

The trustees of The Greg and Marie Family Superannuation Fund understand the rules that apply to non-geared unit trusts and ensure that The Greg and Marie Unit Trust structure is continuously compliant.

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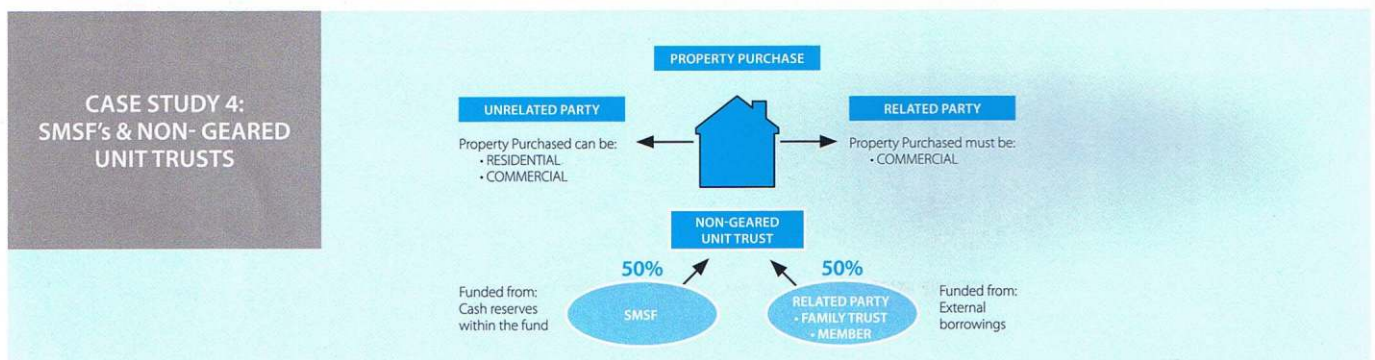
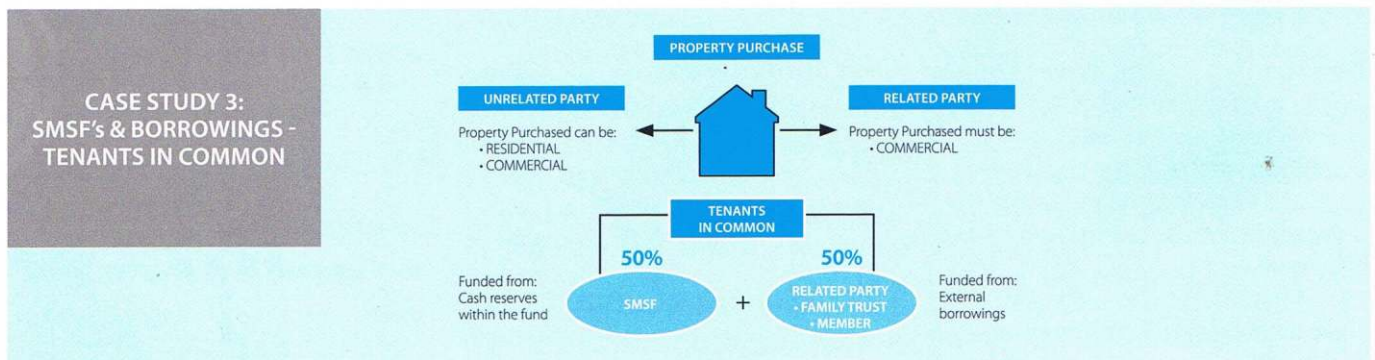
In 2012 the trustees of The Greg and Marie Family Superannuation Fund want to increase their ownership interest in The Greg and Marie Unit Trust.

The fund purchases an additional \$100,000 worth of units (being the

market value of the units) from Greg and Marie and therefore increases the percentage amount of the property it owns.

Even though Greg and Marie are related parties, the fund will not breach any

regulations because the units have been acquired at market value and The Greg and Marie Family Superannuation Fund has continuously satisfied the regulations.



**The new SMSF borrowing rules (Section 67(4A) Borrowing) and the new installment warrant arrangements**

Effective from 24 September 2007, SMSFs are allowed to borrow money under an 'installment warrant' arrangement.

Due to some of the criteria and rules surrounding purchasing property under an 'installment warrant' arrangement, you need to do the sums to ensure you will be better off in the long term as far as cash flow and tax are concerned.

Features of 'installment warrant' arrangements include the following:

1. SMSF enters into a 'limited recourse loan' with the lender and a commercial interest rate is to be paid between the two parties.

2. The monies borrowed are to be used to acquire an eligible asset (e.g. property).
3. A new company is set up (to act as the 'custodial security trustee') to acquire the property on behalf of the SMSF.
4. SMSF to receive legal title to the asset on payment of the final installment or loan amount to the lender.

At this point, the property is transferred from the custodial trustee to the superannuation fund – no CGT or Stamp Duty implications (original legal documentation to be carefully drafted).

These are just a few examples of how investing in real estate is now far more accessible to those who

perhaps did not have the funds in superannuation to make a property purchase outright. We think it provides tremendous opportunities in the real estate sector to those who can lead their clients to advisers, who can then steer them through compliance issues.

The benefits to the professional agent are obvious and could open the doors to a market of potential purchasers previously thought unavailable.

For more information on this subject, please call John Christopoulos or Robert Lissauer at Sothertons on (03) 9820 6400.