



# Own property through a SMSF

## THE ADVANTAGES



# Buying Property

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**While all types of superannuation funds are able to, and often do, hold various forms of property investments, it is generally only a self-managed superannuation fund that gives you the ability to hold the direct property of your choice – and the possibility of using the same property in your business.**

Owning property through your SMSF typically involves the fund holding a residential or commercial rental property that is leased to unrelated tenants, or indeed it could involve the fund holding the business premises through which you run your own business.



# Why own property through an SMSF?

There are a number of advantages to holding property inside an SMSF, as opposed to owning it in your own name.

## 1. Concessional tax on rental income

Where you hold an investment property in your own name, tax will broadly be payable based on your personal rate of tax, which could be as high as 46.5%. Similarly, if you were to hold an investment property through a company, the tax rate is 30%.

Due to the concessional tax rate that applies to superannuation investment earnings, rent received by your SMSF will be taxed at a maximum rate of 15%.

And, because certain expenses related to the ownership of the property such as land rates, property maintenance etc will generally be tax deductible to the fund – the effective tax rate may come down even further.

## 2. Concessional tax on future capital gains

Special superannuation tax rates also apply to any capital gain made as a result of an increase in the property's value.

As a result, depending on when you decide to sell the property, any capital gain your fund makes on the sale of the property may be completely tax-free.

To summarise:

If you sell the property while still in the "accumulation" phase, the fund will generally pay CGT of up to 10% on any growth in the property value assuming that the property has been owned for at least 12 months).

On the other hand, if you decide to sell the property after you have transferred it into the "pension" phase, within your SMSF, any capital gain will be exempt from tax altogether!

## 3. Increased superannuation opportunities

In addition to the above, where the property owned by your SMSF is the property from which you run your own business, superannuation rules require your business to pay a commercial rate of rent to the fund – providing you with a way to accelerate your superannuation savings.

The rent that your business pays into your SMSF will be tax deductible to your business, but more importantly for superannuation purposes, it will not be treated as a superannuation contribution.

Because the tax benefits available on superannuation contributions are currently limited to \$25,000 a year, or \$50,000 if you are aged 50 and over<sup>1</sup>, the ability to make tax deductible rent payments into your superannuation fund – without this rent counting towards these limits – enables you to build your retirement benefits quicker and tax efficiently.

## 4. Other benefits

Depending on your personal circumstances, there could also be other benefits from holding property within your SMSF.

For example, superannuation assets are generally protected from creditors in bankruptcy situations. So, in the unfortunate event that you fall on difficult times, holding property within your SMSF may provide you with some added protection.

Further, if you are a small business owner, superannuation assets are not included when determining your eligibility for the generous small business CGT concessions that apply when you sell your business or retire. By planning ahead, you can ensure that you better qualify for these concessions.

# How does an SMSF acquire property?

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**There are a number of ways that an SMSF can acquire a property. Firstly, where the fund has sufficient money available, it could simply buy the property. This transaction is similar to you buying property personally or through any other business structure.**

Where the fund does not have sufficient money readily available, the fund is able to borrow money to purchase the desired property. Although, it should be noted that there are special rules surrounding any borrowing through your SMSF.

Finally, if you already own property, as long as it's considered business real property (discussed later), you can either sell it to your fund or simply transfer it into your SMSF by way of an in specie contribution. Because an in specie contribution is simply a superannuation contribution that is made using an asset (rather than using money), you need to keep a close eye on your contribution limits to avoid incurring unnecessary tax penalties.

And, regardless of which approach is most suitable to you, it is important to make sure that all transactions are conducted and recorded based on market values and on commercial terms – especially when acquiring property from a related party.

## What else do I need to know?

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**When an SMSF is considering the acquisition of a property – regardless of whether it is by way of purchasing the property or transferring property in specie – there are a number of superannuation and tax rules to be aware of.**

Generally, an SMSF cannot acquire an asset from a related party. A related party includes yourself, a relative, and your business among others. However, this rule does not apply when dealing with property that is classified as business real property.

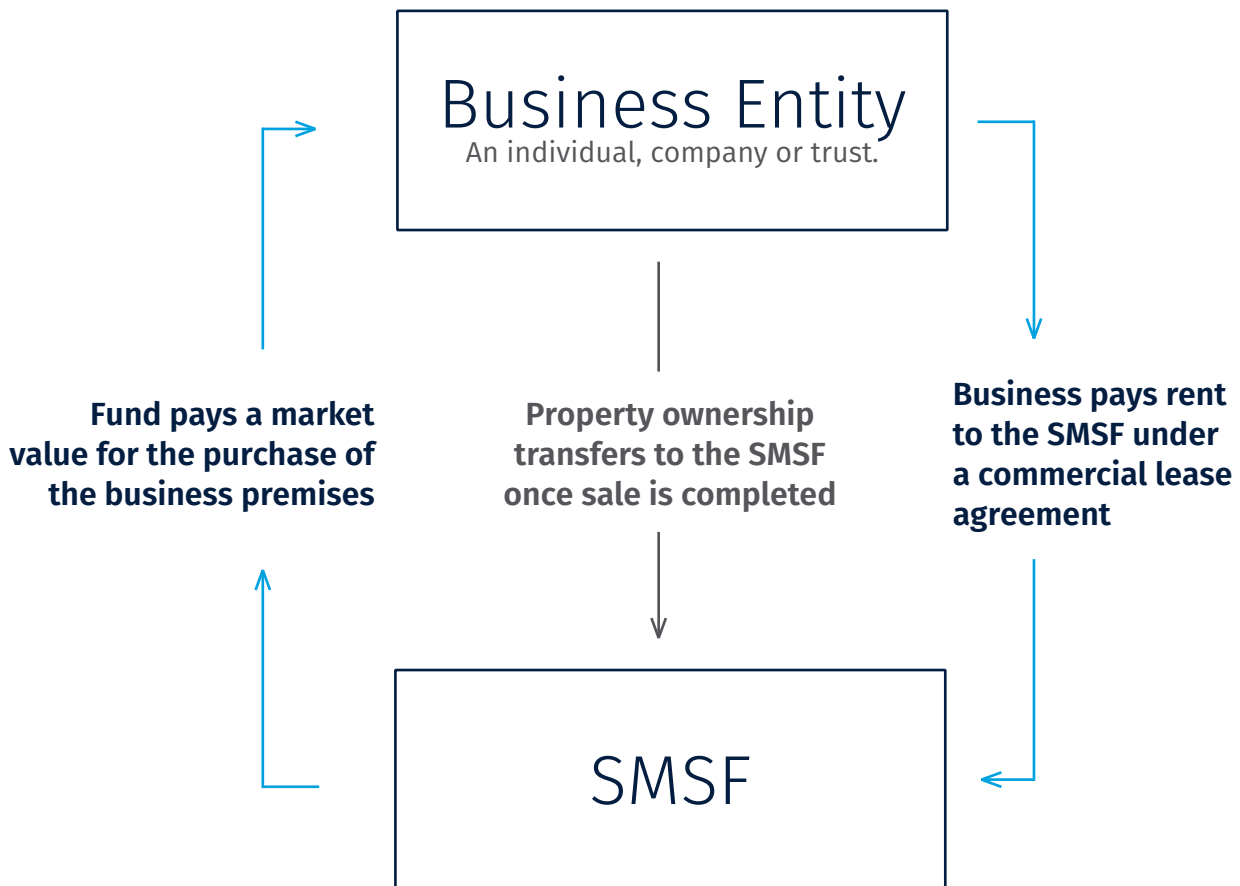
A business real property is one that is used wholly and exclusively in a business – regardless of zoning, and regardless of who is running the business i.e. it need not necessarily be your own business. So, while you can't simply transfer your current residential rental property into your SMSF, if you own property that is used in a business, you can transfer this into your fund.

When transferring property into your SMSF, you may be liable for Capital Gains Tax (CGT) and possibly stamp duty costs upon transfer. Having said that, if you currently own your own business premises, and you're considering the possibility of transferring it into your SMSF, there are a number of Small Business CGT Concessions that may be available to help manage the CGT on transfer to your fund. There may also be stamp duty concessions available depending on the relevant state, your circumstances, and the way that your fund is structured.

Once a property is owned by an SMSF, there are also rules that relate to the use of that property. In short, the property cannot be used by you personally, unless it meets the business real property requirements mentioned earlier. So, while your SMSF can lease an office or a warehouse to your business, we may need to shelve any ideas of buying your own holiday home down the coast through your SMSF.

Also, where you decide to operate your business through premises owned by your SMSF, it is important that a commercial rate of rent be paid to your fund. This makes it particularly important to conduct a thorough analysis of your business cash flows to ensure that you are not placing an unnecessary burden on your business.

The diagram below shows a typical example of a business real property transfer involving an SMSF and a related business entity:



With so many possibilities and different ways of implementing these arrangements, it is important that you plan well ahead to maximise the benefits of property ownership through your SMSF.

For the 2015 / 2016 financial year the contributions limits are:

CONTRIBUTIONS CAP		AGE OF MEMBER
Concessional such as SG and Salary sacrifice	Under age 49 at 30 June 2015: \$30,000	
Non-concessional contributions cap for 2015-16	Under age 65 at any time during 2015-16: \$180,000, or Up to \$540,000 over a three year period under 'bring-forward rule' <sup>1</sup>	Aged 65 for all of the 2015: \$180,000

# Pros and cons, and FAQs of investing in property with a SMSF

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Before retirement, capital gains and rent earned by your SMSF are taxed at only 15 per cent.

You can't live in the property and neither can family members.

You have direct control of your super investments and the diversification in your portfolios.

Renovating a property purchased through a SMSF is not allowed, whilst there is money borrowed against it.

If you use your SMSF to buy a property and hold it until after you retire, you'll pay no tax on the capital gains if you sell, or on the rent if you continue to own it.

There are costs involved to set up an SMSF and there can also be higher fees involved in getting a loan through your SMSF.

Participation of more than one family member in the fund.

Running your SMSF can be complicated, but you can use a professional to do it for you. This will ensure you are fully compliant with the rules and regulations.

## **What are the potential tax benefits of owning property inside my superannuation?**

Within the superannuation environment rental income from investment properties is taxed at 15%. This rate also applies for Capital Gains tax in the first year of ownership, after which it drops to 10% and no capital gains tax is payable on the sale of a property in pension phase.

## **Can I borrow to purchase property with my superannuation?**

Yes. Most banks provide loans to people buying property with SMSF of up to 80% of the property value.

## **Who pays the mortgage and other expenses of the property?**

The SMSF covers interest, maintenance, insurance, rates, body corporate fees, property management and any other associated property expenses. These expenses will usually be deductible to the fund.

## **Can I buy a property before my SMSF is set-up?**

No. You can not purchase a property before you have all the correct SMSF documents in place.

## **Who pays the deposit when buying my next investment property?**

The SMSF pays all deposits on investment property. No out of pocket expense are required.

## **Who can rent my superannuation property?**

The only rule when renting an investment property owned by an SMSF is you cannot rent the property to a related party. This means a member's relative, or spouse.

## **How much will the bank lend me to buy a property with my SMSF?**

Generally, banks will lend between 70% and 80% of the property value. Each loan is assessed on a case-by-case basis.

## **How does borrowing to buy a property inside superannuation affect my personal portfolio?**

Buying property with a self-managed super fund could have an impact on your personal portfolio if you are required to contribute more money into the SMSF to cover expenses. It's extremely important that members choose the right property to match your SMSF capacity (income and expenses).

## **Can I claim depreciation inside a SMSF?**

Yes. Standard deductions such as depreciation are allowable inside an SMSF.

## **What happens if I can't pay the loan for my superannuation property?**

Loans for superannuation property are non-recourse, this means that the lender is only able to take the property and has no right to the remaining assets or funds in your SMSF.

# Contact us

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