Investment Property in Self Managed Super Funds (SMSF) is still a hot topic. It is attractive because of the low tax rates available to Super funds and no tax when accessing super after age 65.

With everyone's super growing, now court cases are revealing the problems associated with incorrect documentation or poor planning and advice. See below some of the mistakes people are making with this structure for investment property funded by loan. *With our alliance partners we can help, if you wish to review your situation – call Shukri Barbara on 02 9411 8133*.

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The Top SMSF Property Investment Mistakes?

Former Prime Minister Paul Keating recently suggested that Self Managed Superannuation Funds (SMSF) should be restricted from investing in residential property

Mr Keating told the *Financial Review*, "If I was treasurer today, I would be looking very hard at the whole entitlement or availability of debt to SMSFs. They have gearing available to them and, of course, many of them are taking the option of buying residential property."

According to the latest Australian Taxation Office (ATO) SMSF statistics, real residential property represents 3.5% of the value of all assets held in SMSFs. This level of investment has been consistent since 2009 with the bulk of properties worth between $200,000 and $1 million. SMSF investment in commercial property is around 12%. However, what has changed is the number of investors with an average of 1,200 new investors using their SMSFs to purchase residential property each year. And, the explosion in limited recourse borrowing arrangements which have increased 1758% between June 2009 and June 2014.

For many SMSFs however, there are some very big risks if the borrowing arrangements and property purchases are not put in place correctly. If your SMSF breaches its compliance obligations, it is at risk of being deemed non-compliant and losing its concessional tax status and the trustees also risk being fined personally under the ATO's new penalty powers that came into effect on 1 July 2014.

Here are the top SMSF property issues:

Should your SMSF buy a property?

Liquidity, diversification and cashflow. The *Superannuation Industry (Supervision) Act* (SIS Act) requires trustees to take heed of these elements when making any investment. When an SMSF invests in real property, there is a risk that the trustees are putting all of the fund's 'investment eggs' in one basket and the rate of return will not be enough to meet the fund's obligations.

Funds in, or entering, pension phase need to meet the minimum pension drawdown requirements. The question is, will the rental yield meet the ongoing expenses of the fund including pension payments? Funds are required to increase the minimum pension drawdown over time: 4% at age 64, and 6% at age 75. That's an increase of 50% in draw down obligations. Will rent increase by 50% to keep pace?

But what if a member wants a lump sum and not a pension, where will the immediate cash come from? What about when a member dies? How will the benefits be paid out from the fund? You can't sell one room of an investment property.

Can my SMSF purchase my investment property?

A common question that often comes up is, can my SMSF buy a residential rental property, holiday home, or house from me or someone related to me? The answer is no, not unless the property is business real property (a property used wholly and exclusively for business). And, in most cases, residential property will not meet the requirements to be business real property. It's important to bear in mind that the penalty for breaching the related party investment rules is up to 12 months in jail.

Improving a property

If your SMSF has borrowed money to purchase a property, it cannot use any part of those borrowings to improve that property. Also, a SMSF cannot borrow money to repair an asset it already owns outright.

However, a SMSF can use its own money to improve or repair a property acquired with borrowings, as long as the improvements do not result in the asset becoming a different asset. For example, the trustees could not change a residential property into a childcare centre. Or, turn a vacant block of land into an investment property.

Take the example of a SMSF that borrows to buy a residential house on a large block of land ripe for development. The fund cannot subdivide the land and build another house because the borrowing rules prohibit a change in the character of an asset bought with borrowed money until the borrowings are extinguished.

Getting the essentials wrong

The common problem areas for SMSF trustees are often simple things in the rush of the moment or simply poor structuring.

The most obvious example is when a property is purchased by an SMSF but the contract is in the name of the individuals. Sometimes people just get carried away and make the purchase without thinking through the details. Or, where there is a related entity involved like a unit trust but the unit trust was not established before the property was purchased or the incorrect name is inserted on the contract or registered with the titles office

Quote of the month

"The punters know that the horse named Morality rarely gets past the post, whereas the nag named Self-interest always runs a good race." *Former Prime Minister Gough Whitlam 1989*

Refinancing – alliances with brokers

With interest rates at below 5% for fixed term loans, refinancing may result in a savings for some clients. Financing new projects with these lower rates may make some projects feasible. With the continuing low rates of interest many are now enquiring about **fixed** rates.

So to help clients analyse their situation and determine whether there is a benefit for them, we have created alliances with brokers who are able to deliver these low fixed rates. Call us on 02 9411 8133 for details.

Financial Planning with your Tax Planning

Tax planning should ideally form part of your overall financial planning, as it may well have an impact on your overall financial situation.

As we are not licenced to give investment advice, we have created alliances with licenced Financial Planners and Advisers as an additional service to clients. To get an overall perspective of a client financial situation, we have persuaded them on arrangements to attend a tax advice meeting with us and you .. when requested, or arrange for them to meet you directly at no cost to you. Call the office on 02 9411 8133 for more details.

Checklists and Templates

To make the compilation & reporting task for 2014 tax returns easier, clients of **Property Tax Specialists** receive checklists and templates to facilitate the process ... **saving them time and money** ... the 'write' way is having clear documentation. ATO way means time/money wastage with audit investigation.

Two heads are better than 1? Discuss your plans? Call to chat …

Contact us if you would like to

- review & discuss your current property & tax situation ... maybe the next deal or

- whether or not to sell a property, which one in the portfolio should be sold
- your asset protection strategy. What is your risk profile? High ..medium ..low
- structuring your next investment property. In whose name should it be?
- planning to legally minimise your tax position or just to explore the possibilities
- Subdividing a block or your Main Residence … Capital Gain or Main Residence
- **Capital Gains** on selling - a previously Main Residence .. estimate tax
- Is your Self Managed Super Fund ready to acquire a property
    1. with limited recourse loans
    2. from lending institutions or yourself
- prepare your next tax return or application to reduce your PAYG

We look forward to being of service. We also look forward to your **referrals**.

To improve our service we welcome all constructive comments on this newsletter and other materials.

Call/email **Shukri Barbara** at Property Tax Specialists at Shukri@propertytaxspecialists.com.au

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2011- **Property Tax Specialist of the Year**
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