# SMSFs and property

**THE POPULARITY OF** self-managed super funds (SMSFs) has increased substantially over the past few years. In fact, SMSFs now account for about one third of total superannuation savings.

One of their major drawcards is the broad level of investment freedom they offer. This includes the ability to invest in residential and business property, an option generally not available with other super arrangements.

### Potential tax benefits

So why use an SMSF to invest in property? Well, depending on your circumstances, it can sometimes be more tax-effective to purchase a property through an SMSF than to buy it outside super.

This is because rental income is taxed in super at a maximum rate of 15%. Once you retire and the fund is paying you a pension, rental income may be tax-free.

When the property is eventually sold, capital gains are taxed at 10% (if the investment has been owned for 12 months or more) and are potentially tax-free if a pension has started.

The table below compares the tax treatment of income and capital gains with other commonly used property ownership options.

| Tax payable on: | Property owned by: | | | |
|---|---|---|---|---|
| | Individual | Company | Super fund | Super pension |
| Rental income | Up to 45%[1] | 30% | Up to 15% | Nil |
| Capital gains[2] | Up to 22.5%[1] | 30% | Up to 10% | Nil |

[1] Ignores the Medicare levy.
[2] Assumes the asset has been held for 12 months or more.

### Strategy tips

There's a lot to consider when investigating the property investment options with SMSFs. As well as making sure it's the right option for you, there are different strategies and rules to consider, such as:

- SMSFs can buy a business property from a fund member or a related party, such as a family member or related company or trust. It's also possible to transfer ownership of a business property into an SMSF by making what's known as an 'in specie contribution'.
- SMSFs generally can't purchase a residential property from a fund member or a related party.
- Buying a property through your SMSF needs to be consistent with the fund's investment strategy.
- You can increase your SMSF's property buying power by borrowing funds. SMSFs can only borrow to invest (using a 'limited recourse borrowing arrangement') in a 'single acquirable asset', such as a single title for land and the accompanying property, but not additional items such as furnishings.
- It's possible to have up to four members in an SMSF. By adding family members, such as adult children, you could increase the fund's balance considerably and increase your capacity to buy property assets.

### Is an SMSF right for you?

While running an SMSF can give you greater control of your super and retirement savings, it's a big commitment.

All members are generally required to be fund trustees and vice versa. As a result, you are responsible for meeting a range of legal and administrative obligations and penalties apply if you don't perform your duties.

Also, to make running an SMSF a cost effective exercise, you and your fellow members will typically need upwards of $250,000 in super.

### Advice and support

Given the complexities involved, a financial planner is best set to help you navigate through the complexities of an SMSF and decide whether it's right for you.

Many planners also recommend using a comprehensive administration service that can take care of the auditing, accounting and administration needed to meet compliance obligations.

To find out more about SMSFs and investing in property, speak to the Central Coast NAB Business team.

This advice may not be suitable to you because it contains general advice that has not been tailored to your personal circumstances. Please seek personal financial and tax and/or legal advice prior to acting on this information. Before acquiring a financial CONTINUED ON PAGE 23

# Common issues raised during the SMSF audit process

**AS WE KICK** off the New Year and SMSF Audit Reporting deadlines loom, we would like to provide some information about new requirements and some reminders to assist with the preparation for the SMSF Audit.

**Outdated investment strategies**

The fund auditor is required to verify if the actual investment allocation is in line with the fund's investment strategy. Where the strategy does not align with the actual investments, the auditor may be required to report this. It is therefore vital that you ensure the investment strategy is reviewed regularly and updated when required. Aspects that must be covered in the investment strategy are risk, diversification, liquidity, insurance and the fund's ability to discharge liabilities.

- The investment strategy may need to be updated where clients:
- add a new member
- commence a pension
- segregate assets
- construct a reserve
- acquire assets under limited recourse borrowing arrangements
- acquire a property or illiquid assets.

**Consideration of insurance for members**

Another key consideration is the requirement that insurance needs to be considered as part of the investment strategy. The 2012/13 audit is the first year that this has been a requirement, so old investment strategy documents not updated since August 2012 may be queried by auditors.

**Confirmation of market value and ownership of unlisted investments**

New regulations require all SMSF assets to be valued at market value at 30 June 2013 and annually at 30 June in future years. This requirement extends to unlisted assets, which include:

- real property
- collectables and personal use assets
- business assets
- unlisted unit trusts
- shares in unlisted companies.

A detailed description of the required supporting documents for these assets should be obtained from your superannuation administrator. The SMSF financial statements and tax return cannot be completed without supporting documents to confirm both ownership and value of all assets. Trustees need to consider ongoing valuation requirements and ensure adequate supporting material can be provided.

As a Registered SMSF Auditor I work closely with many SMSF Trustees, Accountants and Financial Planners on the Central Coast, this has provided me with a wealth of experience in advising on technically challenging SMSF issues.

Harwood Chartered Accounts is a Central Coast based independent firm that offers specialised SMSF audit solutions including Financial Accounts preparation, Audit and troubleshooting to SMSF Trustees, Accountants and Financial Advisors.

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product a person should obtain a Product Disclosure Statement (PDS) relating to that product and consider the contents of the PDS before making a decision about whether to acquire the product. Past performance is not a reliable guide to future returns as future returns may differ from and be more or less volatile than past returns. The material contained in this document is based on information received in good faith from sources within the market, and on our understanding of legislation and Government press releases at the date of publication, which are believed to be reliable and accurate. Opinions constitute our judgement at the time of issue and are subject to change. Neither, the National Australia Bank (NAB) or any of the National Australia Group of companies, nor their employees or directors give any warranty of accuracy, nor accept any responsibility for errors or omissions in this document. From time to time members of the National Australia Group of companies, associated employees or agents may have an interest in or receive monetary or other benefits from the financial products and services mentioned in this document. NAB is associated with issuers of MLC Investments Ltd, MLC Ltd, WealthHub Securities Limited, Jana Investment Advisers Pty Ltd, PFS Nominees Pty Ltd, Aviva Australia Holdings Limited and National Australia Bank Ltd products and services. Our financial planners are Representatives of National Australia Bank Limited ABN 12 004 044 937 an Australian Financial Services Licensee Registered office Level 4 (UB4440), 800 Bourke Street, Docklands VIC 3008 and a member of the National Australia Group of companies.

# Don't get caught out on your SMSF obligations

**THE LAST COUPLE** of years have seen a raft of changes and new obligations placed on self managed super fund (SMSF) owners, meaning trustees, and more are due to hit later this year. This can pose quite a challenge for trustees to stay on top of their responsibilities.

One particular change that many SMSF owners are often not familiar with is the requirement to conduct a review of personal risk insurance needs on each member of their fund. Mitchell Thompson, a local financial adviser with ClearView, helped to shed some more light on the issue.

"Life insurance is not something that many SMSF owners would naturally associate with their super fund, but the requirement to perform a review of personal risk insurance needs is now mandatory. While a personal risk insurance review may not necessarily result in the fund needing to purchase life insurance, the new regulations require a valid assessment be carried out".

### The liabilities are real

"Some SMSF owners are shocked when they learn of the liability they may have if one of their fund members is under-insured and they then suddenly die or become disabled. There is a potential for a member to take legal action against the fund if they feel that the fund has not fulfilled its responsibilities".

Non-compliance is also subject to substantial monetary penalties, so it pays to get the assessment done correctly, as Mitchell pointed out. "A professional risk insurance appraisal is simple to arrange and we find our clients are pleasantly surprised at how easy it can be. Whether fund members end up needing insurance cover or not, there is peace of mind of knowing that your obligations are properly fulfilled".

### Uncovering hidden risks to business survival

A professional review can also be extended to cover other major business risks, as Mitchell elaborated. "We come across situations where a business has a key employee who is critical to the success of the business, but the business owners have not realised the enormous liability they have if that person suddenly dies or becomes disabled. It's a great relief to them when we show how such risks can be eliminated with highly cost-effective insurance solutions".

ClearView

"Another common issue we come across is when business partners have not considered the massive issues that arise if one partner dies or becomes incapacitated. We can design insurance strategies that give the remaining partner the financial power to buy out the other partners' share and provide a smooth transfer of ownership. A little professional advice can be the difference between business prosperity and a complete disaster."

To get help on any of these issues, Mitchell can be contacted on 4325 4030.

### Case study

Let's look at Toby's situation. Toby runs his own building business and with his partner, owns a SMFS which holds 100% of his accumulated superannuation. Via his SMSF, Toby has borrowed $300,000 to purchase an investment property and he makes regular contributions into the SMSF to help meet the loan repayments. Toby currently has no insurance cover.

In this situation, if Toby had an accident and was unable to work, with no income protection insurance, not only would his (and his family's) financial position suffer, he would not have the money to contribute to his SMSF to make the loan repayments. As a result the SMSF may go into a negative cash flow position and assets may need to be sold off at the wrong time to repay debt.

**Disclaimer:**
Before acting on such information you should consider its appropriateness having regard to your personal objectives, financial situation or needs. In particular you should seek financial advice and read the relevant product disclosure statement (PDS) before making a decision about a product. A copy of the relevant PDS can be obtained by contacting Mitchell Thompson on 4325 4030.

# Advanced SMSF Strategies – it's more than just control and compliance

**THE POPULARITY OF** self-managed super funds (SMSFs) continues to grow rapidly and this continues to be widely publicised. According to the Australian Taxation Office (ATO), most people who start self-managed funds say one of the main reasons they do so is to have more control over their super and greater flexibility over investments.

SMSF trustees need to look past these initial benefits and consider whether they are utilising their SMSF to its full potential. Trustees should consider advanced SMSF strategies which build and protect wealth, establish an effective gearing strategies, and to preserve and pass on wealth to your family.

There are a number of strategies in this area and unfortunately we don't have the space to cover them all. Below are a sample of some of the strategies that SMSF trustees should be utilising.

Martyn Kennedy and Tammy Barnden

### Establish and Manage Flexible Pensions

Believe it or not but there are benefits to getting older and these include the ability to establish flexible pensions like account based and transition to retirement income streams. Whilst you can commence from age 55, the magic really starts to happen from age 60 as any pension amounts taken are not reported as taxable income. Trustees should consider:

- Re-contribution strategies prior to the commencement of an income stream which could significantly reduce a potential "death tax" burden
- The use of multiple pensions to make the most of your of your tax free components, provide flexibility with pension payments and the ability to direct various pensions to the most appropriate recipient for estate planning purposes

The subject of SMSF pensions is definitely complex, however if structured correctly will not only provide you an extremely tax effective income stream in your retirement, but can provide a benefit to your family without the tax man getting his hands on it.

### Effective gearing strategies

Gearing is historically a common wealth creation strategy. Rules introduced in September 2007 allowing super funds to borrow have proven to be a popular and effective way of increasing the investment capital available to a SMSF.

The key benefits of such a strategy include:

- Leverage your superannuation savings
- Tax concessions
- Asset Protection

There are, however, inevitable a range of rules to be followed in structuring an effective borrowing arrangement within a SMSF. Getting it wrong can be an expensive exercise and if not managed correctly often can result in double stamp duty costs or the SMSF needing to sell the property at a substantial loss.

Avoid the common pitfalls and:

- Do your research, understand the lenders criteria and consider the quality of the investment
- Know your expected rental income and other cash flows to ensure serviceability of the loan now and into the future
- Establish the correct structure (including bare trust) before you sign on the dotted line and get the documentation right
- Consider your exit strategy

Advanced SMSF strategies build and protect your wealth and provide you with the ability to pass your wealth to your family in the most effective manner. Obtain the right advice from a SMSF Specialist Advisor to ensure you are using your fund to its full potential.

# Do I really need a corporate trustee for my self managed superannuation fund?

**THE ATO RECENTLY** released that corporate trustee registrations represented only 9.57% of all new SMSF's in 2013, meaning that over 90% of new SMSF's trustees were individuals.

This tells me either new trustees did not want to pay the extra cost for a corporate trustee or they did not seek advice prior to setting up their fund.

Below are some of the vital reasons we believe it is always best practice to have a special purpose corporate trustee for your SMSF:

**1. Continuous succession & estate planning flexibility**
A company has an indefinite lifespan (it cannot die), a corporate trustee can make control of SMSF more certain in the event of death or incapacity of member. In the situation of individual trustees i.e mum and dad, timely action, considerable administrative work and costs must be undertaken during a difficult time to ensure trustee/member rules are satisfied.

**2. Administration efficiently**
Members of SMSF's come and go for a variety of reasons such as death, incapacity or family break down. When members are admitted or cease membership of an SMSF with a corporate trustee, that person becomes or ceases to be a director of the corporate trustee. As there is no change to the trustees name, title to all the assets of the SMSF remains in the name of the corporate trustee. This is in stark contrast to when a new member is introduced to an SMSF with individual trustees. As all members must be trustees and all trust assets must be held in the name of the trustees, this will require the title of all assets to be transferred to the new trustees whenever a member is admitted to or exits the fund. You can imagine the paperwork, time and costs associated with the transfer of all shares, bank accounts and property etc to the new name. The cost of this activity would far outweigh the cost of setting up the correct corporate trustee structure in the first place.

**3. Greater asset protection**
Companies are subject to limited liability, if a trustee is sued for damages a corporate trustee will provide greater protection. If an individual trustee suffers any liability their personal assets may be exposed.

If your SMSF currently has individual trustees it may be an opportune time to revisit this arrangement. Morgans can provide you with professional SMSF advice to ensure your SMSF is compliant.

Always seek professional advice prior to making any decisions regarding your Self Managed Superannuation Fund.