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TRANSFERRING REAL ESTATE IN AND OUT OF SMSFS

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1 Introduction

Real property is a popular investment for SMSFs[1] (self managed superannuation funds). However, there are a number of unique issues that come with SMSFs receiving, holding and disposing of real estate. In this paper I have examined a number of those issues. Of course, with such a broad ranging topic it is not possible to deal with all issues in great detail. Therefore, I have dealt with some issues in more detail than others. In addition, given my practice is Victorian based this paper mainly focuses on state based issues (eg duty and land tax) from a Victorian perspective, although some of the other States and Territories are also considered.

The following legislation is referred to throughout this paper - the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**), the *Superannuation Industry (Supervision) Regulations 1994* (**SIS Regs**), the *Income Tax Assessment Act 1997* (**ITAA97**), the *Income Tax Assessment Act 1936* (**ITAA36**) the *Income Tax Assessment Regulations 1997* (**ITAR97**), and *A New Tax System (Goods and Services Tax) Act 1999* (**GSTA 1999**).

[1] References in this paper to self managed superannuation funds, or SMSFs, includes, where the context requires, a reference to the trustee of the SMSF in its trustee capacity

2 Issues to be considered when transferring or holding real estate to super funds

Before I get to the specific issues with transferring, holding and disposing real estate to, or from, SMSFs, I want to deal with a few preliminary considerations that arise with real estate and super funds.

2.1 Prohibition against acquiring assets from related parties

Section 66 of the SIS Act prevents an SMSF trustee from acquiring an asset from a related party unless one of the exemptions apply. Relevantly, for real estate purposes, one of those exemptions is "business real property" where such property is acquired at market value. This means that a member can contribute, or sell, their business real property to the super fund without breaching section 66.

Business real property is defined as certain interests in real property "where the real property is used wholly and exclusively in one or more businesses (whether carried on by the entity or not), but does not include any interest held in the capacity of beneficiary of a trust estate".[2]

An important part of the definition is that the land must be used wholly and exclusively in one or more businesses. This would generally rule out residential property unless the owner of the land is carrying on a residential property rental business or is a property developer and the land is held as trading stock. There is a legislative concession for farm land which allows farm land to still be classed as business real property, even if up to 2 hectares of the land is used as a residence, provided the predominate use of the property is not private or domestic.[3]

The ATO's view on what comprises business real property is set out in its extensive ruling SMSFR 2009/1. Examples of business real property include (presuming no non-business uses):

- your "classic" retail, commercial, industrial and farm land;
- a residential property used as a retail or commercial premises (eg a doctor's surgery);
- a residential property used by the owner in a rental business;
- leasehold interests in business real property;
- vacant land if it is used in a business (eg a car park);

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[2] section 66(5)
[3] section 66(6)

- land held by a property developer for the property developer's business (including where the property was held as pre-development vacant land, in the part development stage, at the completed stage and as a showroom).[4]

2.2 Market value

For SMSFs, market value in relation to real estate is specifically required in a number of circumstances. For example, in the exemption for acquiring business real property from related parties.[5] It is also more generally required for leasing real estate to related parties[6], disposing of real estate to related parties[7] and the non-arm's length income rules.[8] Market value is also required to be used in an SMSF's financial reports[9] and for pensions upon the commencement date and every subsequent 1 July.

For real estate, in addition to requiring the market value of the property, where the real estate is leased to a related party, the market value of the rent will also be required.

Market value, in relation to the value of an asset, is defined in section 10(1) of the SIS Act as follows:

> in relation to an asset, means the amount that a willing buyer of the asset could reasonably be expected to pay to acquire the asset from a willing seller if the following assumptions were made:
>
> (a) that the buyer and the seller dealt with each other at arm's length in relation to the sale;
>
> (b) that the sale occurred after proper marketing of the asset;
>
> (c) that the buyer and the seller acted knowledgeably and prudentially in relation to the sale.

There is no requirement in the SIS Act (other than in relation to certain arrangements with collectables), or the tax acts, that a particular standard of valuation must be obtained. For example, valuation evidence can range from SMSF trustee valuations, to appraisals from agents, to sworn valuation by qualified valuers. The ATO has released guidelines for valuations for SMSFs[10] and for tax purposes.[11]

In my experience, the more "formal" the valuation, the more likely it is to be accepted without scrutiny. For example, a "sworn" valuation is generally preferred. Sworn valuations can be expensive and therefore SMSF trustees may need to do a cost benefit analysis of cost vs level of protection.

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[4] SMSFR 2009/1 paragraphs 366 to 370

[5] Section 66(2) of the SIS Act

[6] Section 71(1)(g) of the SIS Act

[7] Section 109 of the SIS Act – although section 109 does not specially require assets to be disposed of at market value it does require an SMSF to deal with it assets on an arm's length basis or on terms that are no better to the other party than arm's length dealings – it is therefore generally recommended that an SMSF only dispose of assets to related parties at market value.

[8] Discussed below – again the NALI rules do not specially require market value, but again it is generally recommended that dealings with related parties be at market value to avoid the potential application of the NALI rules.

[9] Regulation 8.02B of the SIS Regs

[10] https://www.ato.gov.au/printfriendly.aspx?url=/Super/Self-managed-super-funds/In-detail/SMSF-resources/Valuation-guidelines-for-self-managed-super-funds/

[11] https://www.ato.gov.au/printfriendly.aspx?url=/General/Capital-gains-tax/In-detail/Calculating-a-capital-gain-or-loss/Market-valuation-for-tax-purposes/

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2.3 In-house asset rules

The in-house asset rules prevent an SMSF holding an investment in a related party or related trust, and making loans to related parties, if the combined value of those assets exceeds 5% of the total value of the assets of the SMSF.

The lease of an asset (including real estate) is an in-house asset unless an exception applies.[12] One such exception is the lease of business real property.[13] This could occur, for example, where a member's business premises is held by the SMSF and leased to the business entity of the member.

In order to meet this requirement, the real estate must be subject to a lease or a "lease arrangement"[14] enforceable by legal proceedings, and it must be business real property throughout the lease or lease arrangement.

The in-house asset rules are also important where the SMSF has indirectly invested in real estate via a company or a trust.

When considering the in-house asset rules, it is important to determine who is a related party or a related trust. These rules are contained in Part 8 of the SIS Act. In particular, that part contains the provisions for working out who is a "Part 8 associate." The rules are very complicated and therefore the following is a simplified overview of those rules. When considering the application of the in-house asset rules, the particular provisions of the SIS Act should be carefully reviewed.

In simple terms, Part 8 associates will include the relatives and related companies and trusts of the members of the SMSF and the SMSF's standard employer sponsor (if any). When considering whether someone is a related party or a related trust, the members of the SMSF, the standard employer sponsor and the related parties of the members and the standard employer sponsor are grouped together (**Group**).

A company will be a related party where the Group controls the company under either of the following control tests:

- the Group has sufficient influence (ie control) over the board of the company; or
- the Group controls more than 50% of the voting rights in the company.

A trust will be a related trust where the Group controls the trust under any of the following control tests:

- the Group controls the trustee/the board of the corporate trustee (directly or indirectly; formally or informally);
- the Group has entitlements to income or capital of the trust that exceeds 50% (note that 50% is ok); or
- the Group has the power to remove the trustee of the trust.

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[12] See Part 8 of the SIS Act and in particular sections 71, 82 and 83

[13] Section 71(1)(g) of the SIS Act

[14] Lease arrangement is defined in section 10(1) of the SIS Act as any agreement, arrangement or understanding in the nature of a lease (other than a lease) between a trustee of a superannuation fund and another person, under which the other person is to use, or control the use of, property owned by the fund, whether or not the agreement, arrangement or understanding is enforceable, or intended to be enforceable, by legal proceedings.

As can be seen above, control of 50% of a company or trust is OK as the rules provide that control is greater than 50%.

2.4 The sole purpose test

Section 62 of the SIS Act provides, in effect, that super funds must be maintained for the purpose of providing retirement benefits.[15] A common misconception with the operation of the sole purpose test is that a risky, or unusual investment, will cause a super fund to breach the sole purpose test. In reality, what the test is about is whether a super fund's activities result in the members, or related parties of the members, receiving pre-retirement benefits, or to put it another way, do the activities result in money being taken out of, or deprived from, the super fund? This has been confirmed in the way the sole purpose test has been applied by the Courts[16] and interpreted by the ATO.[17]

Examples of where the sole purpose test may be breached include where the super fund "employs" related parties for more than market consideration (eg a related party builder is paid excessive building fees or profit share arrangements or related parties are employed and receive inflated salaries).

2.5 Arm's length dealings

In simple terms, section 109 of the SIS Act requires SMSF trustees to deal with related parties on an arm's length basis or, if the dealings are not on an arm's length basis, the parties must not be dealing with each other on the basis that it favours the non-SMSF trustee. Like the sole purpose test, section 109 is aimed at preventing benefits being taken out of the super fund rather than a prohibition against involvement in transactions that favour the super fund.

Examples of where section 109 may be breached include where an SMSF trustee pays a related party an inflated price for services (eg building services) or receives a below market value rent.

2.6 The prohibition against borrowing

Under section 67 of the SIS Act SMSF, trustees are prohibited against borrowing unless an exception applies. The most significant exception is the ability to enter into a limited recourse borrowing arrangement (commonly known as an **LRBA**) under sections 67A and 67B of the SIS Act. LRBAs are discussed below. Importantly, if an LRBA is structured incorrectly, or ceases to be structured correctly, then the exemption will no longer apply and the borrowing will cause the SMSF trustee to breach section 67 of the SIS Act.

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[15] The actual test is more complicated than that and does allow the super fund to also be administered for certain other ancillary purposes

[16] see Swiss Chalet case Case 43/95, 95 ATC 374 and Case X6010 90 ATC 438

[17] SMSFR 2008/2

2.7 Prohibition against providing financial assistance to members

Section 65 of the SIS Act prevents an SMSF trustee from providing financial assistance to members or relatives to members. This prohibition will generally have limited application in the real estate context but could be applicable if the SMSF trustee sold real estate to the member on favourable terms. It could also apply if the member is employed by the SMSF as a builder, or other service provider, and paid in an advantageous manner (eg paid for the full price upfront when the standard practice is to be paid in stages).

2.8 Investment strategy

Under section 52B of the SIS Act, SMSF trustees must prepare, regularly review and give effect to, an investment strategy. It is not entirely clear what "give effect" to an investment strategy means. For example, if an SMSF trustee invested in real estate when the investment strategy did not allow for such investment, would this mean that the SMSF is in breach of section 52B? In practice the SMSF trustee could amend its investment strategy to permit such investment. The investment strategy rules do provide a "safe harbour" for super fund trustees that prevents members from taking actions against them for poor returns, provided the investment is undertaken in accordance with the super fund's investment strategy.[18]

2.9 Prohibition against charging assets of the SMSF

Under regulation 13.14 of the SIS Regs, super fund trustees must not give a charge over, or in relation to, an asset of the fund. Charge is widely defined to include "a mortgage, lien or other encumbrance."[19] This is an important consideration to take into account where an SMSF trustee undertakes property development. For example, it is common (in non-SMSF) developments that a developer will require a mortgage over the land or a charge from the landowner in support of the developer's loan from a bank to finance the development.

It is also important that the SMSF trustee doesn't inadvertently breach this provision in its contractual documentation. For example, a lease or a development agreement can contain a contractual term which is an encumbrance as it prevents the SMSF trustee from dealing with the land.

2.10 Trustee remuneration

Section 17A of the SIS Act provides that a fund will not be an SMSF if the trustee, or the director of the corporate trustee of the fund, receives any remuneration from the fund or from any person for any duties or services performed by the trustee or the director in relation to the fund. This is a draconian requirement as a breach of this provision will cause the SMSF to become non-compliant and there is no discretion to the ATO to treat it otherwise.

This raises the question as to whether trustees/directors can be paid for services in relation to real estate held by their SMSF (for example, improvements to the property). Such activities will not be caught by section 17A if the provisions of section 17B are complied with. These provisions include:

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[18] section 55A(5)
[19] Regulation 13.11 of the SIS Regs

- the trustee/director performs the duties or services other than in the capacity of trustee/director;
- the trustee/director is appropriately qualified, and holds all necessary licences, to perform the duties or services;
- the trustee/director performs the duties or services in the ordinary course of a business, carried on by the trustee/director, of performing similar duties or services for the public; and
- the remuneration is no more favourable to the trustee/director than that which it is reasonable to expect would apply if the trustee/director were dealing with the relevant other party at arm's length in the same circumstances.

2.11 Consequences of breaching the SIS Act and SIS Regs

Up until recently, the ATO's ability to punish SMSF trustees for breaching the SIS Act and SIS Regs comprised only of “big stick” measures. These included:

- making the SMSF non-compliant - with the result that the assets of the SMSF, less any non-concessional contributions, are taxed at the top marginal rate (potentially having the effect of losing almost half the assets of the SMSF in tax);
- disqualifying the SMSF trustees/directors;
- taking the SMSF trustees/directors to the Federal Court to seek civil or criminal penalties; and
- for a breach of section 66, a penalty of up to 12 months imprisonment could also be sought.

Due to the drastic nature of these penalties the ATO was often reluctant to enforce them except in the most serious of breaches. As a result, a new penalty regime was introduced from 1 July 2014. Under this regime the ATO has a number of new penalty options including:

- fining SMSF trustees/directors for breaches of the SIS Act (the fines range from $850 to $10,200 per offence);
- directing the SMSF trustee to rectify a breach; and
- directing that the SMSF trustee/director attend an SMSF education course.

2.12 Tax considerations

The starting point when considering tax for real estate held by SMSFs is that section 295-85 of the ITAA97 deems that (almost all) CGT assets will be held on capital account. This means, for example, that even land bought with the intention to sell for a profit, or used in a property development business, will still be held on capital account and qualify for the CGT discount (if held for 12 months).

However, this rule does not apply to assets held by companies or trusts that an SMSF has invested in, even if the SMSF holds all of the units or shares. For trusts, if the land is deemed to be on income account then the proceeds from the sale of the land will flow through to the SMSF as income even if the asset would have been on capital account if held directly by the SMSF. Dividends from companies will also be on income account.

In any event, there is not a large tax differential between the 10% rate for a discounted capital gain and the 15% rate for income and there is no difference if the SMSF is fully in “pension phase” as both income and capital are not taxed.

There are a couple of specific tax measures which can apply to super funds. These are considered below:

2.13 Non-arm's length income (NALI)

The non-arm's length income (**NALI**) rules tax certain types of income at the top marginal tax rate (currently 47% (including the deficit levy)). It is beyond the scope of this paper to go through the non-arm's length income rules in detail.[20] However, briefly, they will catch:

- income derived as a result of non-arm's length dealings;
- private company dividends that are derived as a result of non-arm's length dealings;
- distributions from non-fixed trusts (eg discretionary trusts); and
- distributions from fixed trusts where the fixed trust's income was derived from non-arm's length dealings.

In a real estate context, the non-arm's length rules will generally be avoided if all of the dealings with related parties are undertaken on an arm's length (commercial/market value) basis.

2.14 Public trading trust rules

The public trading trust rules apply so that a trust is taxed like a company. These rules apply where a unit trust is carrying on a trading business and certain other conditions apply. One of those conditions is that super funds (and other exempt entities) hold at least 20% of the units in the unit trust. There is a claw out where the unit trust only holds land for the purpose of deriving rent.

In a real estate context, this means that if an SMSF holds at least 20% of the units in a unit trust that in turn conducts a property development business, then that unit trust will be taxed like a company and the flow through nature of the unit trust will be lost. Therefore, income derived by the unit trust will have to be paid through to the unit holding SMSF as a franked distribution.

Again, a detailed discussion of the public trading trust rules are beyond the scope of this paper.[21]

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[20] For a detailed examination of the non-arm's length rules see Simon Tisher's paper "Non-arm's length income- how does it apply and where is it at?" which he presented at The Tax Institute's 2014 National Superannuation Conference

[21] For a detailed examination of the public trading trust rules see my article "Superannuation funds and public trading trusts" at http://sladen.com.au/news/2014/8/25/superannuation-funds-and-public-trading-trusts

3 Transferring real estate into super funds

There is generally no issue with the acquisition of real estate from unrelated parties as all of the SIS and tax act requirements listed above are aimed at related party transactions. For related party transactions, in contrast, many of the requirements referred to above must be considered.

The two ways of transferring real estate into super funds is via contribution in-specie and via a sale. Both of those methods are considered below.

3.1 Contribution of real estate

Real estate can be contributed to a SMSF by way of an in-specie transfer of the real estate. The prohibition against acquiring assets under section 66 of the SIS Act will apply to such contributions. Therefore, it is important that where the contribution is made by a related party, the real estate is business real property and the real estate is acquired at market value. For the latter requirement, the ATO has accepted that it will be satisfied if the contribution is recorded in the SMSF's accounts at its market value.[22]

For contributing real estate it is important to consider the following:

- The contribution caps;
- Whether the contribution is a concessional or a non-concessional contribution;
- Whether the SMSF can accept the contribution.

3.1.1 Non-concessional contributions

Most contributions of real estate are made by the members of the SMSF and as such will be treated as non-concessional contributions.[23] Such contributions have the advantage of the larger contribution caps (currently $180K or $540K using the "bring forward rule").

3.1.2 Concessional contributions

However, it is possible to make concessional contributions by way of transfer of real estate. For example, contributions by other entities, including in-specie contributions, will generally be concessional contributions.[24] Additionally, contributions by members for which they validly claim a deduction will be treated as a concessional contribution.[25] Concessional contributions have a lower

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[22] See SMSFR 2010/1 at para 39
[23] Section 292-90(2) of the ITAA97
[24] Sections 291-25(2)(a) and 295-160 of the ITAA97
[25] Sections 291-25(2)(a) and 295-190 of the ITAA97

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cap (currently $30K or $35K for those aged 50+) and therefore are generally only useful as a "top up" for non-concessional contributions.

3.1.3 Non-concessional contributions by direction

Care should be taken where it is intended that non-concessional contributions are to be made but where the contributions will not be made directly by the member. For example, a member has an unpaid present entitlement (**UPE**) in a discretionary trust and instead of being paid the UPE the member directs that the trustee of the trust transfer a commercial property held by the trust to the member's SMSF as a non-concessional contribution.

On the face of it, such contributions are concessional contributions as they are contributions "to provide superannuation benefits for someone else."[26] However, if the contribution can be shown to be at the direction of a member then it could be argued that such contribution is a non-concessional contribution.[27]

3.1.4 Staggering contributions

Contributions can also be staggered over 2 financial years. For example, contributions in June could equal $205K[28] per member ($410K per couple) and July could equal $575K[29] per member (or $1,150,000 per couple). That is, a couple could contribute up to $1,560,000 of real estate in a relatively short time. To the extent real estate is worth more than this, the balance could be contributed 3 years later (after the expiry of the bring forward period) or sold across to the SMSF.

3.1.5 Work test

Where members are aged 65+ it is important to consider the restrictions in relation to the acceptance of contributions. For example, for members aged from 65 to 75, the SMSF can only accept contributions if the member satisfies the "work test" of 40 hours of work in 30 consecutive days during the financial year. Members of that age also cannot access the "bring forward rule" (ie they can only make annual contributions – currently $180K). Once a member turns 75 only super guarantee contributions can be accepted on behalf of a member.

3.2 Straight sales of real estate to an SMSF

No issues generally arise with purchase of real estate from related parties. As noted above, purchases from related parties are permitted for business real property acquired at market value and the terms and dealings with the party are otherwise on commercial terms.

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[26] Item 1 of section 295-160 of the ITAA97

[27] For example, the ATO has accepted constructive payments in SMSFR 2009/2 – see paragraphs 42 and 43

[28] Ie $180K of non-concessional contributions and $35K of personal concessional contributions (assuming the member is aged 50+)

[29] Ie utilising the "bring forward rule" $540K and $35K of personal concessional contributions (assuming the member is aged 50+)

3.3 Terms contract sales of real estate to an SMSF

Terms (instalment) contracts can be used for a sale of real estate. Again, terms contract real estate purchases from related parties are permitted provided the real estate is business real property acquired at market value and the terms and dealings with the related party are otherwise on commercial terms.

The ATO has accepted that terms contracts do not constitute a borrowing (and therefore does not cause the SMSF trustee to breach section 67 of the SIS Act).[30] The same cannot be said for vendor finance arrangements which will, in the ATO's view, constitute a borrowing.[31]

Terms contracts are particularly attractive in Victoria as duty is not payable until the transfer of land is exchanged on the payment of the last instalment (which may be many years after signing) even though the possession of the real estate will pass on the payment of the first instalment.

3.4 Capital gains tax

The transfer of real estate to an SMSF may trigger duty capital gains tax (CGT). The CGT could be reduced by the use of the general 50% discount, existing capital losses, the use of the small business tax concessions or by making personal deductible contributions.

Any CGT payable will be a cost of the transaction. Unlike duty or GST, CGT is not necessarily a sunk cost but rather the CGT is brought forward (ie in most cases CGT will eventually be triggered).

3.5 Duty

Most jurisdictions have a duty exemption (or nominal duty) that applies to contributions of real estate from members to SMSFs. For example, the requirements in Victoria are:

- the SMSF must either be a complying superannuation fund at the time of transfer, or will be a complying fund within 12 months after the transfer of the property;
- the transfer must be made without monetary consideration (i.e. a contribution of the property rather than a sale); and
- that there is no change in the beneficial ownership of the property – the Victorian State Revenue Office accepts that a contribution of property to a SMSF, where the benefit of the property is allocated to the member account, will not result in a change in beneficial ownership.

Below is a summary of whether a duty exemption applies for the transfer of real estate to an SMSF in each Australian jurisdiction. Please note I have reviewed the applicability of duty in each jurisdiction but I am not an expert on jurisdictions outside of Victoria. **Advice should be sought from an experienced duty lawyer in the relevant jurisdiction before transferring real estate to an SMSF**.

[30] SMSFR 2009/2 see paras 52 and 76
[31] SMSFR 2009/2 see paras 72 and 73

State	Is duty payable when property is transferred into a SMSF?
VIC[32]	No - S 41 – contributions only **Conditions** • The transfer of dutiable property must be made without monetary consideration to a trustee of a super fund, where there is no change in beneficial ownership • A transfer of property to a trustee of a super fund by a beneficiary of the fund does not effect a change in the beneficial ownership of the property
NSW[33]	Yes, $500 - S 62A **Conditions** • The transferor must be the only member of the super fund or the property is to be held by the trustee solely for the benefit of the transferor • Property or proceeds of sale of property cannot be pooled with property held for another member • No other member can obtain an interest in the property or proceeds of sale • Property is to be used solely for the purpose of providing a retirement benefit to the transferor
WA[34]	Yes, $20 - SS 122 – 124 – Also applies to sales of real estate **Conditions** • There must be consideration for the transfer • Only the transferor can be a member of the super fund • Property can only be held in super fund specifically for the transferor and cannot be pooled with the assets of another member and no other member can obtain an interest in the property • Property, or if sold, the proceeds, can only be held in the superannuation fund to be provided to the transferor as a retirement benefit • Nominal duty is chargeable on a transfer of dutiable property by a person to the trustee of a superannuation fund that is an employer-sponsored fund where there is no consideration for the transfer
QLD[35]	Yes, ad valorem

[32] *Duties Act 2000* (VIC)
[33] *Duties Act 1997* (NSW)
[34] *Duties Act 2008* (WA)
[35] *Duties Act 2001* (QLD)

SA[36]	Yes, ad valorem
NT[37]	Yes, ad valorem
TAS[38]	Yes, ad valorem
ACT[39]	Yes, ad valorem

3.6 GST

Where the transferor of non-residential property is registered for GST, then GST must be considered. Where the recipient is not registered for GST and the transfer is treated as a taxable supply, then 1/11th of the market value of the property will be payable by the transferor as GST, while the unregistered recipient will not be able to claim back the GST.

In such situations, the GST will be a sunk cost of the transfer. In scenarios like this, it should be considered whether the transferor can deregister (after taking into account any adjustments), or whether the recipient can register for GST. In cases involving the latter, potentially no GST will be triggered on the basis that the transfer is not a taxable supply. The parties consider that the transfer of the real estate is not a taxable supply because it is between associates who are each registered for GST without consideration in accordance with section 72-5 GSTA 1999.[40] Alternatively, the transfer would be GST free if the going concern exemption applies.[41] If neither of those exemptions apply, provided the SMSF is registered for GST, then it could claim back any GST payable on the transaction.

3.7 Costs of the transfer of real estate

Where real estate is transferred into an SMSF the costs of such transfer need to be considered. Some costs will be "sunk costs" such as duty, non-claimable GST and advisory costs. These costs would not be payable but for the transaction. Other costs are "brought forward costs" that would be triggered in any event but have been brought forward, for example CGT.

An analysis should be undertaken where a comparison of these costs vs the tax savings of holding the real estate in the SMSF should be considered.

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[36] *Stamp Duties Act 1923* (SA)
[37] *Stamp Duty Act 1978* (NT)
[38] *Duties Act 2001* (TAS)
[39] *Duties Act 1999* (ACT)
[40] See Interpretative Decision ATO ID 2001/503 (distribution in specie for a creditable purpose)
[41] Section 38-325 of the GSTA 1999

4 Holding real estate

4.1 Risks

An often overlooked consequence of holding real estate in a SMSF is the commercial risks associated with holding real estate. Personal liability claims from tenants, visitors and tradespeople injured on the property could arise. Other claims could include claims relating to property development on the real estate, contractual disputes with tenants and seeking to recover losses from tenants.

Of course, many of these risks can be protected against with appropriate insurance cover but losses could still arise, for example, if the claim is not covered by the insurance policy or the insurer rejects the claim. Any losses will put the other assets of the SMSF at risk and to the extent that the SMSF assets cannot satisfy the claim the SMSF trustee(s) will be personally liable.

An example of the personal liability of individual trustees is the decision of *Shail Superannuation Fund and Commissioner of Taxation*[42]. In that case, the trustees of the SMSF were husband and wife. The husband unlawfully transferred over $3 million of the SMSFs cash to his account in Turkey and fled Australia. The SMSF was made non-compliant and issued with a tax assessment of over $1.5 million. The SMSF had no, or negligible, assets while the husband could not be located. The wife was therefore found to be personally liable for all of the SMSF's tax debt.

Options for protecting the other SMSF assets, and the members, against potential liabilities of real estate include:

- Holding and maintaining appropriate insurance (including appropriate coverage and levels);
- Using a corporate trustee – this will mean that any claims will not be made against the members as individual trustees but rather they will be made against the corporate trustee (except if the directors are personally liable – which can occur in certain circumstances under certain legislation or common law);
- Ensuring, wherever possible, that the directors of the SMSF trustee do not give personal guarantees – guarantees undermine the protection of using a corporate trustee – although they will often be required in a LRBA;
- Using interposed entities to hold the real estate (eg companies and trusts) – this will help segregate the risks of the real estate from the other assets of the SMSF while continuing to keep the "beneficial interest" of the asset in the SMSF;
- Using a standalone SMSF to hold the real estate – this should be considered where the particular real estate is higher risk (eg contamination risks or where property development is involved).

[42] [2011] AATA 940

4.2 In-house asset issues

As noted above, assets of an SMSF cannot be leased to related parties unless its business real property.

4.3 NALI

Again, as noted above, the NALI rules can apply to income derived from assets of the SMSF (or from income derived by SMSFs from entities) where the parties to the arrangement are not dealing with each other at arm's length and the SMSF derives more income that it would have had the parties been dealing with each other at arm's length.

Examples of where the NALI rules could be triggered in a real estate context include:

- Payment of higher than market value rent to an SMSF by a related party tenant[43];
- Non-commercial LRBAs with related parties[44];
- The charging of excessive service fees by interposed entities controlled by an SMSF.[45]

4.4 Land tax

Land tax must be considered for real estate held by SMSFs. In Victoria[46] and NSW[47], SMSFs are excluded from the regimes that assess a higher rate of land tax on trusts.

In addition, in Victoria, SMSFs are not aggregated. This means that significant land tax savings can be achieved by using separate SMSFs for separate real estate. Of course, any land tax savings will be offset against the additional cost and complexity in having multiple SMSFs.

[43] TR 2006/7 para 72
[44] ATO ID 2014/39 and ATO ID 2014/40
[45] TR 2006/7 paras 130-
[46] In Victoria it's the trust surcharge regime to which SMSFs are excluded – see section 46A(3)(c) of the Land Tax Act 2005
[47] In NSW it's the special trust regime which doesn't apply to SMSFs – see section 3A(4)(d) of the Land Tax Management Act 1956

5 Structures to hold real estate

An alternative to SMSFs holding real estate directly is to hold indirect interests in real estate via structures such as trusts and companies. For a more in-depth analysis of various structures available see my paper *SMSFs Engaging in Property Developments.*[48]

Some of the main considerations when using structures are:

- Real estate can be held on income account and the proceeds will flow through to the SMSF as income (even though the real estate will would have been a capital asset it was held by the SMSF);
- The in-house asset rules must be considered (as discussed above);
- Trusts can be taxed as companies if the public trading trust rules apply (as discussed above);
- Trusts and companies with SMSF investors can only borrow if the trust or company is "unrelated", satisfies the "pre-99" requirements or the interest held by the SMSF is an in-house asset that is less than 5% of the assets of the SMSF.[49]

48 http://static1.squarespace.com/static/516cccdae4b0bacecd415c77/t/540d59bae4b0aa09e97e9079/1410161082175/TEN+SMSF+Paper.pdf

49 Ibid – see my paper for further explanation of these types of arrangements

6 Developing real estate in super funds

There is a common misconception that SMSFs cannot undertake property development. The SIS and tax laws do not prevent property development, rather a breach will occur if the way property development is conducted causes the SMSF trustee to breach the SIS laws or the adverse tax consequences. For an in-depth analysis of property development by SMSFs, see my paper *SMSFs Engaging in Property Developments.*[50] For the purpose of this paper I will confine my comments in relation to the issue of using a related party builder to conduct the development.

6.1 Issues with related party builders

A significant recent development for SMSFs undertaking property development is the ATO's view on the application of the prohibition of SMSFs acquiring assets from related parties (section 66 of the SIS Act) to building contracts with related party builders.

The ATO has made it clear, in its view, where, under a building contract, a related party builder supplies materials to the SMSF, that such a supply of such materials will be in breach of section 66.[51]

Although, on its face, this view would appear to rule out the use of related party builders, it is still possible provided that the building arrangement is structured correctly so that the SMSF doesn't acquire the materials from the related party builder. The "cleanest" way of achieving this is where the SMSF acquires the materials directly and the related builder just provides the construction services using the SMSFs materials.

That option is sometimes undesirable as the related party builder will have contacts and arrangements with suppliers that the SMSF will not. Therefore, an alternative arrangement is for the SMSF trustee to appoint the related party builder as its agent/attorney to acquire the materials on its behalf.[52] If this option is used, the related party builder must be very diligent to ensure such materials are paid for by the SMSF, rather than by the builder and reimbursed by the SMSF, as that may cause there to be an acquisition of the materials from the related party builder.

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[50] http://static1.squarespace.com/static/516cccdae4b0bacecd415c77/t/540d59bae4b0aa09e97e9079/1410161082175/TEN+SMSF+Paper.pdf

[51] See SMSFR 2010/1 para 19, December 2010 NTLG Superannuation Technical Sub-Group meeting minutes, December 2011 NTLG Superannuation Technical Sub-Group meeting minutes March 2013 NTLG Superannuation Technical Sub-Group meeting minutes and September 2013 NTLG Superannuation Technical Sub-Group meeting minutes

[52] The ATO has accepted such arrangement will not breach section 66 - December 2011 NTLG Superannuation Technical Sub-Group meeting minutes

7 Dealing with liquidity issues with real estate

One of the main issues of holding real estate in an SMSF is the issue of liquidity. Liquidity issues arise because of the difficulties of putting cash into a SMSF (due to the restrictions on borrowing and making contributions). Liquidity issues commonly arise when the SMSF is in “pension phase” requiring the SMSF to pay increasingly higher levels of pensions as the members age. This can cause problems where the rent from real estate is insufficient to meet the minimum pension payments. Liquidity issues can also arise in “accumulation phase” where the SMSF is unable to lease out the real property and therefore has insufficient income to meet the SMSF expenses.

Options for dealing with liquidity issues include:

7.1 Contributions

Contributions can be a great way of adding liquidity into an SMSF. However, contributions have a number of limitations:

- Contributions caps – if the members have already maximised their contributions caps no further contributions can be made without attracting excess contributions tax[53];
- Members aged 65 to 75 – the work test – members in this age bracket can only make or have contributions made on their behalf if they meet the work test (40 hours of work in 30 consecutive days during the financial year);
- Members aged 75+ - these members cannot make personal contribution and can only have super guarantee contributions made on their behalf;
- Personal deductible contributions – these contributions have a number of preconditions[54] with the result that not all members can make such contributions.

7.2 Rollovers

To the extent that the members have benefits in another super fund, those benefits could be rolled over into the SMSF to increase liquidity.

[53] For the 2015/16 year the concessional contributions caps are $30K for members aged less than 50 and $35K for members aged 50+ and the non-concessional caps are $180K and if the member can access the “bring forward rule” $540K over 3 years
[54] For example satisfying the “10% test”, certain notice requirements and having sufficient assessable income

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7.3 Going back into accumulation phase

Where liquidity issues are caused by the requirement to make pension payments an option for the SMSF is to go back into accumulation phase in whole or in part. This of course means that some or all of the income of the SMSF will be taxed but it will also reduce the amount of pension payments.

7.4 Adding members to the SMSF

Adding members (and their benefits or contributions) can add liquidity into the SMSF. Issues can arise with adding members including:

- Adding younger members who cannot receive pensions can mean the SMSF moves to being 100% in pension phase to partially in accumulation phase;
- Adding in children into their parents SMSF can result in control issues both during the parent's life and after their death;[55]
- The SMSF may already have 4 members meaning that no more members can be added.

7.5 Selling the real estate

Selling the real estate is the ultimate solution to liquidity issues as the proceeds can then be invested in more liquid assets. This solution is not always desired and will depend on whether the members wish to retain the property or not.

7.6 Transferring the real estate out as a benefit

This option is discussed below.

7.7 Dealing with the death of a member

This issue is discussed below.

[55] For more information about succession issues with SMSFs see my paper - *Incorporating Superannuation into Estate Planning: Common Challenges* - http://sladen.com.au/news/2014/8/12/incorporating-superannuation-into-estate-planning-common-challenges

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8 Paying benefits through the transfer of real estate

There may be a number of reasons why members wish to transfer real estate out to the members in the form of a benefit. This includes to solve liquidity issues (as discussed above) or because the members wish to use the property for personal uses rather than for investment purpose in the SMSF.

Like all things super, there are a number of issues to consider when transferring real estate as the payment of super benefits:

8.1 Form of payment

An asset can be transferred from an SMSF to a member as an in-specie lump sum. As a general rule an SMSF cannot make an in-specie pension payment.[56]

An exception to the inability to pay pensions by in-specie transfers of assets is where a pension is commuted in part.[57] However, this exemption does not apply if the pension is commuted in full.[58]

If the pension is commuted in part by way of a transfer in-specie of an asset, the in-specie transfer of the asset will count towards the minimum pension payment requirements (for both an account based pension and a transition to retirement income stream).[59] Again, this will not apply for a full commutation.[60]

Payments (including in-specie transfers) as a result of a part commutation of a pension do not count towards the maximum pension payment limit for a TRIS provided the commutation payment is made on or after 16 February 2008.[61]

If the pension is commuted in part then it will continue to be in “pension phase” while a full commutation will result in the pension ceasing and the asset being out of “pension phase”.

So what does all of the above mean? In summary, it means:

- Assets can always be transferred in-specie as a lump sum benefit (if such a lump sum can be paid);
- Generally, assets cannot be transferred in-specie pension payment;
- However, assets can be transferred in-specie if the pension is commuted in part and such transfer will count for the minimum pension requirements but not for the maximum.

[56] See regulation 6.01 of the SIS Regs and APRA’s Superannuation Circular No. I.C.2 paras 9 and 10
[57] SMSFD 2013/2 see paras 9 and 15
[58] SMSFD 2013/2 see para 16 and 17
[59] SMSFD 2013/2 see paras 1 and 15
[60] SMSFD 2013/2 see paras 2 and 17
[61] SMSFD 2014/1 see para 2

The last point means that the transfer of an asset can effectively be paid as a partial commutation of a pension, count for the minimum pension payments, not count for the maximum TRIS pension payments and continue to be "pension phase". It should be noted that a TRIS can only be commuted to the extent the benefits are unrestricted non-preserved or one of the other narrow exemptions.[62] This will often mean that this partial commutation option cannot be used for a TRIS but rather that the member would have to wait until they met a full condition of release (as discussed below).

8.2 Condition of release

In the context of transferring real estate as pension payments, the condition of release requirements can be important. For example, if a lump sum benefit is required, then the member will either have to be aged 65+ or meet one of the other full conditions of release (eg permanent incapacity, terminal illness or aged 55 and permanently retired etc). The same flexibility applies to account based pensions with the additional advantage of a partial commutation retaining "pension phase".

While in theory the same could be achieved with TRISs this would require the member to have sufficient unrestricted non-preserved benefits to effect the transfer.

8.3 Tax to members

The transfer of real estate in-specie will be treated as a lump sum benefit payment to the member unless it qualifies as a partial commutation of a pension (as discussed above).

If a partial commutation of the pension occurs the commuted amount will be taxed as a pension payment unless the member has made an election under regulation 995-1.03(b) of the ITAR97 for that payment not to be treated as a superannuation income stream benefit (effectively, for the payment to be treated as a superannuation lump sum).[63]

If the member is aged 60+ the benefits will be tax free regardless of whether they are a pension or a lump sum. If the member is aged less than 60 then the taxable component will be taxed concessionally.[64]

8.4 Tax to SMSF

If the SMSF is not in pension phase (to the extent of the real estate) or the lump sum results in a full commutation of the pension then the transfer of the real estate will result in a taxable capital gain. Capital gains are taxed at 10% if the real estate is held for more than 12 months (otherwise 15%). The taxable capital gain will be reduced if the SMSF is in unsegregated pension phase for the part of the year.

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[62] SMSFD 2004/1 para 20
[63] TR 2013/5 para 48
[64] For lump sums the lifetime low rate cap amount of up to $195,000 (for the 2015/16) is taxed at 0% with the balance taxed at 15% plus levies. For pensions, the pension will be included in the member's assessable income and taxed at marginal rates less a 15% rebate.

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8.5 Duty

The transfer of real estate from an SMSF to a member is a dutiable transaction and will attract duty unless an exemption applies.

In Victoria, a duty exemption applies for transfers of real estate to members[65]. In order to satisfy the exemption a number of requirements must be met including that the member was a member of the SMSF at the time the real estate was acquired by the SMSF and that the value of the real estate does not exceed the member's interest in the SMSF (if the value does exceed the member's interest then they are entitled to an exemption up to the value of their interest and the balance is dutiable).

Below is a summary of whether a duty exemption applies for the transfer of real estate out of an SMSF in each Australian jurisdiction. Please note I have reviewed the applicability of duty in each jurisdiction but I am not an expert on jurisdictions outside of Victoria. **Advice should be sought from an experienced duty lawyer in the relevant jurisdiction before transferring real estate to an SMSF**.

State	Is duty payable when property is transferred OUT OF a SMSF?
VIC[66]	No - S41A **Conditions** • A transfer of dutiable property to a beneficiary of the fund • Duty, if applicable, was paid when the dutiable property becoming part of the fund or the Commissioner is satisfied that the duty will be paid • The beneficiary was a beneficiary when the property first became part of the fund • The dutiable value of the property transferred does not exceed the value of the beneficiary's interest in the fund • If a beneficiary would be entitled to an exemption from duty, but for the dutiable value of the property exceeding the value of the beneficiary's interest in the land, the beneficiary is entitled to a concession from duty in respect of so much of the dutiable value of the dutiable property that does not exceed the value of the beneficiary's interest in the fund
WA[67]	Yes, nominal - S 127 **Conditions** • Nominal duty is chargeable in respect of a transfer of, or an agreement for the transfer of, dutiable property from the trustee of a superannuation fund to a member of the fund, or the member's dependent or legal representative if the member has died • The member must have been a member of the fund when the property first

[65] Section 41A of the Duties Act
[66] *Duties Act 2000* (VIC)
[67] *Duties Act 2008* (WA)

	became part of the land • The unencumbered value of the property transferred must not exceed the value of the member's interest in the fund • No consideration must have been paid for the transfer or agreement
NSW[68]	Yes, ad valorem
QLD[69]	Yes, ad valorem
SA[70]	Yes, ad valorem
NT[71]	Yes, ad valorem
TAS[72]	Yes, ad valorem
ACT[73]	Yes, ad valorem

8.6 GST

The GST consequences of the transfer of real estate from an SMSF to a member are the mirror of those that apply to the transfer of real estate from a member to an SMSF (as discussed above).

[68] *Duties Act 1997* (NSW)
[69] *Duties Act 2001* (QLD)
[70] *Stamp Duties Act 1923* (SA)
[71] *Stamp Duty Act 1978* (NT)
[72] *Duties Act 2001* (TAS)
[73] *Duties Act 1999* (ACT)

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9 Paying death benefits through the transfer of real estate

In many respects, paying a death benefit through the transfer of real estate is the same as paying a benefit to a member by way of transfer of real estate. However, there are a number of particular issues that arise for death benefits, including:

9.1 Who can receive death benefits

Death benefits can generally only be paid to a member's dependants[74] or their legal personal representative (ie their deceased estate).[75] Dependants include a member's spouse and child. It also includes someone who is financially dependent on the member, or an interdependent[76] of the member, at the time of the member's death.

9.2 Form of payment

Death benefits can be paid as lump sums and pensions. While lump sums can be paid to any dependant or the legal personal representative; pensions can only be paid to children in the following circumstances[77]:

- If they are aged less than 18,
- They are aged between 18 and 25 and were financially dependent on the member just before the member's death; or
- They are disabled.

The above restrictions apply to both death benefit pensions and reversionary pensions.

Pensions paid to non-disabled children must be commuted when the child turns 18.[78]

If the member dies with a pension benefit and the member has nominated a permitted reversionary pensioner then that pension will be "inherited" by the reversionary pensioner.

As noted above, real estate can be transferred to a pensioner as a partial, or a full, commutation of a pension. The same issues arise in relation to the commutation of a death benefit pension as arise to a member benefit pension. These are discussed above.

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[74] As defined in section 10(1) of the SIS Act
[75] Regulation 6.21 of the SIS Regs
[76] As defined in section 10A of the SIS Act
[77] Regulation 6.21(2A) of the SIS Regs
[78] Regulation 6.21(2B) of the SIS Regs

9.3 Benefits must be paid as soon as practicable

Death benefits must be paid as soon as practicable after the death of a member.[79] Soon as practicable is not defined in the SIS Regs. However, the explanatory statement[80] to the regulations that introduced regulation 307-125.02 into the ITAR97 (which has the concept of paying death benefits as soon as practicable) gives examples that range from 1 month to 3 and a half months.

9.4 Tax to recipients

The taxation of death benefits depends on the form of the payment and whether the recipient is a death benefits dependant or not.

If the death benefit is a lump sum then it will be tax free if the recipient is a death benefits dependant while if it is paid to a non-death benefit dependant (eg independent adult children) the taxable component (taxed in the fund) is taxed at 15% plus levies.[81]

The taxation of a pension payment will depend on the age of the deceased and the recipient. If both are aged less than 60 at the date of the deceased's death then the taxable component will be included in the recipient's assessable income and taxed at their marginal rates with a 15% rebate[82] (until they turn 60 it will be tax free). If one or both of the members or the recipients are aged 60+ at the date of the deceased's death the pension will be tax free.

9.5 Tax to SMSF

If the deceased member was not receiving a pension then the transfer of the real estate will result in a taxable capital gain. Capital gains are taxed at 10% if the real estate is held for more than 12 months (otherwise 15%). The taxable capital gain will be reduced if the SMSF is in unsegregated pension phase for the part of the year.

If the deceased member was receiving a pension at the date of their death, then the "pension phase" will continue regardless of whether a reversionary pension is payable or the death benefit is paid out as a lump sum.[83] For the latter, a proviso is that the death benefit is paid out as soon as practicable.

9.6 Duty

The transfer of real estate from an SMSF to a recipient as a death benefit is a dutiable transaction and will attract duty unless an exemption applies.

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[79] See regulation 6.21(1) of the SIS Regs
[80] Explanatory statement to the *Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013*
[81] The taxable component not taxed in the fund is taxed at 30% plus levies
[82] The taxable component not taxed in the fund will be included in the assessable income without a rebate
[83] Regulation 307-125.02 ITAR97

In Victoria, a duty exemption applies for transfers of real estate to recipients in the same way as it applies to members.[84] In order to satisfy the exemption a number of requirements must be met including that the recipient was a beneficiary of the SMSF at the time the real estate was acquired by the SMSF and that the value of the real estate does not exceed the recipient's interest in the SMSF (if the value does exceed the recipient's interest then they are entitled to an exemption up to the value of their interest and the balance is dutiable).

See section 8.5 of this paper for a further discussion in relation to application for duty in relation to transfers of real estate out of an SMSF.

9.7 GST

The GST consequences of the transfer of real estate from an SMSF to a member are the mirror of those that apply to the transfer of real estate from a member to an SMSF (as discussed above).

9.8 Liquidity

The death of a member can create liquidity issues for an SMSF that holds real estate. This is because the SMSF may not have sufficient liquid assets to pay out the death benefit with the result that the SMSF has to deal with the real estate when paying out the death benefit.

Liquidity is generally not an issue for SMSFs that only have a couple as members as upon the death of the first a pension can be paid to the survivor and therefore the real estate can remain in the SMSF.

However, liquidity can be a major issue on the death of the survivor or where unrelated persons are in the same SMSF. Given that the ATO has effectively ruled out cross insurance,[85] and insurance held in reserves, many SMSFs' only option will be to sell the real estate or to transfer the real estate in full, or in part, as a death benefit. Although, it is possible to increase the liquidity of the SMSF using some of the methods outlined above (eg making contributions, adding members and using rollovers).

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[84] Section 41A of the Duties Act

[85] https://www.ato.gov.au/super/self-managed-super-funds/in-detail/news/questions-and-answers/?page=1#Can_an_SMSF_take_out_insurance_on_a_cross_insurance_basis_

10 Conclusion

Real estate is seen as a desirable asset class for many SMSFs. However, as outlined in this paper, there are a number of issues that must be considered for SMSFs acquiring, holding and disposing of real estate. These issues should be carefully considered both before and after real estate has been acquired by an SMSF.

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