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OPPORTUNITIES: BUSINESS REAL PROPERTY IN SELF MANAGED SUPER FUND

With the pressure of a stagnant real property market and the cashflow pressures that follow we continually look for solutions to free up locked capital for property developers.

Recent ATO ruling updates may provide an opportunity to property developers that operate a self-managed superannuation fund or who can transfer their current superannuation portfolio into a self-managed superannuation fund. This can be achieved through the use of the business real property provisions contained in the *Superannuation Industry (Supervision) Act*.

Generally the trustees of a SMSF are prohibited from intentionally acquiring assets from members or a related party (i.e. themselves or their company and trust structures). However business real property is subject to a limited exception to this rule if it is acquired at market value and the fund has fewer than five members. Under these circumstances superannuation funds are permitted to acquire business real property from a related party. This can be as high as 100% of the total value of the assets in the fund, however in such circumstances this strategy would need to be accompanied by a comprehensive investment strategy review

and in some cases a sign off from a financial planner.

Under the *Superannuation Industry (Supervision) Act* business real property comprises:

- Any freehold or leasehold interest in real property (including fixtures attached to land such as buildings);
- Any assignable or transferable interest in Crown land (other than leasehold interest); or
- Any other interest in relation to real property if the real property is used wholly and exclusively in one or more businesses.

Based on the above definition the tax office considers that land held by a property developer for development or redevelopment, or in the process of being developed or redeveloped, will generally be business real property. The following example is an extract from ATO's SMSFR 2009/1:

Example 37: Land development

366. Trevor is a land developer whose business involves purchasing land for development, obtaining council approvals, hiring contractors, building, selling.

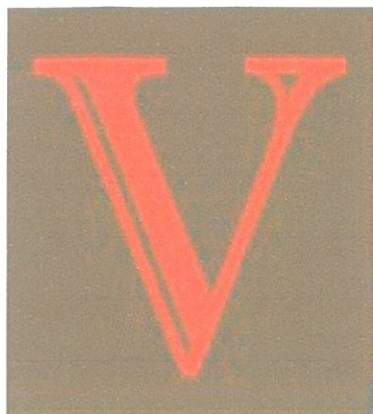
367. Trevor purchases land for development and obtains approval to build seven units on the land.

368. Trevor is a member and trustee of an SMSF. As trustee of his SMSF he wishes to purchase one of the units.

369. Taking into account the use of the property in Trevor's land development business at the time surrounding the purchase, the units will meet the requirements of the business use test if purchased:

- *Off the plan before any activity occurs on the land;*
- *After construction has commenced*
- *After all units have been completely finished but the landscaping is in progress*
- *After the entire development has been completed and the units are being actively marketed;*
- *After the units have been completed for 2 years and the remaining units have been sold but one unit remains and was rented to an unrelated party at market rates; and*
- *One unit used as a display home.*

370. At each stage above, the units are being used wholly and exclusively in Trevor's land development business and will therefore meet the requirement of the business real property definition.



ICCA NEWS

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In circumstances where the unit is purchased shortly before or after development activities are undertaken on the land, the application of the broader approach to the "wholly and exclusively" test ensures that the business use test is met. However, the presence of additional facts such as private use of the unit, an indefinite hold on development activities or the failure to pay market value may change the outcome because of the "wholly and exclusively" test and may give rise to other regulatory issues.

The business real property provisions provide land developers with an opportunity to access some or all of the money in their superannuation funds in order to maintain business perpetuity and remain competitive in a market under pressure.

The access to the superannuation funds comes at little or no premium and may be a more viable and cost effective option than seeking to borrow from a finance institution.

Where an SMSF invests in and develops property the following must be considered:

Superannuation issues

- Sole purpose test — is the property being used for the members' retirement purposes?

- Related party acquisitions — is the property being purchased from a related party? If there is a related party, e.g., builder, are building materials (as compared to services) being acquired from a related party in contravention of the in house asset rules?
- Borrowing — ATO has outlined that borrowing to develop property is not permissible.
- Arm's length — are all of the trustee's dealings at arm's length? Are relevant transactions supported with evidence?
- No charges over fund assets — most building contracts include these and need to be amended accordingly.
- Investment strategy — does this take into account the investment and development?
- Does the trust deed allow for the course of action and is the trustee acting within power?

Commercial issues

- Cash flow — does the SMSF have additional funds to support cost blow outs on the development?
- Trustee remuneration is restricted — trustees must be appropriately qualified, perform services in the ordinary course of a business and the dealings must be at arm's length. This may impact SMSFs

developing property that seek to employ the trustee as a builder or project manager. For example, an SMSF trustee who is also a builder wants to develop property and be paid. They would need to be a registered or licensed builder with appropriate insurance cover, etc.

- Consider risk minimisation strategies — e.g., a sole purpose corporate SMSF trustee and appropriate liability insurance.

We recommend a detailed review be undertaken before any building or development project commences to ensure all items are covered off and appropriately documented.

Should you wish to discuss your specific circumstances and the applicability of the above strategy to your business please contact our office.

The above information does not constitute professional advice. For further information contact Noe Vicca or Kim Macaranas of this office.