# A super idea

**Recent changes to superannuation laws have created a new and exciting way of structuring commercial property investments.** PAT MANNIX

**ON SEPTEMBER 25,** 2007 the superannuation laws changed to allow self-managed super funds (SMSFs) to invest in geared property.

The gearing is required to be in a specific form known as a 'property warrant' and it creates some tantalising opportunities for those people who own business real property or are thinking about purchasing business real property. Firstly, an SMSF is allowed to purchase business real property from a related party, whereas the fund can only purchase residential property from an arm's length third party. In particular, for those running small businesses, if a business real property is owned by a related party and is used in the business then that property could meet the small business capital gains tax (CGT) relief tests. If those tests can be met the property can potentially be transferred to the SMSF tax free.

## EXAMPLE 1

I'll illustrate with an example. Paul and Lucy Barnes run the local bakery and they're paying the freehold premises off with a bank loan. The premises is in their individual names. The market value of the property is $580,000 and the loan is $200,000. Paul and Lucy's net assets (apart from their principal place of residence) are $1.8 million, well under the $6 million threshold for the small business CGT concessions. Also, as the premises is being used in the business it's an active asset for compliance with the small business CGT concessions.

Paul and Lucy are advised that they could roll over their combined existing industry super of $150,000 into an SMSF and then transfer the business premises into the fund.

They have $900,000 between them as a limit for non-concessional contributions for a 12-month period (assuming no other contributions for the ensuing two years) so the transfer of the bakery freehold will be well under this limit.

Paul and Lucy carefully assess their situation and decide to set up the SMSF and transfer the bakery into the new fund. They purchased the freehold for $280,000 10 years ago so they have a $300,000 nominal capital gain in their own names as a result of the transfer of the property into their SMSF at its market value of $580,000. That nominal capital gain receives a 50 per cent discount because it has been held longer than 12 months and is in individual names.


The gain has now been reduced to $150,000. The small business CGT concessions give another 50 per cent discount so the taxable capital gain is $75,000.

The small business CGT laws allow the final taxable amount of $75,000 to be rolled into superannuation tax free so this is what Paul and Lucy do. The property still requires $200,000 in loan monies to complete the transfer transaction so they go back to their advisors for this final piece. They're told that the loan monies to pay out the existing bank by the SMSF can be provided via a property warrant and so this is what they implement. They'll have to pay stamp duty on the transfer of the property but the tax advantages for the future are significant.

The result is that they have a geared property in their SMSF that has a 15 per cent income tax rate on the net rent of the property. The property is completely protected inside the SMSF from potential creditors or lawsuits because the loan for it via the property warrant is a limited-recourse loan.

They also intend to pay down a lot of the loan principal over the next couple of years and they're advised that if the pay down amounts are coming from concessional contributions made from their business then they'll have a further tax saving of between 16.5 per cent and 31.5 per cent which isn't possible outside of super.

Finally, if Paul and Lucy originally used another property as security for the purchase of the bakery in their own names then this mortgage could be released freeing up equity for other financial investments that they may want to make.

This is a tremendous result for Paul and Lucy and shows the power of business real property being transferred into an SMSF in the right circumstances.

GETTY IMAGES

**EXAMPLE 2**

To take this scenario a step further for the more active investor, let's say Paul and Lucy fully own that $580,000 bakery freehold property in their own names and that their SMSF initial bank account is $300,000. They could put down a 35 per cent deposit, paid to themselves as the current titleholders, plus stamp duty and legals from their SMSF, which would be approximately $230,000. They could pay for the balance of the property via a property warrant, so they'd then have a $580,000 property in their SMSF with a loan for 65 per cent.

They would also have $580,000 in their own name that could be potentially tax free via the small business and general CGT concessions (see earlier). This $580,000 could then be contributed as non-concessional contributions back into the SMSF and those same funds could then be used to purchase another two geared properties.

So the result is that the SMSF would have a portfolio of three properties (one used in the business), and if those properties were sold after Paul and Lucy reach age 60 the whole of the capital growth on those properties would be tax free. A brilliant result for active investors that meet the criteria.

**This law change will see many businesses moving their existing commercial property into their SMSF and investors using this vehicle for new purchases.**

For investors who are contemplating purchasing business real property to house their existing business they'd be best advised to look at the advantages of purchase by their SMSF. If they purchase a property via a property warrant that needs some extra fit-out and/or improvements to get it to a level required for the business then these costs can be met by the SMSF. These capital improvements will increase the rent yield of the property which is concessionally taxed in super at 15 per cent. If the business outgrows the commercial property or the business is sold but not the freehold then the investor has the ultimate structure for holding their investment property.

This law change will see many businesses moving their existing commercial property into their SMSF and investors using this vehicle for new purchases. You can't ignore the tax advantages of this structure and they far outweigh the set-up costs.

It's important to take note that in all of the above examples Paul and Lucy would need to ensure that the SMSF continues to meet the investment rules and that the fund's investment strategy and trust deed allows the fund to invest in real property. api

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