Property needs right conditions

DIY super

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One of the attractions of do-it-yourself super funds is the scope to own direct investments. As well as shares in listed companies, interest paying investments such as bonds and term deposits and shares or units in publicly offered managed investment funds, a DIY fund can include investments like direct property.

For instance, if it has the money, a fund can buy the business property from which a member, a relative or anyone a member knows, is running a small business.

It may be a shop, a small factory or an office. As long as it is bought without any debt like a mortgage against the property, the fund can buy the property and then lease it back to the business and receive rent.

While buying a property is one way of acquiring it, another way is to transfer the property into the fund as a contribution. A reader asks what is involved in transferring a business property this way.

She and her husband are in their 40s and have a business that has owned a commercial property for nine years. She says they have been lending money to the business since the purchase of the property, which suggests it may need some financial support. Could they transfer this into the fund as a non-concessional super contribution?

Provided it is a property used exclusively for business purposes, it can be transferred into the fund, says Graeme Colley, national technical manager with OnePath.

To effect a transfer, a property must be unencumbered by a mortgage. Where a property has a mortgage, no transfer can happen unless this debt has been extinguished.

Where a property is acquired by a DIY fund with a connection to a member, whether it's a purchase or a transfer as a contribution, a number of important principles apply.

One is that any acquisition must be made under a proper arm's length arrangement for a true commercial value. Even though there is a connection, it is important to distance yourself from this in a financial sense. This is what arm's length implies.

The next step is making sure that any rental or lease payments are calculated on a commercial basis and regularly paid by the business to the fund. Colley says this can be important when considering a transfer where a business has not been paying rent regularly because the members own the property. You are creating a totally different, more commercial relationship when a DIY fund becomes the property owner.

The requirement for the property to be used exclusively for business purposes means it can't be a property that might have a non-business component, such as residential accommodation above a shop, for example.

Closely linked to this is another important superannuation principle described as the sole purpose test. This states that the sole purpose of any action taken by a trustee must first and foremost be aimed at enhancing the retirement savings of fund members.

A super fund cannot be used as a way of helping a business if it happens to have a financial problem.

Where a property has a mortgage, no transfer can happen unless this debt has been extinguished.

Where a property is acquired by the fund through a contribution arrangement, an important consideration is the contribution rules.

In the case of the reader wishing to make non-concessional contributions, the non-concessional limits are $150,000 per member per annum. Or they can choose to bring three years of non-concessional contributions forward, or $450,000 per member.

Being aware of non-concessional limits is very important given that exceeding these limits can attract a tax penalty of 46.5 per cent.

The crucial issues when using the bring-forward entitlement is being aware that no more than $450,000 can be contributed over a three-year period.

The bring-forward rules apply whenever a non-concessional contribution exceeds $150,000 in a year. The non-concessional contribution balance over the next two years cannot then be greater than $450,000 minus the first year's contribution.

The other major issue where a fund acquires a property for a member is any tax liability that arises.

Whether it buys the property from a member or related party or the property is contributed by members, the transfer is a capital gains tax event. The transfer transaction should be based on a formal valuation obtained from a registered valuer.

One of the potential problems with investment transfers is that they haven't been properly valued. Where they have been undervalued, the Australian Taxation Office is likely to suspect this has been done deliberately to get around the contribution limits that now apply.

Another reason the Tax Office is interested in these transactions is to check that any personal tax obligation associated with the transfer of a property owned by members is met.

Where an investment shifts from a member to a super fund, it is a capital gains taxable event for the property owner or owners. The owners must pay tax on any capital gain between the time they bought the asset and when it was transferred into the fund.

The ATO has the scope to check whether members who make contributions of assets have paid tax on any capital profit.

Members should never be tempted to undervalue any investments that are transferred. They must be aware the Tax Office can substitute its own value for the transferred asset for tax purposes.

Not only can the Tax Office increase the value for super contribution purposes, which could lead to part of the contributions being treated as excessive with penalty tax applied, but there could also be an increase in the consideration a member is deemed to have received for tax calculation purposes.

Of course, anyone who owns a small-business property should be aware of any entitlement to the small-business capital gains tax concessions. Where an owner has total assets – other than a family home and super – worth less than $6 million, they may be able to claim some generous concessions, which can dramatically shrink any tax liability and enhance any super contribution.