

BIG WIN FOR PROPERTY

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Peter Freeman

The biggest drawback of the decision to allow self-managed superannuation funds to borrow to buy property is the way the ability came enmeshed in a set of sometimes complicated rules.

Among these were a number that, in effect, prevented an SMSF from borrowing to finance work on a geared property.

Initially these were so onerous that it wasn't even possible to use borrowed funds to pay for essential repairs.

While this restriction was relaxed in July last year, trustees were left unclear about what would qualify as a repair and what would be classified as an improvement or renovation and so not be eligible to be financed using gearing.

This uncertainty has now been addressed, at least partly, by a tax office draft ruling (SMSF 2011/D1) that spells out a number of rule changes.

"The headline impact of these changes is that investors are no longer restricted to purchasing properties, via their superannuation fund, that are ready for leasing," says Andrew Hewison, a director of Hewison Private Wealth. "They can now purchase a property and add value via capital improvements, which is a big win."

The main proviso, he adds, is that you need to abide by the tax office's view of what constitutes a repair. As explained by Michael Hallinan, of Townsends Business & Corporate Lawyers, the draft ruling basically indicates that "repairing" is the restoration of an asset to regain the asset's previous functional efficiency or, at most, a minor increase in efficiency.

Hallinan, in a detailed examination of the ruling prepared for SMSF service provider SUPERcentral, says that updating a damaged kitchen, replacing roofing with a new roof, painting the exterior of a house and resurfacing a swimming pool should all qualify as repairs.

He even speculates that demolishing an existing house and replacing it with a completely new house with the same number of bedrooms and living areas on the same block may be permissible.

In contrast, adding a second storey to an existing single-storey house, adding one or more rooms or adding a swimming pool would transform an existing asset into a different one and so could not be financed with borrowed funds.

Among the other issues addressed in the draft ruling is the question of whether an SMSF can enter into an off-the-plan purchase and then use borrowed money to complete the purchase. The answer, it seems, is yes, with the main proviso being that the SMSF pays the initial holding deposit - usually 1% of the purchase price - out of its own funds.

Another positive is clarification of the requirement that an SMSF borrow only to finance a single asset.

Rather than defining this inflexibly as, for example, a property on a single title, it appears the tax office will accept situations where a house sits across the boundary of two blocks of land. Similarly, doubts about borrowing to buy an apartment whose parking place is on a separate title have been removed.

If The Cap Fits:

The government has promised that anyone 50 or over who has less than \$500,000 in super will retain the right to make concessional super contributions worth \$50,000 a year. In contrast, from next July the cap for everyone else will be \$25,000.

One implication of the requirement to have less than \$500,000 in super to get the higher cap is that, if implemented, it will provide an incentive for some of those who have a non-working or low-income spouse to consider splitting their super contributions.

By directing some of their super to their spouse, they will maximise the chance of staying below the \$500,000 threshold and qualifying for the higher cap.