

Your SMSF running a B&B? You're dreaming

Robert and Mary want their SMSF to buy a B&B which they'll run until their retirement. Robert and Mary have found a property in the Hunter Valley which they want their SMSF to buy, in part using a loan (limited recourse borrowing arrangement or 'LRBA'). They want to run a bed and breakfast ('B&B') out of the property as a way of generating income for the SMSF as they plan to retire in the next 10 years. Before Robert and Mary jump the gun by putting down a deposit on the property there are a couple of things they need to consider to ensure that the transaction complies with superannuation laws. Will the 'sole purpose test' be satisfied? Robert and Mary will need to ensure that the purchase and use of the property satisfies the 'sole purpose test'.

Sole purpose test

The 'sole purpose test' will be satisfied if an SMSF's sole purpose is to provide benefits for its members. They may have difficulty satisfying the sole purpose test if they intend to reside in the B&B in order to operate and manage the business. Their fund can't provide them with accommodation in this way even it is associated with running the business from the property. A further problem arises if they intend to take a wage as employees because an SMSF cannot directly or indirectly provide financial assistance or benefits to its members prior to their retirement, including use of or access to the assets of the SMSF as this would most likely breach the sole purpose test. They can't run the B&B without pay and they can't be paid by their SMSF to run it. Their SMSF could employ unrelated third parties to run it but that's not the model they had in mind. Does the investment comply with the SMSF's investment strategy? Robert and Mary will also need to ensure that the investment satisfies the investment strategy of the SMSF.

Investment covenants

The current rules regarding an investment risk are based within the "investment covenants" framework in s52B of the Superannuation Industry (Supervision) Act 1993 (Cth) ("SIS Act"). The SMSF trustee will need to consider a number of aspects including the risk in making, holding and realising any investment, the likely return from an investment, diversification, liquidity, costs and tax consequences as part of its investment strategy. As part of this framework, an SMSF trustee must exercise due diligence in relation to all investments made by the SMSF. Robert and Mary would need to ensure that acquiring the property and running it as a B&B would be a prudent investment, especially as they are approaching retirement age, where stable income-generating assets and minimal risk of significant capital loss are important. Is the transaction or type of business allowed under the SMSF's deed? As Robert and Mary want the fund to borrow some of the purchase price of the property they will need to ensure that their SMSF's trust deed allows this. They will also need to ensure that the deed also permits the SMSF to carry on a B&B type of business.

SMSF governing rules

If the rules governing Robert and Mary's SMSF don't contain the necessary powers then their trust deed will need to be amended. Self-managed superannuation funds can run a business but the rules around the operation are so strict that often it is not possible to comply with them or, as in Robert and Mary's case, compliance makes the trustee's plans impossible to put into effect.

For more information on any aspect covered in this article, please call SUPERCentral on 02 8296 6266 or email info@supercentral.com.au.