SUPERCENTRAL

SMSF Property development – issues to consider

Can an SMSF be used to develop a property?

Yes, but there are some superannuation compliance issues that arise when considering whether to develop a property in your SMSF. John and Mary want to knock down and rebuild a property in their SMSF

Let's consider an example of John and Mary who own a property in their SMSF without any mortgage. The property is at a sought-after location and has a good potential for a knock down and rebuild project. They see this as a great investment for their SMSF and wish to utilise the tax concessions available to SMSF investments but are concerned whether to do this would be in breach of the superannuation laws. In short, it is possible to develop a property in your SMSF and still comply with superannuation laws. However, be aware that developing a property in your SMSF is not for the faint hearted, as it will attract greater scrutiny from the auditor and the ATO. Also, it may not just be a question of law and you may need to discuss with your financial advisers and accountants before committing to any such investment. So what are some of the superannuation compliance issues that arise when considering whether to develop a property in your SMSF?

Knock down and rebuild is likely to be considered as running of a business

Knock down and rebuild is likely to be considered as running of a business. While an SMSF is not completely prohibited from running a business, extra caution needs to be taken so that it doesn't breach superannuation laws including the sole purpose test. Like any other investment, the property development must be for the sole purpose of providing retirement benefits for the members. This is not always a simple question but at the very least means you (or anyone related to you) cannot make personal use of the property or unreasonably benefit from the investment. If you are thinking of building a holiday house for your personal use, then look for another investment vehicle. Also, the investment must be allowed under the current trust deed and be in line with the investment strategy of the fund. Legal advice should be sought to see if any amendment to the trust deed is required.

Avoid the brother-in-law tradesman

Can John and Mary use their brother-in-law who is a builder to carry out the development work? From a compliance perspective, it would be safer to engage entities that aren't related to the fund. If however an associated entity is involved, the SMSF's dealing with the entity must be on arm's length terms and appropriate documentation should be in place to support this. Before members or their families are engaged for any paid service, be mindful of the prohibition against providing financial benefits to the members and/or other related parties and ensure there is rationale for engaging their service and their pay rate. You should also ensure that the fund does not acquire assets such as building materials from related parties of the fund. When you purchase materials for the project, make sure the fund trustee buys directly from third parties or obtain advice about having an agency agreement in place for purchasing materials through related parties. As the above list is not exhaustive and not suited for all circumstances, we recommend that you obtain formal advice before committing to such investment.

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