

When is a residential property a business real property in relation to an SMSF?

Whether or not a property is business real property is a common question faced by members who own a property personally and want to transfer it to their SMSF. While the term 'business real property' seems to suggest that a property has to be a commercial property (or other non-residential property) to qualify as such, this isn't always the case.

Builder John wants to sell some of his townhouses to his SMSF

Let's consider an example. John built 20 residential townhouses in his final project as a builder. He now owns the townhouses with a mortgage and works full time managing and leasing the townhouses to tenants on a long-term basis. While this generates good income and is profitable, he wants to sell some of the properties to repay the mortgage. If possible, he wants to sell 5 of the townhouses to his SMSF of which he is the only member. He is the sole director of the corporate trustee of the fund. The fund has sufficient liquidity to buy the units without any borrowing.

Superannuation laws generally prohibit trustees of SMSFs from acquiring a property from members and/or other related parties to the fund but an exception to this is when the property is a business real property. The question is not whether or not the property is a commercial or residential property but is rather whether or not it is being used for a business. Even though usage may be outside the zoning restrictions (and therefore may be stopped in the future by the local council) provided the property is actually being used in a business at the time of the transfer then it can meet the definition of 'business real property'.

In order to meet this business use test, John's properties must be "wholly and exclusively used in one or more businesses" by either John or the tenants.

As John's properties are residential townhouses, the tenants' use of the properties will be private and thus not pass this test.

Is it a business or property investment?

John's use however may constitute a business of property investment. Be aware that not every property investment (i.e. buying and renting property for income) is a 'business'. The ATO in its SMSF ruling has provided some relevant factors that point to carrying on of a business, which include:

- keeping of business records;
- size, scale and permanency of operation;

- whether activities are conducted continuously and systematically;
- a purpose and intention to carry on business;
- a level of repetition and regularity;
- whether activities are planned, organised and carried on in a businesslike manner; and
- the existence of a business plan.

This guidance from the ATO is helpful and we gather that generally, there needs to be sufficient scale of activity, repetition, continuity and system for it to be a business.

However, remember that there is no absolute rule of thumb with this question and trustees should seek advice before committing to acquire a property from a related party.

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