



SMSF Property Issues: Latest Developments and Key Considerations

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SMSF Property Issues

– Latest Developments and Key Considerations

Agenda

- Are SMSF's investing in property?
- Need to know definitions
- Basic rules
- Investing in property through a trust
- Non-arm's length income and expenses
- Market Valuations
- Limited Recourse Borrowing Arrangements
- Property Developments
- ATO focus

Good planning is essential for successful property investing

- Structure for the future
- Know the rules now and throughout the investment period



SMSF Property Issues

– Latest Developments and Key Considerations

Why do SMSF trustees choose to invest in property?

- Long term investment goals
- Capital growth
- Asset protection
- Tax purposes
 - 1/3 CGT discount
 - income tax rate (accumulation and retirement income stream phase)
- Familiar/comfortable with property
- Part of a diversified portfolio



SMSFs investing in property

Statistics from the ATO - June 2023

Asset Class	\$ million	% Total Assets in SMSFs
Residential property	44,836	5.12%
Non-residential property	81,204	9.27%
Overseas property	553	0.06%
Total direct property	135,323	14.45%
Total assets in SMSFs	876,451	
Borrowings	23,503	

Source: [ATO Self-managed super fund quarterly statistical report - June 2023](#)

- Plus indirect property investments held through other entities

Related Parties

SMSFs can invest in real property but related party transactions mean more stringent rules – critical to know who a related party is and when it matters!

Who or what is a related party?

- [Section 10 SIS Act](#) - a member of the fund, a standard employer-sponsor of the fund and a Part 8 associate of either of these two
- [Section 16\(2\) SIS Act](#) - a standard employer sponsor is an employer that contributes to a super fund for its employees due to an arrangement between the employer and the fund
- Most SMSFs do not have an employer sponsor but always review the deed!

Related Parties

Part 8 Associates of individual members

Section 70B SIS Act - a Part 8 associate of an individual member is

- A relative of the member
- The other members and trustees (or trustee directors) of the fund
- Business partners in a partnership (and their spouses and children) and the partnership itself
- A trust controlled by a member of the fund
- A company sufficiently influenced or for which majority voting interest is held by a member or another entity or entities to which the provisions would apply

Part 8 Associates of a standard employer sponsor

- Consider Part 8 associates of a company (Section 70C SIS Act) or partnerships (Section 70D SIS Act)



In-house Assets

[Section 71\(1\) SIS Act](#) – an in-house asset (IHA) of a superannuation fund is

- a loan to a related party of the fund
- an investment in a related party of the fund
- an investment in a related trust of the fund
- an asset of the fund subject to a lease or lease arrangement between a trustee of the fund and a related party of the fund

Assets excluded as IHA listed in Section 71(1)(a) to (j), including

- Property leased to a related party but only where there is a legally enforceable lease and the property is BRP throughout the term of the lease
- Assets specified in SIS Regulations not to be IHA – investments by an SMSF in a related company or trust and that company or trust meets certain conditions

Business Real Property



[Section 66\(5\) SIS Act](#) – Business real property, in relation to an entity means

- (a) any freehold or leasehold interest of the entity in real property; or
 - (b) any interest of the entity in Crown land, other than a leasehold interest, being an interest that is capable of assignment or transfer; or
 - (c) if another class of interest in relation to real property is prescribed by the regulations for the purposes of this paragraph--any interest belonging to that class that is held by the entity;
- where the real property is used wholly and exclusively in one or more businesses (whether carried on by the entity or not) but does not include any interest held in the capacity of beneficiary of a trust estate

[SMSFR 2009/1](#) – Self Managed Superannuation Funds: business real property for the purposes of the Superannuation Industry (Supervision) Act 1993

Provides guidance on the meaning and application of the term business real property in relation to SMSFs

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Investing in Property

	Residential Property	Non-residential Property (Business Real Property)
Are SMSFs able to invest?	Yes	Yes
Acquire from an unrelated party	Yes	Yes
Acquire from a related party	No	Yes
Lease to a related party?	Maybe (subject to sole purpose test and in-house asset rules)	Yes
Arm's length arrangement	Yes	Yes
Sell to a related party	Yes	Yes
Using a trust or other structure	Yes	Yes
Borrowing permitted	Yes	Yes

Options for holding property

Options for ownership

- Directly – tenants in common, partnerships, joint ventures
- Indirectly – unrelated unit trust or related unit trust (Pre-99 unit trusts or Reg 13.22C trusts)



Holding property through a related trust

	Related Trust	13.22C Trusts	Pre-99 Trusts
In-house asset	Yes	No	No
Borrow/lend	Yes	No	Yes
Charge over assets	Yes	No	Yes
Hold other assets	Yes	Property and cash only	Yes
Leases to related parties	Yes	BRP only - lease must be legally binding	Yes
Run a business	Yes	No	Yes
Arm's length required	Yes	Yes	Yes
Acquire from related party	Yes	BRP only - at market value	Yes

Caution - sole purpose test applies always for an SMSFs in investment in any related trust

- transactions conducted on non-arm's length basis likely to cause SMSF to fail

Terms of trust deeds relevant for determining their ability to undertake certain activities

Additional investments in 'Pre-99 Unit Trusts' are not exempt as IHA

[SMSFR 2009/3](#) - Unpaid trust distributions

Non-arm's Length Income and Expenses

Changes to NALI rules in 2018 – supposedly to address LRBA with related party loans at 0%

[Section 295.550 ITAA 97](#) - Meaning of non-arm's length income

(1) An amount of ordinary income or statutory income is non-arm's length income of a complying superannuation entity if, as a result of a scheme the parties to which were not dealing with each other at arm's length in relation to the scheme, one or more of the following applies:

- (a) the amount of the income is more than the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length in relation to the scheme;
- (b) in gaining or producing the income, the entity incurs a loss, outgoing or expenditure of an amount that is less than the amount of a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme;
- (c) in gaining or producing the income, the entity does not incur a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme.

[Treasury Laws Amendment \(Support for Small Business and Charities and Other Measures\) Bill 2023](#)

- Introduced into Parliament 13 September 2023
- Non-arm's length general expenses to be twice the difference between amount charged and amount that should have been charged but no more than taxable income
- Non-arm's length specific expenses – existing rules continue to apply

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Non-arm's Length Expenses

How do the NALI and NALE rules apply to property?

[LCR 2021/2](#) Non-arm's length income – expenditure incurred under a non-arm's length arrangement

- Non-arm's length expenditure in relation to a property is considered a specific expense
 - Be careful of capacity in which activities are performed – as individual or as trustee
- Income from the asset including rental and capital gains in year of NALE is subject to NALI – taxed at 45%
- NALE incurred to acquire property taints the asset forever – rental and capital gains for all years taxed as NALI
 - LRBA arrangements not on an arm's length terms also taint the asset even if acquired at market rates
 - Be careful if asset is buying from a member and a part of the asset is being contributed to the fund

[TD 2023/D1](#) Interaction of Non-Arm's Length Income (NALI) and Capital Gains Tax (CGT)

Market Valuations

Assets must be reported at market value

- SIS Regulation 8.02B – for purposes of SIS Act 35B(1), an asset must be valued at its market value
- ATO guidelines – [Valuation guidelines for self-managed super funds](#)
 - [Valuing Assets](#) – updated guidance on ATO website
- Recent ATO commentary
- What will the auditor want to see
- Objective and supportable basis of valuation
 - Comparative sales
 - Lease assessment
 - Trustee’s discretion?

Limited Recourse Borrowing Arrangements

[SIS Act Section 67](#) – general prohibition on borrowing with some exceptions

[SIS Act Section 67A](#) – exception to borrowing prohibition, with following conditions

- Single acquirable asset including expenses for borrowing or acquisition and repairing (but not improving) the asset
- Asset held on trust for the fund (beneficial interest held by fund)
- Fund trustee has a right to acquire legal ownership by making one or more payments
- Rights of lender limited to the acquirable asset
- No other charge over asset allowed

On cessation of loan, asset does not have to be transferred to the fund. It can continue to be held on trust

- Dealing with Office of State Revenue can be challenging!

Check the SMSF trust deed to ensure borrowing is allowed

Limited Recourse Borrowing Arrangements

Related party loans allowed but safe harbour provisions apply

- Can match a bank loan offer or meet conditions set out in [PCG 2016/5](#)

	Requirement for property loans to be considered arm's-length
Interest Rate	Reserve Bank of Australia Indicator Lending Rates for banks providing standard variable housing loans for investors Interest to be calculated monthly on a compounding basis
Fixed/Variable	Interest rate may be variable or fixed Fixed at commencement up to a maximum five years
Term of Loan	15-year maximum loan term (including where re-financing and any period where rate is fixed)
Loan to Market Value Ratio (LVR)	Maximum 70% LVR for both commercial and residential property
Security	A registered mortgage over the property is required
Personal Guarantee	Not required
Nature and Frequency of Repayments	Must be principal and interest Repayments are monthly
Loan Agreement	A written and executed loan agreement is required

Limited Recourse Borrowing Arrangements

LRBA [interest rates for related party loans](#)

- Reserve Bank of Australia Indicator Lending Rates for banks providing standard variable housing loans for investors
- 2023-24 rates - 8.85% for real property and 10.85% for listed shares or units

Common errors

- Not meeting safe harbour provisions on an ongoing basis
- Using the wrong interest rates – Division 7A rate cannot be used for these purposes
- Not adjusting interest rates annually
- Not making monthly repayments
- Making interest only repayments
- Not registering the mortgage



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Property Development

Property Development

- [SMSFRB 2020/1](#) – ATO concerns about arrangements that pose potential risks to SMSF trustees and their members from a superannuation regulatory and/or income tax perspective
- Taxpayer Alert [TA 2023/2](#) – ATO concerns where profits from property development are diverted to a related SMSF through a special purpose vehicle owned by the SMSF
- Agency agreements

Other Considerations

SMSF early engagement and voluntary disclosures

- Updated [SMSF Regulatory Contravention Disclosure form](#) - must now be signed by at least one trustee/director to comply with whistleblower laws

Investment strategies

- Need to appropriately consider investment in property, particularly when investing via an unlisted unit trust

Illegal SMSF Schemes - Residential property purchased through illegal SMSF schemes



- Scam, illegal early release, financial assistance to members, loan to members
- [Reporting scams](#) to the ATO

Where are Trustees Getting it Wrong?

- Failing the definition of Business Real Property
- Failing tests in Reg 13.22C or 13.22D – can't ever be rectified
- Failing LRBA requirements including safe harbour provisions
- Not adhering to arm's length requirements
 - Market rates of rent
 - Terms and conditions of lease arrangements
- Documents in writing
- Allowing leases to expire – extensions or renewals not undertaken
- Valuations with insufficient evidence
- Paying for expenses personally - NALE



What Will the Auditor Want to See?

- Increased evidence
- ATO [recent auditor referrals to ASIC](#) for:
 - failure to identify and/or report contraventions for matters such as fund borrowings and inadequate documentation for LRBAs
 - failure to gather sufficient audit evidence for market valuations and related party transactions
- Declarations
- Valuations – objective, supportable, independent?
- Rental appraisals
- Title searches - ATO update on expectation of annual title searches to check if [charges over assets](#)
- Engage with your auditor at the beginning of the year to confirm what they will need for the audit
- Check last year's management letters and auditor correspondence to make sure issues are or will be addressed

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