



## **“MADA NEWS” JULY 2008 EDITION**

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### **INTRODUCTION**

Welcome to the July 2008 edition of MADA News for 2008. We hope you've had a great start to the new financial year.

This month's topic should be of interest to many of you already with a self managed super fund or those contemplating setting up a self managed super fund (quite a few considering our one on one discussions around tax planning for 2008/09!).

*Caroline Poon  
Director*

### **BUYING PROPERTY WITH YOUR SELF MANAGED SUPERANNUATION FUND AS TENANT IN COMMON**

There has been much press of late regarding borrowing to invest through a super fund via the instalment warrant provisions. We thought it opportune to discuss in detail a strategy which, in our opinion, is less complicated: buying property as tenant in common with your self managed superannuation fund (“super fund”).

A super fund may invest directly in property even though it does not have sufficient money to become the sole owner. It may become a joint owner as tenant in common with a member of the fund. It can also become a joint owner as a tenant in common with a group of individuals or trust. Tenant in common means that if the member dies, their share will not be inherited by the fund, instead their estate will inherit their share. A super fund cannot own an asset as a joint tenant. It is a breach of the SIS Act.

Using this strategy the super fund will become a part owner in the property. The individual may borrow to fund their portion of the investment but the property in question cannot be used as security for the loan. Accordingly other assets (such as your principal residence or an investment property) may be used as security for the loan.

The rental income of the portion owned by the super fund will be taxed at 15%. Some expenses will be deductible including repairs, rates, depreciation and building allowances (if applicable). If the property is held for more than 12 months, any capital gains will be taxed at 10% (re the portion owned by the super fund) if the property is sold. Further if you are in pension mode, the capital gain in the super fund will be taxed at zero as once in pension mode, there is no tax payable within the fund.

The rental income of the portion not owned by the super fund will be taxed at the owner's marginal rate of tax. The idea is to 100% gear this portion so with interest claimable the member has a negatively geared investment in his or her hands. If the property is held for more than 12 months, only 50% of the capital gain is taxed at the owner's marginal rate if the property is sold.

Residential, commercial or industrial property may be bought in this manner.

It should be noted that in relation to residential property, a member or a related party may not reside in the property. Further, it may not be bought with the view that in future years e.g. when kids go to university that a member or a related party will reside in the property.

What are the risks of this strategy?

Risks of this strategy are broadly listed as follows:

- Substantial change in circumstances e.g. death, divorce or long term unemployment makes an investor more vulnerable
- Borrowings must still be funded even if there is a major change in circumstances. The super fund cannot take over the loan or temporarily make repayments for the co-owner. There may be little choice but to sell the property and it may not be an ideal time for the seller
- If using own property as security, there is a risk that if default on the loan, home or other investment property will be subject to initial claims of creditors

- If a member of the fund dies, there may be added complications if the trustees and beneficiaries of the super fund are different to the trustees and beneficiaries of the estate. For example, problems may arise if it is preferable for the super fund to sell the property, and for the deceased estate to retain it, or vice versa.

### **Subsequent transfers**

A member may consider the subsequent transfer of part or all of their tenancy in common interest to the super fund either as an in specie (in property) transfer to super or where there is sufficient cash available for the super fund to pay a market price for that interest. The transfer must be done at market value.

Generally a super fund trustee is prohibited from purchasing an asset from a member or related party but there are limited circumstances where this is possible. This includes business real property (either a member's place of business or commercial premises from which an unrelated business is conducted).

Subsequent transfers do not apply to residential property as a super fund trustee may not buy residential property from a member or related party.

Watch out for capital gains tax, stamp duty and GST consequences in relation to these transfers; these can be very complex and expert advice needs to be sought before embarking on such a transaction.

*The contents of this article are general in nature and are not advice that applies to any particular client situation. Whilst every care has been taken in preparing the article, specific advice should be obtained before proceeding with any suggestion or recommendation made*

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