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The Do's and Don'ts of SMSF Property Development

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INTRODUCTION

SMSFs (self managed superannuation funds) have been carrying on property development activities ever since SMSFs came into existence. Yet despite that there is still a common concern that such activities will cause the SMSF to become non-compliant, or subject to penalties, on the basis that such activities, and in particular undertaking a property development business, are prohibited.

There is no express prohibition on SMSFs undertaking property development activities or a property development business. Rather, the question is whether such activities cause the SMSF to breach the provisions of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) or the *Superannuation Industry (Supervision) Regulations 1994* (**SIS Regs**) or adverse tax consequences under the *Income Tax Assessment Act 1997* (**ITAA97**) or *the Income Tax Assessment Act 1936* (**ITAA36**).

In this paper I have firstly examined whether an SMSF can carry on a business. Secondly, I have reviewed the provisions of the SIS Act and SIS Regs, and the tax acts, that must be considered when an SMSF carries on property development activities. Thirdly, I have reviewed various structures under which an SMSF can carry out property development. Finally, I have examined issues arising out the use of related party builders when undertaking property developments.

CAN AN SMSF CARRY ON PROPERTY DEVELOPMENT?

As noted above there is no express prohibition on an SMSF carry on property development activities but rather the question is whether those activities, or dealings in relation to those activities, breach the SIS Act or SIS Regs or have adverse tax consequences under the tax acts. These provisions are considered in more detail below.

Another issue, which I have not dealt with in this paper but must be considered, is how the development will be funded (whether by the SMSF or an entity that the SMSF has invested in). Possible funding sources include:

- existing cash from the SMSF;
- cash from the members by way of contributions (subject to the contributions caps);
- borrowings (consider whether borrowings are permitted and what restrictions apply, eg LRBAs);
- non-SMSFs (provided they can invest and what restrictions apply).

CAN AN SMSF CARRY ON A BUSINESS?

A common question raised in relation to property development is whether an SMSF trustee can carry on a property development business. There is a common misconception that super fund's cannot carry on businesses and a property development business in particular. You only have to look at some of the activities of some of the public offer super funds to see that super funds are commonly running business operations. For example, the construction of major commercial buildings.

There is no provision in the SIS Act, the SIS Regs or the tax acts that expressly prevent an SMSF from operating a business or tax income derived from a business in a manner different from other "passive" investment income. The ATO has confirmed this understanding in a number of non-binding publications over the years, including the NTLG Superannuation Sub-Committee minutes of 26 October 2005 and its publication titled "Carrying on a business in a self managed superannuation fund". Essentially, in these

publications, the ATO's view is that while running a business does not cause an SMSF trustee to breach the SIS Act, the activities of the business may breach one or more of the SIS rules (discussed in the next section).

ATO'S CONCERNS IN RELATION TO SMSFS CONDUCTING PROPERTY DEVELOPMENT

While acknowledging that property development by SMSFs is prohibited per se, the ATO has increasingly raised concerns with SMSFs conducting property development. This includes the following recent comments made by Kasey Macfarlane, Assistant Commissioner, Superannuation:

- "An SMSF can undertake a property development or other business venture. However, significant caution is required because the manner in which these activities are undertaken can give rise to breaches of regulatory rules."
- "In particular, the general prohibition on borrowing by SMSFs, the related-party rules and rules about non-arm's length transactions as well as the sole-purpose test."
- For JVs "extreme care" was needed to ensure the SMSF didn't breach the regulatory rules, "particularly if the other party to the joint venture is a related party".
- "The very small number of cases we have seen to date have raised concerns from a regulatory perspective, particularly the rules about related-party transactions and non-arm's length transactions. The cases have also commonly involved related-party joint ventures and trusts that have raised potential application of the NALI provisions in tax law."
- this was an area the ATO would continue to "monitor closely".
- "Our concern is that in some of these cases, involving SMSFs in related-business undertakings may be viewed as a mechanism for diverting members' business-related income into a more tax concessionary environment. If extreme caution is not exercised significant regulatory and income tax issues can arise which may risk members' retirement savings."

Therefore, it is important for SMSF trustees to appreciate that property development by SMSFs must be carefully undertaken (in a way that doesn't breach the super laws) and that they may be reviewed or audited by the ATO (and therefore should be ready for the time and expense associated with such reviews/audits).

SIS ACT CONSIDERATIONS

As noted above, property development and the carrying on of a property development business are not expressly prohibited by the SIS Act and Regs. However, the activities necessary to undertake the property development activities may breach the SIS Act or SIS Regs. The provisions of the SIS Act and the SIS Regs are a paper in themselves and therefore I have only briefly considered them below.

The sole purpose test

Section 62 of the SIS Act provides, in effect, that super funds must be maintained for the purpose of providing retirement benefits. A common misconception with the operation of the sole purpose test is that a risky, or unusual investment, will cause a super fund to breach the sole purpose test. In reality, what the test is about is whether a super fund's activities result in the members, or related parties of

the members, receiving pre-retirement benefits, or to put it another way, do the activities result in money being taken out of, or deprived from, the super fund? This has been confirmed in the way the sole purpose test has been applied by the Courts and interpreted by the ATO.

Examples of where the sole purpose test may be breached in a super fund perspective is where the super fund "employs" related parties for more than market consideration (eg a related party builder is paid excessive building fees or profit share arrangements or related parties are employed and receive inflated salaries).

Arm's length dealings

In simple terms, section 109 of the SIS Act requires SMSF trustees to deal with related parties on an arm's length basis or, if the dealings are not on an arm's length basis, the parties must not be dealing with each other on the basis that it favours the non-SMSF trustee. Like the sole purpose test, section 109 is aimed at preventing benefits being taken out of the super fund rather than a prohibition against involvement in transactions that favour the super fund.

Examples of where section 109 may be breached include where an SMSF trustee pays a related party an inflated price for services (eg building services).

Prohibition against acquiring assets from related parties

Section 66 of the SIS Act prevents an SMSF trustee from acquiring an asset from a related party unless one of the exemptions apply. Relevantly, for property development purposes, one of those exemptions is "business real property". This means that a member can contribute or sell their business real property to the super fund without breaching section 66, therefore allowing the super fund to potentially develop the property.

Business real property is defined as certain interests in real property "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".

An important part of the definition is that the land must be used wholly and exclusively in one or more businesses. This would generally rule out residential property unless the owner of the land is carrying on a rental business or is a property developer and the land is held as trading stock. There is a legislative concession for farm land meeting the definition of business real property which allows farm land to still be classed as business real property even if up to 2 hectares of the land is used as a residence provided the predominate use of the property is not private or domestic.

The ATO's view on what comprises business real property is set out in its extensive ruling SMSFR 2009/1. Examples of business real property include (presuming no non-business uses):

- your "classic" retail, commercial, industrial and farm land;
- a residential property used as a retail or commercial premises (eg a doctor's surgery);
- a residential property used by the owner in a rental business;
- leasehold interests in business real property;
- vacant land if it is used in a business (eg a car park);

- land held by a property developer for the property developer's business (including where the property was held as pre-development vacant land, in the part development stage, at the completed stage and as a showroom).

The in-house asset rules

The in-house asset rules prevent an SMSF holding an investment in a related party or related trust, and making loans to related parties, if the combined value of those assets exceeds 5% of the total value of the assets of the SMSF.

In a property development context, the in-house asset rules will be relevant in relation to investing in trusts and companies that will develop property or where loans are made to related party developers or builders.

When considering the in-house asset rules, it is important to determine who is a related party or a related trust. These rules are contained in Part 8 of the SIS Act. In particular, that part contains the provisions for working out who is a "Part 8 Associate." The rules are very complicated and therefore the following is a simplified overview of those rules. When considering the application of the in-house asset rules the particular provisions of the SIS Act should be carefully reviewed.

In simple terms Part 8 associates will include the relatives and related companies and trusts of the members of the SMSF and the SMSF's standard employer sponsor (if any). When considering whether someone is a related party or a related trust the members of the SMSF, the standard employer sponsor and the related parties of the members and the standard employer sponsor are grouped together (**Group**).

A company will be a related party where the Group controls the company under either of the following control tests:

- The Group has sufficient influence (ie control) over the board of the company; or
- The Group controls more than 50% of the voting rights in the company.

A trust will be a related trust where the Group controls the trust under any of the following control tests:

- the Group controls the trustee/the board of the corporate trustee (directly or indirectly; formally or informally);
- the Group has entitlements to income or capital of the trust that exceeds 50% (note that 50% is ok); or
- the Group has the power to remove the trustee of the trust.

The prohibition against borrowing

Under section 67 of the SIS Act SMSF trustees are prohibited against borrowing unless an exception applies. The most significant exception is the ability to enter into a limited recourse borrowing arrangement (commonly known as an LRBA) under sections 67A and 67B of the SIS Act. LRBA's are discussed below. Importantly, if an LRBA is structured incorrectly, or ceases to be structured correctly,

then the exemption will no longer apply and the borrowing will cause the SMSF trustee to breach section 67 of the SIS Act.

Prohibition against providing financial assistance to members

Section 65 of the SIS Act prevents an SMSF trustee from providing financial assistance to members or relatives to members. This prohibition will generally have limited application in a property development scenario but could be applicable if the SMSF trustee made a loan to a member or sold a development asset to the member on favourable terms. It could also apply if the member is employed by the SMSF as a builder and paid in an advantageous manner (eg paid for the full price upfront when the standard practice is to be paid in stages).

Investment strategy

Under section 52B of the SIS Act, SMSF trustees must prepare, and regularly review, an investment strategy. Although it would be prudent for an SMSF trustee undertaking property development to include this in its investment strategy, interestingly, the investment strategy requirements do not expressly require it to be accurate or for it to be followed. However, the investment strategy rules do provide a "safe harbour" for super fund trustees that prevents members from taking actions against them for poor returns, provided the investment is undertaken in accordance with the super fund's investment strategy.

Prohibition against charging assets of the SMSF

Under regulation 13.14 of the SIS Regs, super fund trustees must not give a charge over, or in relation to, an asset of the fund. Charge is widely defined to include "a mortgage, lien or other encumbrance." This is an important consideration to take into account where an SMSF trustee undertakes property development. For example, it is common (in non-SMSF) developments that a developer will require a mortgage over the land or a guarantee from the landowner in support of the developer's loan from a bank to finance the development.

It is also important that the SMSF trustee doesn't inadvertently breach this provision in its contractual documentation. For example, the development agreement can contain a contractual term which is an encumbrance as it prevents the SMSF trustee from dealing with the land.

Trustee remuneration

Section 17A of the SIS Act provides that a fund will not be an SMSF if the trustee, or the director of the corporate trustee of the fund, receives any remuneration from the fund or from any person for any duties or services performed by the trustee or the director in relation to the fund. This is a draconian requirement as a breach of this provision will cause the SMSF to become non-compliant and there is no discretion to the ATO to treat it otherwise.

This raises the question as to whether trustees/directors can be paid for performing some or all of the development services for the SMSF. Such activities will not be caught by section 17A if the provisions of section 17B are complied with. These provisions include:

- the trustee/director performs the duties or services other than in the capacity of trustee/director; and
- the trustee/director is appropriately qualified, and holds all necessary licences, to perform the duties or services; and
- the trustee/director performs the duties or services in the ordinary course of a business, carried on by the trustee/director, of performing similar duties or services for the public; and
- the remuneration is no more favourable to the trustee/director than that which it is reasonable to expect would apply if the trustee/director were dealing with the relevant other party at arm's length in the same circumstances.

Consequences of breaching the SIS Act and SIS Regs

Up until recently, the ATO's ability to punish SMSF trustees for breaching the SIS Act and SIS Regs comprised only of "big stick" measures. These included:

- making the SMSF non-compliant - with the result that the assets of the SMSF, less any non-concessional contributions, are taxed at the top marginal rate (effectively losing almost half the assets of the SMSF in tax);
- disqualifying the SMSF trustees/directors;
- taking the SMSF trustees/directors to the Federal Court to seek civil or criminal penalties; and
- for a breach of section 66, a penalty of up to 12 months imprisonment could also be sought.

Due to the drastic nature of these penalties the ATO was often reluctant to enforce them except in the most serious of breaches. As a result, a new penalty regime was introduced from 1 July 2014. Under this regime the ATO has a number of penalty options including:

- fining SMSF trustees/directors for breaches of the SIS Act (the fines range from $850 to $10,200 per offence);
- directing the SMSF trustee to rectify a breach; and
- directing that the SMSF trustee/director attend an SMSF education course.

TAX CONSIDERATIONS

The starting point when considering tax for property developments by SMSFs is that section 295-85 of the ITAA97 deems that (almost all) CGT assets will be held on capital account. This means, for example, that even land bought with the intention to sell for a profit, or used in a property development business, will still be held on capital account and qualify for the CGT discount (if held for 12 months).

However, this rule does not apply to assets held by companies or trusts that an SMSF has invested in, even if the SMSF holds all of the units or shares. For trusts, if the land is deemed to be on income account then the proceeds from the sale of the land will flow through to the SMSF as income even if the asset would have been on capital account if held directly by the SMSF. Dividends from companies will also be on income account.

In any event, there is not a large tax differential between the 10% rate for a discounted capital gain and the 15% rate for income and there is no difference if the SMSF is in pension phase as both income and capital are not taxed.

Non-arm's length income

The non-arm's length income rules tax certain types of income at the top marginal tax rate (currently 47% (including the deficit levy)). It is beyond the scope of this paper to go through the non-arm's length income rules in detail. However, briefly, they will catch:

- income derived as a result of non-arm's length dealings;
- private company dividends that are derived as a result of non-arm's length dealings;
- distributions from non-fixed trusts (eg discretionary trusts); and
- distributions from fixed trusts where the fixed trust's income was derived from non-arm's length dealings.

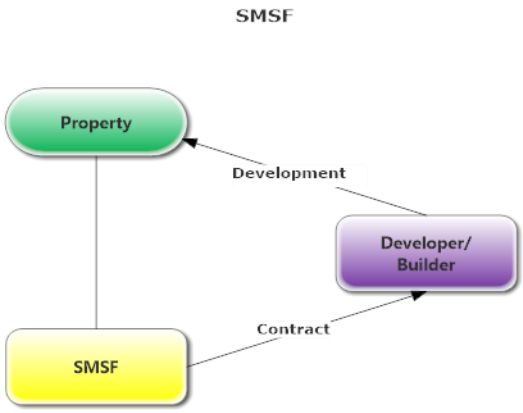
In a property development context, the non-arm's length rules will generally be avoided if all of the dealings with related parties are undertaken on an arm's length (commercial/market value) basis.

In the ATO's view, NALI can also apply to related party LRBAs. The ATO has confirmed they will not apply NALI to related party LRBAs if they match benchmarked terms from a commercial lender or comply with the safe harbour terms set out in PCG 2016/5.

STRUCTURES

In the following section of this paper, I have examined various structures under which an SMSF can undertake property development or invest in an entity which undertakes property development activities.

SMSFs



Property development activities can be undertaken directly by the SMSF trustee provided the SIS Act and SIS Regs are not breached.

Advantages of using this structure include:

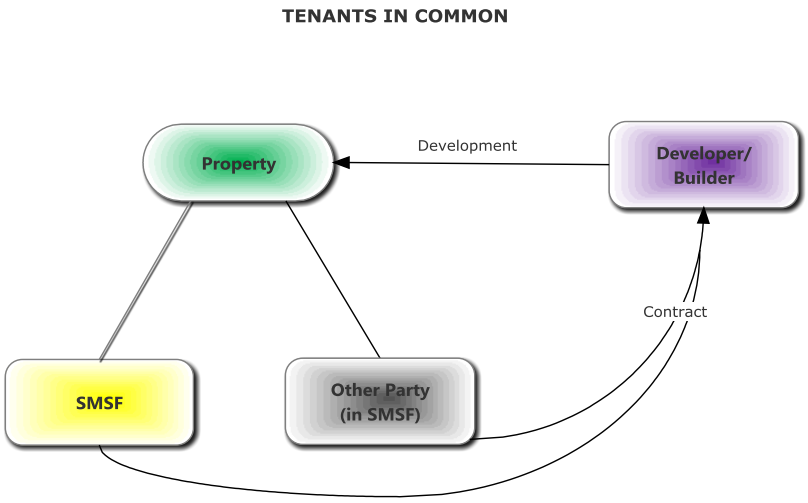
- there is no need for other entities and therefore there can be less cost and administration;

- the SMSF's cash can be used directly in the development;
- existing SMSF assets can be developed (although not with borrowing);
- income and capital are taxed at SMSF rates;
- the SMSF can undertake a property development business.

Disadvantages of using this structure include:

- SIS Act and SIS Regs restrictions can make development difficult
- there is no asset protection – SMSF assets are subject to claims from the development;
- it is difficult to use borrowing where making improvements;
- SMSFs cannot use borrowing to improve existing assets;
- it is difficult to bring other parties into the development (ie they would have to become members of the SMSF);
- the difficulties of using related party developers/builders.

Tenants in common

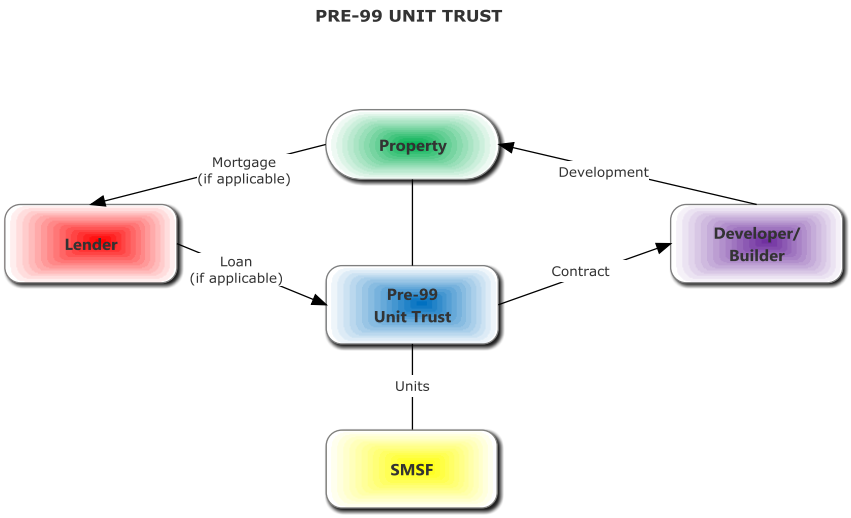


It is possible for an SMSF to hold assets as tenants in common with another party. That other party could be a related party or an unrelated party (including another SMSF).

As the SMSF holds an interest directly in property the tenants in common structure has the same advantages and disadvantages as the SMSF structure. In addition, it has the following disadvantages:

- if the asset is non-business real property and the other tenant in common is a related party, the SMSF will be unable to buy the other party's interest in the property;
- interactions with the co-owner could cause a breach of the SIS Act, for example an inadvertent borrowing by the SMSF or the provisions of financial accommodation to the related party co-owner;
- the tenants in common will be treated as a tax law partnership.
- duty may apply if the co-owner's interest is acquired by the SMSF.

Pre-99 unit trusts



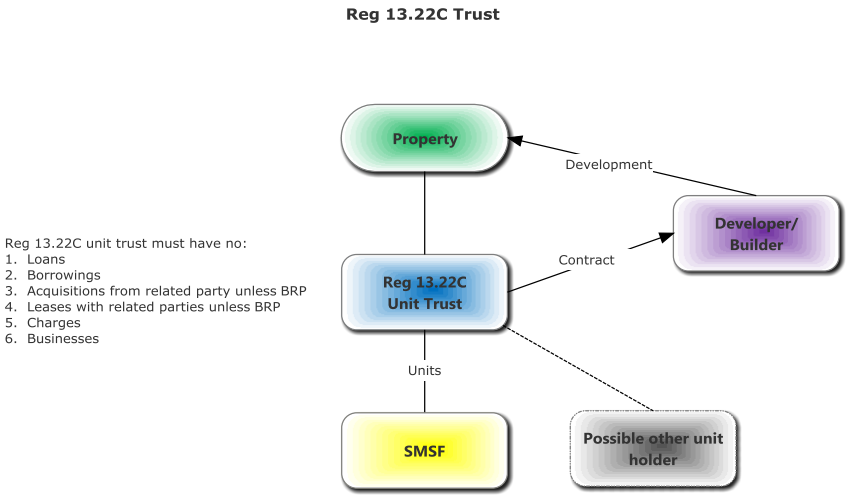
Where an SMSF acquired units in a unit trust (or company) prior to 12 August 1999, or under the transitional period operating from that date to 30 June 2009, such units will never be in-house assets. Any units acquired from 12 August 1999 (other than those acquired under the transitional rules) will be in-house assets.

This means that such unit trusts (commonly known as pre-99 unit trusts) can undertake activities that an SMSF cannot do directly without causing the SMSF to breach the in-house asset rules. Such activities can include borrowing and dealing with related parties. This can make a pre-99 unit trust valuable in a property development sense.

It is important to note that although the units in a pre-99 unit trust may not be in-house assets that the other SIS Act and SIS Regs rules and the tax acts will continue to apply to the holding of the units. This includes the sole purpose test, section 109 of the SIS Act, the non-arm's length income rules and the public trading trust provisions. Therefore, it is particularly important that the activities of the pre-99 unit trust be undertaken on an arm's length basis.

In addition, as any further units will be in-house assets and the distributions cannot be left unpaid without, in the ATO's view becoming an in-house asset (as financial accommodation), there can be cash flow issues. This is especially so where the pre-99 unit trust has low levels of cash, a principal and interest loan and the obligation to pay distributions. This issue can often be fixed (in the short to medium term) by interest only loans (and possibly with the capitalisation of interest).

Reg 13.22C unit trusts



Reg 13.22C unit trusts are sometimes referred to as non-geared unit trusts due to the specific prohibition against the trustee of such trusts from borrowing. However, the restrictions are much wider than that. For an SMSF to invest in such a unit trust that trust must satisfy the requirements of regulation 13.22C (or 13.22B) of the SIS Regs and not breach regulation 13.22D of the SIS Regs. These requirements include:

- the trustee of the unit trust, is not a party to a lease with a related party of the superannuation fund, unless the lease relates to business real property; and
- the trustee of the unit trust, is not a party to a lease arrangement with a related party of the superannuation fund, unless the lease arrangement:
    - is legally binding; and
        - relates to business real property; and
- the trustee of the unit trust, is not a party to a lease, or lease arrangement, with another party in relation to an asset that is the subject of another lease or lease arrangement between any party and a related party of the superannuation fund (unless the asset is business real property); and
- the trustee of the unit trust, does not have outstanding borrowings; and
- the assets of the unit trust do not include:
    - an interest in another entity; or
    - a loan to another entity, unless the loan is a deposit with an authorised deposit-taking institution within the meaning of the Banking Act 1959; or
    - an asset over, or in relation to, which there is a charge; or
    - an asset that was acquired from a related party of the superannuation fund after 11 August 1999, unless the asset was business real property acquired at market value; or
    - an asset that had been, at any time (unless it was business real property acquired by the trustee of the unit trust, at market value) in the period from the end of 11

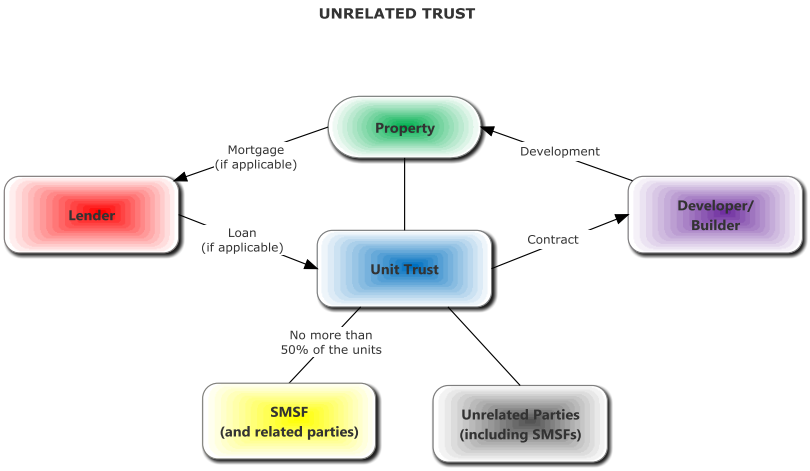
August 1999 to the commencement of this Division, an asset of a related party of the superannuation fund;

- the trustee of the unit trust does not conduct a business.

Although restrictive, the reg 13.22C unit trust has the significant advantages that units in such a trust held by an SMSF will not be an in-house asset and the SMSF can acquire units in such a trust from related parties . A reg 13.22C unit trust also has the advantage that related parties can hold units in such a unit trust, even where the Group controls the unit trust.

In a property development context, the trustee of a reg 13.22C unit trust can acquire property and develop it but it must do so without borrowing money, charging the asset, acquiring assets from a related party (including materials from a related party builder) or operating a business. Therefore, any property development would need to be fully funded from capital contributions by the unit holders.

Unrelated trusts



An unrelated trust is a unit trust which does not fall within the definition of a "related trust" under section 10(1) of the SIS Act. As noted above in the discussion of the in-house asset rules, determining whether a trust is a related trust is a complicated task. However, as a simple rule of thumb, if the SMSF and its Group hold no more than 50% of the units in the trust, hold no more than 50% of the shares in the corporate trustee, hold no more than 50% of the director roles in the corporate trustee and do not have the unilateral power to remove the unit trust's trustee, then the unit trust will not be a related trust.

An example of an unrelated trust is where two unrelated SMSFs each hold 50% of the units in the unit trust and their respective related parties hold no more than 50% of the shares in the corporate trustee and 50% of the director roles in the corporate trustee.

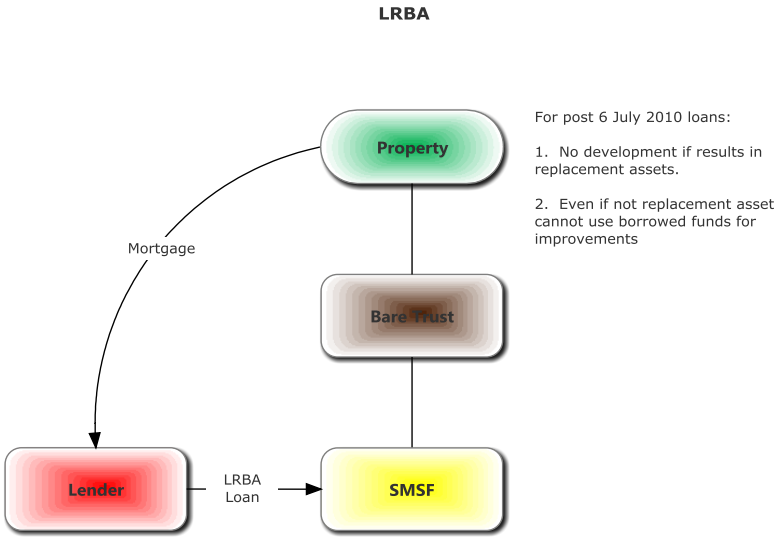
Unrelated trusts have significant advantages, as, like pre-99 unit trusts, the units held by the SMSF will not be treated as in-house assets regardless of what activities the unrelated trust does. Therefore, the unrelated trust can borrow, charge its assets, deal with related parties and carry on a business without

causing the units held by the SMSF to be in-house assets. As noted above for the pre-99 unit trusts, units in an unrelated trust can still cause an SMSF to breach the SIS Act (for example the sole purpose test or section 109) or trigger adverse tax consequences under the non-arm's length income rules. Therefore, it is important that an unrelated trust deals on an arm's length basis to avoid the potential application of these rules.

Leveraging using an unrelated trust has a particular advantage over LRBAs as the loan can be full recourse and neither the single acquirable asset rule nor the replacement rules apply.

As a result of the advantages noted above, the unrelated trust is the best structure for SMSFs to have an interest in property development. The biggest downside however is that an SMSF and its Group can only have a 50% interest in the unit trust. Therefore, this structure will not be appropriate where the SMSF and its Group want to control more than 50% of a unit trust or other investors cannot be found.

LRBAs (limited recourse borrowing arrangements)



The examination of the LRBA (limited recourse borrowing arrangement) rules is a topic in itself. Therefore, in this paper I have confined the issues of using LRBAs to those relating to property development.

New law LRBAs

LRBAs put in place after 7 July 2010 (**New Law LRBAs**) are governed by sections 67A and 67B of SIS Act. In a property development context, these New Law LRBAs are very restrictive for the following reasons:

- they can only be used to acquire single acquirable assets;
- borrowed funds cannot be used to improve assets under a New Law LRBA;
- assets under an LRBA cannot be improved to the extent that it results in a "new asset".

Despite these restrictions, the development of a property held under a New Law LRBA can occur where that improvement is funded from the SMSFs own funds (not borrowed funds) and the nature of the property does not change. The ATO gives the following examples of permitted improvements:

- Each (or all) of the following changes to a residential property would be treated as improvements but would not result in a different asset:
    - an extension to add two bedrooms;
    - the addition of a swimming pool;
    - an extension consisting of an outdoor entertainment area;
    - the addition of a garage shed and driveway;
    - the addition of a garden shed.
- The trustees of an SMSF enter into an LRBA where the single acquirable asset is a property which has a car washing facility on it. The property is leased to a tenant who operates a car washing business. The trustees decide to expand the facility by extending the back of the building to double the number of wash bays. The extension, which involves concreting, roofing and plumbing work, will be funded from accumulated funds held by the SMSF and will result in higher rent being received from the tenant. Although there is an improvement to the asset, that improvement does not result in the commercial property becoming a different asset. The fundamental character of the property remains a car wash facility.

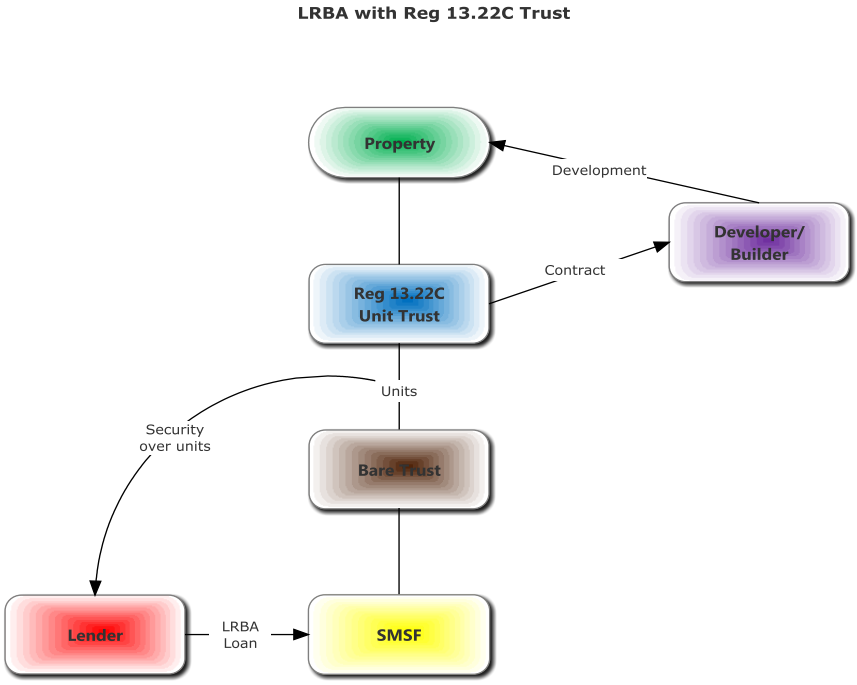
Old law LRBAs

Any LRBAs put in place between 24 September 2007 and 7 July 2010 (**Old Law LRBAs**) have the following significant advantages over New Law LRBAs:

- they could be used over multiple assets;
- property could be improved and subdivided under Old Law LRBAs;
- the borrowed funds could be used to make improvements.

This gave a lot more flexibility to do property development under Old Law LRBAs. Old Law LRBAs retain this flexibility post 7 July 2010 provided the terms of the arrangement permit such activities. If they don't then, in the ATO's view, changes to the arrangement may result in it being deemed to be refinanced into a New Law LRBA.

New Law LRBAs and reg 13.22C unit trust combination



Due to the difficulties of undertaking property development activities under a New Law LRBA, one alternative structure is for the property to be held by a reg 13.22C unit trust and for the SMSF to acquire the units in the unit trust using a New Law LRBA. In that way the unit trust trustee can undertake development of the property and not be restricted by the LRBA rules. The units held by the SMSF in the reg 13.22C unit trust under the LRBA structure will not be affected by such activities and therefore there will be no breach of the LRBA rules.

The major downside of this structure is that the activities of the reg 13.22C unit trust will be highly restricted (as discussed above). In particular the property held by the reg 13.22C unit trust cannot be used as security for the LRBA loan. Therefore, any security given to the lender will have to be restricted to the units in the reg 13.22C trust or other assets provided by guarantors.

Companies

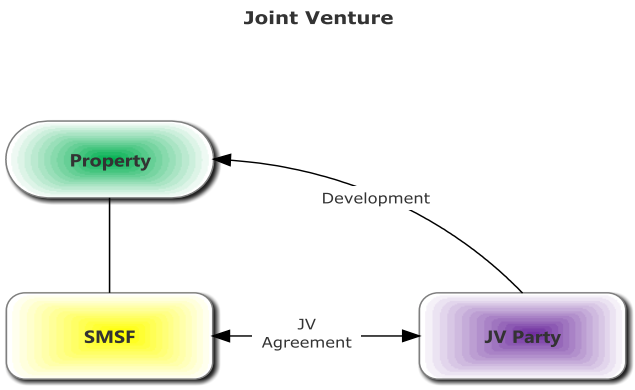
From an in-house asset perspective companies are effectively treated the same way as unit trusts. That is, SMSFs can invest in pre-99 companies, reg 13.22C companies and unrelated companies.

Unit trusts are generally favoured over companies due to their flow through nature from a tax and income perspective. That said, companies could still be used in certain circumstances, including:

- where a unit trust would be treated as a trading trust and taxed like a company in any event;
- accumulating income at the corporate entity was desirable;
- to avoid the complications arising out of the obligation to pay unit trust distributions in cash (or through reinvestments in units) rather than leaving them as unpaid present entitlements;

- the ability to use a corporate group structure.

Joint ventures



Typically under a joint venture arrangement each party will contribute something to the venture and they will each share the profits in an agreed manner. For example, an SMSF could "contribute" its property and a builder could contribute its building services and at the end of the arrangement the developed property, or proceeds from the sale of the developed property, would be shared according to some type of agreement or formula.

There are no provisions in the SIS Act or SIS Regs which prevent an SMSF from entering into a joint venture. However, entering into and implementing a joint venture could cause an SMSF to breach the SIS Act or SIS Regs. One example where this could occur is where the SMSF charges its assets under the JV agreement or in support of the joint venture partner's development activity.

USE OF RELATED BUILDERS

A significant recent development for SMSFs undertaking property development is the ATO's view on the application of the prohibition of SMSFs acquiring assets from related parties (section 66 of the SIS Act) to building contracts with related party builders.

The ATO has made it clear in its view where, under a building contract, a related party builder supplies materials to the SMSF, that the supply of such materials will be in breach of section 66.

Although on its face, this view would appear to rule out the use of related party builders, it is still possible provided that the building arrangement is structured correctly so that the SMSF doesn't acquire the materials from the related party builder. The "cleanest" way of achieving this is where the SMSF acquires the materials directly and the related builder just provides the construction services using the SMSFs materials.

That option is sometimes undesirable as the related party builder will have contacts and arrangements with suppliers that the SMSF will not. Therefore, an alternative arrangement is for the SMSF trustee to appoint the related party builder as its agent/attorney to acquire the materials on its behalf. If this option is used, the related party builder must be very diligent to ensure such materials are paid for by the SMSF, rather than by the builder and reimbursed by the SMSF, as that may cause there to be an acquisition of the materials from the related party builder.

COMPARISON OF STRUCTURES

	Tax	Gearing	100% control by one group	Interests can also be held by related parties	Asset protection for the SMSF	Special restrictions
SMSF direct	SMSF rates	Yes if under a LRBA	Yes	No	No	• Usual SIS and Tax Act restrictions. • With an LRBA the asset cannot be improved if it will cause it to be a "replacement asset" • Cannot acquire materials from related builders
Tenants in common	SMSF rates	Possible under a LRBA but difficult	Yes	Yes	No	
Pre-99 unit trust	Flow through unless a public trading trust but property can be held on income account	Yes	Yes	Yes	Yes from SMSF assets Further protection can be gained by way of investments in other structures	New unit acquisitions will be in-house assets and difficulties with P&I loans
Reg 13.22C ungeared unit trust	Flow through unless a public trading trust but property can be held on income account	No	Yes	Yes	Yes from SMSF assets	• Very restricted under regs 13.22C and 13.22D • Cannot acquire materials from related builders
Unrelated trust	Flow through unless a public trading trust but property can be held on income account	Yes	No – maximum 50% control	Yes – maximum 50% for SMSF and related parties	Yes from SMSF assets Further protection can be gained by way of investments in other structures	In ability to use the structure without other unrelated parties holding at least 50% of the units
Company	Corporate rate	Yes if unrelated	Yes if satisfy reg 13.22C	Yes	Yes	Loss of flow through tax treatment including the CGT discount
JV	SMSF rates	Yes if under a LRBA	Yes	Yes	No	If not structured properly will be treated as a partnership