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Pros and cons of having your business premises in your SMSF

Rent money could go into your super savings

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ONE way to free up capital in your self-managed super fund before you reach the preservation age of 55 is to transfer your business property into your fund.

By doing this you will release money from your superannuation ahead of time, free up the equity in your company's premises and give your business a cash injection to expand or provide cashflow.

And there will probably be no capital gains tax on the transfer to the SMSF, as small business CGT concessions will come into play. But stamp duty may apply on the transfer, depending on which state you live in and the current ownership of the property. Such transactions can be done only on an arm's-length basis and the sale must be at the market rate.

If there are insufficient funds in the SMSF to pay for the entire property, it is possible to take out a limited recourse loan. Since September 2007, SMSFs have been able to borrow money to buy property or equities. Limited recourse means the lender has no recourse to any other assets in the SMSF should the fund default.

But it's not all roses. First, the business will have to pay a rent to the SMSF for the premises. Again, this has to be at market rates. But the good news is the rent becomes the earnings of the fund, so rather than being taxed at the company rate, it will be taxed at only 15 per cent. If the fund is in the pension phase, no tax is payable on rent earnings.

Second, there could be issues for the SMSF if the business owner were to die or become bankrupt.

Col Lewis, head of technical services at Ipac Securities, says that if you were to die and the beneficiary were a non-dependent adult, a lump sum would need to be paid out of the SMSF. This might necessitate the sale of the property to raise the necessary money.

Equally, there could be difficulties if the business owner became bankrupt. While the assets in the SMSF are protected from bankruptcy, the owner can no longer act as a trustee of the fund and must cease to be a member of the fund. If this were the case, then the fund might have to be wound up or the assets transferred to a small APRA fund. If you switch to an APRA fund, fees will need to be paid to the trustee. And switching to a retail fund is probably not a viable option as they do not usually accept real property as an asset of a member's account.

Even if you don't own your business premises, there may be an argument to buy through your SMSF. This is because of the tax-friendly environment and the advent of limited recourse borrowing. Rather than run the risk of having to move because the landlord decides to sell, you will have the security of knowing exactly who your landlord is and their intentions.

If a limited recourse loan is taken out, it is advisable to buy insurance to ensure the interest repayments can be met. This is particularly important when part of the premises is rented out to other businesses. After all, if a property lies empty for a time, it may affect the SMSF's ability to meet the loan payments.

If your business were to run into difficulties and you faced problems paying the rent to the super fund, then as trustee you would be obliged to take normal recovery action, which may include evicting your business from the premises.

Life insurance will also address the issue of liquidity that can arise if the business owner were to die, as it can provide the necessary funds to pay the money out of the SMSF.

Another plus is that if you don't sell the property until after you reach 60, then there will be no tax payable on the proceeds.

A downside to having the business property in an SMSF is that it might make up a disproportionate percentage of the assets held.

This could affect the diversification strategy of the fund and the long-term returns and also weaken liquidity.

Liquidity is a particular problem when the SMSF is in the pension phase, as you have to fund regular income payments to the members.

While there are pros and cons of having your business premises in your SMSF, the double whammy of your company's premises helping to build your retirement savings in a tax-friendly environment while providing your business with an injection of cash can prove very attractive.