

Wealth Personal Finance Super wars

The tax fears leading some SMSF investors to dump property

Analysis shows DIY super funds are still likely to pay less tax despite concerns about the proposed levy on unrealised capital gains.

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Investors are ditching property from their self-managed super funds because of concerns about rising rates, tougher lending conditions and the prospect of taxes on unrealised capital gains [<https://www.afr.com/link/follow-20180101-p5ct38>], say industry specialists.

“It’s getting too hard for many SMSF property investors,” says mortgage broker Phoebe Blamey, a director of Clover Financial Solutions, who recently helped a number of investors sell their SMSF [<https://www.afr.com/wealth/personal-finance/why-losing-a-trust-deed-is-more-serious-than-you-think-20230317-p5ct3v>] residential properties. “They are selling out because the returns and high costs mean there is no point in continuing.”

But exclusive analysis by consultancy BDO Australia comparing the tax treatment of assets held in an SMSF with those owned by individuals and companies shows DIY super funds easily remain the most efficient tax structure for a long-term property investment.



Owning property in an SMSF may produce a better result because of potentially lower taxes on earnings and capital gains, says Mark Wilkinson. **Dominic Lorrimer**

Mark Wilkinson, a BDO partner specialising in superannuation and private wealth, says: “Don’t let a proposed change in legislation determine whether you hold property and other capital-appreciating assets in your super fund.”

Wilkinson adds: “Generally, companies and individuals will pay a higher rate of income tax than superannuation funds on capital gains when assets are sold. The proposed new superannuation rules only tax part of the capital gains – the proportion based on an individual’s total superannuation balance above the \$3 million that accrues after July 1, 2025.”

His analysis, illustrated in the accompanying table, uses the example of a property purchased for \$2 million that is valued at \$3 million on July 1, 2025 (when the planned unrealised capital gains may be introduced) and sold five years later. Based on 10 per cent growth assumptions, the combined income, capital gains and assumed unrealised capital gains tax for an SMSF is around 73 per cent lower than for an individual and 130 per cent less than the amount paid by a company.

“It demonstrates that some people will be better off leaving property in a super fund even if the government’s proposed changes are introduced,” Wilkinson says. “It ultimately is a case-by-case issue.”

Comparison of tax outcome for property ownership

SMSF

(\$)	Year 1	Year 3	Year 5	Total tax paid
Value of asset	3,300,000	3,993,000	4,831,530	–
Capital growth	300,000	363,000	439,230	–
Income	120,000	145,200	175,692	–
■ Tax on income	18,000	21,780	26,354	–
■ Tax on TSB growth	4,090	13,540	24,975	–
■ Total tax per year	22,090	35,320	51,329	180,072
■ Capital gain at the end of 5 years	(4,831,530 - 2,000,000) x 10%			283,153
Overall total tax				463,225

COMPANY

(\$)	Year 1	Year 3	Year 5	Total tax paid
■ Tax on income	36,000	43,560	52,708	–
■ Tax on TSB growth	–	–	–	–
■ Total tax per year	36,000	43,560	52,708	219,784
■ Capital gain at the end of 5 years	(4,831,530 - \$2,000,000) x 30%			849,459
Overall total tax				1,069,243

INDIVIDUAL

(\$)	Year 1	Year 3	Year 5	Total tax paid
■ Tax on income	29,467	38,791	50,073	–
■ Tax on TSB growth	–	–	–	–
■ Total tax per year	29,467	38,791	50,073	196,401
■ Capital gain at the end of 5 years	(4,831,530 - 2,000,000)/2 = 1,415,765			607,761
Overall total tax	1,415,765 then taxed at marginal tax rates			804,162

Assumptions: SMSF, company and individual have \$3 million property at June 30, 2025; in SMSF, the \$3 million invested exceeds the proposed \$3 million cap; after five years, the property is sold and the benefit distributed (cost base \$2 million); 10% growth, income 4% pa; tax on the growth in the member balance is paid by the member personally; Medicare levy not included

SOURCE: BDO

Australian Taxation Office analysis shows the value of property owned by SMSFs has been falling despite the value of overall assets in the funds continuing to rise.

Total assets up to the end of last year increased by about 2.4 per cent, while commercial and residential property fell by 2.6 per cent, according to ATO analysis.

“Sure, this could be a straight valuation effect, but it shows that not much is going into the sector,” says Alex Dunnin, executive director of research for Rainmaker Information, which monitors superannuation performance.

“Since the end of March 2022 when rates were jumping up, SMSF property assets have fallen in value by 5.2 per cent,” Dunnin says.

SMSF investors in residential properties, whose mortgage costs are already higher than those of owner-occupiers, are also facing demands from lenders for more liquidity to meet cash flow obligations, such as maintenance and other costs.

“There are a lot of very nervous SMSF investors,” adds Chris Foster-Ramsay, of Foster Ramsay Finance. “They are questioning the value of property in their funds because of rising interest rates and the increasing cost of servicing their properties.”

Added to this is the growing concern about the federal government’s plans to double the tax rate from 15 per cent to 30 per cent for earnings on super funds above \$3 million, say sector specialists.

SMSF Association chief executive Peter Burgess says it is awaiting additional detail from the government about the planned changes and intends to make representations about potential impacts on the \$868 billion sector.

Burgess warns proposals to tax unrealised gains are “quite unusual” and suspects it could cause cash flow problems for some funds with a high exposure to illiquid assets, such as property, making it more difficult to repay loans, pay bills and run a fund effectively.

Mortgage costs rising faster than rental and other income sources (such as salaries) are also causing problems for some SMSF investors already facing higher interest rates than owner-occupiers and less choice of lenders, say fund specialists.

A typical \$1 million loan costs between 6.3 per cent and 6.9 per cent, according to RateCity, which monitors rates. An average \$1 million standard variable loan for an owner-occupier is about 6.19 per cent.

In addition, some lenders charge upfront fees of more than \$3000 and annual charges of about \$400.

An investor who borrowed \$350,000 for a \$500,000 property paying around 6.9 per cent for a loan is earning a net yield of around 3.5 per cent from rental income, which means a monthly shortfall of about \$1400, says Blamey.

“For many investors it is no longer viable,” she says, adding many are considering owning property in their own name or in a company structure.

But BDO analysis, based on reasonable growth and tax assumptions over the five years after the introduction of the proposed unrealised gains, shows that SMSFs remain the most tax efficient.

“It depends on the circumstances of the individual. The fund may produce a better result because of its potentially lower income taxes on earnings and capital gains,” says Wilkinson.

“[Even] when you add in the additional income tax on the unreleased gain, the combined rates in many cases may be lower than those applied to the company or individual when taxed at marginal rates.”

He adds that individuals and companies “get clobbered” by capital gains when the property is sold.

The total income, capital gains and unrealised capital gains tax paid by the SMSF over the five years is about \$463,000, compared to \$804,000 for an individual and more than \$1 million for a company.



Many investors are bailing out of SMSF property, says mortgage broker Phoebe Blamey.



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