FARM BUSINESS
FACT SHEET

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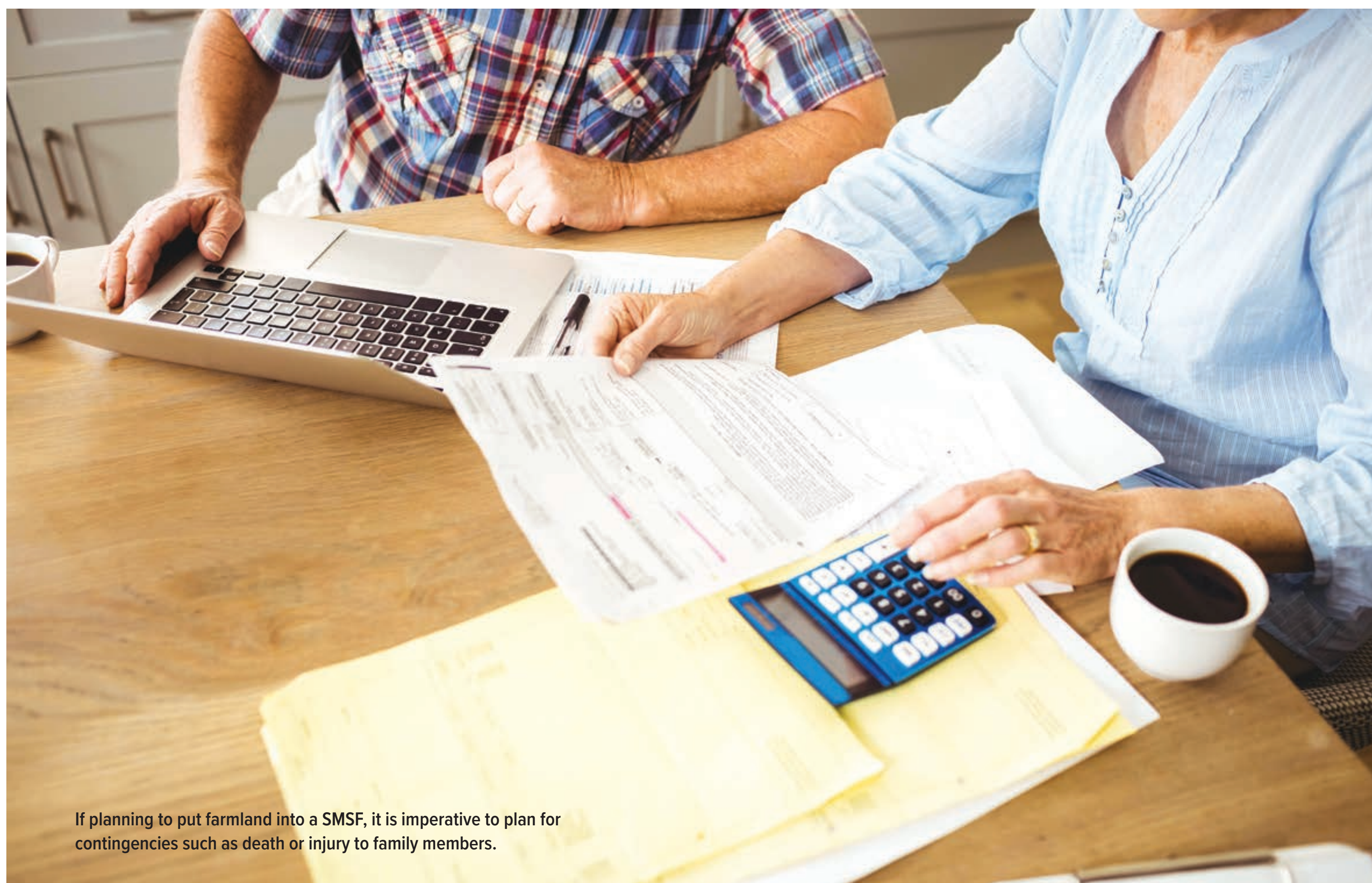
The transfer of farmland into a self-managed superannuation fund



If planning to put farmland into a SMSF, it is imperative to plan for contingencies such as death or injury to family members.

Background

For many Australians, their most important retirement investment is superannuation. Compulsory contributions for employees and tax incentives for business owners have made superannuation a 'go-to' when planning for a financially secure retirement.

Many Australian farmers have identified the benefits of placing their most substantial asset, farmland, into a tax-effective and protective environment conducive to aiding a secure retirement.

These benefits have seen a self-managed superannuation fund (SMSF) become a common structure for transferring farmland into the superannuation system, achieved by accessing the small business capital gains tax (CGT) and superannuation contribution concessions.

As with most major business decisions, all factors (positive and negative) need to be taken into consideration before transferring farmland into the confines of the highly regulated superannuation environment.

Key points

- Superannuation is a tax-effective way to save for retirement, however it is a highly regulated and complex system.
- A self-managed superannuation fund (SMSF) is an attractive and popular structure used as part of a financial strategy to obtain financial security.
- Owning farmland in a SMSF may be a good way to create more wealth, but the limitations of the structure need to be balanced against the benefits.

Some superannuation basics

PHASES OF SUPERANNUATION

The **retirement phase** is the period during which a superannuation fund pays out an income stream/ pension, and the earnings (including capital gains) on those pension assets are exempt from any tax.

The most common way to access a superannuation pension is to reach the specified preservation age and retire. The preservation age ranges from 55 to 60 years, depending on an individual's date of birth.

The alternative to the retirement phase is the **accumulation phase**. This is the period where all earnings inside superannuation will be subject to a 15% tax.

From 1 July 2017, an individual can have no more than the transfer balance cap (TBC) in the retirement phase. For the 2017-2018 and 2018-2019 years, the TBC is $1.6 million. Any retirement savings exceeding the TBC will need to be transferred to the accumulation phase, or withdrawn from the superannuation system.

TYPES OF SUPERANNUATION CONTRIBUTIONS

Superannuation contributions can be divided into two types: concessional (before-tax) and non-concessional (after-tax). Each is subject to a contributions cap, which sets a limit on the amount of contributions that can be made in any one year.

Concessional contributions are any payment made to superannuation where a tax deduction can be claimed. This also includes any salary-sacrificed amount paid into superannuation. From 1 July 2017, the annual concessional cap for an individual is $25,000. Concessional contributions are taxed at a rate of 15%.

Non-concessional contributions (NCC) are amounts paid into a superannuation fund from after-tax income. NCC are exempt from the 15% contributions tax. From 1 July 2017, the annual NCC cap limit was reduced to $100,000.

If an individual is under the age of 65, they can contribute up to $300,000 in NCC for the 2018-2019 year, representing the annual cap over a three-year period (2019-20 and 2020-21 in advance). This is known as the 'bring-forward rule'. To be eligible to bring-forward contributions, the taxpayer's superannuation balance as at 30 June 2018 will also need to be less than $1.5 million.

Note that superannuation contributions arising from the small business CGT concessions, which are within an individual's CGT cap, are excluded from being treated as a NCC (provided the contribution is made within 30 days of receiving sale proceeds). The CGT cap for 2018-19 is $1,480,000.

Key benefits of a SMSF holding farmland

A SMSF can be the 'vehicle' used in a succession-planning process that allows farmers to access the tax-effective superannuation environment. The SMSF provides a means of separating the farming operation from the land ownership. This separation of the land asset from the business operations not only provides access to attractive superannuation tax rates, it also has the added benefit of achieving asset protection.

The separation is achieved by transferring the land asset ownership to a SMSF while the business operations remain outside of the fund. By transferring the land into the superannuation system, this inherently provides excellent asset protection going forward. The farming business will continue to operate as it did previously, prior to any land separation.

The land will be rented by the SMSF to the farming business at an agreed market rate. This subsequently provides tax-effective (maximum of 15%) rental income to the fund members, while the farm business will receive a tax deduction for the lease payments. When the members of the SMSF are in the retirement phase and balances are within the TBC, all income (including capital gains) generated by the fund will be tax free. This will be the case whether the farmland is rented to the next generation or to a third party.

Another benefit of a SMSF owning the farmland is that it potentially minimises estate-planning risk, as the assets held in superannuation will not form part of a deceased individual's estate. By having in place a superannuation binding death benefit nomination (BDBN), a member(s) of a SMSF can ensure that a particular asset (e.g. farmland) is transferred to a specified individual on their death.

Once the members reach retirement age and can be paid a pension from their SMSF, the accumulation phase converts to the retirement/pension phase.

Assets within superannuation will not form part of the estate and therefore are unable to be subject to a contested will action. This also applies to assets directed to off-farm children via a BDBN.

Case study of a retiring farming family

SITUATION

- John and Molly farm 1420 hectares with Sam and Tilly (their son and daughter-in-law).
- John is 63 and Molly is 61.
- Other assets include residential property and $300,000 in shares to come from Molly's mother's estate.
- Home block is unencumbered and valued at $1,250,000.
- Family agreement is that Sam and Tilly will pay John and Molly $75,000 per annum in retirement.
- John and Molly can each contribute $100,000 p.a. as a NCC or $300,000 using the bring-forward rule.
- They can each contribute up to $500,000 as a CGT concession on sale of active farm assets or up to $1,445,000 if the asset being sold or transferred has been owned for 15 years or more.

STRATEGY

- John and Molly set up a SMSF.
- Molly transfers her shares from her mother's estate into the SMSF using the $300,000 NCC bring-forward rule.
- Transfer home block into a SMSF using the small business 15-year exemption rule and rent it to Sam and Tilly for $75,000 p.a. (the commercial lease rate).

OUTCOME

- All income to the SMFS will be tax free, including $15,000 relating to shares transferred from Molly's mother.
- Sam and Tilly can claim an annual tax deduction for the $75,000 rent.
- John and Molly have a tax-free superannuation pension of $90,000 p.a., compared to $77,656 outside superannuation (at 2018-19 marginal tax rates).
- For estate planning, John and Molly arrange to have BDBNs in the SMSF, leaving the farmland to Sam and shares to their off-farm children.

Key disadvantages/risks of a SMSF holding farmland

1. The asset cannot be used as security for business borrowing. This is based around the 'sole purpose test' of a SMSF, which is to provide benefits to its members upon their retirement, or to their dependants in the case of the member's death before retirement. Using a SMSF's assets as security for business borrowing potentially exposes the fund to the risk of not meeting the sole purpose test. This type of asset exposure is strictly not allowed.

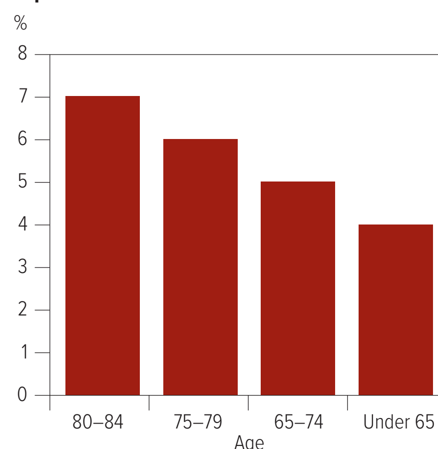
2. Once a member reaches retirement age and can be paid a pension from their SMSF, the accumulation phase converts to the retirement/pension phase. If the rent received from the farming business for the lease of the land is insufficient ('liquidity trap') to cover the minimum annual pension payment percentage (Figure 1) this may lead to action, such as partly converting back to the accumulation phase (lose 'tax-free' status) or the need to sell fund assets (e.g. farmland).

3. When a SMSF member dies the payment of a death benefit is required and if the recipient of the benefit is a spouse or 'dependant', the payment can either be in the form of a lump sum or income stream. However, where the death benefit is to a non-dependant (e.g. adult child), ordinarily the payment will be as a lump sum. In this situation, a problem arises where the SMSF cash reserves are not adequate to cover the benefit payment such as a lump sum, and therefore may require the SMSF to sell off assets (for example farmland). This in turn could trigger CGT consequences inside the SMSF, where assets such as the farmland are sold or transferred to the beneficiary in lieu of a death benefit payment entitlement.

SUMMARY OF ACRONYMS

SMSF – Self-managed superannuation fund
CGT – Capital gains tax
TBC – Transfer balance cap
NCC – Non-concessional contributions
BDBN – Binding death benefit nomination

FIGURE 1 Minimum annual percentage of superannuation paid out as a pension.



4. Another death benefit payment problem may occur where a member of the SMSF passes away and their pension reverts to a surviving member. Where this 'reversionary' pension passes to a member and subsequently causes them to exceed their personal TBC ($1.6 million), the SMSF has two options to deal with the cap breach:

- the SMSF rolls back the excess to accumulation phase; or
- the SMSF pays out the amount.

If the latter option is chosen, this again may require fund assets to be sold and CGT consequences to arise.

FREQUENTLY ASKED QUESTIONS

At what age can I access my superannuation?

Date of birth	Age to access superannuation
Before 1 July 1960	55
From 1 July 1960 until 30 June 1961	56
From 1 July 1961 until 30 June 1962	57
From 1 July 1962 until 30 June 1963	58
From 1 July 1963 until 30 June 1964	59
On or after 1 July 1964	60

Does a SMSF operate like a retail or industry superannuation fund except that I have more control?

A SMSF operates exactly as any other superannuation fund, but you have 100% control over it. That is, as the trustee you are responsible for how the fund operates, how the money is invested, types of investments, etc.

Does a SMSF require an investment strategy?

Yes. Legislation requires SMSFs to have an investment strategy. There is no prescribed format for an investment strategy, and strategies will vary from fund to fund based on, but not limited to, the following:

- age of members;
- the composition of the fund's investments;
- future contributions to the fund;
- risk of investments;
- cashflow needs; and
- liquidity.

The investment strategy must be in writing and should be reviewed at least annually, or when investment opportunities available to the fund are inconsistent with the fund's investment strategy.

USEFUL RESOURCES

www.ato.gov.au/super/self-managed-super-funds

GRDC Farm Business Fact Sheet – National: grdc.com.au/tax-implications-sale-of-farmland

A Guide to Succession: Sustaining Families and Farms, www.grdc.com.au/Guide-Succession-SustainingFamiliesAndFarms

MORE INFORMATION

Contact your accountant or financial adviser.

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