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Family planning gives birth to a few problems

Investing DIY super cash with a relative can look attractive, but don't rush into it without good advice.

Phil Jaquillard, Director, SuperGuardian.

On paper it looks like an attractive investment idea for a super fund. A *Weekend AFR* reader has a relative who owns an apparently successful small business and wants to sell shares in the private company.

The reader has some cash in his self-managed superannuation fund. Could some of this be used to buy shares in the relative's private company as an investment?

According to Phil Jaquillard, a director of Adelaide-based DIY fund administrator Super Guardian, there are some potential restrictions you need to weigh up that may reduce the appeal.

Because this company is owned by a relative, any investment would be classified as an in-house asset.

An in-house asset is one where there is a family relationship between the fund members and the investment. Under special superannuation rules that apply to in-house assets, you can invest in a related private company that is running a business so long as no more than 5 per cent of your total fund assets are involved.

"If you already have 3 per cent in other in-house assets, you will only be able to commit another 2 per cent to bring it up to 5 per cent," Jaquillard says.

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But this isn't the only issue that relates to investments in private companies. Probably the main point is the special income rules.

These rules are determined by section 273 of the Income Tax Assessment Act, which says that any dividend from a private company that is paid to a super fund is potentially taxable at 47 per cent, with no entitlement to dividend imputation tax credits.

Jaquillard says you can seek the Tax Commissioner's discretion to not apply that provision and instead have the income taxed at the standard DIY fund rate of 15 per cent along with a right to imputation tax credits.

The way to do this is by making a request to the ATO for a private ruling.

Jaquillard says that example rulings or interpretative decisions suggest that if there is no reason why the dividends should be taxed at 47 per cent, it is likely to be given the concession tax treatment.

Jaquillard says DIY fund investors must also review whether it's a valid investment that fits with the fund's investment strategy.

The section 273 rules describe what the taxman will consider when making a determination as to whether the income will be taxed at 47 per cent with no franking credits or at 15 per cent with credits.

Would a super fund be better off lending the relative money for the business instead of buying shares?

According to Jaquillard, it is a similar issue. Any loan would be an in-house asset investment, and if you are getting a commercial rate of interest on the loan, that might mean the income was treated as a normal 15 per cent taxable super income.

If the interest rate was more generous than a commercial realistic rate, the risks would be that the excess could be classified as special income and subject to the top tax rate.