

## Non-Residency and SMSFs - Making sure the rules are covered

The residency conditions must be carefully considered in relation to any potential, or existing, SMSF members who are likely to spend periods of time outside of Australia.

Failure to meet the residency conditions is likely to result in a fund losing its complying fund status and thereby becoming ineligible for concessional taxation treatment.

Outlined in this paper are the three tests applied to determine whether an SMSF is an 'Australian superannuation fund'.

### Australian Superannuation Fund

For an SMSF to be considered a complying superannuation fund (and thus entitled to concessional taxation treatment) it must be an Australian superannuation fund as defined in s 295-95(2) of the ITAA 1997.

There are 3 tests which need to be met if a fund is to be considered an Australian superannuation fund:

- the fund was established in Australia, or any asset of the fund is situated in Australia at that time; and
- the fund meets the 'active member' test; and
- the central management and control of the fund is ordinarily in Australia.

The first test is relatively straightforward and is discussed briefly below.

The second and third tests are discussed below in more detail, with the third one being considered the most complex to determine.

To assist in determining compliance, the ATO Taxation Ruling TR 2008/9 'Income tax: meaning of 'Australian superannuation fund' in subsection 295-95(2) of the Income Tax Assessment Act 1997' sets out its interpretation of the 'residency' law.

### Test 1 - Australian

As mentioned, compliance with this test is easily able to be determined, as virtually all SMSFs will have been established in Australia.

However, for any SMSF not established in Australia, it merely needs to hold an asset in Australia to meet the test.

### Test 2 - Active Member

The active member test is a more complex test, because of a few potential traps.

Members will generally be considered active if contributions and/or rollovers are received by the fund on their behalf.

To meet the active member test, where a SMSF has at least one active member at any time during a year of income, the percentage of the **resident** active members' benefits must be at least 50% of the total active members' benefits in the fund.

Where a member has temporarily left Australia, contributions should cease on their behalf (i.e. so the member is not an 'active' non-resident member), to ensure that the 50% test is met.

It is important to remember that rollovers will be considered to be contributions under the active member rules.

### Test 3 - Central Management and Control

The ATO considers that central management and control (CM&C) of a fund refers to "...strategies and high level decision making processes and activities of the fund" (TR 2008/9, paragraph 20). Examples of these processes and activities are the formulating, reviewing, updating and variation of the fund's investment strategy, monitoring investment performance and management of any reserves.

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The focus, in other words, is on the level of involvement of the funds' trustee(s) with any such strategic decisions, including review and assessment of the performance of any outsourced 'advisers'.

Some confusion remains from the law as it was applied prior to the changes in 2007.

Under the pre 2007 rules, if a trustee or trustees were absent from Australia for a period of up to 2 years and were exercising CM&C from outside Australia during that time, then the fund would be deemed to meet the residency rules.

Recommencement of the 2 year period could be re-triggered by the trustee(s) returning to Australia for a period of 29 days or more.

Under the current rules, returning to Australia for a minimum period, either before or after 2 years have elapsed, will not change the determination about whether the absence is of a temporary nature or not. However, if the intention to be overseas is temporary and the duration is less than 2 years, then the CM&C of the fund should still be considered 'ordinarily' in Australia.

The question then is what does 'temporarily' mean? The Ruling, at paragraph 33, states the following:

"The CM&C of a fund will be 'temporarily' outside Australia if the person or persons who exercise the CM&C of the fund are outside Australia for a relatively short period of time and during that time they exercise the CM&C of the fund overseas. The duration of the

absence must either be defined in advance or related (both in intention and fact) to the fulfilment of a specific, passing purpose."

### Note:

An SMSF may lose its status as an Australian superannuation fund when, for example, a posting intended to be for a short duration (less than 2 years) is converted to a more permanent posting by way of a contract extension. If the CM&C was exercised out of Australia, the fund may not meet the requirements to be an Australian superannuation fund.

This is covered at paragraph 152 of TR 2008/9.

Where a person or persons who exercise the CM&C of the fund are leaving Australia indefinitely, if they continue to exercise the CM&C whilst overseas, the fund will not be an Australian superannuation fund.

### Planning options

If an SMSF trustee is going overseas, consideration should be given to the following issues:

- If an equal number of trustees is located in Australia or overseas, the ATO will accept that the fund is 'ordinarily' in Australia as long as each of those domiciled trustees /directors 'substantially and actively' (not passively) participates in the CM&C of the SMSF.

This means that if it is a single member SMSF and the non member trustee will be staying in Australia, or if there are 4

trustees and 2 will be staying in Australia, there is generally no problem, from a CM&C perspective, regardless of the length of the overseas stay, so long as the resident trustee(s)/director(s) are substantially active in the CM&C.

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- If the above does not apply, then the 'relatively short' (temporary) duration of the overseas stay and the intention to return to Australia need to be established. TR 2008/9 contains a number of examples which will assist in gaining an understanding of the way in which these rules are expected to apply.
- If, as a result of the above analysis, it seems likely that the fund will fail the CM&C test, the following options should be explored:
  - handing over the trusteeship of the fund to an approved trustee, such that the SMSF would become a Small APRA Fund (SAF); or
  - rolling over the benefits to a public offer fund and

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winding up the SMSF. This may mean selling assets and may not be an attractive option; or

- appointing an enduring power of attorney; or
- appointing an alternate director (where a company is the trustee).

## Note:

In some cases it may be possible for a person:

- holding an Enduring Power of Attorney; or
- acting as alternate director for the absent member/director;

to exercise the CM&C of a fund.

The ATO released, in April 2010, a ruling (SMSFR 2010/2) regarding the interpretation of sub paragraph 17A(3)(b)(ii) of the SIS Act and the use of either an enduring power of attorney on behalf of a member trustee of a fund, or the appointment of an alternate director by a member director of a fund.

The SMSFR includes examples of situations as well as the mechanics of an effective use of an enduring power of attorney or alternate directorship.

## Enduring Power of Attorney

A power of attorney is a legal document, through which a person (donor) appoints others to make decisions, and enter into transactions, regarding their financial and property matters. An enduring power of attorney means

the power will continue, even if the donor loses mental capacity.

## Alternate Director

An alternate director is appointed to be the alternate of the actual director. They usually act when the actual director is unable to attend to their directorship, possibly as a result of absence.

When an alternate director acts in regards to the directorship, the exercise of the director's powers has the same effect as if they were exercised by the actual director.

One significant difference between appointing an enduring power of attorney or an alternate director is that, in the event of the incapacity of the member:

- the enduring power of attorney will continue to be able to act on behalf of the member; whereas
- the role of alternate director will cease if the role of the director ceases.

## Note:

SMSFR 2010/2 deals with the instance of an individual member having appointed more than one person to be their attorney. It states "Where an enduring power of attorney is executed in favour of multiple attorneys, one or more of those attorneys can be appointed as a trustee, or a director of the corporate trustee, in place of the member."

## Example

Andrew, a sole member and director of the trustee of his SMSF.

He has in place an enduring power of attorney in which his two children, Grace and Simon, are his attorneys.

Andrew plans to take up a position overseas for an indefinite period. His choices in regards to the SMSF trusteeship are:

- have **either** Grace **or** Simon replace him as director of the corporate trustee;
- appoint **both** Grace **and** Simon as directors to replace him as director of the corporate trustee; or
- appoint **either** Grace **or** Simon as his alternate director, to act in regards to his directorship in his absence.

## Conclusion

This is a complex area. If you have clients in this situation, it is strongly recommended that you read TR 2008/9, 'Income tax: meaning of 'Australian superannuation fund' in subsection 295-95(2) of the Income Tax Assessment Act 1997' and SMSFR 2010/2, 'Self Managed Superannuation Funds: the scope and operation of sub-paragraph 17A(3)(b)(ii) of the Superannuation Industry (Supervision) Act 1983', as required, and/or seek further advice.

## More information

Should you have any queries or require more information, please contact the team at Topdocs on 1300 659 242.

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