AET

Residency

Do your clients meet the residency test?

Superannuation funds are allowed certain tax concessions provided that they comply with a number of regulatory conditions, one of which relates to the residency status of the fund.

Self managed super fund (SMSF) trustees and members must ensure that their SMSF complies with the central management and control test and the active member test at all times so that the SMSF is an Australian superannuation fund. If a superannuation fund does not meet the residency requirements at any stage of the year, the fund is not an Australian superannuation fund and therefore will not be a complying superannuation fund. Any discretion that the Commissioner of Taxation may normally have to treat a non-complying superannuation fund as complying is not available for an SMSF that is not an Australian superannuation fund.

An SMSF that is not an Australian superannuation fund is not entitled to any tax concessions and will incur a significant tax penalty. An amount equal to the market value of the fund's total assets (less any contributions the fund has received that are not part of the taxable income of the fund) will be included in the fund's assessable income. This amount is taxed at the highest marginal tax rate. For every year that the fund remains non-complying, its assessable income is taxed at the highest marginal tax rate.

When is a fund an Australian superannuation fund?

A superannuation fund is an Australian superannuation fund if:

- the fund was established in Australia, or any asset of the fund is situated in Australia, and
- the central management and control of the fund is ordinarily in Australia, and
- active members who are Australian residents hold at least 50 per cent of the fund value.

Central management and control

For clients who are trustees of SMSFs, the residency test is particularly important. As the trustee is responsible for the central management and control of a fund, their physical location is very relevant.

In a small APRA fund (SAF), retail, corporate or industry fund environment, the trustee will invariably be a body corporate, incorporated in Australia, with the business of the fund being managed from Australia. As a result, the central management and control test is generally easily met.

The central management and control of a superannuation fund is ordinarily in Australia at a time even if that central management and control is temporarily outside Australia for a period of not more than two years.

Prior to 1 July 2007, fund trustees were able to be absent from Australia for two years, however, by returning to Australia for a period of 28 consecutive days, this two year time period was re-triggered. For example, trustees returning to Australia every second Christmas for a month were able to continue to meet the residency requirements.

However, the 28 day provision no longer applies and trustees who are temporarily absent for more than two years will rarely meet the central management and control test.

Active members

Active members are members who contribute, or for whom contributions are made to a fund. For the purpose of the residency test, contributions include rollovers to a fund.

Options for non-resident trustees

For SMSF trustees who do not meet the residency test and **do not** contribute:

Option 1 – Rollover to a retail, corporate or industry fund

- The rollover of the SMSF to one of these funds will trigger a CGT event.
- Upon the member's return to Australia, they may elect to rollover their benefit back to an SMSF, this will also trigger a CGT event.

Option 2 – Complete a change of trustee to a SAF

- A change of trustee from an SMSF to a SAF is not a CGT event.
- A change of trustee back to an SMSF can occur when the member returns to Australia. This is not a CGT event.

For SMSF trustees who do not meet the residency test but who **will** make contributions there are also two options:

Option 1 – Rollover to a retail, corporate or industry fund and contribute to the large fund

- These types of funds generally have many members and non-resident members are unlikely to hold at least 50 per cent of the assets. As a result, it is possible for a non-resident member to still make contributions and not breach the active member test.
- The rollover of the SMSF to this type of fund will trigger a CGT event.
- Upon the member's return to Australia, they may elect to rollover their benefit back to an SMSF, and this will also trigger a CGT event.

Option 2 – Complete a change of trustee to a SAF

- A change of trustee from an SMSF to a SAF is not a CGT event.
- The contributing Australian resident members must hold at least 50 per cent of the assets in the SAF.
- Alternatively, a retail, corporate or industry fund could be opened to accept contributions and the active member test would not be triggered.
- A change of trustee back to an SMSF can occur when the member returns to Australia and this is not a CGT event.
- Any balance in the retail, corporate or industry fund can be rolled over into the SAF or SMSF when the member returns to Australia, however, this would be a CGT event.

Power of attorney

In April 2010, the ATO issued an SMSF ruling (SMSFR 2010/2) relating to the definition of an SMSF and the use of legal personal representatives (LPRs) as trustees.

The issue of using an LPR has been somewhat difficult in the past as many State Trustee Acts limit the amount of time that an LPR can act in their capacity as a trustee (of any trust), typically to 12 months. The ATO has addressed this issue in the ruling by clarifying that the LPR is not acting in the capacity of trustee. Instead, the member retires as trustee and the LPR is formally appointed in their place as trustee (or director of the corporate trustee).

As with any new trustee appointment, the LPR needs to complete the ATO new trustee declaration.

The member can then have no ongoing high level involvement in the decision making and operation of the fund. All decisions must then be made by the new trustee.

Only an LPR appointed under an enduring power of attorney can be appointed as a trustee. It is also important that the trust deed of the fund allows a person to be a member of a fund without the requirement that they be a trustee. It is fairly common for trust deeds to require all members to be trustees.

Summary

Retail, corporate and industry funds are unlikely to encounter compliance difficulties relating to contributions received for non-residents. However, capital gains tax issues may arise for clients who wish to transfer their SMSF to a large (retail, corporate or industry) fund and/or who wish to transfer their contributed balance to a small fund.

SAFs can meet the residency requirements provided that non-resident members do not contribute. Alternatively, if they do contribute then they must hold less than 50 per cent of the assets of the fund and the other members who are Australian residents must make contributions.

SMSFs with trustees who are temporary non-residents for over two years are generally not able to comply.

The decision of an SMSF trustee to become a non-resident can have significant consequences for a fund and trustees should consider their options thoroughly.

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