





SMSF RESIDENCY ISSUES


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#NC2020




Jemma Sanderson

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Jemma Sanderson is a Director of Cooper Partners Financial Services, heading up their SMSF specialist services. Jemma provides strategic advice on SMSFs, estate planning and wealth management to clients, as well as technical support to accounting, legal and financial planning groups. Jemma is a regular presenter on superannuation and SMSFs for the professional bodies across Australia, and is the author of the popular publication "SMSF Guide", published by the Taxation Institute, currently in its ninth edition and the author and convener of the Taxation Institute's Graduate Diploma of Applied Tax Law Advanced Superannuation Unit. In August 2019 she was named for the third year in a row as SMSF Adviser of the Year at the 2019 National Women in Finance awards. Jemma was recognised for her contribution to the SMSF industry as the recipient of the Chairman's Award at the 2018 SMSF Association conference.



Agenda

1. The legislative framework and the areas that the biggest issues are encountered;
2. You're in or you're out – the lack of discretion regarding the active member test;
3. How the "safe harbour" in TR 2008/9 operates;
4. What are "high level" decisions?
5. How to manage the risks;
6. Other considerations and strategies with respect to the definition of an Australian Superannuation Fund.

Australian Superannuation Fund



Importance

- ITRA86 26(1) - taxation at concessional rate of 15% applies to a complying superannuation fund;
- ITAA97 295-95(1) – ability to deduct contributions made to an Australian Superannuation Fund;
- ITAA97 295-385(1) – exempt current pension income applies to a complying superannuation fund;
- ITAA97 Division 301 – taxation concessions regarding the payment of benefits applies where the benefits are paid from a complying superannuation fund;
- ITAA97 295-320 and 295-325 – a fund that is not a complying superannuation fund is subject to tax at 45% on its income (ITRA86 26(2)), plus the first year after that status is taxed on the assets less tax-free component.
- SISA 42(a)(i) – complying superannuation fund definition requires resident regulated superannuation Fund;
- SISA 10(1) – resident regulated superannuation fund means one that is an Australian Superannuation Fund in ITAA97

ITAA97 295-95(2)



Australian Superannuation Fund

- Three elements:
 - (a) Fund established in Australia, or any asset is situated here
 - (b) Central management and control (CMC) is ordinarily in Australia; and
 - (c) Active member test
- Let's break it down.....

Establishment / Asset Location



Australian Superannuation Fund

Straightforward:

- was the fund established in Australia?
- is there ANY asset of the fund that is situated in Australia?

This is not the difficult test for SMSFs to meet with respect to the definition of an Australian Superannuation Fund. However, is still important to tick off. Once a fund is set up here, this is met, even if assets in the Fund are held internationally.

Active Member Test

Australian Superannuation Fund



ITAA97 295-95(2)(c)

“at that time either the fund had no member covered by subsection (3) (an **active member**) or at least 50% of:

- (i) the total market value of the fund’s assets attributable to superannuation interests held by active members; or
 - (ii) the sum of the amounts that would be payable to or in respect of active members if they voluntarily ceased to be members;
- is attributable to superannuation interests held by active member who are Australian residents.”

Active Member Test

Australian Superannuation Fund



ITAA97 295-95(3)

“a member is covered by this subsection at a time if the member is:

- (a) a contributor to the fund at that time; or
- (b) an individual on whose behalf contributions have been made, other than an individual:
 - (i) who is a foreign resident; and
 - (ii) who is not a contributor at that time; and
 - (iii) for whom contributions made to the fund on the individual’s behalf after te individual became a foreign resident are only payments in respect of a time when the individual was an Australian resident.”

Active Member Test

Australian Superannuation Fund



Important elements:

- The residency status of the individual;
- Their contribution status:
 - Those not contributing are not “active members”
 - Therefore, pension recipients are not “active members”
 - The balances of non-contributing members can confuse and funds can believe that they are fine
- To satisfy the active member test, more than 50% of the contributors to the Fund need to be residents of Australia;
- Zero discretion on this item – if you fail it, the test under 295-95(2) is failed and the Fund is non-complying;

Contributions Whilst a Non-Resident

Caught by the Active Member Test?



- Generally, yes.
- Unless, it relates to time when the individual was an Australian resident; or
- There are other active members within the Fund who would ensure that the 50% test is met;
- For the avoidance of all doubt – make contributions to APRA fund whilst absent;

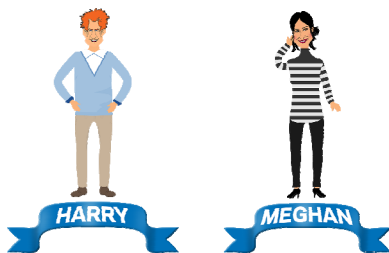
Rollover to SMSF Whilst a Non-Resident

Caught by the Active Member Test?



- Depends on:
 - Timing of the rollover (whilst non resident or not);
 - The time that the accumulated benefits being rolled over relate to;
- If the benefits being rolled over relate to when the individual was a resident – fine (PBR);
- Otherwise, whilst a non-resident, leave the benefits in an APRA fund;
- Once the individual's residency status is reinstated, they can then rollover their APRA fund to the SMSF;
- For the avoidance of all doubt – don't add any further capital to the SMSF whilst a non-resident / absent;

Case Study – Harry and Meghan



Case Study – Harry and Meghan



- Harry and Meghan have decided that an overseas destination is more appropriate as their base;
- They will continue to travel back and forth to Australia due to Harry's work commitments – travel approximately once or twice a quarter;
- They do not know if and when they may return to Australia as their base;
- They have an SMSF with Harry's father Charles and his wife Camilla, as follows:

	Charles (Pension and Accum'n) \$	Camilla (Pension and Accum'n) \$	Harry \$	Meghan \$
Tax-Free Component	1,845,000	857,450	-	-
Taxable Component	3,012,000	1,092,550	158,000	215,000
Total	4,857,000	1,950,000	158,000	215,000

Case Study – Harry and Meghan



- Charles and Camilla have been retired for some years, and ineligible to make any super contributions due to their ages;
- Harry receives contributions to the SMSF of \$1,400 in the 2019/2020 year after he and Meghan depart the country – they relate to employer contributions for work done after departure;
- Are there any adverse implications?

Case Study – Harry and Meghan



Questions and Answers

- Given that Charles and Camilla's benefits comprise 95% of the Fund, then that is more than 50%?
NO
- On the basis that Harry is a non resident, the active member test will be breached:

	Active Member	Resident Active Member
Charles	No	No
Camilla	No	No
Harry	Yes	No
Meghan	No	No

- As Harry is the only active member, and he is a non-resident, then 0% of the active members for the year will be Australian residents, so the 50% test is not met;
- The SMSF would then be non-complying – tax liability of approximately \$2M.

Case Study – Harry and Meghan



What if?

- The contributions related to a period of time before Harry was a non-resident?
 - This would be fine under 295-95(3)(b)(i);
- The contribution was only \$50?
 - Doesn't matter – there is no *deminimus*;
 - The active member test has no discretion for the ATO and no thresholds. If you fail it, you fail it and the Fund is not an Australian Superannuation Fund;
- There were no contributions directly to the SMSF, but Harry rolled over his other superannuation account totalling \$150,000 to the Fund after he became a non-resident;
 - If the benefits accrued prior to ceasing to be a resident – this is fine under 295-95(3)(b)(i);
 - If Harry was contributing to an APRA Fund whilst a non-resident and then rolled over the benefits whilst he was still a non-resident, then test is not satisfied and breach.

Case Study – Harry and Meghan



Advice

- Make contributions to an APRA fund ONLY where the individual is a non resident;
- Even if that status is unclear, still make those contributions to an APRA Fund;
- Really important that employers are told with LOTS OF NOTICE;
- Not worth the risk;
- Impact on all members, not just Harry, given non-complying status;
- Question – is Harry a non-resident or not?

Central Management and Control (CMC)



Australian Superannuation Fund

- Important elements of the requirement in the legislation:
 - 295-95(2)(b) CMC is "ordinarily" in Australia;
 - 295-95(4) CMC is ordinarily in Australia at a time even if that CMC is temporarily outside Australia for a period of not more than two years.
- TR 2008/9 has detail about the Commissioner's view on the above, including:
 - What is CMC;
 - What is "ordinarily"
 - What does "temporarily" mean in this context;
 - When might the CMC not be ordinarily in Australia;
 - When CMC is effectively delegated.

What is CMC

TR 2008/9



- No definition in legislation;
- Common law:
 - Where the real business is carried on;
 - Where are operations controlled and directed
 - The place of personal control, and not the physical operations;
 - High level management and control;
 - Strategic decision making.

What is CMC

TR 2008/9



- Therefore, for an SMSF, where the main "business" is investment (TR 2008/9 para 116):
 - Formulating an investment strategy;
 - Reviewing, updating and varying the investment strategy;
 - Monitoring and reviewing the investments;
 - Determining how assets are used to fund member benefits
- To distinguish between the operational side of things:
 - Accepting regular contributions;
 - Actual placement of investments;
 - Administration;
 - Annual accounts;
 - Actual payment of benefits.
- Also need to distinguish the delegation of decisions to external providers / outsourcing – generally is not CMC as ultimate decision rests with the Trustees;

What is "ordinarily"

TR 2008/9



- Regularly, usually or customarily exercised in Australia;
- Question of fact – who is making the decisions and where are they making those decisions;
- Continuity and permanence;
- If it is temporarily outside Australia, doesn't mean it will fail the "ordinarily" test;
- 295-95(4) provides a scenario where the CMC rule would be satisfied:
 - Absence is temporary;
 - Absence is for two years or less;
- View of the ATO re this clause:
 - Provides one situation where the CMC test would be satisfied;
 - Doesn't mean that you can be absent for less than two years and it is all good;
 - Doesn't mean that you can be absent for more than two years and it is all bad;
 - Down to temporary or permanent absence, not necessarily the time;

Temporary versus permanent

TR 2008/9



- Test time – at the time of departure, or change of circumstances, can't be retrospective;
- Temporary (para 33 of the ruling) - duration of the absence is defined in advance or related to the fulfillment of a specific purpose;
- Permanent (example 8(a) at para 65) – factors to consider:
 - The indefinite nature of the absence;
 - The length of the stay in the overseas country;
 - The divestment of the majority of assets in Australia
- Congruence between permanent departure, and seeking to be a non-resident for tax purposes;
 - Can't have your cake and eat it too – getting benefit of being a non-resident, and retaining complying status of SMSF;

CMC and Residency

The Balancing Act



- When individual's depart Australia to work overseas, generally:
 - a) they want to be a non-resident of Australia for personal tax purposes;
 - b) they want to keep their SMSF
 - c) they don't want to hand over control to someone else of their super
 - d) they want to keep the investments in their SMSF
- In order to achieve (a) above, the need to leave Australia "permanently";
- This is then contrary to the requirements in 295-95 and TR 2008/9 for the Fund to satisfy the requirements of being an Australian Superannuation Fund;
 - CMC – can easily be addressed, but contrary to (c) above;
 - Active member – NO contributions whilst they are away

Resolving Non-Resident Members

Enduring Power of Attorney



- Section 17A SISA allows LPR to be appointed as Director / Trustee and SMSF test met;
- Australian resident EPA can be appointed, and satisfies the requirements under 295-95;
 - SMSFR 2010/2 – confirms this;
 - Can have the same EPA for multiple members;
 - Individual steps down / resigns, EPA replaces them as Trustee / Director;
 - If multiple EPAs, can have only one in the role
 - Subject to EPA legislation of each jurisdiction – must be EPA, not just PA;
- Need to sign Trustee Declaration within 28 days of appointment as Trustee / Director;
- Alternate Directors also available;

Resolving Non-Resident Members



Enduring Power of Attorney

- Have to be ACTUALLY exercising the CMC – not just puppet, otherwise fail 295-95(2);
 - Example 5(b) of TR 2008/9 (para 50);
 - Question of fact;
- Once EPA is in the role of Director, they are acting personally, not as the attorney or agent;
 - The death of the relevant member Donor doesn't automatically resign the Attorney from the Fund Trusteeship – then need to consider operation of 17A again;
 - *Dawson v Dawson [2019] NSWSC 826*

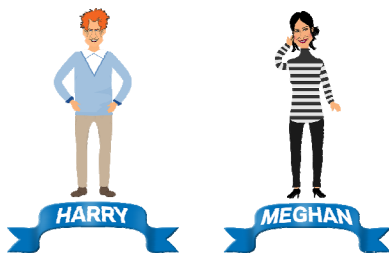
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Case Study – Harry and Meghan



Case Study – Harry and Meghan



- Same situation as before, but Harry is aware of NO CONTRIBUTIONS whilst he is away;
- Harry and Meghan are directors of the Corporate Trustee of the Fund along with Charles and Camilla;
- What action should be taken so that there are no CMC issues?

Case Study – Harry and Meghan



- TR 2008/9 – CMC could be exercised ordinarily overseas or ordinarily in Australia?
- Which would apply?
- Paragraph 35 – “where each of those trustees / directors substantially and actively participate in the exercise of the CM&C of the Fund from those locations, it is accepted that the CM&C of the fund will ordinarily be in Australia”
- So, no action required, unless it is really Harry and Meghan that make all of the high level strategic decisions, albeit Charles and Camilla have the bulk of the benefits;
 - Tends to be more of an issue when it is Mum and Dad that go overseas with big balances and leave the kids behind;
 - Then question whether each director / Trustee substantially and actively participates

Case Study – Harry and Meghan



What if?

- Harry and Meghan resign as Directors within the Fund?
 - Is the Fund meeting the definition of an SMSF under SISA 17A where they are members but not Directors?
- Harry and Meghan appoint Charles as their individual EPAs and they resign as Directors;
 - This would satisfy the requirements;
 - Charles is wearing three hats – one on his own behalf, one on behalf of Harry, and one on behalf of Meghan;
- Harry and Meghan are really the ones that run the show, and they appoint Charles as their EPA and resign as Directors.....BUT, Harry still that Charles does has to
- They do not know if and when they may return to Australia as their base;
- Their SMSF is currently as follows:

Case Study – Harry and Meghan



What if?

- Harry and Meghan are really the ones that run the show, and they appoint Charles as their EPA and resign as Directors.....BUT:
 - Harry still undertakes all investments through on-line accounts;
 - If Charles signs anything, he has to run it past Harry and Meghan beforehand;
- Unlikely to tick the right boxes:
 - The substantial and active participation is overseas here, not in Australia;
 - Charles is a puppet, and not independently exercising the CMC;
 - Although the investing via the on-line accounts is not CMC, the other items would be CMC.

Summary



Watch out, but all is not lost.....

- The residency status of the Fund is paramount to maintaining the tax concessions;
- Even if clients don't think that they will be non-residents of Australia, still worthwhile having a good look at it all – generally they want to be non-residents for tax purposes, so get caught;
- Mechanisms to manage – clients need to be aware of the loss of control, both with the EPA and then the investment menu of the APRA fund they may contribute to;
- If the Fund has individual Trustees, is a good opportunity to change to a corporate (you have to update the asset registrations anyway);
- NO CONTRIBUTIONS TO THE SMSF whilst they are away (to avoid all doubt);
- If they are temporarily absent and that changes – that is a big issue, so ongoing monitoring and communication.

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