



22 September 2023

Assistant Secretary, Personal and Small Business Tax Branch
Personal and Indirect Tax and Charities Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: individualtaxresidency@treasury.gov.au

Dear Sir/Madam,

SMSF ASSOCIATION SUBMISSION – MODERNISING INDIVIDUAL TAX RESIDENCY CONSULTATION PAPER

The SMSF Association welcomes the opportunity to provide this submission in response to the Government's consultation paper on Modernising Individual Tax residency.

In the 11 May 2021 Budget, alongside the modernising of individual tax residency rules, the former Government announced changes to two components of the tax residency rules for self managed superannuation funds (SMSFs). These measures are to still be legislated and have not yet been opened for consultation.

The two elements in question are the removal of the active member test and the extension of the temporary absence rule for non-residents from 2 to 5 years.

We thank the Government for the October 2022 Budget announcement which confirmed that the reform of the residency rules has been incorporated into the Government's policy agenda.

These reforms are important reforms for the SMSF sector, and we ask the Government and Treasury to undertake the necessary industry consultation and progress the required legislation as a matter of priority. Noting that they require only a simple, legislative amendments.

We have appended to this submission further details on the SMSF residency rules, highlighting the policy objectives for the amendments proposed.



If you have any questions about our submission, please do not hesitate to contact us, and we thank you again for the opportunity to provide this submission.

Yours sincerely,

Peter Burgess
Chief Executive Officer

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of over 1.1 million SMSF members and a diverse range of financial professionals. The SMSF Association continues to build integrity through professional and education standards for practitioners who service the SMSF sector. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers, tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them with access to independent education materials to assist them in the running of their SMSF.



Appendix - Superannuation residency rules and SMSFs

Background

Currently, the definition of 'Australian Superannuation Fund' in section 295-95 of the ITAA 1997 creates administrative difficulties and red tape for members of SMSFs. This issue also equally applies to small APRA funds.

It involves situations where Australians who are temporary residents overseas are being prevented from making contributions to their SMSF due to the penalties involved and the fund potentially being taxed as a non-complying superannuation fund.

The only alternative is for the individual to make contributions to a large APRA-regulated superannuation fund and upon their return to Australia rollover those contributions back to their SMSF. This is cumbersome as it involves making contributions to a fund which is not the preference of the individual and causes unnecessary duplication.

The result is the incurrence of significant additional costs arising from the holding of multiple superannuation fund accounts, and the need to consolidate accounts by rollover upon return to Australia. This in turn increases fund administration and compliance costs for the individual affected, reducing their overall superannuation balance, which is something the Productivity Commission has highlighted as a concern.

It also exposes superannuation balances to market risk when later seeking to consolidate the duplicated account into their primary account.

The duplication of superannuation accounts does not align with the current superannuation policy settings.

The fact that the residency rules unfairly affect superannuation members who 'choose' to save for retirement in an SMSF but do not affect those who save in a large APRA-regulated superannuation is inequitable.

Failure for a fund to meet the definition of an Australian superannuation fund means that it is treated as a non-complying fund. A complying superannuation fund that becomes a non-complying superannuation fund is taxed currently at 45 per cent on its taxable income for the financial year and also taxed at 45 per cent on the value of the fund's investments at the commencement of the financial year in which it becomes non-complying, less the amount of broadly any non-deductible contributions (non-concessional contributions).

Active member test

We believe that the active member test does not provide any additional integrity to the superannuation system as the establishment and central control and management tests already ensure that only Australian based superannuation funds can benefit from the superannuation tax concessions. Instead, the active member test is an unnecessary source of red tape, especially for SMSFs and small APRA funds, adding unnecessary costs and reducing the efficiency of the superannuation system.



Confusion and complications relating to the active member test is also one of the most popular topic areas for technical questions received from advice professionals through the SMSF Association's Technical Research Service.

Removal of the Active Member Test

The 'active member' test should be removed from the requirement for any superannuation fund to qualify for taxation concessions under the income tax law. Residency of the fund should be determined on the same principles as all other entities for income tax purposes, that is, the place of establishment and the location of the management and control of the entity.

Removing the active member test would ensure that SMSF members who are working overseas can still contribute to their fund irrespective of whether their fund balance exceeds 50 per cent of the fund's assets. This would mean if the fund was established in Australia and the central control and management ordinarily remains in Australia, then an SMSF member can continue to contribute to a fund of their choice.

Temporary absence exception for the central management and control test

The existing two-year exemption is too short in the context of modern work arrangements, where executive and other staff are often expected to commit to an overseas placement of greater than two years. Often, what initially starts out as a one or two year overseas assignment also gets extended for greater than the initial period.

Extension of the temporary absence exception from two to five years

Extending the central control and management exception will reduce red tape and compliance issues for Australians working overseas while not compromising the integrity of the superannuation or taxation systems.

These proposed amendments will benefit SMSF members who spend time overseas working and still wish to make contributions to their fund to save for their retirement. We do not believe there will be any negatively affected superannuation fund members from the proposed amendments.

In response to COVID-19, the ATO issued temporary relief where the individual trustees of an SMSF or directors of its corporate trustee were stranded overseas. This has been a successful introduction of a more practical application of SMSF residency rules that has not resulted in negative outcomes.

Conclusion

We believe that these proposed changes would have a negligible impact on revenue as the changes would simply cause concessional taxed contributions to be redirected to an SMSF instead of a large APRA-regulated fund. In other words, it would simply result in a re-direction of contributions rather than creating an increase in concessional taxed contributions.

These proposed amendments to the SMSF residency rules would remove a source of inefficient red tape in the superannuation system helping SMSF members better save for retirement. It would also support the Government's policy to ensure that all superannuation fund members are able to exercise choice of where their contributions are made. Further, it is consistent with removing the inefficiencies that exist as a result of members having multiple superannuation accounts.

Both of these proposed changes can be affected with simple, legislative amendments.