MLC TechConnect

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SMSFs and overseas residency

A superannuation fund must meet the definition of an 'Australian superannuation fund' (ASF) at all times, along with other conditions to be eligible for tax concessions.

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Background

An ASF must meet all three of the following conditions:

- The fund was established in Australia, or at least one of the fund's assets is located in Australia.
- The central management and control (CMC) of the fund is 'ordinarily' in Australia.
- The fund has no active members, or alternatively that the 'active member' test is met.

SMSF trustees who are or plan to be overseas must consider the CMC requirement and the active member test. If the SMSF cannot meet the ASF definition, it will become a non-complying superannuation fund.

The implications of becoming non-complying are:

- An amount equal to the market value of the fund's total assets (less any tax-free component of member benefits) are 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 taxable income is taxed at the highest marginal tax rate.

Any discretion the Commissioner of Taxation normally has to treat a non-complying superannuation fund as complying is not available for an SMSF that fails the ASF definition.

In the 2021/22 Federal Budget the Government proposed to relax residency requirements for SMSFs by extending the CMC timeframe for temporary absence from two years to five years. Furthermore, the active member test is proposed to be removed. No further progress has been made on the announcements and they are not yet law.

Fund established in Australia

An SMSF is established in Australia when the initial contribution to start the fund is paid to and accepted by the trustee or trustees in Australia. It is not necessary for the trust deed to be signed and executed in Australia. This is a 'once-and-for-all' requirement that, when satisfied, is relevant for all times.

If a super fund was not established in Australia, it can satisfy the test if at least one asset of the fund is situated in Australia at the relevant time. The location of an asset is determined by reference to the type of asset and the common law rules established by the courts for assets of that kind.

Central management and control

The central management and control (CMC) of an SMSF must ordinarily be in Australia. The CMC relates to who, when and where the strategic and high level decision-making processes and activities of the fund are made. In the context of the operations of a super fund, the strategic and high level decision making processes include:

- formulating, reviewing and updating the fund's investment strategy
- monitoring and reviewing investment performance
- formulating a strategy for managing reserves (if applicable), and
- determining how the fund's assets will be used to pay member benefits.

The other principal areas of super fund operation that form part of the day-to-day operations of the SMSF does not constitute CMC (eg fulfilment of administrative duties, the acceptance of contributions that are made on a regular basis and the actual investment of fund assets),

Establishing who exercises the CMC of a super fund is a question of fact determined with reference to the circumstances of each case. A trustee who performs the high level duties and activities of the fund exercises CMC. Where a trustee uses an investment manager, the investment manager is not exercising CMC.

If there is an equal number of trustees/directors in Australia and overseas and each substantially and actively participates in the central management and control of the fund, this test is satisfied.

If the CMC is 'temporarily' outside of Australia it will be taken to be ordinarily in Australia. To be temporarily outside of Australia the period outside Australia must be defined in advance or relate to the fulfilment of a specific purpose. Whether it is temporary will be based on the circumstance of each particular case. For temporary periods outside Australia of two years or less the CMC is generally considered ordinarily in Australia (safe harbour).

If the CMC of the fund is permanently outside Australia, it will not be 'ordinarily' in Australia, even if the actual period of absence ends up being two years or less.

Example 1 – Central management and control

Andrew and his partner Michelle are trustees of their SMSF. The fund was set up in 2010 and the trustees have regular six monthly meetings in Australia.

Andrew is a chartered accountant working for a large international firm. His employer offers him a secondment (with his family) to another country for two years. They retain their home, bank accounts and private health insurance while away.

The secondment extends for another year due to work commitments. They return home for holidays during their overseas stay. At the end of three years, they return to Australia permanently. While they are away, they hold six monthly trustee meetings to exercise investment decisions and strategies. The CMC is temporarily outside of Australia, therefore taken to be 'ordinarily in Australia' as their absence from Australia is of a temporary nature. This is supported by the intention to return to Australia, the retention of the family home and not establishing a permanent residence overseas.

If, however, their intentions change while overseas and they work overseas on an indefinite basis, the absence will not be temporary. From the time their intentions change, the CMC will not be ordinarily in Australia even if intentions change in less than two years of living overseas.

Active member test

The third test that must be met is the active member test. The active member test is relevant where a member who is a foreign resident makes contributions to the SMSF. Rollovers are treated as contributions for the purpose of the active member test.

The active member test is satisfied if at the relevant time the SMSF has no active members. Alternatively, the active member test requires that Australian resident members for whom contributions have been made:

- hold superannuation interests of at least 50% of the total market value of the fund's assets, or
- are entitled to at least 50% of the amounts payable to all active members if they voluntarily ceased to be members.

An active member of an SMSF is one who:

- is a contributor to the fund (includes rollovers); or
- had contributions made to the SMSF on their behalf.

However, a member will not be an active fund member at the relevant time if:

- they are a foreign resident;
- they are not a contributor at that time; and
- the only contributions made to the fund on their behalf were made in respect of a time when they were an Australian resident.

If a foreign resident wishes to contribute or rollover existing benefits into their SMSF, they must ensure that the SMSF will satisfy the active member test. Where the active member test cannot be met, the foreign resident should not contribute to the SMSF. They can contribute to a retail superannuation fund.

Planning strategies

Addressing the CMC test

If a majority of SMSF members move overseas and the CMC won't be considered to be ordinarily in Australia, strategies may be used to address the CMC test and ensure the complying status of the fund is maintained.

Use an enduring power of attorney

To ensure the CMC requirement is met by the SMSF an SMSF member can have their legal personal representative (LPR) who holds an enduring power of attorney (EPOA) and is an Australian resident appointed as SMSF trustee or director of the corporate trustee.

The appointment must be executed in accordance with the SMSF trust deed (for individual trustees) or the corporate trustee's constitution (for a corporate trustee). SMSF ruling SMSFR 2010/2 provides guidance for SMSFs on the use of LPRs as trustees or directors of the SMSF's corporate trustee.

The LPR will act in their own capacity as trustee or director rather than as the member's agent. They will also be responsible for any civil and criminal penalties for any SMSF breaches. Except where the member is appointing an alternate trustee or director, the member will resign as trustee or director and the LPR is formally appointed in their place as trustee or director.

Once the member resigns as trustee the member can 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 (the LPR).

To be appointed as a trustee or a director, the LPR:

- must consent in writing to the appointment as a trustee or as a director of the corporate trustee
- cannot be a disqualified person, and
- must sign a declaration stating that they understand their duties as a trustee no later than 21 days after their appointment as trustee or director.

Where there is a corporate trustee, the CMC may be satisfied by appointing an alternate director. If the LPR holding an EPOA is appointed as an alternate director, the member does not cease to be a director of the corporate trustee. An alternate director exercises some or all of the director's powers for a specified period, at a time that the member is not performing those duties themselves. The alternate director is personally liable for any decisions they make in the capacity as alternate director.

Note: It may not be necessary for all of the overseas members to resign (where the CMC won't be considered to be temporarily outside Australia). As long as there is not a majority of members overseas, the CMC will be satisfied where all members participate in the strategic and high level decision making processes and activities of the fund.

Example 4 – EPOAs

Alan and his partner Olla are the only members of their SMSF. They are moving overseas to work indefinitely. Both have executed an EPOA in favour of Alan's brother, Charles. Alan and Olla both resign as fund trustees and Charles is appointed as trustee for Alan and for Olla.

As the strategic and high level decision making processes and activities of the fund are made by Charles, in Australia, the fund continues to meet the CMC test. The EPOA must remain valid during the period Charles is trustee and he'll be subject to civil and criminal penalties if he breaches his trustee duties.

Alternatively, if only Alan or Olla appointed Charles as trustee (who actively participates in the central management and control of the fund), an equal number of trustees would be in Australia and overseas and the CMC test would also be satisfied.

Convert to a small APRA fund (SAF)

Another option is to convert the SMSF to a small APRA fund (SAF). This involves the current trustee/s retiring and appointing an approved trustee. This allows the CMC to reside in Australia. The change of trustee will not be a CGT event for the SMSF. However, a SAF may cost more to run because of ongoing fees. The approved trustee may also place restrictions on the type of assets the SAF can invest in. The active member test must still be met. When the member/s return to Australia permanently the SAF can convert back to a SMSF.

Roll over to a public offer fund

The SMSF can be wound up and super fund can be rolled over to a public offer super fund. This will be a CGT event so it is important to consider any potential CGT on the disposal of the assets. Also, not all assets can be transferred to a public offer fund (eg business real property). The member/s can make contributions to the public offer fund as the active member test will no longer be an issue.

Contact details

For further information, please contact MLC Technical Services on **1800 645 597**