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SMSFs AND 'AUSTRALIAN SUPERANNUATION FUND' STATUS

The importance of being an ASF

Will Moloney and David Barrett

Being an 'Australian superannuation fund' (ASF) is one of the requirements to be considered a 'complying superannuation fund'. Although this concept is relevant for all superannuation funds, it is most likely an issue for self-managed superannuation funds (SMSFs). A consequence of not being an ASF is the imposition of significant taxation penalties.

The *Income Tax Assessment Act 1997* (ITAA97) provides that a superannuation fund is an ASF for the income year if each of the following tests is satisfied:

- Australian establishment or situated asset test
- central management and control test
- active member test.

More information about the Australian Taxation Office's (ATO) interpretation of 'Australian superannuation fund' is contained in Taxation Ruling TR 2008/9 (the Ruling). In the ATO's view, an SMSF must meet all three tests at all times during the income year.

Requirements of being an ASF

Being an ASF is important for both taxation purposes and superannuation law purposes. Where an SMSF is not an ASF, it will not be a 'complying superannuation fund' for the purposes of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act).

The ATO considers that all tests must be satisfied at all times dur-

ing the income year for an SMSF to be considered an ASF for SIS purposes, which in turn is a requirement for being a complying superannuation fund. Loss of complying status in a particular income year means the market value of the fund's assets, less any pre-July 2007 undeducted contributions and post-June 2007 untaxed contributions, will be subject to tax at the top marginal tax rate (currently 45%). In following years, while the fund remains non-complying, the fund's assessable/taxable income is also taxed at this rate.

If an SMSF loses its ASF status, the ATO must apply the tax law as described above—it has no discretion.

Test 1: Australian establishment or situated asset

The first test is usually readily satisfied. The Ruling indicates that a superannuation fund is established in Australia if the initial contribution establishing the fund is paid to and accepted by the trustee(s) in Australia. The place where the fund deed is signed and executed has no bearing.

In the event that an SMSF is not established in Australia, the first test may also be satisfied if any asset of the fund is located in Australia. Determination of the location of an asset depends on the class of asset (eg. land, shares, trust interests, debt/bank accounts, etc.); different legal principles apply depending on the class.

In simple terms, opening and depositing funds into an account with an Australian resident bank will satisfy the first test. Note that an SMSF must hold an asset located in Australia at all times in order to continue to meet this test.

Test 2: Central management and control

The law requires that the central management and control (CM&C) of an SMSF is ordinarily in Australia.

What is central management and control (CM&C)?

The ATO considers that CM&C comprises the 'strategic and high-level decision-making processes' and activities of the SMSF, including for example:

- formulating, monitoring, reviewing, updating or varying the investment strategy
- formulating a reserve (if any) management strategy
- determining how assets are used to fund member benefits.

The more day-to-day administrative type operations, such as acceptance of contributions, actual investment of the fund's assets, preservation, payment and portability of benefits, and other general compliance activities associated with the SMSF's legal obligations are not part of CM&C.

Who exercises CM&C?

The trustee of an SMSF has the legal right and responsibility to exercise CM&C, and in general it will be the trustee who exercises CM&C.

However, this is not necessarily the case. If the trustee delegates this function, the ATO considers that it is the parties who in practice exercise CM&C who are the relevant parties in determining where CM&C is exercised.

Where is CM&C exercised?

The place where the 'strategic and high level decision-making processes' are performed is relevant in determining where CM&C is situated. In each case the location is determined by the facts of the particular situation.

If the decision-making processes are made by a number of trustees or directors of a corporate trustee ('trustee director') via meetings at a specific place, then that place will be the location of CM&C. In the case of a single member fund with a single director corporate trustee, it is the place where that director makes the decisions that is relevant.

The residence status, whether for taxation purposes or otherwise, of individual trustees, a corporate trustee or its directors is not usually of itself a determinative factor in the location of CM&C. Note that, in relation to corporate trustees, s 201A of the *Corporations Act 2001* requires that a proprietary company that is not a public company has at least one director, and that director ordinarily resides in Australia.

Meetings may be conducted electronically, by teleconference, video-conference, etc. If so, the location of the individual participants will determine the location of the meeting. Where a majority of trustees are located outside Australia, CM&C would be outside Australia.

However, if equal numbers are located inside and outside Australia, there is a presumption that CM&C is or-

dinarly in Australia. For this to apply, each trustee/trustee director must substantially and actively participate in the CM&C of the fund. Trustee/trustee directors who passively accept decisions made by other trustee/trustee directors are not said to substantially and actively participate in the CM&C of the fund.

When is CM&C 'ordinarily' in Australia?

The concept of 'ordinarily' not only implies regular, usual or customary CM&C in Australia, but also that a 'mere temporary absence' is acceptable and does not cause the CM&C to be outside Australia. Therefore, the distinction between temporary and non-temporary absence is critical as any period of 'non-temporary' absence will mean that CM&C is not ordinarily in Australia.

Whether CM&C is temporarily or non-temporarily absent is largely related to the intention of the members. The Ruling indicates that an SMSF's CM&C will be temporarily outside Australia where the persons who exercise CM&C are outside of Australia for a relatively short period of time, defined in advance or related to a specific purpose.

A person's intention at the particular time is also relevant. An intention to return to Australia within two years will generally be a temporary absence, whereas if there is no specific intention to return, the individual will not be temporarily absent. Of course, intentions can change—temporary absence may become non-temporary (and vice-versa) at any time.

How long can a temporary absence last?

The law states that up to two years' of temporary absence will not prevent CM&C being ordinarily in Australia, although the Ruling indicates that an acceptable absence may exceed two years if it continues to be 'temporary'. That is, the duration of the absence is either defined in advance or related to the fulfilment of a specific passing purpose.

The Ruling provides examples of absences of two and a half years (2.5) and three (3) years being treated as a temporary absence. However, each case should be assessed on its own individual circumstances to determine if absence is temporary—not all absences in excess of two years will be treated as temporary.

CM&C alternatives when a member/trustee/trustee director goes overseas

There may be cases where the determination of the location of CM&C is unclear. The Ruling includes a number of examples which may help. However, if uncertainty still exists, advice may be sought directly from the ATO, potentially as a private ruling.

There are a number of options when an SMSF member heads overseas for an extended period, including:

1. Where a majority of trustees/trustee directors remain in Australia, CM&C may remain in Australia, so no further action is required.



The quote

Being an ASF is important for both taxation purposes and superannuation law (SIS) purposes.

2. If all CM&C functions are conducted through meetings held only on Australian soil, then arguably CM&C remains in Australia; returning to Australia to conduct meetings may be a valid strategy in some circumstances.
3. The existing trustee(s) could be replaced with an approved trustee and become a small-APRA fund.
4. The overseas member's role as trustee/trustee director could be transferred to a legal personal representative ('LPR') situated in Australia who holds an enduring power of attorney ('EPOA') in respect of that overseas member.

SIS imposes a general requirement that members of an SMSF are trustees or trustee directors of the fund. Option 4 in the list above relies on an exception in SIS to this general requirement. The ATO's view in SMSF Ruling 2010/2 is the trustee or trustee director must be removed and the EPOA holder appointed in their place as a trustee/trustee director. Note that in the case of a corporate trustee, the LPR may be appointed as an alternate director, meaning the director who has moved overseas could remain as a director.

The appointment of the LPR as a trustee/trustee director and removal of the member must be in accordance with the trust deed, SIS and any other relevant legislation.

The ATO made the following key points in this ruling:

- Where an EPOA is executed in favour of multiple attorneys, one or more of those attorneys can be appointed as a trustee or trustee director in place of the member.
- Multiple members can execute an EPOA in respect of the same legal personal representative who can be appointed as a trustee or trustee director in place of each of those members.
- A member can execute an EPOA in favour of any existing member who is an existing trustee or trustee director of the SMSF.

It is critical that an SMSF member is comfortable that the person they choose to act as attorney is trustworthy, given the extent of the power they would be acquiring if appointed as trustee/trustee director. The person acting as attorney must act as trustee/trustee director, and not as an agent for the person they replaced.

The LPR will be subject to civil and criminal penalties for any breaches of their duties under the SIS Act, the corporations law (for trustee directors) and other legislation. An attorney cannot be appointed to the position of trustee/trustee director if they are a 'disqualified person' under SIS (ie. typically someone who is insolvent or has been convicted of a dishonest conduct offence).

Note also that an attorney (or any trustee/trustee director) cannot generally receive remuneration in relation to their role as a trustee/trustee director.

Test 3: Active members

The active member test requires that an SMSF has either no active members or, if there are active members, that at least 50% of all active members' assets (either based on market value or the value payable to the member) are attributable to active members that are Australian residents.

A member of an SMSF is an 'active member' at a particular time if he or she is a contributor to the fund or contributions have been made on his or her behalf.

A foreign resident who is not a contributor does not become an active member simply because a contribution in respect of a period when he or she was an Australian resident is made at a time while he or she is non-resident.

Who is a contributor?

The Ruling provides guidance on the meaning of 'contributor'.

A member is a contributor where they are making contributions and have an intention to continue to make further contributions to the fund. Where regular contributions are being made, a person is a contributor not just at the time of making the contributions, but also between contributions, unless the facts indicate otherwise.

However, when a member's intention to contribute ceases, and he or she does actually cease making contributions, he or she ceases to be a contributor.

Where foreign residents wish to continue to make contributions and these contributions will cause the SMSF to fail this test, contributions should be made to a different fund that won't fail the test as a result of the contributions (eg. an APRA-regulated fund).

The term 'contribution' has a broad meaning, and includes amounts such as rollovers and transfers from foreign superannuation funds, as well as what is commonly understood to be a contribution.

Example:

Consider the James family—Jack and Jane, and their two adult children Jill and Jim. They have the following account balances (based on market value):

Jack	\$200,000
Jane	\$100,000
Jill	\$60,000
Jim	\$50,000

Jack and Jane go overseas and become non-residents. Jill and Jim remain in Australia and continue to have their respective employers pay super guarantee contributions into the fund, hence they are active members.

If Jane continued to contribute (ie. continued to be an active member), but not Jack, \$110,000 of the fund assets would be attributable to active members who are Australian residents (Jill and Jim). This would amount to 52% ($\$110,000 / \$210,000$) of all active members' assets in the fund, so the 50% is satisfied. Note however that these numbers would change as contributions are made.

If, on the other hand, Jack continued to contribute, but not Jane, only 35% ($\$110,000 / \$310,000$) of the fund's assets would be attributable to active members who are Australian residents, and the 50% test would be failed.

If both Jane and Jack continued to contribute, then the result would decrease further to 27%.

It is, therefore, important that Jack is not an active member while he is not an Australian resident. Jill's position should be monitored closely.

Conclusion

Understanding central management and control and the active member test, and strategies to maintain ASF status when SMSF members are overseas, is critical when providing SMSF advice, as the potential penalties for non-compliance are severe. **FS**