SMSF residency

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SMSF's must be 'complying' to ensure they attract the tax concessions they are known for. An SMSF's complying status relies on it being an 'Australian Super Fund'. There are three tests that determine this and this fact sheet explains them further. Failing the tests has serious detrimental consequences for your fund.

All self managed superannuation funds (SMSFs) need to qualify as an Australian Superannuation Fund in order to comply with legislation and obtain concessional tax treatment.

The SMSF residency rules explained here, could pose a problem when fund members accept job opportunities off-shore, or depart the country for an extended period of time.

All SMSFs need to satisfy what's known as the 'residency test'. If an SMSF becomes a non-resident fund, the tax concessions will be lost and the market value of the fund assets will be deemed as part of the income of the fund and taxed at the highest marginal rate.

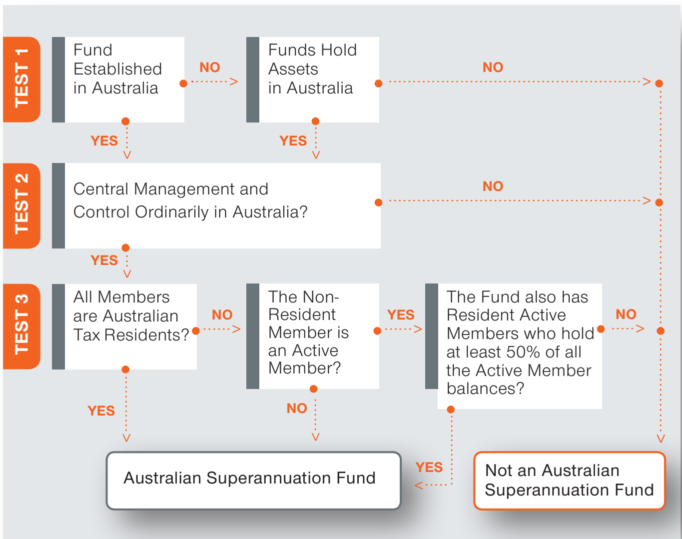
Residency Tests

Essentially legislation provides three tests to assess the residency of the fund. The tests are 'conducted' each year – and each year the answer to each of the three questions following must be 'Yes', at all time during the year:

Test 1 Establishment or assets held in Australia.

Test 2 Central management and control ordinarily in Australia.

Test 3 Majority of active assets are held by Australian residents.



Test 1: Establishment or assets held in Australia

Test 1 is the easiest to satisfy as this can be met essentially by ensuring establishment is in Australia. The concept of establishment is a once and for all requirement. That is, once it is determined that a fund was established in Australia, it will satisfy the first test for all subsequent financial years.

Test 2: Central management and control ordinarily in Australia

The Central management and control (CMC) of the fund must ordinarily be in Australia.

Central Management & Control is a subjective test

The test looks at where the strategic, investment related and main decisions concerning the SMSF are ordinarily made. This is not a black and white test.

What is central management and control?

CMC involves the strategic and high level decision making processes in relation to the SMSF and includes:

- formulating the investment strategy for the fund;
- reviewing and updating or varying the fund's investment strategy as well as monitoring and reviewing the performance of the fund's investments;
- if the fund has reserves - the formulation of a strategy for their prudential management; and determining how the assets of the fun are to be used to the fund member benefits.

Day-to-day activities of the fund do not constitute CMC because they are not of a strategic or high level nature. Examples include the acceptance of contributions that are made on a regular basis, individual investment of the fund's assets, fulfilment of administrative duties and payment of benefits

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Trustees can engage external advice but cannot delegate its function to make the strategic and high level decisions of the fund to a third party. A trustee acting on the advice of a third party is still seen to be exercising CMC. The actions of a financial adviser located in Australia would constitute the day-to-day management and operational side of the fund's activities and would not be relevant in satisfying the CMC test.

What constitutes 'ordinarily in Australia'?

The physical location of the trustees at the time of making the strategic decisions determines where the CMC is located, but the concept of 'ordinarily in Australia' allows for decisions to be made by someone who is temporarily overseas.

To be 'ordinarily in Australia' whilst being located overseas, the emphasis is placed on the trustees intent and substance of their absence as well as whether or not the duration is 'temporary'. The decision surrounding what is temporary involves consideration of the circumstances of each particular case.

What factors would make my absence not appear temporary?

- You leave Australia for an undetermined time;
- No return flight is booked;
- You sell the family home in Australia;
- Your contract of employment within the foreign country is of no predetermined length of time or is greater than two years;
- The contract has renewal clauses;
- You purchase a home overseas as your main residence;
- You enter into a long-term lease on a property overseas;
- You relinquish all connection with Australia or denounce Australian citizenship;
- You acquire citizenship of another country in the time you are away.

The old 28 day test: From 1 July 2007 changes took effect to remove the old rule known as the 28-day test, where the trustee could essentially 'reset' this temporary period by returning to Australia for at least 28 days within every two year period. It is no longer possible to 'refresh' the two-year period.

Test 3: Majority of active assets are held by Australia tax residents

If the fund has any non-resident members, for the SMSF to remain complying, they cannot be active members if their balance makes up more than 50% all of the total balance of all active members.

This test is only relevant if any member is a non-resident
You will only need to consider this test if any of the members of the SMSF are non-residents for Australian income tax purposes

What does it mean to be an active member?

An active member of an SMSF is one who makes contributions to the fund or has contributions made to the fund on his or her behalf.

SMSF trustees must consider the impact of any contributions into the fund while a member is a foreign resident.

'Contributions' for the purposes of the residency test is wider than the traditional definition of 'contributions'.

What is the meaning of contributions for the purpose of the residency test?

- direct cash payments made by an employer or an individual to the fund;
- a transfer of shares (or other asset) to the fund 'in-specie' by an employer or individual;
- spouse contributions;
- Government co-contributions;
- superannuation guarantee shortfall amounts;
- transfers from the Superannuation Holdings Special Account;
- a roll-over superannuation benefit;
- a directed termination payment;
- a superannuation lump sum that is paid from a foreign superannuation fund or an amount transferred to the superannuation fund from a foreign superannuation scheme

Tip – Be careful with Rollovers and contributions for non-residents
If you rollover funds, or contributions are made on your behalf into an SMSF whilst you are a non-resident – you become an Active Member and risk failing Test 3. If you fail Test 3 the fund risks losing the tax concessions available to resident SMSFs.

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Making contributions after ceasing to be an Australian resident

Single member SMSF
If you cease to be an Australian resident, any contribution made by you, or on behalf of you to an SMSF, will mean that your fund will not meet the definition of an Australian superannuation fund.

If you cease to be a resident but wish to retain your fund, in theory you could cease making contributions so that you do not fail Test 3. However, in practice it is unlikely that you would satisfy Test 2 relating to central management and control.

More than one member in the SMSF
Non-residents will not be able to contribute to their SMSF if their member balance represents more than 50% of the super fund's assets that belong to active, contributing members.

Non-residents may be able to contribute if they hold less than 50% of the total active assets. The fund will pass Test 3 if the other member(s) are Australian residents, they are active members and the value attributable to the other member(s) exceeds 50% of the total fund assets.

Examples of multiple member funds and Test 3:

A. Each member holds exactly 50% of the funds' assets. One of the members is a non-resident. Contributions are being made for both members and they are both Active Members. As the non-resident member does not own more than 50% of the assets, the fund would satisfy Test 3.

B. The non-resident member makes greater contributions than the resident member to the point where his balance now exceeds 50% of the total balance. The fund will fail Test 3 and risks losing its Australian resident super fund status.

C. Both members become non-residents. A single contribution by either member will cause the fund to fail Test 3 and lose its Australian status. There may also be issues with satisfying Test 2 in these circumstances.

TIP - If Test 3 is an issuev...
Consider making super contributions outside of the SMSF – for example to retail or industry super fund. You can then rollover those contributions to your SMSF when you return and become an Australian resident

Consequence of being made a non-resident fund
What tax rate will the fund pay if it is not an Australian Super Fund? If the fund fails one of the residency tests the tax rate increases from 15% to the highest marginal rate (currently 45%).

A self managed super fund will be deemed non-complying if it does not satisfy the tests involved in meeting the definition of an 'Australian superannuation fund'.

If non-complying, an amount equal to the market value of the fund's total assets (less undeducted contributions) will be included in the fund's assessable income.

For every year that the fund remains non-complying, the assessable income is taxed at the highest marginal tax rate.

A side note: Salary sacrificed contributions are treated as employer contributions. If salary sacrificed super contributions are made to a non-complying super fund, the contributions will be a fringe benefit.

The employer will:

- be subject to FBT on the sacrificed amount, and
- need to record the sacrificed amount on the employees payment summary as a reportable fringe benefit.

SMSF residency

How can a trustee plan for overseas travel?

Trustees can ask themselves several questions:

- Is the travel intended and scheduled to be less than two years?
- Can the fund continue to meet the CMC test?
- Are more than 50% of the active assets with Australian tax resident active members?

If the answer to any of the questions is NO you will need to consider what options are available to you as a trustee and which one best suits your needs. There may be alternatives accessible to you to overcome some of the issue, such as appointing an Enduring Power Of Attorney.

While the rules seem strict and hefty penalties will apply if the rules are violated they should not be seen as a prohibition on overseas travel. Rather a clear understanding of the rules is necessary prior to considering extended travel. As trustee you should seek professional advice relating to your particular circumstances.