

Heffron Super News



Rely on our Excellence

In this issue:

"Central Management & Control" - what & where is it?

In the past few weeks, we have been inundated with budget rumours – each of which “comes from a very good source” and inevitably requires action before Budget night.

Despite this (or perhaps because of it!) we have decided that this month’s Heffron Super News should cover something completely different – residency of a self managed superannuation fund.

The latest ATO guidance on this topic is a Taxation Ruling issued in December 2008 (TR 2008/9) which discussed the meaning of ‘Australian superannuation fund’ for tax purposes¹.

This ruling was extremely useful in that it set out the ATO’s view on some of the more challenging concepts and will help advisers with overseas clients.

¹ Specifically for subsection 295-95(2) of the Income Tax Assessment Act 1997.

The three key tests

Only Australian superannuation funds receive the tax concessions available to complying superannuation funds under the Income Tax Assessment Act 1997.

To be considered ‘Australian’ for an income year a fund must meet three tests. These are:

- The fund was established in Australia, or any asset of the fund is situated in Australia; and
- The central management and control of the fund is ordinarily in Australia; and
- Either:
 - the fund has no ‘active members’²; or
 - at least 50% of the total balances of all active members belong to Australian residents.

(Note that the Fund must meet all three tests, not just one or two of them.)

² Generally speaking, an ‘active member’ is one who is contributing or rolling benefits over into the fund.

The ruling discusses each of these three tests but our newsletter concentrates on the trickiest issue – determining whether central management & control (CM&C) lies in Australia.

What Is CM&C?

CM&C is the strategic and high-level decision making processes and activities of the fund, as distinct from the day-to-day side of fund operations.

For example, devising the investment strategy is a high-level decision but the actual investment of the fund’s assets is an operational matter.

Other examples of operational duties would include accepting contributions made on a regular basis, actually paying benefits or fulfilling administrative duties.

Who exercises the CM&C is seen as a question of **fact** and will depend on the circumstances of each case.

What is the relevance of ‘ordinarily’ [in Australia]?

Tax law recognises that not *all* trustees will be in Australia *all the time*. Where trustees travel, there is every chance that periodically,

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decisions which fall into the CM&C category will be made overseas.

Given the serious consequences of failing the definition of 'Australian superannuation fund' (see below) the law only requires that CM&C is *ordinarily* (not exclusively or at all times) in Australia.

TR 2008/9 is therefore particularly useful in providing examples of situations where the ATO considers that CM&C is still ordinarily in Australia even though it may appear otherwise from the facts.

Location, location, location

CM&C is determined by where the decisions are made – not the jurisdiction in which the decision makers are taxed and not the country in which they normally live. In theory, then, it is possible (although not particularly practical) for two individuals who are both foreign residents to have an Australian superannuation fund if they both return to Australia every time a high level decision is made.

Temporary absence

The legislation specifically incorporates provisions which allow CM&C to be temporarily outside of Australia without

compromising the claim that CM&C is 'ordinarily' in Australia.

The provisions which achieve this are quite subtle and require some care.

For example, s 295-95(4) of the Income Tax Assessment Act 1997 provides that:

"To avoid doubt, the central management and control of a superannuation fund is ordinarily in Australia at a time even if that central management and control is temporarily outside Australia for a period of not more than 2 years."

Many commentators have interpreted this provision as providing a blanket exemption for those who are (as a matter of fact) outside Australia for no more than 2 years. They have also concluded that an absence of longer than 2 years will not be acceptable.

In fact, the exemption is more complex.

A period longer than two years may be acceptable.

The ruling uses the example of Joseph and Marian (trustees of their SMSF) who move to London so that Joseph can take up a 2 year secondment to the UK with his employer. Both he and his employer have every intention that he would return to working in Australia at the end of 2 years and he and Marian maintain a number

of important links with Australia during their absence – for example, they retain their home, they have investments (in addition to their superannuation) in Australia etc.

The secondment ultimately lasts longer than 2 years due to unforeseen delays. In these circumstances, the CM&C of their SMSF remains 'ordinarily' in Australia even though they may exercise CM&C in London for more than 2 years. The important factor is that the absence was always intended to be temporary.

A period of shorter than two years may not be acceptable.

If we change the circumstances of the above example a little, we may have a completely different result.

Consider the case where Joseph and Marian change their minds shortly after they arrive in London. They enjoy their new lifestyle and decide that they will remain in London at the end of the contract. This means that the absence is no longer temporary and hence CM&C is no longer ordinarily in Australia. In these circumstances, they will fail the CM&C test even if:

- they initially take no action to make their stay permanent (eg sell their house in Australia etc); or
- they ultimately return to Australia within the two year

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period (say their circumstances change again and they return to Australia in 12 months' time).

The ruling suggests that some indicators of an absence being temporary might be:

- whether there is a timeframe for their return to Australia and its length (the examples provided suggest that an intention to return at some point in the future but with no definite date in mind could be problematic – for an absence to be only temporary, it must be both finite and short);
- what they do with their Australian assets (selling the family home, for example, suggests that the absence is not temporary).

While these factors are not necessarily decisive in their own right, they assist in building a picture of the decision makers' intentions – and those intentions are crucial.

Importantly, the two year rule contained in the current legislation is fundamentally different to the equivalent provisions in the pre 2007 legislation. Previously, clients who were overseas could effectively ensure that they continued to meet the CM&C test by simply returning to Australia every two years.

CM&C in more than one location

One very interesting point made in the ruling is that CM&C can be in more than one location at any point in time.

For example, an SMSF with two trustees – one of whom is overseas for an extended period (ie, not temporarily) and one of whom is in Australia – could argue that CM&C is both overseas *and* in Australia.

This is crucial for expatriates with single member SMSFs. These clients could simply ensure that their fund had a second trustee (or director of the trustee company) who actively shares in all key decisions. This will enable the Fund to meet the CM&C test.

Arranging for a third party to exercise CM&C

The ruling specifically considers the case where the trustees of a superannuation fund appoint another party (who is not a trustee) to exercise CM&C on their behalf.

The ATO have concluded that where those duties and powers are delegated, it is the individual or group that actually makes the decisions which exercises CM&C. At first glance, this suggests that trustees could simply ask (say) an Australian-based accountant, adviser or a trusted friend / family

member to exercise CM&C. CM&C would then remain in Australia even if that person had not been formally appointed as a trustee of the Fund.

Unfortunately, the ruling specifically indicates that the ATO has not advised on whether this is actually possible under SIS or the Corporations Act 2001 (which governs decision making for corporate trustees).

In particular, can a trustee delegate his or her duties and responsibilities to another party?

Our view is that there are serious risks associated with this type of delegation, for example:

- if the trustees override a decision made by the other party **or** if the other party checks with the trustee before making a decision, CM&C rests with the trustee. The delegation (designed to solve a residency problem) is immediately ineffective.
- what protection does the other party have if the trustee ultimately does not like the decision made?
- what practical difficulties will a party who is not a trustee have in implementing decisions (for example, will they be able to open a bank account? Make a new investment? etc).

For this reason, we favour formally appointing the other party

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as a trustee rather than simply informally delegating certain powers to them. We feel this puts the matter beyond doubt.

Providing the other party also holds an enduring power of attorney for the fund member(s), he or she can act as trustee in their place without breaching the normal SMSF rules stipulating that all trustees must be members of the Fund.

Failing the 'Australian superannuation fund' definition

If a fund fails the definition of Australian superannuation fund there are several unpleasant consequences.

The conditions to qualify as a **complying superannuation fund** include being a resident regulated superannuation fund *at all times* during the year of income.

Complying superannuation funds are taxed at 15% while non-complying funds are taxed at the highest marginal rate – currently 45%.

A further sting in the tail is that a fund that was original complying but then loses that complying status (say, by failing the definition of Australian superannuation fund) has an additional once-off tax liability. At the time it loses its complying status, it is taxed at 45% on:

- total market value of the Fund's assets just before the start of the income tax year; less
- total undeducted / non-concessional contributions.

To make matters worse, *yet another tax* is applied if the Fund regains its complying status (say the Fund once again meets the definition of Australian superannuation fund). At that point, tax of 15% is applied to:

- total market value of the Fund's assets just before the start of the income year; less
- amounts in the Fund representing all contributions (both concessional and non-concessional) made by current members.

Clearly, then, the ability to always meet this definition is crucial.

Conclusion

The December 2008 ruling is invaluable in providing guidance on the CM&C of SMSFs – in particular, the interpretation of the two year rule. On balance, we favour the following approach for SMSF clients moving overseas:

- if practical, ensure that at least 50% of the trustees remain in Australia – since CM&C can be divided between two locations; or

- otherwise, formally appoint alternative decision makers to act as trustees of the Fund.

Note that as mentioned earlier, the CM&C test is only one of three which must be satisfied to be an Australian superannuation fund. Even if this test is met via one of the approaches above, it will still be crucial to ensure that the other two tests are met. As a general rule, this will mean suspending contributions for the overseas members.

Other news

Our latest E-book is available. Please visit our website at www.heffron.com.au for your free copy.

Don't forget our Advanced SMSF Training days – 2 September (Brisbane), 9 September (Sydney) and 11 September (Newcastle).

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