

## Residency of superannuation funds - an analysis

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The ATO recently released *Draft Taxation Ruling* TR 2008/D5 examining the meaning of the expression 'Australian superannuation fund' in section 295-95(2) of the *Income Tax Assessment Act* 1997 (Cth) (**ITAA 1997**). The meaning of the expression is relevant to determining whether a superannuation fund is a 'resident regulated superannuation fund' and a 'complying superannuation fund' for the purposes of the *Superannuation Industry (Supervision) Act* 1993 (Cth) (**SIS Act**) (sections 19 and 42). In this article, we discuss the ATO's position on the tests set out in the ITAA 1997, with a particular focus on the central management and control (**CM&C**) test.

### Scope of draft ruling

The ATO's draft ruling addresses the 3 tests set out in the section 295-95(2) definition of 'Australian superannuation fund'. In particular, the ATO focuses on the CM&C test and considers the requirements of that test. However, although the following terms appear in the definition of 'Australian superannuation fund', the draft ruling does not consider the meaning of:

- superannuation interests;
- Australian resident; and
- foreign resident (paragraph 4).

Also, the draft ruling does not consider the issue of whether a trustee can actually delegate their duties and powers as trustee of a superannuation fund (paragraph 5).

## Tests

There are 3 cumulative tests that a superannuation fund must meet for it to be considered an Australian superannuation fund (section 295-95(2) of the ITAA 1997).

The tests are as follows:

- the fund is established in Australia **or** any asset of the fund is situated in Australia (**first test**);
- the CM&C of the fund is **ordinarily** in Australia (**second test**); and
- the 'active member' test (**third test**).

To qualify as an Australian superannuation fund, all 3 tests are applied at the same time in the relevant income year **and** all 3 tests must be met at that same time. A failure to meet a requirement of any of the 3 tests will result in the fund not being considered an Australian superannuation fund. It is sufficient if a fund satisfies the 3 tests at the same time in a given income year, for the fund to be considered a resident fund for the entire income year in which that time occurs (paragraph 10).

### First test

The first test examines whether the fund has a nexus with Australia. Specifically, the first test requires the fund to either be established in Australia or have any of its assets situated in Australia (section 295-95(2)(a) of the ITAA 1997). The ATO is of the view that the requirements of this test should be read disjunctively (paragraph 11). As such, we examine the two different requirements separately.

#### *Whether fund is established in Australia*

A fund is established in Australia if the initial contribution made to establish the fund is **paid to** and accepted by the trustee or trustees of the fund **in** Australia. This requirement is a once and for all requirement. That is, the first test will always be satisfied if, at the time of its initial set up, the fund is determined to be established in Australia (paragraph 13).

### *Whether any asset is situated in Australia*

Alternatively, a fund will be connected with Australia if the fund has any asset situated in Australia. The location of assets depends on the type of asset concerned and should be determined in accordance with principles derived from case law (paragraph 15).

By contrast to the first requirement in the first test, this is not a once and for all inquiry. That is, if a fund not set up in Australia ceases to have any asset in Australia, the fund will not meet the first test and, thus, will not be an Australian superannuation fund (paragraph 16).

### **Second test**

The purpose of the second test is to narrow the nexus requirement in the definition. A fund may be connected with Australia by reason of its establishment here, but may not be **sufficiently connected** with Australia. Accordingly, the second test requires the CM&C of the fund to be **ordinarily** in Australia. The second test, thus, requires an examination of what constitutes the CM&C of a fund. Also, consideration needs to be given to when the CM&C of a fund can be said to be ordinarily in Australia.

### *What constitutes the CM&C of a fund?*

The nature of the CM&C of a superannuation fund involves a focus on the strategic and high-level decision making processes and activities of the fund. According to the ATO, only strategic and high-level decision making processes and activities of the fund constitute its CM&C, and not the mere day-to-day operations of the fund (paragraph 20).

The strategic and high-level decision making processes of a fund include:

- the formulation of an investment strategy for the fund;
- reviewing and updating the fund's investment strategy;
- monitoring and reviewing the performance of the fund's investments;
- if the fund has reserves, the formulation of a strategy for its prudential management; and

- determining how assets of the fund are to be used to fund member benefits (paragraph 19).

By contrast, the day-to-day operations of the fund include the following:

- acceptance of contributions;
- the actual investment of the fund's assets;
- the fulfilment of administrative duties; and
- the preservation, payment and portability of benefits (paragraph 20).

Also, under this requirement, the CM&C process involves the following factual inquiries:

- who exercises the CM&C of the fund;
- when the CM&C of the fund is actually exercised; and
- the location of the CM&C of the fund (paragraph 19).

*Who exercises the CM&C of a fund?*

In most cases, the trustee of the fund, having the legal responsibility or duty to exercise the CM&C, will be the entity exercising the CM&C. However, in deciding who is exercising the CM&C of a fund, it may be that another person is exercising the CM&C instead of the trustee. If a person other than a trustee independently and without any influence from the trustee performs duties and activities that constitute the CM&C of the fund, that person will in fact be exercising the CM&C of the fund (paragraph 22).

However, the ATO takes the view that if a trustee uses an investment manager to carry out part or all of the investment management function of the fund, but the investment manager does not in fact exercise any duties which constitute the CM&C of the fund, the investment manager is **not** exercising the CM&C of the fund. The position is similar if the trustee acts only on external advice, provided that the trustee itself makes the **actual** strategic and high-level decisions of the fund (paragraphs 23 and 24).

### *Where is the CM&C of a fund located?*

The location of the CM&C is the place where the strategic and high-level decisions relating to the fund are actually made (paragraph 25).

### *When is the CM&C of a fund 'ordinarily' in Australia?*

The term 'ordinarily' requires a factual inquiry into all the relevant circumstances of the fund. Usually, in the context of the exercise of CM&C, it denotes some element of continuity or permanence and, therefore means that, in the ordinary course of events, the CM&C is regularly, usually or customarily exercised in Australia (paragraph 26). However, if the CM&C of a fund is temporarily exercised outside Australia, it will not prevent the CM&C of the fund from being found to be ordinarily in Australia at a particular time.

### *Temporary absences*

A fund will be found to be ordinarily in Australia at a time even if the CM&C is temporarily outside for a period of not more than 2 years (section 295-95(4) of the ITAA 1997). This deeming operates as a safe harbour rule. However, the safe harbour rule does not apply indiscriminately. That is, whether the CM&C of a fund is ordinarily in Australia will not be limited to circumstances covered by the safe harbour rule.

The ATO takes the view that the CM&C of a fund will be temporarily outside Australia if:

- the person exercising the CM&C of the fund is outside Australia for a relatively short period of time; and
- the duration of absence must either be defined in advance or related to the fulfilment of a specific, passing purpose.

The question of whether the CM&C of a fund is temporarily outside Australia is one of degree and requires an examination of all the facts and circumstances of the case (paragraph 30).

As such, the CM&C of a fund may nevertheless be ordinarily in Australia if the period of absence is greater than 2 years. On the same basis, the CM&C of a fund may not be ordinarily in Australia even if the period of absence is less than 2 years (where the safe harbour rule does not apply). The determinative factor of whether the CM&C of a fund is ordinarily in Australia is the **intention** of the person who exercises the CM&C of the fund. To determine whether an absence is temporary or not involves a factual enquiry, on a real time basis, by reference to all the facts and circumstances of the case.

### **Third test**

The final step in determining whether a fund is an Australian superannuation fund involves the application of the **active member** test. The active member test comprises of 3 requirements:

- the fund has no active member; or
- the fund has active members who are Australian residents, where at least 50% of:
  - the total market value of the fund's assets are attributable to superannuation interests held by active members (section 295-95(2)(c)(i) of the ITAA 1997); or
  - the sum of the amounts that would be payable to or in respect of active members if they voluntarily ceased to be members is attributable to superannuation interests held by active members (section 295-95(2)(c)(ii) of the ITAA 1997).

The active member test is satisfied if **any** of the above requirements are met.

#### *Definition of active member*

A member is an active member of a superannuation fund, at a particular time, if the member:

- is a contributor to the fund at that time; or
- is an individual on whose behalf contributions have been made (section 295-95(3) of the ITAA 1997).

However, the definition excludes a member of a fund from being an active member at the relevant time if:

- the member is a foreign resident; and
- the member is not a contributor at that time; and
- the only contributions made to the fund on their behalf since they became a foreign resident were made in respect of a time when they were an Australian resident (section 295-95(3)(b) of the ITAA 1997).

The term “contributor” is not defined in the ITAA 1997. As such, the ATO takes the view that the concept of a ‘contributor’ is directed at establishing the status of a member as a contributor at a particular point in time and not to the specific act of contributing. It involves a factual analysis of the circumstances of the case when determining the status of a member (paragraph 66).

## **Conclusion**

The ATO’s treatment of the CM&C aspects of superannuation funds is consistent with its position in respect of the residency tests for a company (see, in this regard, *Taxation Ruling* TR 2004/15). In this respect, the ATO’s interpretation is probably expected and is consistent with Australia’s tax position to cast jurisdiction to tax only on superannuation funds that are sufficiently connected with Australia.