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# YourGuardian

## Insurance – Inside or Outside your SMSF?

Self Managed Super Fund (SMSF) Trustees often focus on retirement savings, paying little attention to insurance and the role it can play in providing to dependents in the event of death or disability.

Holding insurance within an SMSF can enable larger superannuation benefits to be paid to dependents in the event of a member's death or disability.

One of the recommendations the Government has accepted from the Cooper Review is to make it a requirement that SMSF trustees consider life and TPD insurance as part of their investment strategy. Trustees will not be compelled to take out insurance, but they will need to provide evidence that they have at least considered it.

There are essentially four differing types of insurance that Trustees of an SMSF can consider.

### Income Protection Insurance

This insurance provides a benefit if you're unable to work because of an illness or injury to assist with meeting ongoing financial commitments.

The premiums are tax deductible to either the individual or to the SMSF, although it may be more tax effective if this type of insurance is held personally if the individual's tax rate is greater than that of the SMSF (maximum of 15%).

If the SMSF receives insurance proceeds the member will need to temporarily cease work due to physical or mental ill health to be eligible to receive the benefit in the form of an income stream.

### Life Insurance

This insurance is intended to pay a lump sum in the event of death to dependents and will help increase the amount payable to cover for loss of earnings and ongoing financial commitments.

The premiums are tax deductible to the SMSF, but not to an individual.

Life insurance is commonly provided along with Total and Permanent Disability (TPD) insurance.

### Total and Permanent Disability (TPD) Insurance

This insurance provides a benefit in the event of becoming totally and permanently disabled and will assist with meeting ongoing financial commitments and any necessary medical care.

The premiums are tax deductible to the SMSF, but not to an individual.

It is important to note that the Australian Taxation Office has issued a draft ruling (TR 2010/D9), which proposes that from 1 July 2011 TPD insurance premiums may not be 100% tax deductible. The deductibility will depend on the type of TPD policy, which are normally either 'any' or 'own occupation' cover.

'Any occupation' is a policy which will pay a benefit if the insured person is unlikely to be employed in any occupation for which they are reasonably qualified, educated or experienced in due to ill health – should remain 100% tax deductible.

'Own occupation' is a policy which will pay a benefit if the insured person is unlikely to be employed in their own occupation due to ill health – will not be 100% tax deductible.

Typically 'any occupation' policies often align with superannuation conditions of release so access to any benefit payment is often not an issue. An 'own occupation' TPD policy may be better held personally as access to any benefit payment may not be possible until a condition of release has been met if held within your superannuation fund.

### Trauma Insurance

Trauma insurance is designed to pay out a lump sum of money if you are struck with a major medical event or condition covered by the policy.



The events and diseases covered by trauma insurance vary between companies and depend on what level of policy you buy. Events and illnesses typically covered include:

- Heart attack
- Stroke
- Cancer
- Loss of limbs
- Quadriplegia

The premiums are not tax deductible to either the individual or to the SMSF.

If the SMSF receives insurance proceeds that does not coincide with the members satisfying a condition of release under SISR, the proceeds may be trapped in the SMSF until such time that the member meets a condition of release.

## Advantages of Insurance in the SMSF

- Trustees can customise their insurance to suit their specific needs;
- Contributions made to the fund can be used to pay the insurance premiums
- As premiums are paid by the SMSF it can assist with cash flow outside of super, which can assist with payment of living expense, debt repayment, etc;
- Net cost saving on premiums
- Share of income/loss

### Example

On an annual insurance premium of \$1,000 a \$626 saving can be had on TPD insurance funded via an SMSF rather than if paid personally. An individual on the marginal tax rate of 38.5% would need to earn \$1,626 to pay the \$1,000 premium. This compares to an SMSF, who although pays 15% on contributions, is entitled to a tax deduction on the premium, so only needs to earn \$1,000.

## Disadvantages of Insurance in the SMSF

- The insurance may be more expensive due to the lack of accessibility to wholesale cost savings which retail or industry funds access;
- Members may need to qualify for insurance (via medical tests etc) which they were not subject to in a retail or industry fund.

## Tax Trap in the SMSF

Where a member does not have a tax dependant, strong consideration should be given to holding life insurance outside of super. This is because the tax payable on insurance held within the SMSF upon payout, is significantly higher than if held outside the SMSF (as outlined below).

### Case Study – Tax on Insurance held in and out of the SMSF

- John was born on 1/1/1949
- Joined his SMSF on 01/01/1990
- Died on 01/10/2010
- John had a member balance of \$1 million, comprising \$800,000 Taxable and \$200,000 Tax Free.
- Upon John's death his SMSF receives life insurance proceeds of \$1.5m
- Johns intends leaving his entire balance to his adult son (aged 35 – a non tax dependant)

### Insurance held inside the SMSF – tax deduction for policy premium claimed.

Component	Amount	Tax Rate	Tax
Tax Free	\$200,000	0%	\$0
Taxable - Taxed	\$1,960,983	16.5%	\$323,562
Taxable - Untaxed	\$339,017	31.5%	\$106,790
<b>TOTAL TAX PAYABLE</b>			<b>\$430,353</b>

### Insurance held inside the SMSF – no tax deduction for policy premium ever claimed.

Component	Amount	Tax Rate	Tax
Tax Free	\$200,000	0%	\$0
Taxable - Taxed	\$800,000	16.5%	\$132,000
Insurance - Taxed	\$1,500,000	16.5%	\$247,500
<b>TOTAL TAX PAYABLE</b>			<b>\$379,500</b>

### Insurance held outside the SMSF.

As evident from the chart below, if John held his life insurance policy outside of the SMSF the tax payable is significantly lower.

Component	Amount	Tax Rate	Tax
Tax Free	\$200,000	0%	\$0
Taxable - Taxed	\$800,000	16.5%	\$132,000
Insurance Proceeds	\$1,500,000	0%	\$0
<b>TOTAL TAX PAYABLE</b>			<b>\$132,000</b>



## Trustee Tips!

### TIP 1

The implications of claiming a tax deduction within your SMSF are significant and can end up costing you dearly upon payout of the insurance benefit.

### TIP 2

When rolling monies over from a retail or industry fund in your SMSF it is important to note that any insurance may cease at this date. It may be beneficial to leave an amount in the account to cover the annual insurance policy or obtain a new insurance policy within your SMSF.

### TIP 3

Any insurance policies held in your SMSF need to be paid for and owned by the trustee(s) of the SMSF and not the insured.

### TIP 4

Determining the most appropriate ownership structure for insurance involves assessing both access and tax implications of the various alternatives (among other considerations).

### TIP 5

Any proceeds from a policy held by an SMSF will be added to the member's account and forms part of the members balance. As such a condition of release will need to be met to access the money.

Statistics show that less than 13% of SMSF's hold insurance within the SMSF, although many SMSF members may hold insurance outside of super.

Proportion of all SMSFs with insurance = 12.7%	
SMSF Size	Proportion of SMSFs
\$1-\$50,000	4.7%
>\$50,000 - \$100,000	7.3%
>\$100,000 – \$200,000	16.0%
>\$200,000 - \$500,000	30.1%
>\$500,000 - \$1m	21.7%
>\$1m - \$2m	13.3%
>\$2m - \$5m	6.2%
>\$5m - \$10m	0.7%
>\$10m	0.1%
<b>Total</b>	<b>100%</b>

Source: ATO unpublished data.

Source: Super System Review – Final Report (Chapter 8) Self-managed Super Solutions.

## Summary

There are pros and cons to holding insurance in your SMSF and we strongly recommend you speak to a licensed Financial Adviser to discuss your individual needs.

For further information about any aspect of this newsletter, please contact [Olivia Long](#) or your [Client Manager](#) on 1300 787 576.



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