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Insurance inside SMSFs

SuperGuardian
Information

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Welcome to our final instalment on expenses inside SMSFs where we will slide insurance premiums under our microscope.

SMSF trustees are required to consider the insurance needs of the members as part of the fund's investment strategy. Therefore, if trustees are required to consider insurance it is important to know what sort of insurance they should be considering.

The Superannuation Industry (Supervision) Regulations 1994 (SISR) outline that only insurance linked to specific conditions of release are permitted to be held on behalf of members. Those conditions of release are:

- Death
- Permanent Incapacity
- Terminal illness
- Temporary Incapacity

Likewise, the Income Tax Assessment Act 1997 (ITAA97) only provides a tax deduction to a superannuation fund for premiums on an insurance policy that are linked to:

- A superannuation death benefit
- A payment due to terminal illness
- A disability superannuation benefit
- An income stream paid due to temporary inability to work

As a result, SMSFs can, and most commonly do hold Life, Total and Permanent Disablement (TPD) and Income Protection insurance policies covering members of the fund, and the premiums on these policies can provide welcome tax relief via a tax deduction that is not otherwise enjoyed outside of super. As a follow up to our previous articles on expenses, insurance premiums that are deductible can be claimed regardless of whether the fund is producing exempt or assessable income.

Insurance arrangements within an SMSF can however be complex, particularly TPD, and require a comprehensive knowledge of superannuation and tax laws as well as the strategic advantages and disadvantages insurance can provide.

The simple things

When taking out any of the above insurances it is important to name the SMSF as the policy owner. If the SMSF is not named as the policy owner the fund will not have complied with the operating standards, in particular the requirement to keep fund assets separate from personal assets. As most insurance is not a deductible expense when held outside of superannuation, income protection is the exception, being able to identify the policy owner makes claiming a deduction so much easier. Similarly, being able to identify the correct policy owner will assist in the event the policy is paid out.

Total and Permanent Disablement Insurance

For policies taken out after 1 July 2014, TPD can only be owned by a fund if the policy cover is detailed as 'any occupation'. Any occupation policies largely share the same definition as 'permanent incapacity' and 'disability superannuation benefit' which is that a member is unlikely, because of ill health (mental or physical), to engage in gainful employment that they are reasonably qualified for by education, training or experience.

If a member wishes to take out TPD insurance that details 'own occupation' this must be held outside of superannuation. Own occupation refers to a total and permanent disability preventing a person from returning to their previous role. Own occupation TPD insurance cannot be held inside a SMSF as it does not meet a relevant condition of release, as the member is still employable, albeit in another role. This is also the case for trauma insurance.

It should be noted that the restriction on own occupation and trauma insurance is only relevant from 1 July 2014. Policies held prior to that time can still be maintained although the deductibility of the premiums is limited. Trauma policies are not deductible at all and own occupation TPD policies are deductible to the degree that the policy will satisfy the definition of a disability superannuation benefit. As such, the Income Tax Assessment Regulations 1997 provide guidance on how much an own occupation policy premium may be deductible.

To claim or not?

The decision to claim a tax deduction for life insurance premiums has become more relevant than ever, since the introduction of the transfer balance cap. When a tax deduction is claimed on the premiums and an insurance claim made on the death of a member, the subsequent payments may incur increased taxes when paid as a lump sum. The increased tax liability is subject to who the benefit is paid to.

There are other taxation advantages and disadvantages linked to insurable benefits that will be the focus of an upcoming technical bulletin.

Other insurance

Of course, insurance isn't limited to the fund members. Insurance policies can be held inside SMSFs for various assets if they are reasonable and relate to the fund. This may include insurance for residential or commercial property, or collectibles which must be insured within 7 days of acquisition. A deduction for these expenses would be an investment expense.

In conclusion it is prudent that SMSF trustees consider insurance as part of the fund's investment strategy. In determining whether superannuation is the appropriate vehicle to hold insurance, consideration needs to be given to the ability to fund the premiums but also the need for the tax deduction. Finally, it is important to understand that insurance can provide benefits to a fund and its members but there may be tax consequences that need to be fully investigated as part of any insurance strategy.

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