Insurance inside Super: Is it time for a change?

Thursday 24th November 2022

Welcome

SUPERGUIDE | WEBINAR

Presenter

Garth McNally, GM Super Consulting

Garth has worked in the Australian Superannuation industry for over 25 years with a specific focus on self-managed super funds. He provides ongoing support and training to individuals as well as to professionals working in the superannuation area, including advisers, accountants and lawyers.

Garth is a regular contributor to industry publications and to the leading professional bodies including Chartered Accountants Australia & New Zealand (CA ANZ) & CPA Australia (CPA).

SUPERGUIDE | WEBINAR

GM Super Consulting

Important

Disclaimer

The information covered within this webinar is intended to be general in nature and is not personal financial (or financial product) advice. It does not take into account your objectives, financial situation or needs. Before acting on any information, you should consider the appropriateness of the information provided having regard to your objectives, financial situation and needs.

In particular, you should seek independent financial advice prior to making any investment decision.

You should consider the appropriateness of this information having regard to your individual situation and seek taxation advice from a registered tax agent before making any decision based on the content of this presentation.

Any examples within this presentation are provided for illustrative purposes only. They should not be relied on.

Attendance at this webinar and/or viewing the content provided, is considered as acknowledgement, acceptance and agreement to this Disclaimer and the contents contained within.

Webinar overview

Tax considerations for holding insurance within Super

Structuring insurance policies within a SMSF

What the super rules "allow" and what the super rules "require"

Considerations for various types of insurance

Key considerations

- What is the real purpose of holding insurance? Is that need met with the way you have your insurance structured?
- Who is likely to receive your superannuation benefits, including insurance proceeds on death & are they a "Tax Dependent"?
- Consider any tax payable on insurance proceeds where personally owned vs. superfund owned. Should we consider holding insurance outside of Super?
- Will changes to our personal circumstances result in a need to change the way we should hold insurances?
- What effect will the insurance premiums have on our end retirement savings?

Key considerations

- What is the real purpose of holding insurance? Is that need met with the way you have your insurance structured?
- Who is likely to receive your superannuation benefits, including insurance proceeds on death & are they a "Tax Dependent"?
- Consider any tax payable on insurance proceeds where personally owned vs. superfund owned. Should we consider holding insurance outside of Super?
- Will changes to our personal circumstances result in a need to change the way we should hold insurances?
- What effect will the insurance premiums have on our end retirement savings?

SUPERGUIDE | WEBINAR

Key considerations

- What is the real purpose of holding insurance? Is that need met with the way you have your insurance structured?
- Who is likely to receive your superannuation benefits, including insurance proceeds on death & are they a "Tax Dependent"?
- Consider any tax payable on insurance proceeds where personally owned vs. superfund owned. Should we consider holding insurance outside of Super?
- Will changes to our personal circumstances result in a need to change the way we should hold insurances?
- What effect will the insurance premiums have on our end retirement savings?

SUPERGUIDE | WEBINAR

Key considerations

- What is the real purpose of holding insurance? Is that need met with the way you have your insurance structured?
- Who is likely to receive your superannuation benefits, including insurance proceeds on death & are they a "Tax Dependent"?
- Consider any tax payable on insurance proceeds where personally owned vs. superfund owned. Should we consider holding insurance outside of Super?
- Will changes to our personal circumstances result in a need to change the way we should hold insurances?
- What effect will the insurance premiums have on our end retirement savings?

SUPERGUIDE | WEBINAR

Key considerations

- What is the real purpose of holding insurance? Is that need met with the way you have your insurance structured?
- Who is likely to receive your superannuation benefits, including insurance proceeds on death & are they a "Tax Dependent"?
- Consider any tax payable on insurance proceeds where personally owned vs. superfund owned. Should we consider holding insurance outside of Super?
- Will changes to our personal circumstances result in a need to change the way we should hold insurances?
- What effect will the insurance premiums have on our end retirement savings?

SUPERGUIDE | WEBINAR

What is the reason you are holding Insurance

SUPERGUIDE | WEBINAR

What is the reason you are holding insurance?

SUPERGUIDE | WEBINAR

Reason for insurance?	Considerations
To pay off personal debt (Mortgage, Car Loans, Personal Loans etc.) **or** **To provide a lump sum for beneficiaries**	• Who will receive the death benefit payment & what are the tax outcomes? Spouse vs. Adult Children = different tax outcomes • Will the after tax amount be sufficient to pay off the debt? Will the after tax amount be sufficient to meet your intentions? • Do you need to increase the level of insurance to account for any tax payable?

Reason for insurance?	Considerations
To replace lost income (income protection etc.)	• Will the insured amount be sufficient to meet your needs? • How long will the payments last (the benefit period)? • Could a better tax outcome be achieved outside of Super?

Reason for insurance?	Considerations
To pay off fund debt (SMSF Loans etc.)	• Will the SMSF be able to use the insurance proceeds to pay off the loan? Or will the insurance proceeds simply increase the amount of the death benefit that has to be paid out from the SMSF? • Should the insurance actually be owned OUTSIDE the SMSF (keyman, personal, etc.)

Reason for insurance?	Considerations
To protect the SMSF Trustee & the SMSF assets	• Are appropriate insurances in place to provide appropriate levels of protection? • Are these policies owned appropriately

Reason for insurance?	Considerations
To pay off personal debt (Mortgage, Car Loans, Personal Loans etc.) or To provide a lump sum for beneficiaries	• Who will receive the death benefit payment & what are the tax outcomes? Spouse vs. Adult Children = different tax outcomes • Will the after tax amount be sufficient to pay off the debt? Will the after tax amount be sufficient to meet your intentions? • Do you need to increase the level of insurance to account for any tax payable?
To replace lost income (income protection etc.)	• Will the insured amount be sufficient to meet your needs? • How long will the payments last (the benefit period)? • Could a better tax outcome be achieved outside of Super?
To pay off fund debt (SMSF Loans etc.)	• Will the SMSF be able to use the insurance proceeds to pay off the loan? Or will the insurance proceeds simply increase the amount of the death benefit that has to be paid out from the SMSF? • Should the insurance actually be owned OUTSIDE the SMSF (keyman, personal, etc.)
To protect the SMSF Trustee & the SMSF assets	• Are appropriate insurances in place to provide appropriate levels of protection? • Are these policies owned appropriately

Tax considerations

SUPERGUIDE | WEBINAR

Recipient is a Tax Dependent

Super fund

Benefit Payment

Tax Dependent

- Spouse (former/de-facto, same sex)
- Child under 18
- Financial Dependent
- Interdependent Relationship

=

Tax Free Payment

Adult children are not Tax Dependents

Recipient is NOT a Tax Dependent

Super fund

Benefit Payment

Tax Non-dependent

Need to determine various Tax Components of the death benefit payment

=

Tax Free Component
Paid Tax Free

Taxable (Taxed Element) Component
Taxed at 15%

Taxable (Untaxed Element) Component
Taxed at 30%

Insurance proceeds

Example

- Allan recently passed away
- He had a member balance of **$300,000**
  - Taxable component $250,000
  - Tax-free component $50,000
- A lump sum death benefit of **$500,000**, including life insurance of **$200,000** is paid to Allan's adult son

Example

- Allan recently passed away
- He had a member balance of **$300,000**
  - Taxable component $250,000
  - Tax-free component $50,000
- A lump sum death benefit of **$500,000**, including life insurance of **$200,000** is paid to Allan's adult son

	$	Tax %	Tax Payable
Tax-free	$50,000	0%	$0
Taxable (taxed)	$312,288	15%	$46,843
Taxable (untaxed)	$137,712	30%	$41,314
TOTAL	**$500,000**	**Plus Medicare**	**$88,157**

Example

- Allan recently passed away
- He had a member balance of **$300,000**
  - Taxable component **$250,000**
  - Tax-free component $50,000
- A lump sum death benefit of **$500,000**, including life insurance of **$200,000** is paid to Allan's adult son

	$	Tax %	Tax Payable
Tax-free	$50,000	0%	$0
Taxable (taxed)	$312,288	15%	$46,843
Taxable (untaxed)	$137,712	30%	$41,314
TOTAL	**$500,000**	**Plus Medicare**	**$88,157**

IMPORTANT: There is a Tax Calculation that is carried out when a member passes away before they enter retirement – hence why the Taxable "untaxed" element does not equal the insurance proceeds.

Rule changes, cost and effect on retirement savings

SUPERGUIDE | WEBINAR

- Changes to the types of insurances allowed inside Super
- Reduced contribution limits & Total Super Balance restrictions
- Transfer balance cap restrictions (reduced pension limits)
- Cost of premiums increasing over time & as we get older
- Strict rules on how death benefits need to be paid from Super
- What effect will this have on our end retirement savings balance? Should we at least consider holding insurance outside of Super?

Insurance inside super vs outside super

Inside super	Outside super
Tax deduction for Insurance premiums available to the fund / Tax deduction may be available for contribution to Super	
Smaller deduction for Income Protection premiums (Funds tax rate)	
Tax may be payable on Life & TPD insurance proceeds paid to certain beneficiaries (Adult Children etc.)	
Reduces retirement savings	

Insurance inside super vs outside super

Inside super	Outside super
	No tax deduction for life insurance premiums
	Higher deduction for Income Protection premiums (Marginal tax rate)
	No tax payable on proceeds if held personally
	Effect on personal cashflow (affordability)

Insurance inside super vs outside super

Inside super	Outside super
Tax deduction for Insurance premiums available to the fund / Tax deduction may be available for contribution to Super	No tax deduction for life insurance premiums
Smaller deduction for Income Protection premiums (Funds tax rate)	Higher deduction for Income Protection premiums (Marginal tax rate)
Tax may be payable on Life & TPD insurance proceeds paid to certain beneficiaries (Adult Children etc.)	No tax payable on proceeds if held personally
Reduces retirement savings	Effect on personal cashflow (affordability)

Adverse tax Outcomes

The need for insurance may outweigh these other issues

Rule changes, cost and effect on savings

Superannuation rules around insurance

SUPERGUIDE | WEBINAR

SMSF specific issues

SMSF Investment Strategy Requirements	• **The SMSF Trustees must consider whether they "should hold a contract of insurance that provides insurance cover for one or more members of the fund"**
SMSF Collectables & Personal Use Assets Requirements	• The Trustees MUST hold insurance over the asset, with the policy owned by the SMSF Trustee
Protecting SMSF Assets & Trustees	• Super rules require SMSF trustees to "protect" the fund assets – to act as any prudent person would • Insurance over SMSF assets could include - Building Insurance, Public Liability and even insurances required by lender, if applicable
The types of Insurances allowed through Superannuation Funds	• Only policies that will be paid out when the insured event occurs (Death, TPD, Income Protection, Asset protection etc) • Trauma Insurance / TPD Own Occupation no longer allowed

Investment strategy: Suggested considerations

Actual Requirement

- **No strict (absolute) requirement for insurances to be taken out for or by Fund members**
- **HOWEVER, there is a requirement for Trustees to maintain evidence regarding decision making process, considerations included in that process and the outcomes from that process**

Members	Legislative Requirements	Trust Deed
Insurability	**Evidence that SIS rules have been addressed**	**Does the SMSF Trust Deed have any specific rules or requirements?**
Other insurances already held	**Regular review of members position**	
Financial position of members; is insurance needed?	No absolute requirement to hold insurance	**Erosion of member entitlements must be considered**

Investment strategy: Suggested considerations

Actual Requirement

- **No strict (absolute) requirement for insurances to be taken out for or by Fund members**
- **HOWEVER, there is a requirement for Trustees to maintain evidence regarding decision making process, considerations included in that process and the outcomes from that process**

- The trustees have assessed the personal position (liabilities etc.) relevant for each fund member and have considered any existing insurances held by the members external to the SMSF
- The trustees have assessed the SMSFs liabilities and reviewed the outcomes or consequences for the SMSF following the death of a member
- The trustees have assessed the potential needs of the member's dependants following their death or Total and Permanent Disablement
- The trustees have assessed the appropriateness of life insurance, TPD insurance and income protection insurance products available
- The trustees have assessed the cost of insurance cover being held within the SMSF
- The trustees have assessed the need for insurance cover over assets owned within the SMSF

Larger super funds

Industry / Retail Funds

- Most offer Life, TPD & Income protection
- Many funds have automatic cover with automatic acceptance limits

Life Insurance	Also referred to as death cover. Pays a lump sum / income stream to beneficiaries when you die or on diagnosis of a terminal illness.
Total and Permanent Disability Insurance	Pays a benefit if you become seriously disabled and are unlikely to work again.
Income Protection Insurance	Also referred to as salary continuance cover. Pays a regular income for a specified period (usually 2 or 5 years or up to a certain age – 60/65) in the event you can't work due to temporary disability or illness.

Larger super funds: Recent changes

Putting Members' Interests First (PMIF)

- Recent Government policy change that effects younger members and/or members with low super balances
- Superfunds cannot provide automatic insurance for new members before they're at least age 25 and their account balance has reached $6,000—unless the member requests, in writing, they want cover
- These changes don't apply where an employer pays for the insurance

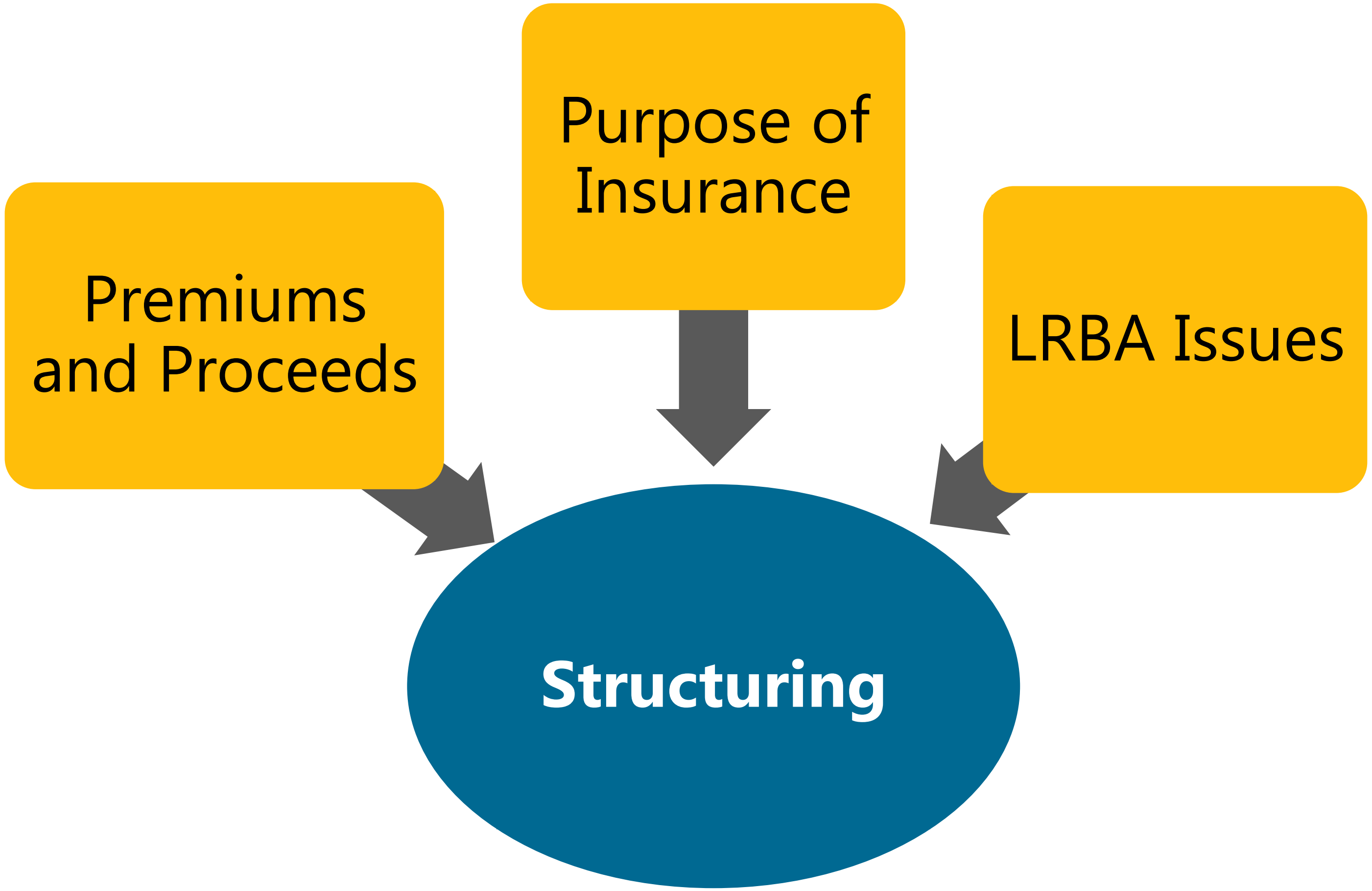
Protecting Your Superannuation Package (PYSP)

- Superfunds are required to cancel insurance cover for **inactive accounts**
- A super account becomes inactive when it hasn't received a contribution or a rollover for 16 months
- If account becomes inactive, you can still hold the insurance if you like, but you are required to tell your fund

Structuring insurance in an SMSF

SUPERGUIDE | WEBINAR

Structuring insurance

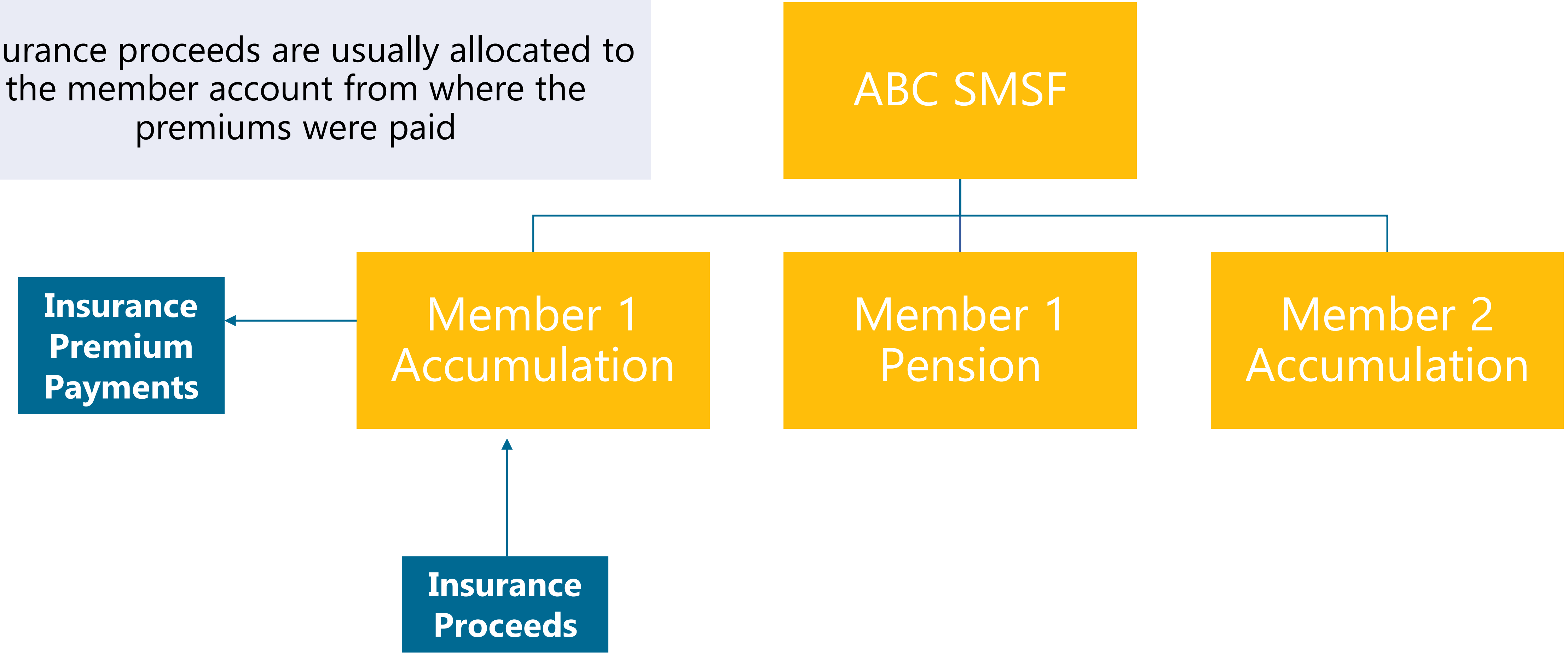


Standard position

Insurance proceeds are usually allocated to the member account from where the premiums were paid

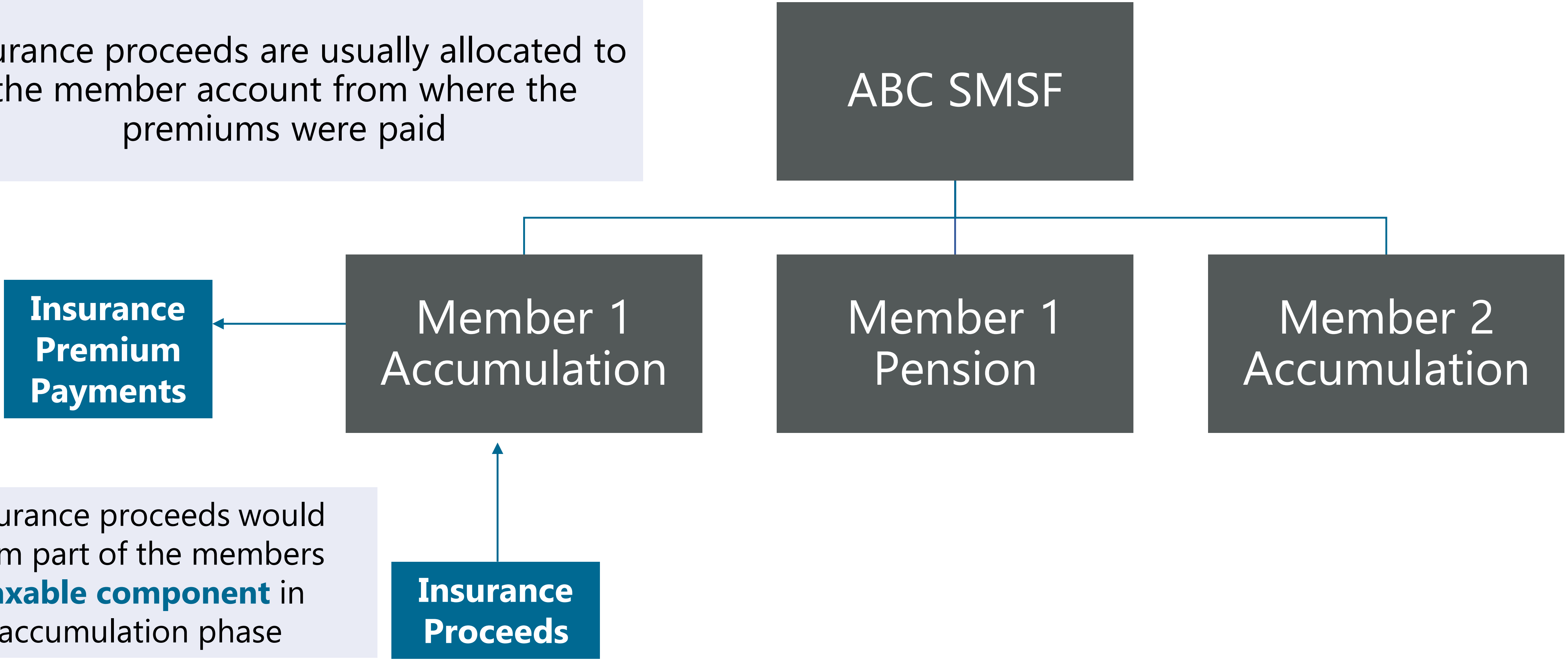
Standard position

Insurance proceeds are usually allocated to the member account from where the premiums were paid



Standard position

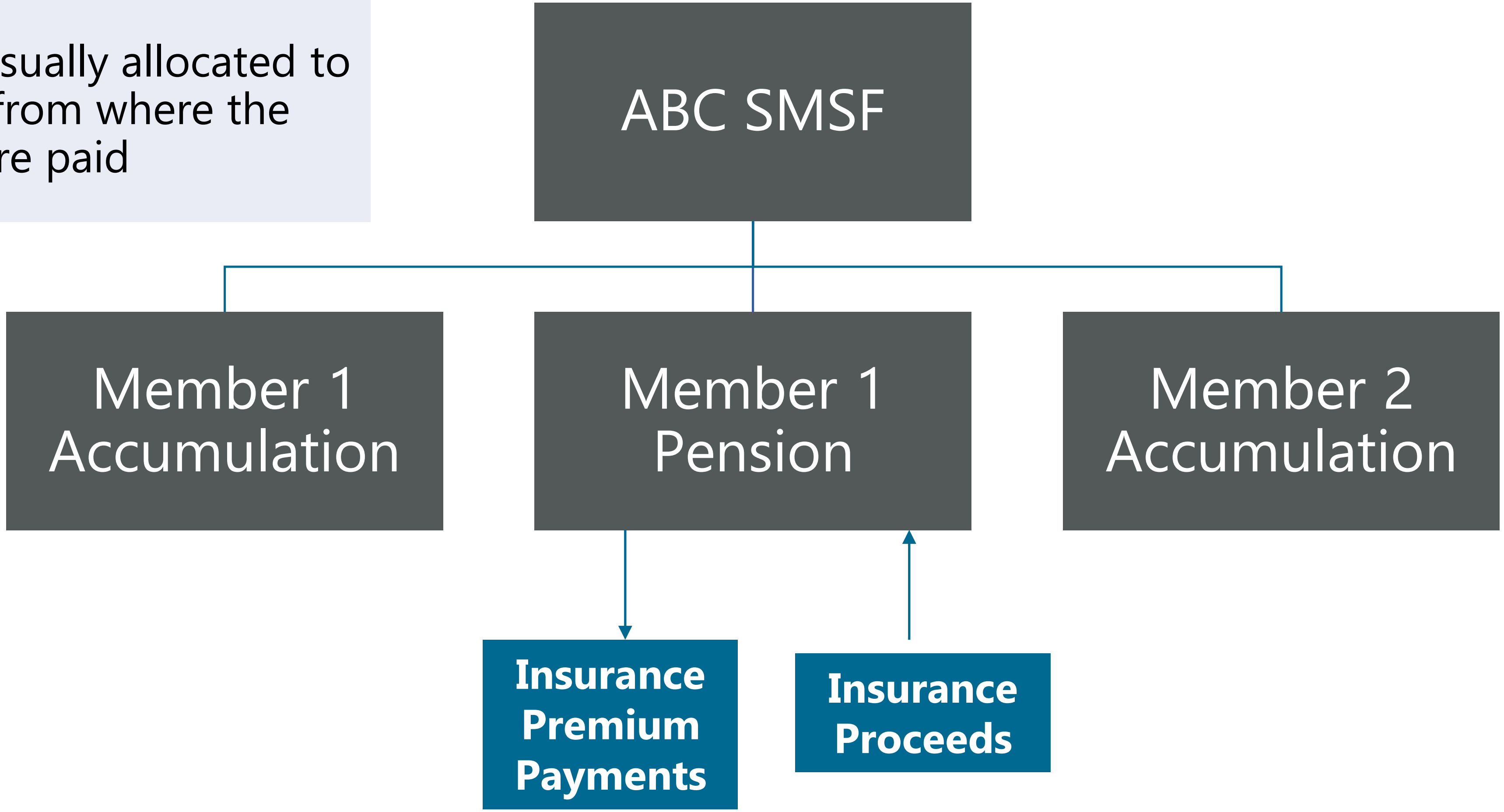
Insurance proceeds are usually allocated to the member account from where the premiums were paid



Insurance proceeds would form part of the members **taxable component** in accumulation phase

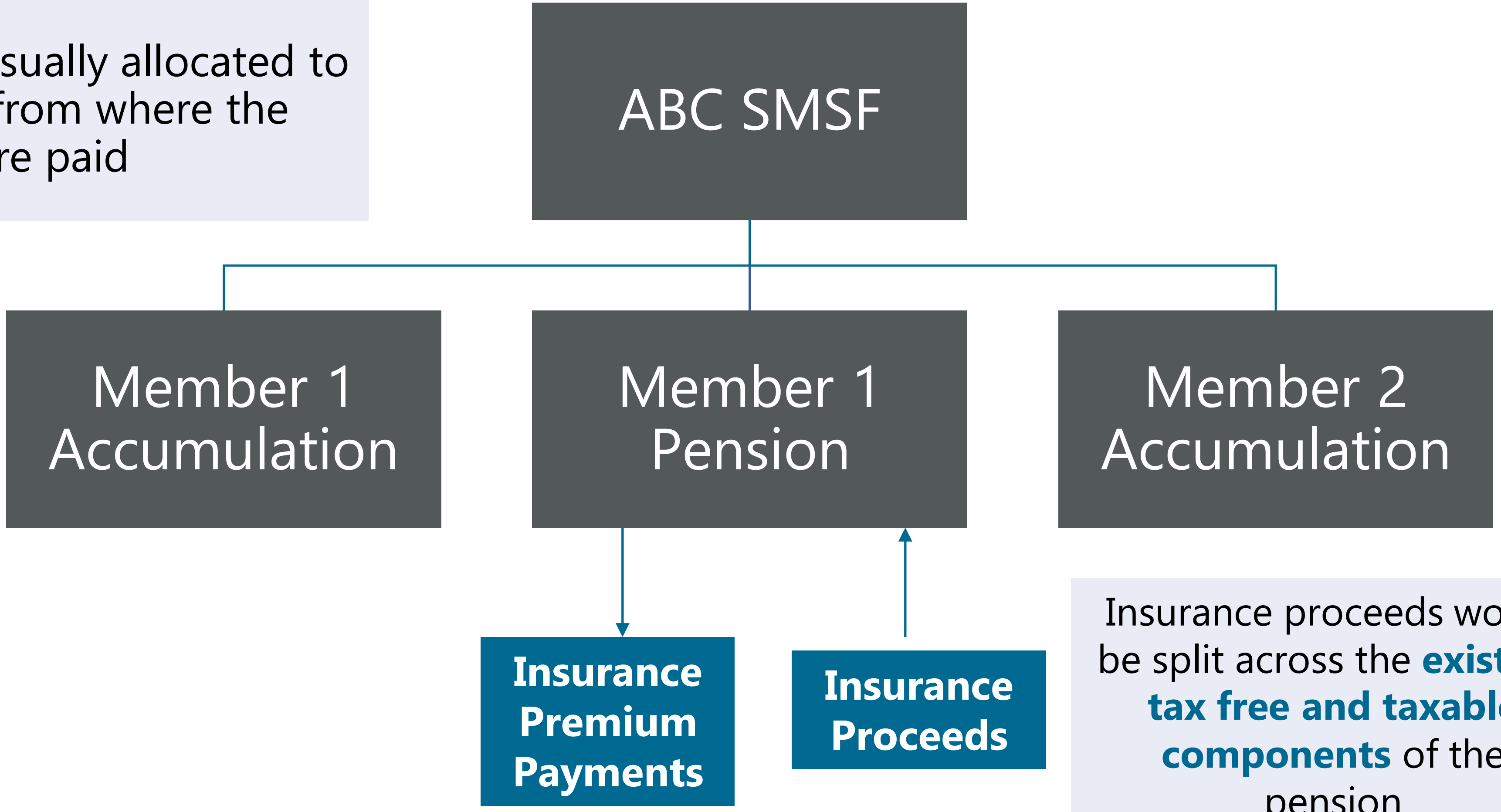
Standard position

Insurance proceeds are usually allocated to the member account from where the premiums were paid



Standard position

Insurance proceeds are usually allocated to the member account from where the premiums were paid



Insurance proceeds would be split across the **existing tax free and taxable components** of the pension

Structuring Insurance - LRBAs

- Take care when structuring insurance for SMSFs with borrowings
- What is the purpose of the insurance:
- To reduce SMSF debt?
- To provide for dependents / beneficiaries?
- Consider Transfer Balance Cap outcomes for surviving member

Structuring Insurance - LRBAs

- Take care when structuring insurance for SMSFs with borrowings
- What is the purpose of the insurance:
- To reduce SMSF debt?
- To provide for dependents / beneficiaries?
- Consider Transfer Balance Cap outcomes for surviving member

Insurance proceeds are added to the member account & increase the member death benefit which needs to be paid out from SMSF; may not allow SMSF to reduce debt:

David:	$1,010,000 Member balance
Sue:	$1,010,000 Member balance

Cash:	$20,000
Property:	$2,500,000
LRBA:	$500,000

Life Insurance of $500,000 on each member

Structuring Insurance - LRBAs

- David passes away.
- Insurance proceeds added to David's member benefits.
- Trustees must now pay out $1,510,000 as David's death benefit.
- Trust Deed permitting, Sue could take this as a pension, lump sum or combination.

Structuring Insurance - LRBAs

- David passes away.
- Insurance proceeds added to David's member benefits.
- Trustees must now pay out $1,510,000 as David's death benefit.
- Trust Deed permitting, Sue could take this as a pension, lump sum or combination.

In most cases, insurance proceeds will simply increase the member death benefit that needs to be paid out from the SMSF; may not allow SMSF to reduce debt:

David:	$1,010,000 + $500,000 = **$1,510,000**
Sue:	$1,010,000

Cash:	$520,000
Property:	$2,500,000
LRBA:	$500,000

Final thoughts

Final thoughts

- Insurance held inside super should not be "set and forget"; as circumstances change, so should insurance
    - Increase cover, Reduce cover, Move outside super

- Revisit the reasons "WHY" the super fund is the holding vehicle for the insurance
    - Tax benefits: Is this still valid?
    - Affordability: Still valid – vs – Tax outcomes

- Has your overall position changed?
    - Change to beneficiaries: Dependents vs. Non-Dependents
    - Divorce / Widow / Widower
    - Is the insurance cover still actually needed?
    - Cost vs. benefit analysis

Resources

Resources

- Insurance insider super: A definitive guide
- Guide to SMSFs and insurance
- Life insurance through super: A definitive guide
- Income protection through super: A definitive guide
- TPD insurance through super: A definitive guide
- Protecting Your Super package: What you need to know
- Case study: How to reduce tax on your TPD payments from super
- SMSF compliance: What are trustees' responsibilities

Insurance inside super: A definitive guide

Life insurance through super: A definitive guide

Income protection insurance through super: A definitive guide

TPD insurance through super: A definitive guide

Wrap up

SUPERGUIDE | WEBINAR