

>> PIS Tech Update 73

Professional Investment
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Summary

Recent announcements from the Government may change the way we approach holding life insurance inside super.

Insurance Inside or Outside a Super Fund and Recent Changes

There are several reasons why having insurance in a super fund may make good sense. Firstly, the premium for death and total and permanent disability ('TPD') risk cover is tax deductible and proceeds are exempt from capital gains tax ('CGT'). Members incurring such premiums outside the fund are not entitled to a deduction but do get a CGT exemption.

The premium for income protection cover is also tax deductible but the proceeds are assessable to the fund. This is the same tax treatment as having this type of insurance outside a fund.

Where premiums are claimed on the above insurance in a super fund, then an untaxed element can arise in relation to a lump sum payment which can result in more tax being payable on the benefit. For example, a death benefit lump sum that is paid to a non-dependant such as an adult child may be exposed to a 31.5% tax rate based on the formula in s 307-290 of the *Income Tax Assessment Act 1997* (Cth); this is one downside to claiming insurance in a fund.

Having a fund pay for insurance however assists with cash flow. Many have reduced their non-essential expenditure and may therefore be without adequate insurance (as revealed by the recent Victorian bushfires).

So, while it generally makes good sense to have insurance in an SMSF, there can often be hurdles, eg, complex application forms and medical tests. One option may be to seek to obtain cover in a public offer/industry super fund that offers automatic acceptance. Moreover, such funds may offer better premium rates due to their bulk purchasing power. Naturally, having insurance in another fund may minimise the impact of the untaxed element (ie, the 31.5% tax discussed above).

There have also been some recent developments impacting on insurance that clarify certain grey areas.

The first relates to deductibility of premiums for TPD. Amending legislation will shortly be issued providing a deduction for premiums that cover own occupation (typically higher premiums as it relates to ability to perform a specific role, e.g. an adviser) compared to general (any) occupation. A general (any) occupation policy has a lower premium and a broader definition of TPD (eg, unable to undertake work the person is capable of doing by education, training or experience). This change will relate to the periods 1 July 2004 to 30 June 2011. From 1 July 2011, deductions for TPD will only apply to the extent of a general (any) occupation premium so the excess will not be deductible.

Hopefully, when the legislation issues the condition of release ('COR') will also be amended to allow funds to pay out occupation-specific TPD proceeds even though they have not satisfied a general occupation definition under SIS.

Trauma Insurance

The ATO have generally argued that trauma insurance is not consistent with the sole purpose test. However, the ATO's draft SMSFD 2009/D1 clarifies that trauma insurance can be held in a fund provided the proceeds are received and form part of the fund's assets until a relevant COR occurs. (An event such as cancer, stroke or heart attack, by itself, may not satisfy a COR, e.g., a 40 year old may suffer a heart attack and re-enter the workforce after a short spell.)

The ATO have therefore confirmed that trauma insurance can be held in a fund and that this can be consistent with the sole purpose test. However, the ATO do state that the size of the premium may be a relevant factor and also whether taking out the policy may be providing a benefit to someone outside the fund (e.g., if the policy taken in the fund lowers the premium on a policy outside the fund).

Insurance can also be very helpful where an SMSF enters into a borrowing arrangement and to provide funding for an anti-detriment payment. Having insurance can protect against the fund's liquidity in the event of a death or disablement of a member and the requirement to pay a benefit when regular repayments of the borrowing still have to be made. Insurance proceeds can also fund the extra lump sum payment required on death to claim the anti-detriment deduction. Note, however, that under most SMSF deeds the insurance proceeds must also be paid out in addition to the deceased member's account balance. Thus, the SMSF deed must have flexibility for managing insurance to provide planning opportunities for managing borrowings and the anti-detriment payment.

Thus, now is an ideal time to review the appropriateness and adequacy of insurance for everyone and your SMSF deeds!

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DBA Lawyers – November Seminars

The November seminar series is about to commence. Key topics to be covered include SMSF Succession Planning, Non-complying funds, along with an update on the latest developments in the SMSF space.

Details of the seminars are available via the following link:

http://www.dbabutler.com.au/download/DBA_Network_workshops_2009.pdf

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Regards

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