

SMSFs and insurance

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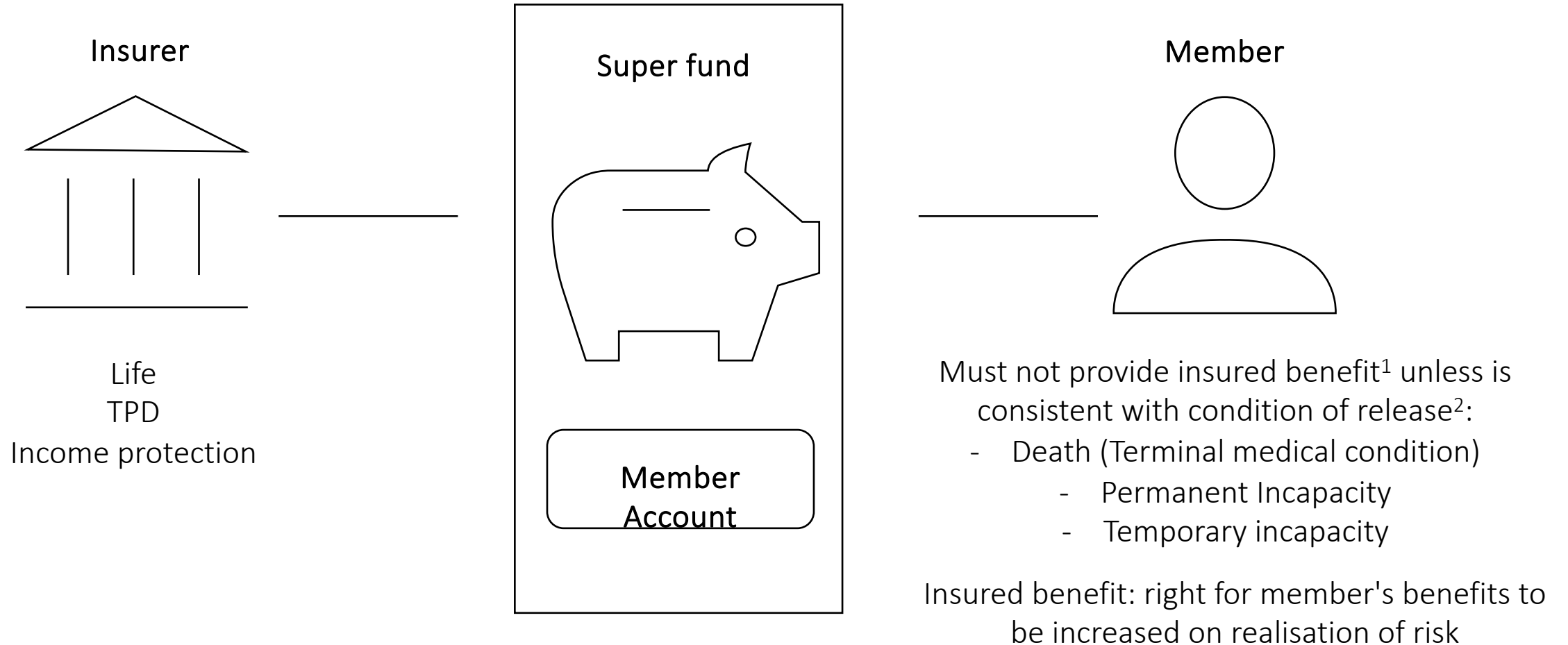
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Allowable policies



Death

Death

Terminal illness condition of release

- two medical certificates
- member likely to die within specified period that does not exceed 24 months

Cashing restriction: Nil

Non-allowable policy

- pay terminal illness benefit where likely to die with 36 months

Total and permanent disability

Permanent incapacity

- trustee reasonably satisfied member no longer able to work in any role the member is reasonably qualified for by training, education or experience

Cashing restriction: Nil

Non-allowable policy

- own occupation policy/trauma
 - linked policies
- TPD policy with loss of sight/limb benefits without additional any occupation hurdle

Income protection

Temporary incapacity

- ill health that caused the member to cease working but does not constitute permanent incapacity

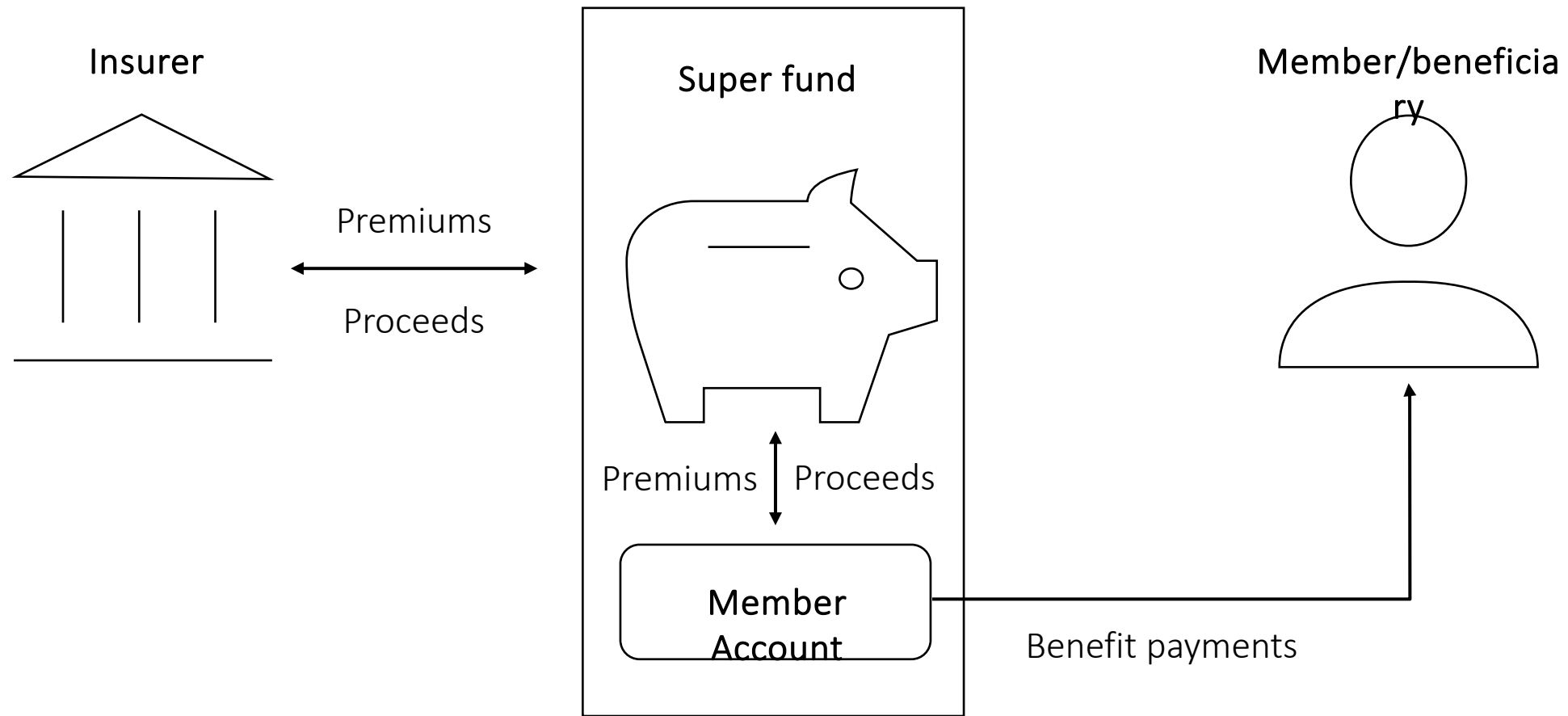
Cashing restriction:

- Non-commutable income stream
 - paid to continue gain/reward receiving prior ill health
 - for period not exceeding period of ill health

Non-allowable policy

- pay lump sum crisis benefits etc

How does insurance in super work?

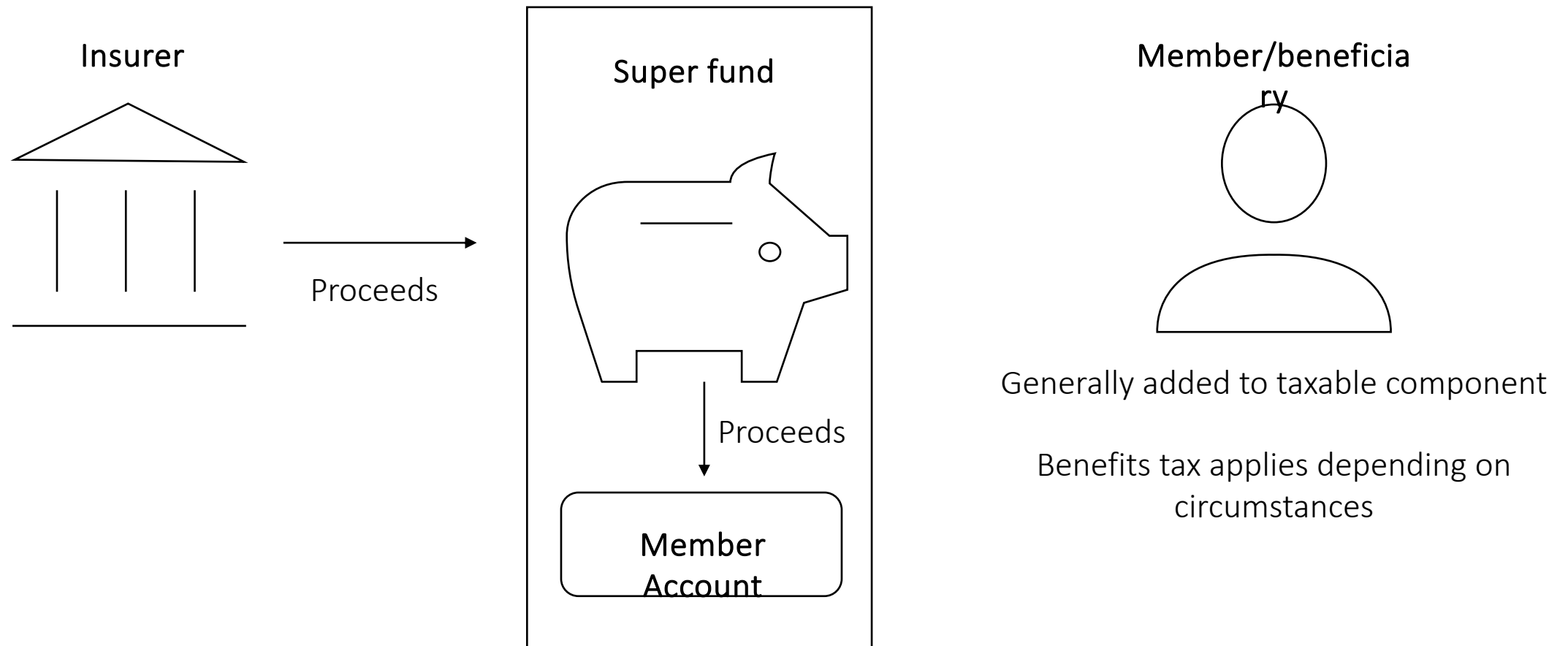


Premium deductions

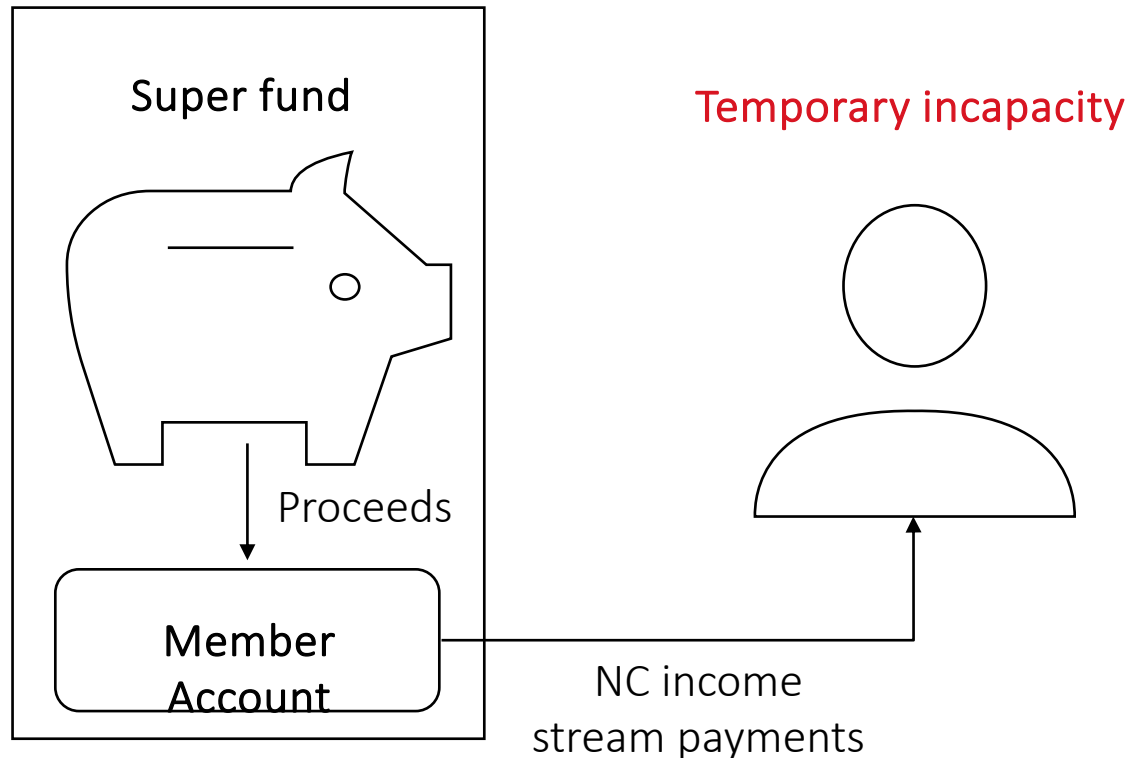
Premium deduction	Grandfathered 'own occupation' deduction: % specified in regs ¹ or confirmed by insurer	
Term life - 100%	TPD own occupation	67%
TPD 'any occupation' - 100%	TPD own occupation – own occupation with one or more of the following inclusions: activities of daily living, cognitive loss, loss of limb, domestic (home) duties	67%
Income protection: - 100% - also deductible where held directly	TPD – own occupation bundled with death (life) cover	80%
No deduction available where: - made choice to apply alternative deduction under 295—470 - choice applies to all future years	TPD – own occupation bundled with death (life) cover with one or more of the following inclusions: activities of daily living, cognitive loss, loss of limb, domestic (home) duties	80%

¹ ITR 295-465.01

Insurance proceeds – tax components and tax



Tax/admin treatment of proceeds



Tax/admin issues

Proceeds non-assessable / payments non-deductible

Payments not super benefit

- proportioning rules do not apply

NC income stream not a super income stream

- fund not entitled to ECPI
- payments fully assessable to member (PAYG)

Allocate to accum. / pay as lump sums - reclassify to 'other income stream payments' in SAR

- allocate and pay from TTR pension – issues!

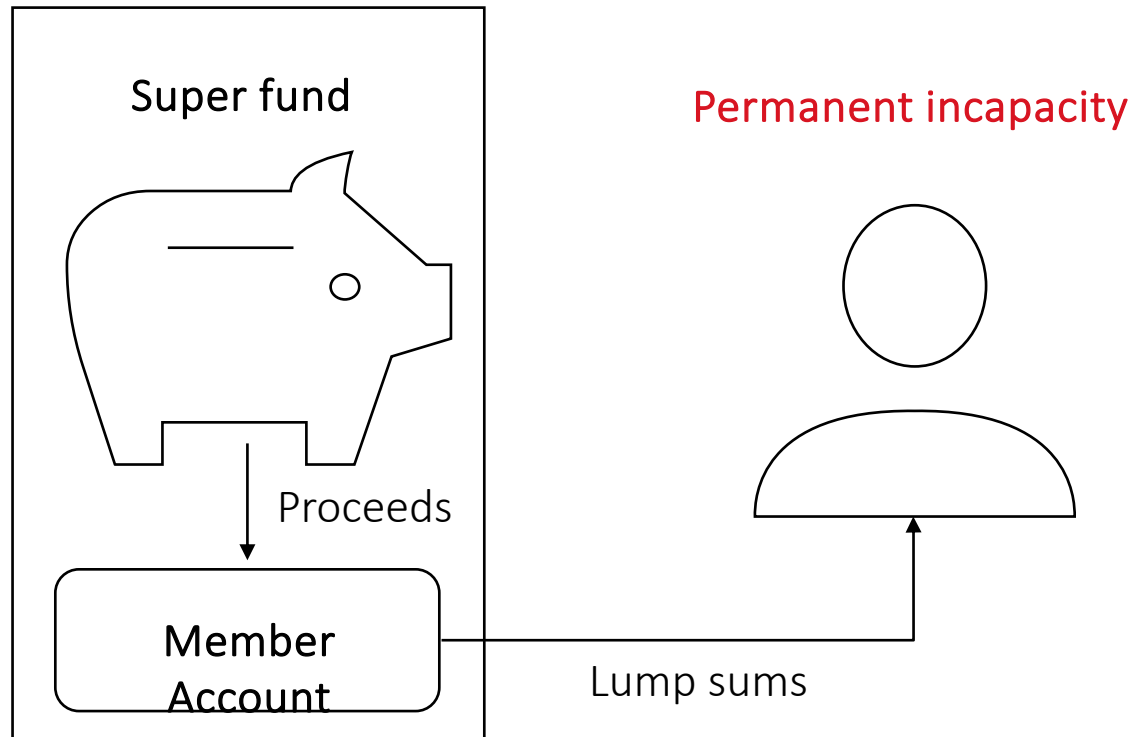
Cannot pay TI benefits after member has recovered

TI benefit must not reduce minimum benefits

Questions:

- can benefits be paid retrospectively?
- can benefits be paid from accumulation phase if no insurance?
- do insurance proceeds need to be taken as benefit payments?

Tax treatment of proceeds



Lump sum

- Allocated to account premiums deducted from Super benefit payments
- Proportioning rules apply
- Tax depends on tax components and age
- table

If disability super benefit

- tax free uplift applies
- based on formula – not insurance proceeds!
- Disability super benefit payment
- 2 medical certificates satisfy any occupation COR
- Australian registered medical practitioners

Age	Under 60		60 and over	
Tax component	Tax free	Taxable	Tax free	Taxable
Tax rate (max.)	Tax free	22%	Tax free	

Formula

$$\textit{Tax free} = \textit{Existing tax free} + \left[\textit{Amount of benefit} \times \frac{\textit{Days to retirement}}{\textit{Service days} + \textit{Days to retirement}} \right]$$

Where:

Existing tax-free component = the sum of the tax-free component of the benefit worked out apart from using the disability formula

Amount of benefit = the amount of the disability benefit being paid, including any insurance proceeds

Days to retirement = the number of days from the day on which the person stopped being capable of being gainfully employed to their last retirement date (generally age 65)

Service days = the number of days in the service period for the lump sum.

Case study - Bob

Bob is a member of an SMSF and recently became permanently incapacitated. His details are the following:

- Age 53
- DOB: 01/06/1971 (Date will turn 65: 01/06/2036)
- Date of permanent incapacity: 06/07/2024
- Days to retirement: 4349
- Service days: 12819
- Super: \$450,000 (100% taxable/fully preserved)
- Insurance proceeds: \$1,100,000

Bob needs to withdraw \$200,000 lump sum

Tax treatment

$$\text{Tax free} = \$0 + \left[\$200,000 \times \frac{4,349}{4,349 + 12,819} \right]$$

Tax component	Amount	Tax @ 22% (max.)
Tax free	\$50,664	\$0
Taxable	\$149,336	\$32,854

Key observations

Tax-free uplift only applies to lump sum amount – not entire benefit!

- future payments?

The larger the benefit the larger the tax-free uplift

- NCCs?

The earlier the service date of the fund, the bigger the denominator and the smaller tax-free uplift

- Service date?

Case study – Bob...

It is 2 years later – Bob would like to draw another \$200,000 lump sum from super

Does lump sum qualify as disability super benefit payment?

Can rely on original medical certificates for multiple payments – but only where¹:

- lump sums are paid over ‘a short period of time’
- no evidence circumstances have changed

Obtain new certificates?

If can’t – tax-free uplift does not apply

- entire \$200,000 is taxable component

Strategy?

¹ATO ID 2015/19

² Assume balance has grown back to \$1.55m after \$200,000 withdrawal

Rollover to a different fund to allow wind-up

Rollover qualifies as lump sum benefit for tax purposes

Triggers tax-free uplift on entire balance²

$$\text{Tax free} = \$0 + \left[\$1.55m \times \frac{4,349}{4,349 + 12,819} \right]$$

Note - Days included in service days and days to retirement in denominator counted only once

Tax component	Rollover (\$1.55m)	Future \$200k lump sum	Tax @22% (max.)
Tax free	\$392,646	\$50,664	\$0
Taxable	\$1,157,354	\$149,336	\$32,854

Do not need new certificates for future lump sums

Case study – Bob...

Bob has \$360,000 financial assets outside super that he wants to contribute

- tax and to maximise disability support pension

Should Bob make NCC before or after rollover to new fund?

NCC to existing fund prior to rollover

$$\text{Tax free} = \$360,000 + \left[\$1.91m \times \frac{4,349}{4,349 + 12,819} \right]$$

Tax component	Amount
Tax-free	\$843,841 (44.2%)
Taxable	\$1,066,159

Alternative

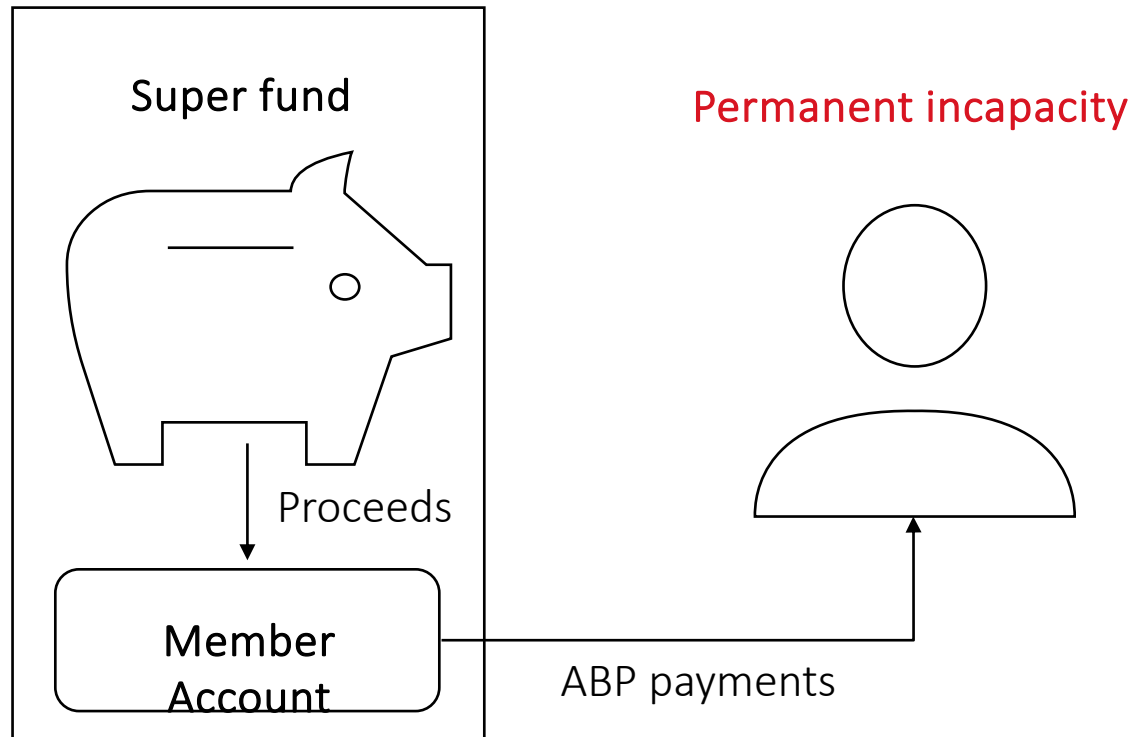
Rollover first then make NCC

- tax-free from NCC excluded from amount rolled over
- lower tax-free uplift

Tax-free component \$91,195 (4.8%) lower

Tax component	Amount
Tax-free	\$752,646 (39.4%)
Taxable	\$1,157,354

Tax treatment of proceeds



Pension payments

15% pension offset applies where under 60

- tax-free uplift does not apply

If need future payment over minimum:

- additional pension payment (15% offset)
- lump sum commutation (tax-free uplift)
 - medical certs?

If rolled over to new fund and started ABP

- tax free uplift (applied to entire benefit)
- 15% pension offset

Beware applying multiple tax-free uplifts

- multiple rollovers
- rollover and then commutation

Age	Under 60		60 and over	
Tax component	Tax free	Taxable	Tax free	Taxable
Tax rate (max.)	Tax free	Assess. income 15% offset	Tax free	

Deductions

Can claim choose not to claim premiums as deduction and claim deduction for future liability to pay benefits instead

To be eligible:

- makes the choice¹:
 - not to claim premium as deduction
 - instead to claim a deduction based on the fund's future liability to pay benefits, and
- pays a superannuation death or disability benefit in consequence of a member's termination of employment (or pay a benefit due to temporary inability to work)

Amount of deduction

$$\text{Deduction} = \text{Benefit amount} \times \frac{\text{Future service days}}{\text{Total service days}}$$

Benefit amount = the value of the super interest used to pay a lump sum or pension, or for temp incapacity – total payments received in year

Future service days = days from the date of employment terminating to the member's last retirement date (generally age 65)

Total service days = future service days plus the member's existing service days.

¹ Under 295-465(4)

Case study - Bob

If Bob's SMSF paid \$5,000 disability insurance premium in year he became permanently incapacitated and he started ABP with full balance – could claim either:

- \$5,000, or
- $\$1.91\text{m} \times \frac{4349}{17,168} = \$483,841^1$

If claim future liability to claim benefit deduction:

- can never claim cost of premiums again
- carry forward tax losses reduced by exempt income
- roll Bob out – leaving spouse to benefit from deductions

Practical eligibility issues

Must have paid premium in yr to claim alternate deduction

Example

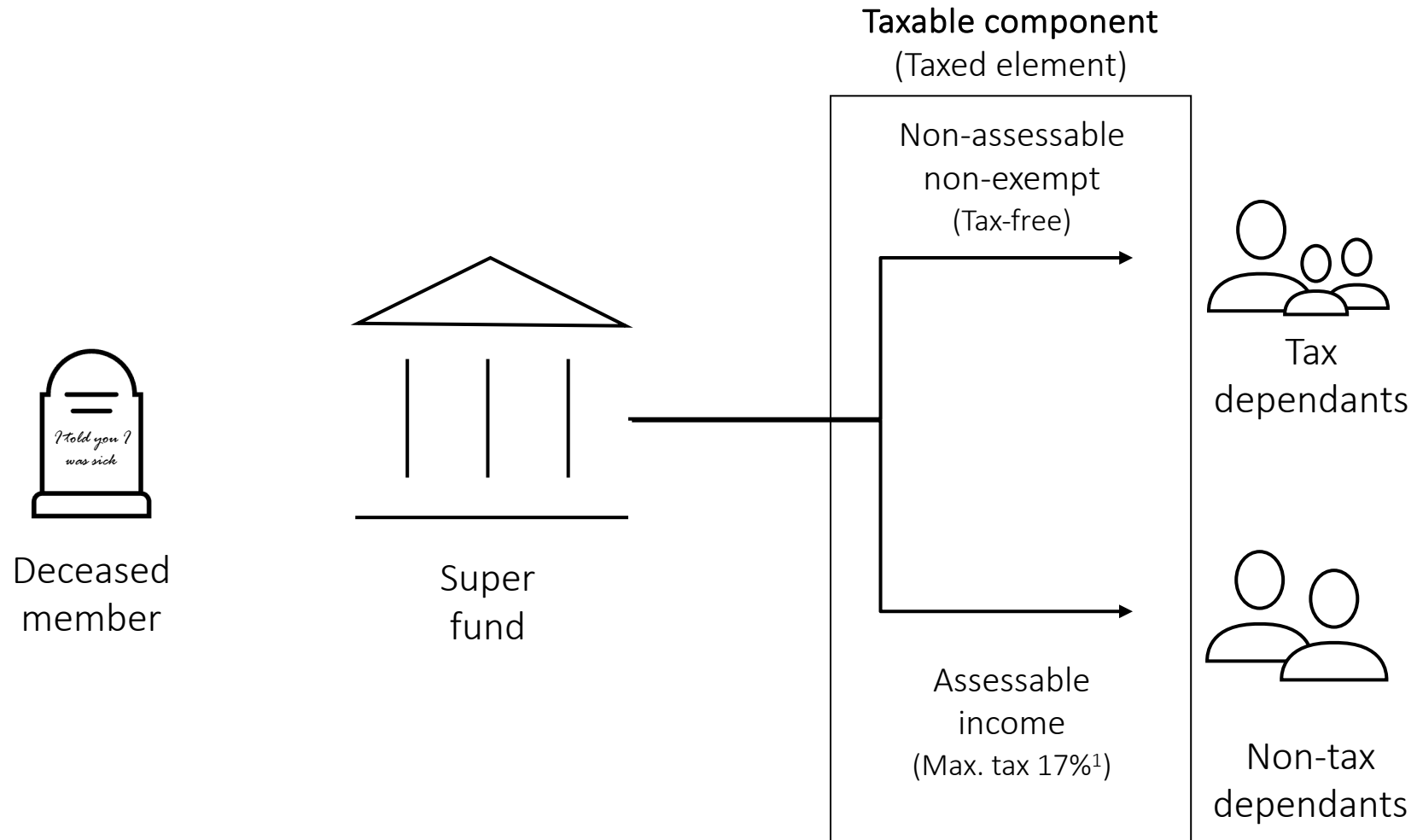
- insured event occurred before policy anniversary
- insurer approved claim and cancelled policy
- no deduction available as no premium paid so can't claim alternative

If lump sum/pension paid in following year

- can claim alternative where premium paid in previous year but deduction not claimed

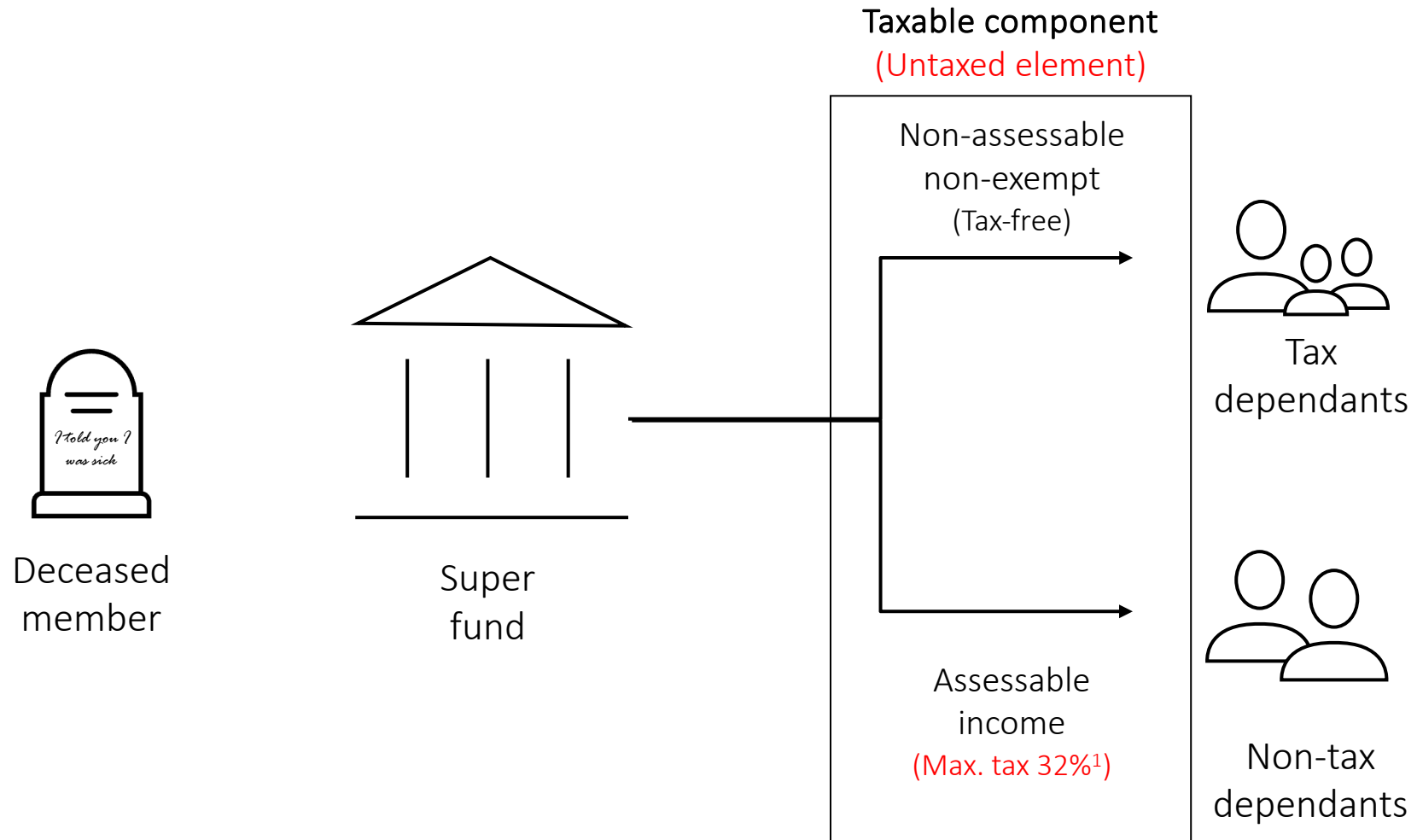
Meaning of: to pay a super death or disability benefit *in consequence of a member's termination of employment*

Death benefits tax



¹ Including Medicare Levy

Death benefits tax



¹ Including Medicare Levy

Untaxed element

Applies where claimed a deduction for premiums (or future liability) in respect to the payment

$$\textit{Untaxed element} = \textit{Taxable component} - \textit{taxed element}$$

$$\textit{Taxed element} = \textit{Amount of lump sum} \times \left[\frac{\textit{Service days}}{\textit{Service days} + \textit{Days to retirement}} \right] - \textit{Tax free component}$$

Where:

Days to retirement = the number of days from the day on which the person stopped being capable of being gainfully employed to their last retirement date (generally age 65)

Service days = the number of days in the service period for the lump sum

Death benefits and insurance

Case study - David (53)

SMSF set up 2 years ago

\$200,000 balance (50% tax free component)

Recently took out \$1 million life cover

Super benefit payable to adult child

Has small industry fund with \$500 balance and start date of 20 years ago

Compare consolidating now v leaving separate

- assume David dies in 2 years and super balance has remained the same

	No rollover (Service days 1,460) (Days to retirement 3,650)
Total days	5,110
Tax free	\$100,000
Taxable (taxed)	\$242,857
Taxable (untaxed)	\$857,143
Tax and Medicare	\$315,571
Net death benefit	\$884,429

TPD/life proceeds – new pension

TBC credit = commencement value of new pension

Proceeds added before commencement of:

disability pension

death benefit pension

Count towards TBC

Life proceeds – reversionary pension

TBC credit = market value of pension at time of death

Pension automatically reverts on death

Proceeds added to existing pension account later

Do not count towards TBC

Premiums need to be deducted from pension account

- age?
- TTR pensions

Benefits

Holding in super can provide benefits

- lower cost
- no impact on cash flow

Insurance in SMSFs

Flexibility provides opportunities

Need to be able to administer

- premiums
- proceeds
- payments
- tax

Insurance and death benefits

Creates a sum worth fighting over

- death benefit planning essential

TBC and Div 296

- is super the best place?

Thank you.