

# Risk Insurances in & out of SMSF

This is a complicated area and the following information is of a general nature only. One of the advantages of a self-managed superannuation fund (SMSF) is that it allows trustees to structure your insurance to suit your needs. However, some types of insurance are not suited to the SMSF environment, and it is vital that trustees consider the positives and negatives of each before entering into each insurance arrangement.

SMSFs, by definition, assume that the individuals concerned are taking full responsibility for family future if the unthinkable happens. There should be sufficient life insurance cover to pay out personal debt, ensure an adequate long term income for a surviving spouse, and to cover other costs relating to providing for your family.

**Well Suited:** Life and Total & Permanent Disability (**TPD**) insurance are well-suited to being held within an SMSF, as long as certain issues are considered. One reason people are under-insured is the cash flow impact. Using your SMSF to pay for a life insurance policy allows trustees to help provide benefits for their dependents, without the impact on day-to-day cash flow. Life insurance is commonly provided with Total & Permanent Disability (TPD) insurance. TPD insurance is provided to a person who has suffered a permanent injury.

Trustees may be able to claim a tax deduction in the SMSF for the premiums, although the long term implications of this needs to be considered. The ability to pay life insurance as a lump sum or income stream provides flexibility, as trustees can consider the tax implications of each option, as well as the specific needs of the beneficiaries.

**Maybe Suited:** Income protection insurance may be suitable for an SMSF, but the specific needs of the members must be considered. As with life insurance, for many the cost of paying for an income protection insurance policy from personal funds means insurance is prohibitive. Members may be able to use employer contributions to their SMSF to fund a policy to provide for income protection in the event of temporary incapacity.

A benefit paid under temporary incapacity is paid to the member as a non-commutable income stream throughout the period of the incapacity, similar to how the benefit would be paid outside of superannuation.

Premiums for an income protection policy are tax deductible both inside and outside of superannuation. However, the tax benefit is diluted inside the SMSF, as the maximum tax rate is 15%.

**Not Suited:** Trauma insurance is able to be held within an SMSF, but possesses many drawbacks. Unlike Life & TPD insurance, the premiums for a policy are not deductible for an SMSF. In addition, simply being paid out for a Trauma policy by an insurance company does not necessarily mean the insured will be able to access the proceeds!

To access any benefit from superannuation, a condition of release must be met. Whilst these conditions are generally met in the event of death or permanent disablement, the conditions required for temporary incapacity do not always match the circumstances experienced should you suffer and claim on a trauma policy. For a member, this may result in a policy being paid to their SMSF but the member being unable to access it.

**Taxation Implications.** The taxation implications of insurance policies within superannuation funds should not be ignored. The difficulty arises when planning the best option to extract the insurance payment from the fund. This is a significant area of complexity. There are however, several methods that deal with insurance policies within SMSFs each with their own taxation and superannuation implications.

When a member dies the insurance payment that is received by the fund can only be paid out to SIS Act dependants. These are generally the deceased's spouse, children or estate. Further to that the fund is generally required to pay the benefits as a lump sum to your non dependent children or your estate.

The taxation components of a life insurance policy may also impact on how to pay a life policy within a superannuation fund. If the life policy expense is claimed as a tax deduction by the trustee of the superannuation fund then any insurance proceeds may potentially have an untaxed element. The amount of the untaxed element depends on several factors and can only truly be calculated at the time of death.

**Death Benefits to the spouse Lump Sum v Pension.** In deciding the amount of a death benefit to pay out as either a pension or lump sum, factors such as the age of the spouse and the amount of untaxed element should be considered. Where the deceased and the spouse are under 60, a lump sum would be paid tax free however, a pension may have tax implications depending on the proportions of taxed and tax free components and the presence of an untaxed element. If either the deceased or the spouse is over 60 at the time of death then once again a lump sum would be paid tax free plus a pension, excluding the proportion which is an untaxed element, would also be tax free.