SMSF Strategy

Holding insurance through your SMSF: what you need to know

Insurance is an important consideration for all of us. But for SMSF trustees, there is also a legal requirement to consider the need to hold insurance cover for each of their members. This handy guide gives you the information you need to know about holding insurance through your SMSF.

What are the advantages of holding insurance through your SMSF?

Save money on your premiums

If you hold life and total and permanent disability (TPD) insurance through your SMSF, the premiums will generally be tax deductible. So premiums for life and TPD policies held inside your SMSF will generally be cheaper than for those held outside your SMSF (where the premiums are generally not tax-deductible). However unlike Life and TPD Cover, income protection is generally 'tax deductible' to the policyholder (such as when you hold it in your own name outside of super). Because of this, there is no tax saving on premiums to holding income protection insurance inside super.

You can either make additional contributions to your SMSF to pay for the premiums or they can be paid from your existing superannuation balance.

Are there any disadvantages?

The downside of funding insurance using your super balance is that you will be reducing your existing retirement savings.

Also, if you were to fund the insurance premiums by salary sacrificing or making personal tax-deductible contributions to your SMSF, you need to be careful that you do not exceed the concessional contributions cap (currently it is $25,000, although this may change in future years). Otherwise, you may incur additional tax liabilities.

In some cases, tax could apply to insurance proceeds included in a benefit paid from the fund. This will depend on you or your beneficiaries' circumstances. For example:

- life insurance proceeds paid as part of a lump sum death benefit to a spouse will be tax free, while proceeds paid to a non-dependent adult child will generally be taxed at up to 32%.
- TPD proceeds paid out to the life insured from the super fund, will be taxed as a superannuation disability benefit.

Finally, it is important to check that your SMSF Trust Deed is up-to-date and includes all relevant and appropriate features, in line with your estate planning objectives and current superannuation legislation.

Let’s look at how it works – a case study

Sebastian and Jennifer are a married couple in their 40s with two young children. Sebastian earns $120,000 per year and Jennifer earns $60,000 per year, so their marginal tax rate is 39% and 34.5% respectively (this include the Medicare levy). They have decided to both take out term life and TPD insurance, and have agreed that should the unexpected happen to either of them, the death benefit will be paid to the surviving spouse to assist the family in maintaining its current standard of living.

The level and cost of cover are detailed in the following table:

Individual	Type of cover	Level of cover	Premium
Sebastian	Term Life	$1,500,000	$1,700*
Sebastian	TPD	$1,500,000	
Jennifer	Term Life	$1,000,000	$991**
Jennifer	TPD	$1,000,000	
		Total	**$2,691**

* based on 40 yo male, non-smoker, professional, TPD (Any), std rates.

** based on 40 yo female, non-smoker, clerical, TPD (Any), std rates.

In obtaining their insurance cover, Sebastian and Jennifer have two options:

1. hold the cover in their personal names (outside of super) and pay for it directly through their after-tax employment income; or
2. have their SMSF acquire and hold the insurance on their behalf, and fund the premiums via salary sacrifice contributions from their respective pre-tax employment incomes.

Comparison between holding the insurances inside and outside of SMSF

	Insurance held in personal names outside of SMSF	Insurance held inside SMSF
Annual Premiums	$2,691	$ 2,691
Sebastian: pre-tax income required to fund his premiums	$2,787	$1,700
Jennifer: pre-tax income required to fund her premiums	$1,513	$991
Tax on salary sacrificed contribution into SMSF	Not applicable	$403.65
Tax deduction available to the policyholder	Nil	($403.65)*
Real cost of cover	**$4,300**	**$2,691**

*15% of premium cost.

Outcomes

Sebastian and Jennifer decide to take out their insurance using their SMSF. This means they can:

- Save $1,609 on the total premiums of the cover by having the insurance policies inside their SMSF in contrast to holding the insurance policies in their personal names.
- Pay their premiums by salary sacrificing into their SMSF, effectively funding the premiums through their pre-tax income.
- Where the Life insurance proceeds are to be paid to the surviving spouse via the SMSF it will be paid out tax free.

What you need to know before you get started

Types of insurance that can be held within an SMSF

Type of insurance	What it covers
Term life insurance	Pays a lump sum when you die (or in most cases if you become terminally ill).
Total and permanent disability insurance (TPD)	Pays a lump sum in the event you suffer an illness or injury that leaves you incapable of working for the rest of your life.
Income protection insurance	Provides a regular income (generally up to 75% of your previous work or business income) if you suffer an illness or injury that leaves you temporarily unable to work. Benefits are payable until you are able to return to your normal work.

Consider each member's need for insurance

Under the SMSF rules, trustees will need to demonstrate that they have properly considered each member's personal circumstances to determine their insurance needs. For example, in relation to a member, a trustee might consider:

- their existing insurance arrangements both inside and outside the SMSF
- their income, expenses, assets and liabilities
- the affordability of cover having regard to their retirement goals
- the availability of cover given their age and health, and
- the impact their death or disability would have on their own/ their beneficiaries' standard of living and their ability to fund ongoing expenses as well as pay any associated medical bills and care costs.

Assess tax on proceeds

Trustees will also need to assess how any insurance proceeds will be taxed when determining the level of insurance required.

What happens if a trustee doesn't properly consider the insurance needs of members?

Trustees have a legal obligation to consider the need to hold insurance for members and the failure to do so may result in penalties and liability issues applying. However, even more importantly, failing to consider the insurance needs of each member could drastically impact their or their beneficiaries' standard of living should the member die or become disabled.

How your financial adviser can help

Your financial adviser can help you meet your obligations as an SMSF trustee and make sure all of your insurance needs are covered by:

- undertaking a full insurance needs analysis for each member and provide recommendations on the type and level of insurance required
- identifying and recommending appropriate insurance policies to hold within an SMSF
- recommending a contribution strategy to pay any premiums; and
- updating the SMSF's investment strategy to reflect that the trustees will consider the need to hold insurance for the members of the fund.

Contact your financial adviser for more information.

Speak to us for more information

If you would like to know more about self managed super funds, talk to your Count Financial Adviser. They can give you more detailed information on the best approach for your situation.

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