Life cover in the super context

IN the last edition of WSBA we spoke about life insurance and eluded to the different covers available. In this article we will provide an overview of having life insurance inside or outside of superannuation, and how the structure of your life insurance (and TPD) will affect the benefit payment made. Within super you generally have term life, TPD and income protection cover. We will be discussing term life and TPD only in this article.

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When insurance is held outside of super, the ownership of the policy can vary, depending on the need for the policy.

For example, more commonly if a policy is being used for family protection, the policy will be owned by the life insured, or the spouse of the life insured, or maybe even jointly.

A beneficiary may be nominated under the policy, and if no beneficiary is nominated then the benefit would generally be paid to the insured's estate. Premiums for personal insurance policies outside of super are not generally tax deductible.

If the policy is being used for business purposes, then the policy could be owned by the life insured, a business partner, or even a business entity depending on the purpose of the policy (key man cover, buy sell cover etc).

Premiums for business insurance policies may be tax deductible depending on the purpose of the policy.

When insurance is held within superannuation, the policy will be owned by the superannuation fund Trustee, and this includes Self Managed Super Funds.

Premiums paid are deemed to be super contributions and will count towards contributions caps. The premiums paid may be tax deductible if you are paying them from after tax dollars.

Quite often premiums are paid from super contributions made on your behalf by your employer which do not affect your personal cash flow.

The most appropriate type of policy ownership will depend on your circumstances, and the purpose of the policy.

Advantages of having insurance in super

One of the main advantages of having insurance cover in super is tax efficiency. Premiums being paid from your super fund are deducted from contributions made, and therefore do not affect your cash flow.

If you are paying the premiums from after tax dollars, you may be entitled to claim a tax deduction for those premium payments.

In addition to this you may also be entitled to the Government Co-contribution for the premium payments (from after tax dollars) if you quality under the income threshold.

Insurance held within super is treated differently when paid to dependent and non dependent beneficiaries. This is a very important point to consider when you are looking at having your insurance held within super.

The definition of dependent is different under the Tax Act and the SIS Act[1]. The SIS Act dictates who can receive a benefit payment from superannuation, but it is the Tax Act which dictates how the benefit is taxed in the hands of the beneficiary.

Disadvantages of having insurance in super

One of the main disadvantages of having insurance in super (as part of an accumulation fund) is that every dollar spent on insurance premiums being deducted from your super account balance, means less money to invest for retirement.

The contribution caps also have a bearing on how much you can put into your super each year as a concessional contribution, and when you take into consideration that insurance premiums count towards this cap, it reduces to opportunity to contribute investment dollars.

1 SIS Act – Superannuation Industry (Supervision) Act 1993

Another disadvantage is that holding insurance in super is more restrictive than holding the cover outside of super as a condition of release must be met for the benefit to be paid.

This is not generally an issue for term life cover, as the main event for this cover to be paid is the death of the life insured.

However, under TPD (and income protection) the benefit payments are more restrictive when the cover is held in super as whilst the claim may be approved by the insurer, the benefit may not be released by the Trustee to the insured person if condition of release under the SIS Act is not met.

Estate planning considerations

As noted earlier, beneficiary nominations are treated differently for cover held in and outside of super.

For cover outside of super, generally the benefit is paid to the life insured (for TPD cover), and to the insured's estate or nominated beneficiary for term life cover. There are not usually any tax consequences to the person receiving the benefit upon receipt of the benefit.

However, the beneficiary nomination for cover held in super can be made as non-binding or binding, or as determined by the super fund Trustee.

If the Trustee is a SMSF, then the Trust Deed should be reviewed to ensure that a benefit payment can be made to a nominated beneficiary and not automatically paid to the insured's estate.

Payment to a beneficiary under a super policy may have a tax consequence depending on whether the beneficiary is a financial or non financial dependent.

It is very important to discuss your estate planning arrangements with a duly qualified adviser (legal and/or financial) so that you put into place the arrangements that you would like, and also make sure that any previous arrangements are 'over ridden' in the event that your personal circumstances change.

The consideration of having your insurance cover within or outside of super is very important, and either course may have an impact on your cash flow, may have potential tax implications, and may affect the ultimate payment of a benefit to your beneficiaries/estate.

It may be an appropriate strategy for you to have cover both inside and outside of super to get the best result overall.

There are a number of other important matters to consider when you are looking at insurance cover inside or outside of super, and this brief article has only touched on some of those issues.

You should always seek the guidance and advice from qualified advisers in these areas to make sure you have the most appropriate strategies for your circumstances.

Christina Matthews and Dr Jim Taggart OAM are Representatives of Taggart Nominees Pty Ltd. Taggart Nominees Pty Ltd holds AFSL No: 234973, and is a Life Insurance Broker. The information is this article is general in nature and does not constitute financial advice.

References:
Superannuation Industry (Supervision) Act, 1993.
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