

## SMSFs AND INSURANCE - CHANGE IS ON THE WAY

Self-insurance in general and some specific types of external insurance, such as trauma insurance, are to be outlawed in SMSFs and most other super funds.

The Government recently amended the SIS Regulations, with changes to the rules concerning insurance offered by regulated superannuation funds.

Previous changes to the rules covering ownership of insurance within super funds include:

- changes to the extent of tax deductibility available in respect of premiums paid for some total and permanent disability (TPD) insurance - basically, premiums for 'own occupation' TPD cover<sup>1</sup>; and
- a requirement that trustees of SMSFs regularly review the fund investment strategy and, as part of the review, consider whether insurance cover should be taken out for members of the SMSF.

Through the more recent amendments, the Government has introduced further changes, including:

- **A ban on self-insurance by superannuation funds:**

From 1 July 2013, most super funds are not permitted to offer benefits for death, terminal illness, permanent incapacity or temporary incapacity cover unless the fund holds external insurance cover to meet the payment of those benefits<sup>2</sup>; and

- **A limit on the types of insurance cover the fund is permitted to hold:**

Initially proposed to also apply from 1 July 2013 but now to be deferred to 1 July 2014, super funds will not be permitted to obtain external insurance cover, to provide insurance benefits to members, unless it is the type of cover that, in the event of a claim, the benefit will be able to be paid to the member (or their dependants) under any of four conditions of release, being death, terminal illness, permanent incapacity or temporary incapacity<sup>3</sup>.

Although the impact of these changes on the operation of SMSFs will vary from fund to fund, the expectation is that the limit on the types of insurance cover permitted to be held will have a greater impact.

Whilst some SMSFs may have self-insured member benefits, generally by creating an insurance reserve, the complications brought about by the application of the contribution caps to amounts transferred from reserves (i.e. in one or more large payments) effectively limits the viability for many SMSFs.

Many fund members presently have cover in their SMSFs for various reasons which, seemingly, may not meet the new rules. For example:

- an individual aged 55 who is unable to obtain TPD cover, but could qualify for trauma insurance. Meeting a condition of release to enable the benefit

to be paid out by the SMSF would not usually be a concern in this scenario - the SMSF could receive the payment from the insurer and the member could access an income stream under the transition to retirement condition of release, until subsequently meeting a full condition of release; or

- the trustee of a SMSF, having acquired an asset under a SMSF borrowing arrangement, desires to insure the member who is the main source of contributions to the fund, so as to ensure the fund can continue to meet the loan repayment obligations in the event of that member's death or incapacity. Own occupation disability cover generally provides more certainty that a claim will be accepted.

Although there is no certainty the member would meet a condition of release if an insurance claim occurred, as the test for the permanent incapacity condition of release is the broader 'any occupation' test, the purpose of the cover in this example is not to pay benefits, but to fund loan repayments.

Whilst cover similar to those referred to in the examples above will be permitted to remain **if held prior to 1 July 2014**, under a specific exemption, the Regulations would initially appear to remove the ability

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of funds to take out similar cover in future, which we will consider in some detail below. Despite that, post 1 July 2014 the exemptions permit funds to change insurers or to upgrade cover in respect of policies held prior to 1 July 2014, which would otherwise not be permitted if cover was not in place at 1 July 2014.

Given the 'grandfathering' which is to be permitted, trustees will need to maintain records of insurance in existence at 30 June 2014 (or self-insurance in existence at 30 June 2013), so as to satisfy future audit requirements.

We have used the words 'seemingly' and 'would initially appear' in this document, as some options to hold a

broader range of cover may still remain.

The Explanatory Statement (ES) which introduced the amendments to the Regulations states that "From 1 July 2014 the exemption cannot be used to provide a member with a type of cover they did not have prior to 1 July 2014." Note that the prohibition refers to cover taken out to '... **provide a member** with a type of cover ...' as extracted from the ES above and '... provide an insured benefit **in relation to a member** ...' (new SIS Reg. 4.07D(2)) (our emphasis added).

What then, if the purpose of the cover is not for the benefit of a member? The Regulations do not appear to remove that option, such as the instance referred to in the 2<sup>nd</sup>

of the examples above as, in that example, the cover is not taken out to provide a benefit **to a member**.

Naturally, premiums to provide such cover should not be paid from a member's account in the fund - possibly from a reserve established for the specific purpose. We have covered the holding of insurance for purposes other than to provide direct member benefits in some of our web videos on topics including **SMSF Borrowing and Estate Planning for SMSFs**, [which can be accessed here](#).

### More information

Should you have any queries, or require more information, please contact the team at Topdocs on 1300 659 242.

#### Notes:

- <sup>1</sup> [A detailed paper on the deductibility of TPD insurance premiums can be accessed here.](#)
- <sup>2</sup> A fund which is self-insuring at 30 June 2013 may continue to self-insure until 30 June 2016. New members added to the fund between 1 July 2013 and 30 June 2016 may be covered under the self-insurance arrangement.
- <sup>3</sup> The Regulations provide a degree of 'grandfathering' of the rules, as insurance cover in existence at 30 June 2014 will be permitted to remain.

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