

SMSFs AND INSURANCE - REMEMBER THE NEW RULES

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

An amendment to the SIS Regulations has changed the rules concerning insurance offered by regulated superannuation funds.

The changes are effective from 1 July 2013 (in part) and from 1 July 2014 for the remainder. It is the latter changes which most impact SMSFs.

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

- changes to the tax deductibility available in respect of some premiums - particularly, for 'own occupation' TPD cover¹; and
- a requirement that trustees, in reviewing the fund investment strategy, consider whether insurance cover should be taken out for members of the SMSF.

The most recent amendments introduced new operating standards, 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 (i.e. the fund must not self-insure)²; and

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

From 1 July 2014, super funds are 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 incapacity³.

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 of that option 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 an SMSF, having acquired an asset using borrowed funds, 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.

The question to consider is whether TPD cover to be taken out should be based on an 'own occupation' or 'any occupation' test.

Own occupation disability cover generally provides more certainty a claim will be accepted but, in the event of receipt of claim proceeds by the trustee, a benefit may not be able to be paid to the member as the broader 'any occupation' test is applied under SIS.⁴

As the purpose of the cover in this example is not to pay benefits, but to fund loan

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repayments, we come back to the consideration of the most appropriate type of cover and whether that cover is permitted.

Whilst cover similar to those referred to in the examples above will be permitted to remain, under a specific grandfathering exemption, **if held prior to 1 July 2014**, the Regulations would initially appear to remove the ability of funds to take out similar cover in future. We will consider that in some detail below.

The exemptions also permit funds to change insurers or to upgrade or downgrade cover in policies held prior to 1 July 2014, which would otherwise not be permitted if the cover was not in place at 1 July 2014.

Given the 'grandfathering', 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 exist.

The Explanatory Statement (ES) which introduced the amending 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 the prohibition refers to cover taken out to '... **provide a member** with a type of cover ...' (from the ES) and '... **provide an insured benefit in relation to a member** ...' (new SIS Reg. 4.07D(2)) (our emphasis).

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 2nd 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 by logging in to the Topdocs portal](#).

To date, there has been no indication from the ATO confirming

that insurance cover, such as own occupation TPD cover, may be obtained in respect of a member of an SMSF, to cover actual liabilities.

In fact, the ATO has released both an Interpretative Decision, ID 2015/10, and a subsequent case study dealing with the use of an SMSF to hold insurance policies on the lives of members for the purpose of a buy/sell agreement.

In ID 2015/10 and the case study, the holding of insurance policies under a buy/sell agreement is likely to be deemed in breach of the sole purpose test and, possibly, the provision of financial assistance rules.

Conclusion

Care needs to be taken by trustees in ensuring that any life or TPD cover will meet the rules set down in the new operating standards.

More information

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

Notes:

- ¹ [A detailed paper on the deductibility of TPD insurance premiums can be accessed here.](#)
- ² 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.
- ³ The Regulations provide a degree of 'grandfathering' of the rules, as insurance cover in existence at 30 June 2014 will be permitted to remain.
- ⁴ The test for the permanent incapacity condition of release is the 'any occupation' test, meaning there is no certainty the member would meet a condition of release with an 'own occupation' claim. Basically, the 'own occupation' test is a test to ascertain whether the individual is likely to be capable of returning to the role they occupied prior to becoming disabled. The 'any occupation' test considers whether the member could work in any field for which they are reasonably trained or qualified. For an extreme example, the company CEO who started work in the mailroom may be deemed unfit to continue as CEO, but fit to return to the mailroom role, so would not be considered to be permanently incapacitated under SIS.

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