Insurance policies

* 1. Can an insurance policy be transferred from a member to a superannuation fund?
  2. What is the tax treatment of an insurance payment made from a policy which has been transferred from a member to the superannuation?
  3. What is the tax treatment of a death benefit when not deduction is claimed in the year the payment is made although a deduction may have been claimed in prior periods?

**Background information:**

An insurance policy is an annually renewable product with the removal of the RBL provisions a number of trustees have sought to transfer these policies to a superannuation fund. One argument is that as this is an annually renewable product this is merely a transfer of an existing arrangement. There is no acquisition from the member. Is there a tax implication of the transfer should a death benefit be paid?

Alternatively an SMSF has an insurance policy from its commencement date. The fund claims a deduction annually. In the final year the trustee elects not to claim a deduction. Is the payment from the policy assessable or not?

**Further information sought and provided as follows:**

**What would be the purpose of the transfer of the policy from the member to the SMSF?**

The member may have held the policy personally as the benefit paid upon death would trigger an excess RBL in order to pay a pension to the member in this circumstance a testamentary trust would be required upon the death of the member. With the removal of RBLs the client may wish to transfer the policy to the fund. One pension comprising of insurances and accrued benefits can be paid to dependants in the event of the member's death.

**What advantages does transferring an existing policy provide over the alternative of an SMSF taking out a policy in its own right?**

The advantages of transferring the policy are:

* + that there are no medical requirements as these were done at the commencement of the policy, and
  + that the fund meets ongoing payments and therefore the costs of insurance are reduced. For example, if I pay $1000 of after tax dollars for insurance and my tax rate exceeds 15% I am able to maximise savings by contributing the grossed up $1000 and paying 15% tax. Reducing tax and increasing savings.

**What is the nature of the policy? For example is it a life, key-man, trauma or other type of policy?**

Policies will usually be life, disability, income protection. Key man and trauma are less likely as they do not payout a benefit when the event occurs unless the member dies or meets a disability definition.

**Who owned the policy prior to its transfer to the SMSF? For example, was it the member or an employee or other?**

Generally the owner is the member or relative; that is spouse or the employer, that is, company.

**What exactly is being transferred to the SMSF under the policy? Are rights being transferred, and if so what rights?**

The ownership of the policy is transferred, the fund will take on responsibility for future premiums and will claim the benefit should a claim event occur.

**On transfer how do the rights and obligation associated with the policy change?**

**Who is the insured person or what is the insured event? Does this change after the transfer?**

The insured and event would remain the same.

**Who are the beneficiaries under the policy? Does this change after the transfer?**

**Who pays the premiums under the original policy? Does this change after the transfer?**

Death benefit beneficiaries are identified by the will or insurer upon the death of the insured death. Therefore there should be no change.

**Is it intended that a claim will be made for a superannuation contribution when the policy is transferred to the SMSF?**

The policy is transferred at renewal and the SMSF would make the contribution in future periods. This may be met from future contributions.

**Industry view/suggested treatment:**

The transfer is not an acquisition from a member it is merely a change of owner when made at the policy anniversary as the fund pays any future premiums. The tax treatment does not vary from current tax arrangements.

The payment is not assessable when a claim is made in the year no deduction is claimed.

I was particularly focused on Section 66 but if there is an implication on Reg. 1.03 and S62, this is also useful.

**Technical references:**

Nil

**Impact on client:**

The changes arising from simpler super have seen financial advisors review and restructure insurance arrangements. Uncertainty in relation to these matters can result in incorrect tax treatment of death benefits.

**Tax Office response:**

As the questions asked are very broad, the Tax Office can only offer responses in similar broad terms.

In preparing a response, we have focused only a policy that is a life policy as defined in the *Life Insurance Act 1995* (the Life Act). Under the Life Act, a life policy includes certain disability policies.

* + **Transfer of the policy from member to an SMSF**

**Requirements for transferring a life policy**

It is clear from the Life Act that a life policy can be assigned. However, sections 200-203 of the Life Act set out certain requirements that must be met. The assignment must be by way of a memorandum of transfer (the form of which is prescribed by regulations), signed by both the transferor, transferee, and an officer of the life company, the assignment must be endorsed on the policy or an annexure to it and the assignment must be registered in a register of assignments kept by the life company.

If a member of a self-managed superannuation fund were to seek to transfer a life policy held in his or her own name to the trustees of the self-managed superannuation fund, we assume it remains necessary to follow this procedure even if the individual is one of the trustees of the fund.

Further, we assume that this process must be followed even if the transfer occurs at the time of the renewal of the policy. Were this not the case we believe it would be necessary to treat the policy as a completely new policy. This would appear not to be the intention having regard to the suggestion that a medical examination would not be required. Further, we presume that accrued bonuses, accrued discounts on premiums or other rights in recognition of premiums previously paid by the member or the length of time that the member held the policy is meant to be retained.

**Section 66 of SIS Act**

In light of the previous paragraph, it is highly likely that we would consider the assignment to be an acquisition of an asset from a related party that is prohibited by section 66 of the SIS Act.

Further, if the policy is acquired from a member of the fund, or a relative of a member of the fund, the acquisition would not come within the exception for certain in-house assets in subparagraph 66(2A)(a)(iii) of the SIS Act.

**Section 62 of SIS Act**

The question states that the transferred policies may be life, disability, income protection, or less commonly key-man or trauma.

Sole purpose test questions arise depending on the nature of the policy transferred. For example *APRA Circular II.A.4* says 'An unreasonable diversion of contributions as premiums for the contingent trauma cover would be difficult to reconcile with the sole purpose test and the fundamental retirement objective of superannuation.' It would appear questionable from a sole purpose perspective if the policy is not a good fit with the self-managed superannuation funds benefit structure and is transferred to get a tax benefit in respect of premiums (although the SMSFR 2007/D1 on the sole purpose test states that 'The Commissioner considers that, in a SIS Act context, superannuation tax concessions, although a form of benefit, are not a factor when applying the sole purpose test'.

**Contribution**

The transfer of the life insurance policy may represent a contribution of property. If that is the case, a method needs to be established to calculate the amount of the contribution for the purposes of allocating an account to the credit of a member, the contributions caps, deductions and co-contributions.

* + **What is the tax treatment of an insurance payment made from a policy which has been transferred from a member to the superannuation fund?**

Assuming that the relevant policy is a policy of insurance on the life of an individual as described in item 5 of the table in subsection 118-300(1) of the ITAA 1997 (that is, a term policy) any capital gain or loss made on a payment made in satisfaction of the policy may be disregarded. Nor is the amount ordinary income assessable under section 6-5 of that Act.

* 1. **What is the tax treatment of a death benefit when no deduction is claimed in the year the payment is made although a deduction may have been claimed in prior periods?**

The tax treatment of a superannuation death benefit that is a superannuation lump sum paid by a superannuation fund from the proceeds of an insurance policy is determined having regard to whether the trustee of the fund has been, or is to be, claimed under section 295-465 or 295-470 of the ITAA 1997 (or former sections 279 or 279B of the ITAA 1936). The benefit will include an element untaxed in the fund if a deduction has been, or is to be, claimed by the trustee.

**Meeting discussion**  
Several members suggested that the answer would need to distinguish between term life policies and other life policies. It was suggested that the arrangement would be most likely to relate to a term life policy under which there are no accrued benefits. The representative for the ICAA said the answer would be reviewed and if necessary follow-up questions would be submitted