Strategy 7
Purchase Life and TPD insurance tax-effectively

When taking out Life and Total and Permanent Disability (TPD) insurance for certain business purposes, you may want to arrange the cover in a super fund rather than outside super.

What are the benefits?

By using this strategy, you could:

- reduce the premium costs, and
- enable certain beneficiaries to receive the death or TPD benefit as a tax-effective income stream.

How does the strategy work?

There are a range of situations in which you could use Life and TPD insurance to protect your business and the interest you have in it.

In some of these cases, it may also be worthwhile taking out the insurance in a super fund, rather than outside super. These could include to:

- repay business debts, or release a loan guarantee or security (see Strategy 1)
- fund a Buy Sell agreement (see Strategy 3), or
- equalise your estate (see Strategy 6).

One of the key reasons for holding the cover in a super fund is that you could benefit from a range of upfront tax concessions generally not available when insuring outside super. For example:

- **If you earn less than 10% of your income[1] from eligible employment (eg you're self-employed),** you can generally claim your super contributions as a tax deduction – regardless of whether they are used in the fund to purchase investments or insurance.
- **If you run your business through a company or trust and you sacrifice some of your salary into super,** you can purchase insurance in your fund with pre-tax dollars (see case study).

These tax concessions can make it cheaper to insure through a super fund. This will usually also be the case if the sum insured is increased to make a provision for any lump sum tax that is payable on TPD and death benefits in certain circumstances (see FAQs on pages 22 and 23).

Another benefit of insuring in super is that you (or certain eligible dependants) have the option to receive the TPD (or death) benefit as an income stream, rather than a lump sum payment. Where this is done:

- because lump sum tax won't be payable when the income stream is commenced, there is no need to increase the sum insured, and
- the income payments will be concessionally taxed (see FAQs on pages 22 and 23).

An income stream generally won't suit when the purpose of the insurance is to repay business debts or release a loan guarantee or security. This is because, to achieve this objective, the money will need to be received as a lump sum payment.

However, when the insurance is used to fund a Buy Sell agreement or equalise your estate, the beneficiary(ies) may prefer to receive the proceeds as a regular and tax-effective income to meet ongoing living expenses.

A financial adviser can help you determine whether you could benefit from insuring in super. They can also review your insurance needs over time to make sure you remain suitably covered.

1 Includes assessable income, reportable fringe benefits and reportable employer super contributions.

Case study

Tom and Harry are both aged 50 and each own 50% of a concreting business valued at $1 million. The business is run through a company from which they draw a salary, and they both pay tax at a marginal rate of 38.5%[2].

To protect their respective interests in the business, their financial adviser recommends they:

- execute a Buy Sell agreement (see Strategy 3), and
- fund the agreement by each taking out $500,000 in Life insurance, where the premium for both of them will be $1,029[3] in the first year.

Their adviser also explains that it will be more cost-effective if they take out the insurance in super. This is because if they arrange for their company to sacrifice $1,029 of their respective salaries into super, they will be able to pay the premiums with pre-tax dollars[4].

Conversely, if they purchase the insurance outside super and pay the premiums themselves from their after-tax salaries, the pre-tax cost would be $1,673 after taking into account their marginal tax rate (ie $1,673 less tax at 38.5% [$644] equals $1,029).

By insuring in super, they could both make a pre-tax saving of $644 on the first year's premiums and an after-tax saving of $396, after taking into account their marginal rate of 38.5%.

For both Tom and Harry	Insurance purchased outside super (with after-tax salary)	Insurance purchased inside super (via salary sacrifice)
Premium (pa)	$1,029	$1,029
Plus tax at marginal rate of 38.5%	$644	N/A
Pre-tax salary received or sacrificed	$1,673	$1,029
Pre-tax saving	N/A	$644
After-tax saving	N/A	$396

Let's now assume they continue this cover for 15 years and the amount of insurance increased by 5% pa, to ensure the benefit payable keeps pace with inflation. Over this period, the after-tax savings for Tom and Harry could amount to $21,609 each (in today's dollars). So insuring in super could be significantly cheaper over a long time period.

Note: This case study highlights the importance of speaking to a financial adviser about the benefits of taking out insurance in a super fund. A financial adviser can also address a range of potential issues and identify other suitable protection strategies – see Tips and traps.

2 Includes a Medicare levy of 1.5%.

3 For simplicity purposes, we have assumed they both pay the same premiums. These premiums are based on MLC Limited's standard premium rates as at 1 November 2010 for non-smoking males aged 50, with $500,000 in Life Cover that increases by 5% each year and ignores the policy fee. In reality, they may pay different premiums based on factors such as their age, health and the amount of insurance each of them requires to protect their respective business interests.

4 Because super funds generally receive a tax deduction for death and disability premiums, no contributions tax is deducted from the salary sacrifice super contributions (see FAQs on page 23).

Tips and traps

- Insurance cover purchased through a super fund is owned by the fund trustee, who is responsible for paying benefits subject to relevant legislation and the fund rules (see 'Restrictions on non-death benefits' in the Glossary). When insuring in super, you should be clear on the powers and obligations of the relevant trustee when paying benefits.
- When making salary sacrifice or personal deductible contributions to fund insurance premiums in a super fund, you should take into account the concessional contribution cap (see Glossary).
- When insuring in super, you can usually arrange to have the premiums deducted from your account balance without making additional contributions to cover the cost. This can enable you to get the cover you need without reducing your cashflow.
- While Critical Illness insurance is generally not available within super, it is possible to purchase Income Protection (or Salary Continuance) insurance in super with a choice of benefit payment periods up to age 65. To find out more about the tax implications, see FAQs on page 25.
- It may be even more cost-effective over the longer term if you pay level premiums, rather than stepped premiums that increase each year with age (see Strategy 8).