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## Up Coming Events

### MDRT Australia National Roadshow

Brisbane – Friday 17<sup>th</sup> August

Sydney – Monday 20<sup>th</sup> August

Melbourne – Tuesday 21<sup>st</sup> August

Program is now available

### Risk Specialist Focus Club

Friday 2<sup>nd</sup> November.

Venue: Head Office

### AFA National Conference

14<sup>th</sup> to 16<sup>th</sup> October

Venue: Crowne Plaza Royal Pines Resort

Program is now available.

## Trauma in super – not worth the effort!

When a person decides to purchase trauma, or critical illness insurance, the primary motivation is to obtain adequate protection in the event of a serious medical condition. Normally, trauma insurance benefits are used by a client to do one of two things;

- pay medical expenses; or
- pay off debt (usually the mortgage at home).

There have been some advisers who believe that its appropriate to put trauma insurance within a superannuation fund (especially Self Managed Super Funds - SMSF). This strategy argues that the trauma insurance benefits provide a capital injection into the superannuation fund to assist with retirement. This could be a very dangerous strategy for the adviser and their client. Let's look at the implications and potential problems.

### Contributions

As per normal, a self-employed individual can claim a tax deduction for contributions to a superannuation fund just as an employer can claim a tax deduction for contributions made on behalf of an employee for either SG contributions or salary sacrifice contributions. Both of these contributions are limited by the Age-Based limits for 2006-2007. These contributions are then normally taxed at 15% within the superannuation fund.

### Premiums

Trustees of a superannuation fund are specifically excluded from obtaining any tax deductions on premiums for trauma insurance held within the superannuation fund (Trustees are eligible to obtain a tax deduction from premiums on term insurance, total and permanent disability insurance and income protection insurance with a benefit period of two years or less, held within the superannuation fund. The premiums and tax paid by the fund will erode the accumulated investment within the fund. As an example, a member is informed by his fund that his trauma premium will be \$2,000 per annum. The member assumes that his normal contribution to the superannuation fund (superannuation guarantee or salary sacrifice) of \$2,000 will cover the premiums, but due to 15% contributions tax levied on the contributions, and no tax deduction available for the premiums, the member needs to contribute \$2,353 in order to pay the \$2,000

trauma premium! If the member decides to make the contribution to superannuation with "after tax" dollars (ie undeducted contribution) where the fund then pays the trauma premium, then the taxation benefit to the client is the same as it would have been if the trauma insurance was held outside of superannuation (ie ordinary policy).

The sole purpose of a superannuation fund is to either provide death or retirement benefits for a client, or to provide ancillary benefits in the case of disability. APRA has stated that the amount of contributions applied to purchase trauma insurance policies, would be an unreasonable diversion of contributions as premiums for the contingent trauma, and would be difficult to reconcile with the sole purpose test and the fundamental retirement objectives of superannuation. If a superannuation fund fails to meet the sole purpose test, then trustees may be liable to criminal and civil proceedings. If a superannuation fund fails the sole purpose test, then all of the income and the assets are taxed at 45%.



### Benefit Payments

For those adventurous individuals who still think that trauma insurance within superannuation may still be a viable option, you need to consider what will happen if a claim is paid. Trauma insurance benefits do not necessarily meet a condition of release from the superannuation fund. A member of a super fund may satisfy the requirements under the trauma insurance policy, but fail to meet the trustee rules of superannuation fund for condition of release (ie permanent incapacity, severe financial hardship – limited to \$10,000 per annum, or compassionate grounds. Thus, the proceeds from the trauma policy would remain in the superannuation fund until the member is retired.

For clients who are 55 or older, they may be able to argue that they can retire once they cease gainful employment and have access to their benefits. This is true, but any lump sum benefit paid from a superannuation fund would still be subject to the normal taxation



of benefits as an ETP!

### Benefit Payment – lump sums

If the member of the super fund meets a normal condition of release (ie retirement or TDP), then the trustee would be able to pay the benefits to the member.

When the money is paid to the member as a lump sum, the adviser should be concerned about the taxation treatment.

For the 2006-2007 tax year, the trauma insurance benefits in this case would be treated as an ETP. For those individuals under 55, the rate of tax is 2.1% (including Medicare Levy); while for those over the age of 55 will pay no tax for the first \$135,590, and 16.5% (including Medicare Levy) on the excess. For any amounts in excess of the relevant RBL, it would be taxed at the highest rate of tax (ie 39.5% including Medicare Levy). Under the new provisions announced on 9 May 2006 in the Budget which commenced on 1 July 2007, these benefits will be tax free upon the member turning 60.

### Benefit Payment – pension (or annuity) income

If the member decides that they do not wish to take a lump sum, then the proportion of the pension income relating to the trauma insurance benefit would be taxed at the recipient's marginal tax rate and would be eligible for the 15% tax rebate. Under the new provisions announced on 9 May 2006 in the Budget which commenced on 1 July 2007, then the proportion of the pension income relating to the trauma insurance benefit would be tax free upon the member turning 60.

### Alternative to Superannuation

As an alternative, it would be simpler for a member of a superannuation fund to own a trauma insurance policy outside of superannuation (ie ordinary policy). The premiums would not be tax deductible, but the member would have immediate access to their policy benefits upon claim which would be tax free. If the individual wants to use the trauma benefits for retirement purposes, member may still make an undeducted contribution to superannuation with the proceeds from the trauma policy provided they are under age 65, subject to the limits introduced in the May 2006 Budget (\$1 million prior to 1 July 2007, then \$150,000 per year or \$450,000 over 3 years).

While Trauma insurance is necessary for most clients, placing this type of insurance in superannuation is like mixing oil and water... great by themselves but never meant to be together. No adviser wants to confront a client who loses more than 4.6% of their superannuation assets in tax! Until the ATO and APRA relax the taxation and superannuation rules regarding trauma insurance in superannuation, it is

better to keep trauma insurance as a stand alone policy.

Source: Jeffery Scott CommlnSure

## The risk of not advising on business risk

Business protection, like protection for the family and individual, is something many consumers may overlook. And yet as any business owner would know, losing a key staff member can affect business profitability and goodwill.

Some advisers dismiss the business market because they think it may be too technical. Another reason advisers give for not servicing this market is they are unsure about how and where to prospect the right clients and who is involved in the process.

While there are technical aspects to getting business risk insurance right, do not lose sight of the rewards this business opportunity brings. With over 1.2 million businesses in Australia with less than 20 employees, the SME market offers advisers a significant opportunity for new business.



Through this article we hope to quell some of those concerns and demonstrate how this area of financial planning can open up the lucrative small to medium sized (SME) business market.

There are four types of business insurance cover:

- **Succession planning** – insurance for the involuntary exit of the business owner.
- **Key person** – providing money for the business to help overcome the economic effect of death or disability of a key person.
- **Loan protection** – provides cover to help repay loans in the event that an unforeseen situation should arise.
- **Business expenses** – provides protection for the business to meet its overheads following the disability of a key person who the business depends on for its cash flow.

### Who are the right clients?

Prospecting should be focused around:

- small business owners (less than 20 employees) where the loss of a business partner or key employee would have devastating effects to the business function;

- tightly held businesses that have 2-4 business owners, partners and directors where the sale of their portion of the business may be delayed; and
- industries that include: tradespeople, professionals, manufacturers and specialist businesses.

### Where to being

Many SMEs have not considered the benefits of income protection (IP) and business expenses (BE) insurance.

In fact almost three quarters of small business owners don't have income protection despite its tax deductibility and even less have business expenses cover. Half don't know that IP and BE insurance may be tax deductible and only a quarter of them could maintain their lifestyle for more than six months if the small business owners suffered a serious illness or injury.

### Emotional triggers

Successful advisers in this market have made it clear that their success is derived from their ability to get the client to personalise the business issues.

Consider discussing with your clients:

- how they would feel about losing a business they spent so much time and effort building and growing;
- their concern about protecting the businesses cash flow and/or equity for future business sustainability; or
- how would they feel about working in partnership with a business partner's spouse or other family member.

Once you identify the client's triggers, it's then a matter of providing logical solutions. Remember you are not creating tax or legal problems but building solutions.

Should tax or legal issues need to be addressed, as they inevitably will, make sure the right technical relationships are in place – the accountant, who will assist with valuations and potential tax implications, and the lawyer to assist with legal agreements and ownership structures.

Your role is to work as the financial solution provider who brings together the appropriate resources and expertise to ensure all parties – client, adviser, accountant and lawyer work together to ensure certainty of the outcome.

Source: Aviva

