Did you know?

Peter Rushbrook
National Technical Manager

12 November 2010

Income protection through super

Following high demand from advisers, CommInsure recently introduced a new income protection policy through superannuation within the Colonial Super Retirement Fund. This week's *Did you know?* looks at some of the key considerations surrounding income protection via super.

Income protection through super – background

Income protection is an ancillary benefit under superannuation. The sole purpose test provides that a regulated superannuation fund must be maintained solely for at least one of the legislated core purposes (retirement, death, etc.) or for at least one of those core purposes and for one or more of the prescribed or approved ancillary purposes. A superannuation fund cannot operate with the only asset being an income protection policy. When choosing CommInsure's income protection super policy, a life insurance component must therefore also be included.

Two key changes in legislation have led to more individuals taking up income protection insurance via superannuation. From 1 July 2007, Reasonable Benefit Limits (RBLs) were removed within superannuation. And since 28 March 2007 (TD 98/27), trustees of superannuation funds have been able to claim tax deductions for income protection cover with benefit periods of longer than two years.

How can income protection via superannuation be funded?

At CommInsure, payments can be made to Total Care Plan Super polices via non-concessional, concessional, Super Guarantee, or salary sacrifice contributions or a rollover from Colonial First State's FirstChoice or FirstWrap product suite. Where premiums are selected to be funded via a superannuation rollover, CommInsure has simplified this process by allowing premiums to be automatically rolled over from either the Colonial FirstChoice or FirstWrap products.

How is income protection paid to members at claim time?

Step 1: Payment of benefits from insurance company to super fund. When a member of a super fund satisfies an insurance policy condition for payment, the insurance company pays the owner of the policy, which is the trustee of the superannuation fund. The money that is paid from the insurance company to the super fund is not taxed in the hands of the trustee and when the proceeds are paid from the super fund to the member, the fund cannot claim a tax deduction for the payment.

Step 2: Payment of benefits from super fund to a member. There are a number of conditions that must be satisfied for a benefit to be paid under temporary incapacity (Schedule 1 – Item 109 – SIS Regs 1994):

- The payment must be a non-commutable income stream cashed from the regulated super fund (which includes SMSFs)
- The payment is used to continue (in whole or part) the gain or reward which the member was receiving before the temporary incapacity
- The payment period must not exceed the period of incapacity from employment of the kind engaged in immediately before the temporary incapacity.

Importantly, received funds are taxed in the hands of the client the same way as an ordinary or non-superannuation policies.

CommInsure

This means that members must receive the benefits from the trustee (not directly from the life insurance company or from some other source), and it must not be paid as a lump sum (i.e. must be paid weekly, fortnightly, or monthly). The member can receive partial or total disability payments, based on their income immediately prior to disability and when the member returns to work, the payments stop. It is important to note that no provision is available for ancillary type benefits such as specific injuries and crisis benefits, which are often paid whilst the client is working.

Agreed vs indemnity

CommInsure's income protection through super can be taken as an agreed value or an indemnity style policy. As the benefit paid from the super fund is based upon an indemnity definition: if the life insured is either unemployed, a homemaker, or had a sea change and has significantly reduced their income prior to disability, then the benefits paid to the member may be significantly reduced or locked in the super fund.

Agreed value income protection policies inside super can provide a greater level of certainty; however, it is not the same as an agreed value income protection policy outside of super.

Considerations

Cash flow may be the main driver behind placing income protection within the superannuation environment and, as we all know, some cover is better than no cover at all. While having income protection insurance inside superannuation may be great in terms of paying and funding premiums, members of super funds who hold their income protection via superannuation must be aware of the potential complications that may arise at claim time.

Summary

CommInsure has extended its product range to include income protection via super. The policy can be funded via direct member or employer contributions or via superannuation rollover monies. Careful consideration of the implications of placing cover within the superannuation environment is paramount.