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# AFA National Conference 2009

GOLD COAST October 4-6 • RACV Royal Pines Resort

# Welcome

# AFA National Conference

# 2009



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**AFA** National **Conference** 2009

GOLD COAST October 4-6 • RACV Royal Pines Resort

# Investment & Technical

## Session Stream 6

# David Shirlow



# **Ins & Outs of Insurance & Super**

**David Shirlow**

**Executive Director**

**MAStech, Macquarie Adviser Services**

**October 2009**

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# Agenda

- Background on criteria used
- Disability cover
  - TPD
  - DII & temporary disability
  - DII & permanent disability
    - » converting to TPD

# **Background on criteria used:**

**tax efficiency & access to  
benefits**

# Pre-tax cost comparison

**Non-super**

**Employer**

Salary/Profit

1.87

-0.87

Tax → **ATO**

1.00

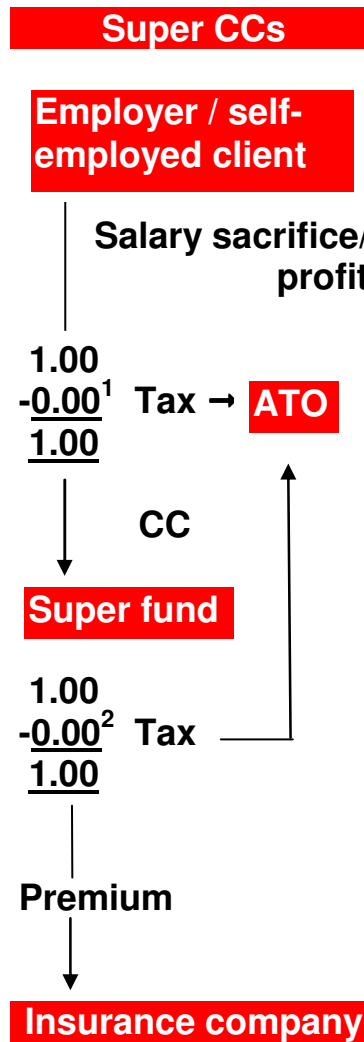
**Client**

1.00

Premium

**Insurance company**

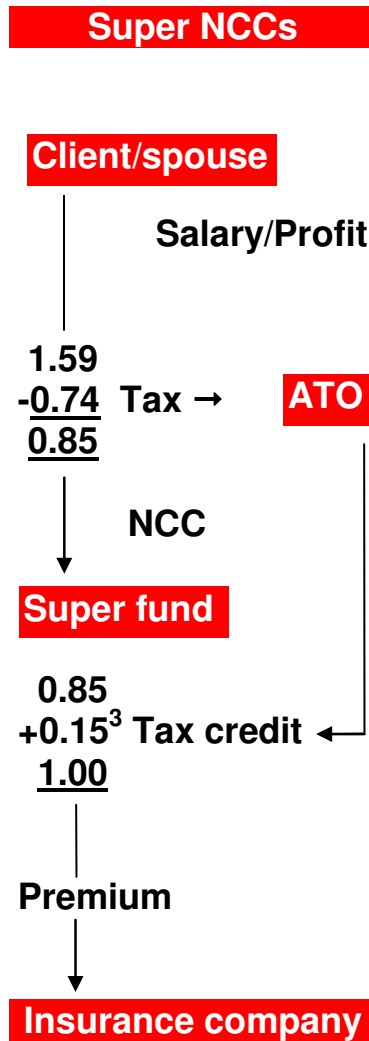
# Pre-tax cost comparison



<sup>1</sup> Nil tax payable as deduction for CC offsets tax liability on salary/profits

<sup>2</sup> Nil tax payable as deduction for premium offsets tax liability on CC

# Pre-tax cost comparison



<sup>3</sup> Value of tax deduction for \$1 premium payment

# **Disability Cover**

# TPD

## ***Question:***

- With respect to total & permanent disablement (TPD) insurance, which of the following statements are true?
  - a) Funding TPD insurance via super is always cheaper than non super
  - b) 'Own occupation' TPD is no longer available via superannuation funds
  - c) Super fund 'own occupation' TPD benefits can always be paid immediately to the member
  - d) Premiums for own occupation TPD may not be fully deductible at the fund level in future

# TPD

<b>Pre-tax cost of funding \$1.00 of premium payment under age 50 – with benefits tax</b>			
<b>Funding method</b>	<b>Non super</b>	<b>Super NCC</b>	<b>Super CC</b>
ESP % (eff. benefits tax)	N/A	0% - 70% (Nil <sup>1</sup> - 15% <sup>2</sup> )	0% - 70% (Nil <sup>1</sup> - 15% <sup>2</sup> )
Marg Tax Rate	31.5%	\$1.46	\$1.00 - \$1.18
	39.5%	\$1.65	
	46.5%	\$1.87	
		\$1.24 - \$1.46	
		\$1.40 - \$1.65	
		\$1.59 - \$1.87	

Refer Appendix 1 for assumptions & Appendix 2 for calculation formula

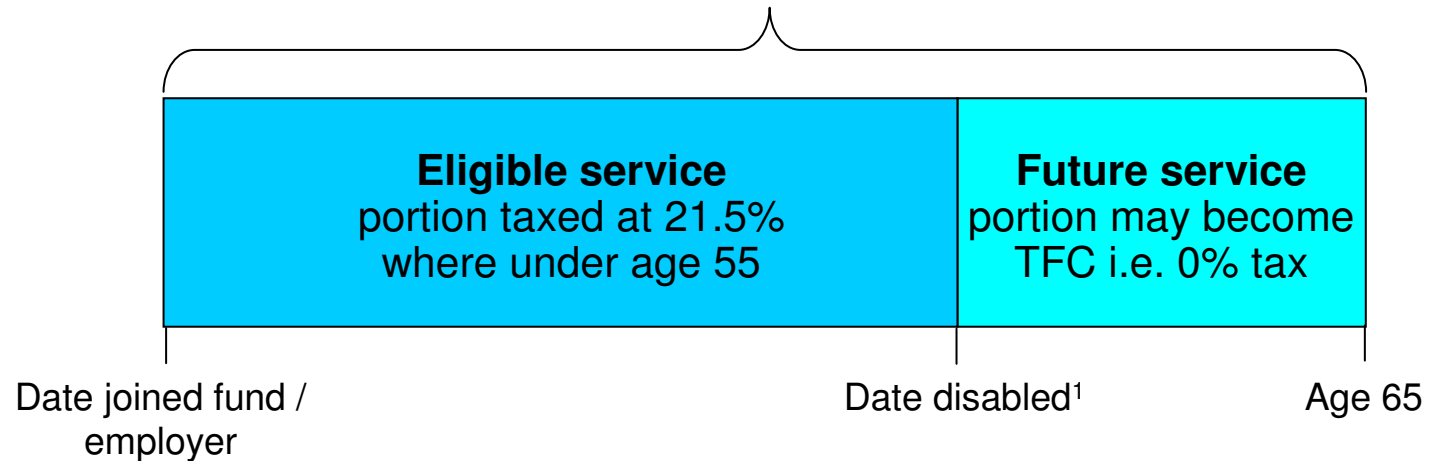
<sup>1</sup> Assumes super benefits tax = 100% tax free;

<sup>2</sup> Assumes super benefits tax = 70% taxable at 21.5%

# TPD

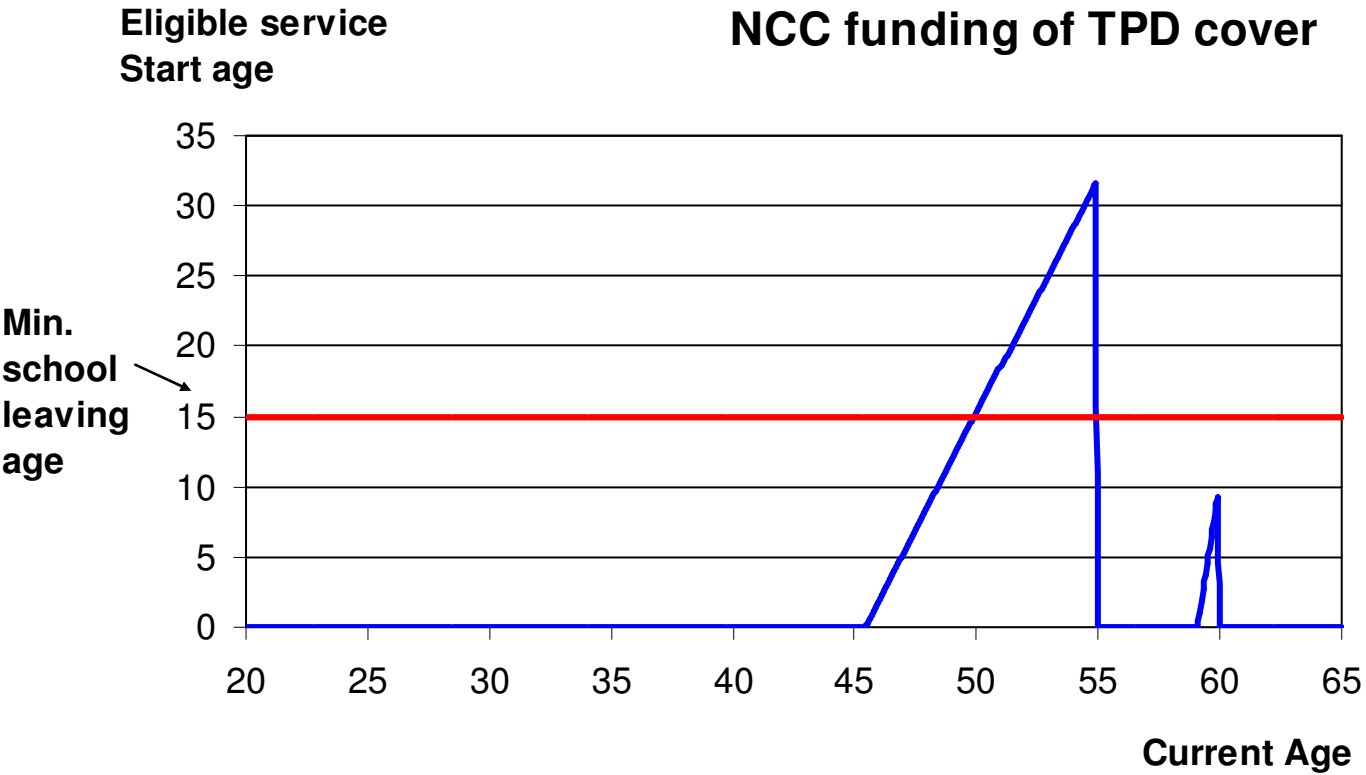
**Insured benefit** - prima facie taxable component

**Total service**



<sup>1</sup> Tax legislation refers to date of payment in some contexts and date disabled in others. We are assuming these 2 dates coincide, otherwise there is potential for overlap of the service periods indicated.

# TPD



■ NCC funding preferred over non-super where start age is above blue line  
(subject to assumptions on earlier slides)

# TPD

## ***Tax efficiency where super premium deduction available***

- Where funding “any occupation” TPD and the premium is deductible, the general order of preference is:
  1. Super CC's
  2. Super NCC's
  3. Non-super
- Key exception:
  - Client aged 51–54 with start date before age 29 :  
NCC's 3<sup>rd</sup>

# TPD

## ***Tax issue – where super premium deduction not available***

- EM to main super reform bill indicates no change but...
- Deduction for so much of premium as is attributable to liability to provide 'disability superannuation benefit':
  - *'...2 legally qualified medical practitioners have certified that...unlikely that the person can ever be gainfully employed in a capacity... reasonably qualified because of education, experience or training.'*
  - 'own occupation' – definition problematic
  - 'any occupation' – substantially ok?
  - Govt position?
    - Past yrs & current arrangements: transitional relief?
    - Future yrs: clearly an issue – ATO NTLG super s-c minutes

# TPD

## ***SIS issue – access to benefits:***

- SIS 'permanent incapacity' condition of release
  - *'engage in gainful employment for which... reasonably qualified by education, training or experience'*
- Own occupation TPD definition – potential mismatch
- Member less than 55:
  - reliant on meeting 'perm incapacity' condition of release?
- Member 55 plus:
  - retirement condition of release, TTR pension

# TPD

## **Question:**

- With respect to total & permanent disablement (TPD) insurance, which of the following statements are true?
- a) ~~Funding TPD insurance via super is always cheaper than non super~~
- b) ~~'Own occupation' TPD is no longer available via superannuation funds~~
- c) ~~Super fund 'own occupation' TPD benefits can always be paid immediately to the member~~
- d) Premiums for own occupation TPD may not be fully deductible at the fund level in future

# TPD

## ***Example - any occupation***

- Peter is age 50
- Taxable income \$250,000 (marginal tax rate = 46.5%)
- Super fund service period of 10 years
- Considering \$500,000 of 'any occupation' TPD cover
- Cost effective to place cover inside or outside super?

[assume prem rate is \$1.666 / \$1,000 sum insured, no policy fee – i.e. not Macquarie Life prem rates]



# Macquarie Life insurance tax calculator

## Client details:

Include impact on existing super balance?

Client name:	Peter	
Date of birth:	16-Sep-59	(Age = 50)
Taxable income (\$):	250,000	(MTR = 46.5%)
Eligible service date (ESD):	16-Sep-99	
Calculation date:	16-Sep-09	e.g. today's date

## TPD cover:

Net TPD cover required:	500,000	
TPD cover type:	Any occupation	
	Non-super	Super
	Any occupation	Any occup inside super
Gross TPD cover:	500,000	547,057
Lump sum tax:	N/A	47,057
<b>Net TPD cover:</b>	<b>500,000</b>	<b>500,000</b>
Super contribution method:	N/A	Concessional
TPD cover premium (yearly):	833.00	911.40
Pre-tax cost of premium:	1,557.01	911.40
Cost of TPD cover:	Pre-tax	911.40
	1,557.01	

Pre-tax cost of TPD cover:	\$1,557.01	\$911.40
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Pre-tax cost saving (loss) if insurance in super:	\$645.61
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**TPD**  
Peter – any occupation

Select:  
•Any occupation  
•Super Optimiser (any occup inside super / own outside)

Cover gross up automatically calculated

Significant savings inside super via CC

# TPD

## ***Results – any occupation***

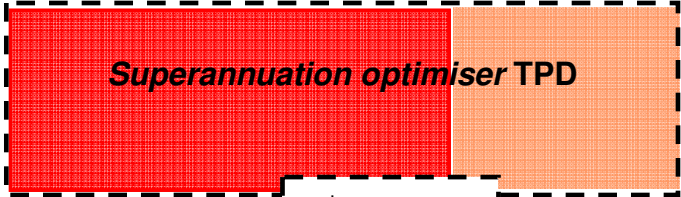
<b>Cost of cover</b>	<b>Super - CCs</b>	<b>Super - NCCS</b>	<b>Outside Super</b>
<b>(p.a.) Pre-tax</b>	\$911.40	\$1,448.01	\$1,557.01
<b>After-tax</b>	\$487.60	\$774.69	\$833.00

- **Answer:** Both super CCs and super NCCs cheaper than non-super
- What if Peter preferred 'own occupation' TPD cover?

[assume own occu prem rate is \$2.54 per \$1,000 sum insured, no policy fee; Super Protector rates are \$1.66531 and 0.87378 per \$1,000 for inside and outside super components respectively]

# TPD

eg severe stroke resulting in paralysis & cognitive impairment



\$547,057

eg stroke resulting in pain and fatigue when sitting for long periods of time

-any occupation and  
-meets SIS definition of permanent incapacity

-own occupation and  
-Not meeting super component

Trustee of super policy

Non-super policy

→ claim proceeds subject to super tax and law

→ claim proceeds generally tax free

= \$547,057 own occupation TPD



# Macquarie Life insurance tax calculator

TPD Peter  
– Super  
Optimiser

**Client details:**  Include impact on existing super balance?

Client name:	Peter	
Date of birth:	16-Sep-59	(Age = 50)
Taxable income (\$):	250,000	(MTR = 46.5%)
Eligible service date (ESD):	16-Sep-99	
Calculation date:	16-Sep-09	e.g. today's date

Select:  
•Any occupation  
•Super Optimiser  
(any occup  
inside super /  
own outside

**TPD cover:**

Net TPD cover required: 500,000  
 TPD cover type: Super Optimiser

	Non-super	Super	
	Own occupation	Any occup inside super	Own occup outside super
Gross TPD cover:	500,000	547,057	547,057
Lump sum tax:	N/A	47,057	0
<b>Net TPD cover:</b>	<b>500,000</b>	<b>500,000</b>	<b>547,057</b>
Super contribution method:	N/A	Concessional	
TPD cover premium (yearly):	1,270.00	911.02	478.01
Pre-tax cost of premium:	2,373.83	911.02	893.47
Cost of TPD cover:	After-tax 1,270.00	965.40	

Super Optimiser structure: linked policies inside & outside super

After-tax cost of TPD cover: \$1,270.00 \$965.40

After-tax cost saving (loss) if insurance in super: \$304.60

# TPD

## *Results – own occupation*

Cost of cover	Super – CCs	Super - NCCS	Outside Super
(p.a.) Pre-tax	\$1,804.49	\$2,340.89	\$2,373.83
After-tax	\$965.40	\$1,252.37	\$1,270.00

- **Answer:** Both super CCs and super NCCs cheaper than non-super

# TPD

## ***Rules of Thumb:***

- Insuring TPD benefits that meet the SIS / tax law definitions - order of tax efficiency:
  1. super CCs
  2. super NCCs generally, assuming deductions passed on
  3. non-super generally
- To the extent benefits don't meet those definitions:
  - strong reasons to use non-super cover
- Macquarie Super Optimiser - product innovation enables split to achieve optimal result

# DII & temporary incapacity

## ***Question:***

- With respect to disability income insurance (DII), which of the following statements are true?
  - a) Funding DII via super is always cheaper than non super
  - b) Only DII benefits with a 2 year benefit term are allowable in super
  - c) A monthly DII benefit paid from a super fund is a 'superannuation income stream'
  - d) None of the above

# DII & temporary incapacity

## ***Temporary incapacity benefits:***

- Premiums
  - Non-super: premiums fully deductible
  - Super: TD 2007/3
    - » fully deductible even if benefits exceed 2 yrs
    - » if funded by CC ded'n effectively at member's MTR
- Benefits paid to client:
  - Non-super: fully assessable income
  - Super: fully assessable income
    - » not 'superannuation benefits' so not rebatable

# DII & temporary incapacity

<b>Pre-tax cost of \$1.00 of DII premium<sup>1</sup></b>			
<b>Client's Tax Rate</b>	<b>Non super</b>	<b>Super NCC</b>	<b>Super CC</b>
<b>17.5%</b>	\$1.00	\$1.24	<b>\$1.00</b>
<b>39.5%</b>	\$1.00	\$1.40	
<b>46.5%</b>	\$1.00	\$1.59	

## Key assumptions:

- Premiums in all cases fully deductible to the payer.
- Neutral taxation treatment of benefit payments received by individual
- No tax on fund trustee re insurance proceeds<sup>2</sup>

<sup>1</sup> See calc formula Appendix 3

<sup>2</sup> Refer ATO views in minutes of NTLG Super Tech Sub-Group – meeting held 16 June 2009

# DII & temporary incapacity

## **Question:**

- With respect to temporary disability insurance, which of the following statements are true?
  - a) Funding disability income insurance (DII) via super is always cheaper than non super
  - b) Only DII benefits with a 2 year benefit term are allowable in super
  - c) A monthly DII benefit paid from a super fund is a 'superannuation income stream'
  - d) None of the above

# DII & temporary incapacity

## ***Rules of Thumb:***

- Super CCs & non-super are tax efficient ways to insure basic DII income benefits while a client is temporarily disabled
  - Extra benefits should be insured via non-super

# DII & permanent incapacity

## ***Question:***

- True or false?
- When a temporary incapacity benefit recipient becomes permanently incapacitated their benefit and related tax effects can change too.

# DII & permanent incapacity

## ***Macquarie Life Super Protector:***

- DII TPD commutation option:
  - Client receiving DII benefit payments
  - Option to commute to lump sum if TPD conditions met

## ***Example:***

- Jim age 45, on DII pmts for 2 yrs, meets TPD conditions
- Monthly benefit \$6,250, no other income
- Commutation factor 132
- TPD lump sum =  $\$6,250 \times 132 = \$825k$
- Options: take TPD or maintain DII pmts

# DII & permanent incapacity

- ***Example (continued):***

1. Maintain DII

- \$6,250 per month 100% taxable = \$4,794 net

2. Take TPD lump sum \$825k – 100% TC in super fund acct

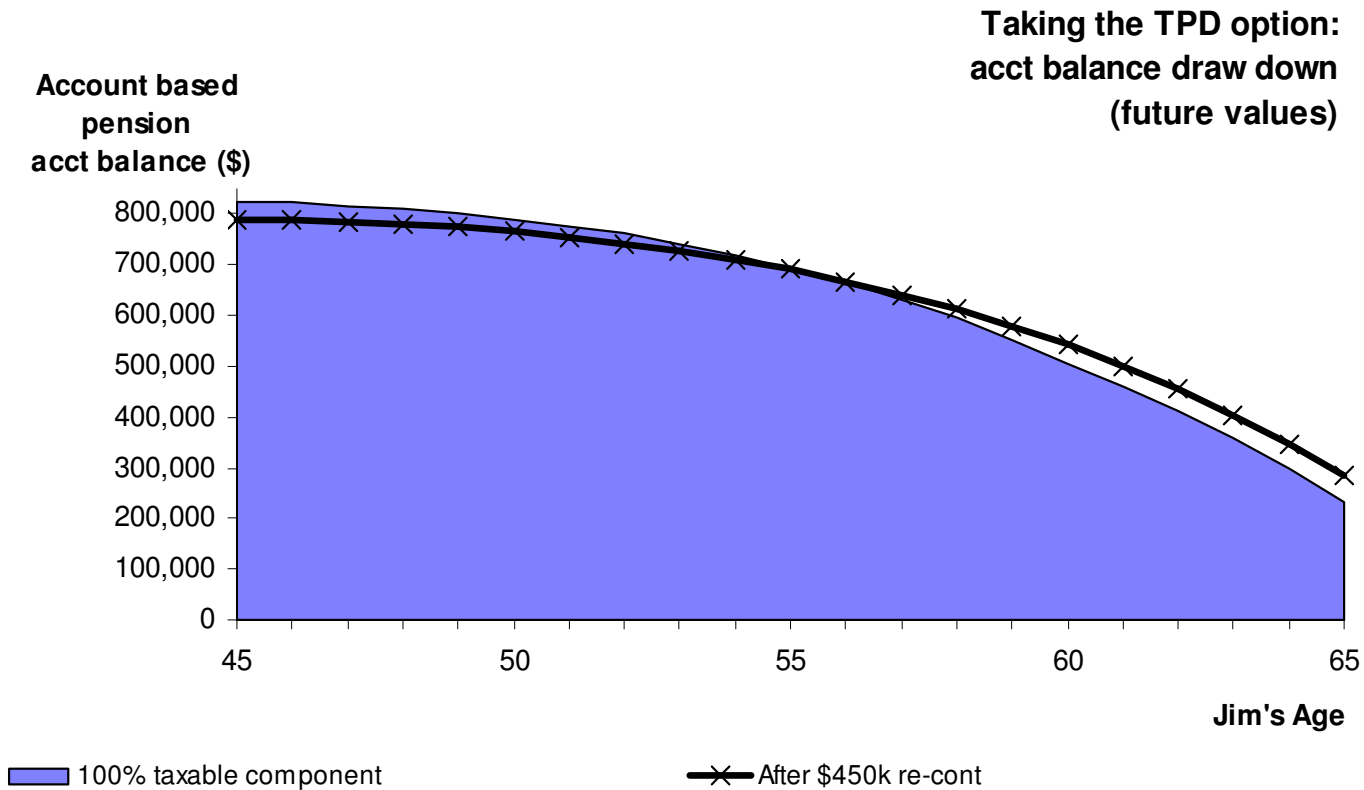
- a) Start disability ABP immediately

- draw pension pmts so net \$4,794 per month

- b) Cash out net \$450k & re-cont

- draw pension pmts so net \$4,794 per month

# DII & permanent incapacity



## Assumptions:

1. Gross DII payments indexed by 2.5% pa
2. Other return assumptions – see Appendix 4
3. Tax payable with re-cont strategy based on 10 yrs eligible service

# DII & permanent incapacity

- ***Example (continued):***

For commutation:

- May be capital value available at 65
- May be capital available upon death before age 65
  - lump sum or pension to spouse?
- Flexibility to vary income: useful taking account of tax, social security

Against commutation:

- Commutation shifts investment risk to recipient

# DII & permanent incapacity

## ***Question:***

- True or false?
- When a temporary incapacity benefit recipient becomes permanently incapacitated their benefit and related tax effects can change too.

# DII & permanent incapacity

## ***Rule of Thumb:***

- Super CC funding provides additional options where client becomes permanently incapacitated & DII TPD commutation option available

# **Conclusions**

# **Ins & Outs of Insurance & Super**

**David Shirlow**

**Executive Director**

**MAStech, Macquarie Adviser Services**

**October 2009**

# **Appendices**

# Appendix 1 – calculation assumptions

- All references to a super arrangement assume that the fund is a complying super fund and is a taxed super fund, not an exempt fund such as certain public sector schemes
- All super contributions are within the relevant annual cap for tax purposes
- The benefit of all super fund deductions for premium payments is credited to the client's super account. This will be common if the client has an accumulation account within the fund or if the contributions funding the premiums are CCs. It will not be common where NCCs are made to a super fund as a stand-alone insurance arrangement
- No tax liability arises for a super fund trustee on insurance proceeds it receives under the policy
- No Government co-contributions have been accounted for
- No anti-detriment benefits have been accounted for. (These are typically not generated in relation to insured benefits)
- SF tax refers to the super fund tax rate of 15%
- Super law refers to the Superannuation Industry (Supervision) Act 1993 and regulations made under it
- In the examples where insurance is being funded inside super using NCCs, for simplicity, we have disregarded the effect of any tax free component arising from the contributions used to fund the premiums. In practice, the benefit paid out may include a small amount of tax free component, the extent of which will depend on the total amount of NCCs (less withdrawals etc) made to the account from which the benefit is paid
- The level of gross premium payable to the life office (either by the individual directly, or by the superannuation fund) are the same in each case – in practice the availability of group life arrangements and pricing differences generally may mean this is not the case
- Timing issues (such as receipt of tax benefits) are ignored
- BF Tax is the effective benefits tax that is payable on superannuation lump sums
- Benefits are assumed to be paid from accumulation phase, and the date of death or disablement and benefit payment all occur on the Calculation Date entered

# Appendix 2 - TPD

Pre-tax cost of \$1.00 of TPD cover:

<b>Non Super</b>	<b>Super CC *</b>	<b>Super NCC *</b>
Pre-tax cost = $\$1 / (1-MTR)$	Pre-tax cost = $\frac{\$1 * (1- SF \text{ tax})}{(1-SF \text{ tax}) * (1-benefit \text{ tax})}$	Pre-tax cost = $\frac{\$1 * (1- SF \text{ tax})}{(1- MTR) * (1-benefit \text{ tax})}$

\* Refer Appendix 1 for assumptions

# Appendix 3 – DII & temporary incapacity

<b>Pre-tax cost of \$1.00 of DII premium</b>			
<b>Client's Tax Rate (MTR)</b>	<b>Non super</b>	<b>Super NCC</b>	<b>Super CC</b>
	$\frac{\$1 * (1 - \text{MTR tax})}{-}$	$\frac{\$1 * (1 - \text{SF tax})}{-}$	$\frac{\$1 * (1 - \text{SF tax})}{-}$
31.5%	\$1	\$1.24	\$1.00
39.5%	\$1	\$1.45	
46.5%	\$1	\$1.59	

## Key assumptions:

- Premiums in all cases fully deductible to the payer.
- No tax on fund trustee re insurance proceeds
- Neutral taxation treatment of benefit payments received by individual

# Appendix 4 – DII & permanent incapacity

## **Modelling assumptions:**

- Return assumptions (gross of fees & taxes):
  - Income rate: 4.31% pa, including franking credits & tax deferred income
  - Capital growth: 4.55% pa
  - Asset turnover rate: 20% pa
- Total fees: 1.5%, deducted from gross income
- 2009/10 and 2010/11 income tax thresholds & rates used
  - Jim has no other income
- Rebates/Tax Offsets include:
  - Low income Rebate
  - Superannuation Pension Rebate
- No tax on TPD commutation proceeds in hands of fund trustee