AVOIDING NASTY SURPRISES WHEN FUNDING INSURANCE VIA SUPER ROLLOVER

By the AIA Technical and Education Centre of Excellence (TECE) team

November 2021

An upfront discount on personal insurance via a 15% 'tax' rebate on the cost of a superannuation life policy is very appealing, especially when entitlement simply relies on premiums being funded via a superannuation rollover. However, the arrangement has the potential to yield nasty surprises, many of which are easily avoidable with adequate planning beforehand.

This article outlines five potentially adverse knock-on effects of a superannuation rollover. These should be considered as part of any recommendation to fund superannuation life cover using a rollover arrangement, both for existing and prospective policies.

1. 'Notice of intent' form

Claiming a deduction for personal super contributions is a fairly straightforward process. The client must advise the super fund of the amount of personal contributions made during the income year that they wish to claim as a personal tax deduction, and receive an acknowledgement from the fund, in order for the fund to convert those amounts from non-concessional to concessional contributions and tax them accordingly.

Eligible contributing members must submit the appropriate 'notice of intent' (NOI) form (also known as a section 290-170 form) to the super fund before the earlier of the following two dates:

- Lodgement of the contributing member's income tax return (for the income year of contribution), and
- The end of the income year following the 'contributing' income year.

But in addition to these deadlines are a set of preconditions that invalidate an NOI if, in broad terms, the fund no longer holds the contribution or if part or all of the capital has been converted into an income stream. This rule could impact clients funding a super life policy via rollover. Consider the example of Barry, a 55 year old sole trader:

- Barry made a $25,000 personal contribution into his 'primary' super fund on **1 June 2021** which he intends on claiming as a deduction in his 2020/21 tax return (the logistics will be left to his accountant until tax time).
- He has a stand-alone 'insurance-only' super fund with $1,000,000 of life and disability cover.
- The annual premiums are being funded via rollover; this entitles Barry to a 15% upfront rebate.
- On **1 August 2021** an amount of $10,000 (being the net yearly premium due) was rolled over from his primary fund into his insurance-only fund. Note, the balance of Barry's primary fund immediately before the rollover was $125,000 ($100,000 taxable and $25,000 tax-free due to the personal contribution made 1 June 2021).
- On **1 November 2021** Barry's accountant submits an NOI to the primary fund for the $25,000 contribution Barry made on 1 June 2021. The fund duly advises that the NOI is invalid due to the $10,000 **rollover processed on 1 August 2021**.

What does an invalid NOI mean for Barry?

Barry can submit a new NOI but for a reduced amount of $23,000 (in practice this figure will vary depending on the client's balance, tax-free/taxable component mix of the source fund and how much is rolled over). Not only has this come as a shock to both the client and their accountant, but the 15% rebate is also partially offset by the additional tax liability. These issues could have been avoided by submitting the NOI to Barry's primary fund before the 1 August 2021 $10,000 rollover[1].

Two crucial questions

- Is your client eligible (and planning) to claim a deduction for personal super contributions made into 'Fund A' during an income year?
- Does this client hold insurance cover within a separate fund ('Fund B') where the premiums are funded by a rollover from 'Fund A'?

If you've answered yes to both questions, then where commercially possible, ensure the NOI is submitted (and duly acknowledged) to 'Fund A' before any ensuing rollover. Or alternatively and if available, take the insurance policy out as an integrated solution within the client's existing platform super fund – this way, no rollover is required and the tax benefits are still realised from the tax deduction of the premiums within the member account. Otherwise, for those clients relying on personal tax deductions, they risk being short-changed at tax time[2].

> **"Or alternatively and if available, take the insurance policy out as an integrated solution within the client's existing platform super fund"**

2. What are the benefit payment options?

Where the policy is held within a separate super fund to that which receives their contributions, consider what the benefit payment options are at claim time, given that the second super fund has its own separate set of product rules.

More specifically, does a surviving spouse have the option of retaining the death benefit within the super fund housing the insurance (being the destination of the insurance proceeds) by electing to receive it as a death benefit income stream? Is the surviving spouse able to roll over the death benefit into another super fund to commence a death benefit income stream? Or is the surviving spouse compelled to cash out the entire death benefit from the super fund altogether? Any product-imposed constraints may be at odds with the estate planning objectives of the client.

3. Change in eligible service period

A rollover may result in the eligible service start date being converted to an earlier date within the destination fund. For a life insurance policy this may not necessarily be a bad thing given the way the taxable component-element untaxed is determined (relevant if non-tax dependants will be ultimate beneficiaries). However for permanent disability cover, an earlier service period start date may produce a relatively lower super disability tax concession[3].

4. United Kingdom expats

Consider whether the client is inadvertently requesting a rollover of UK-sourced pension monies that were previously transferred to the Australian super environment. Indeed, the source fund may not permit the member to roll monies out of the fund, so the rollover option (and the upfront 15% rebate) may not be an option in any case. If a rollover is permitted, an unauthorised payment charge could be triggered by Her Majesty's Revenue & Customs (depending on UK-prescribed timeframes and criteria). Note that since the rules changed in 2015 there are only a few Recognised Overseas Pension Scheme (ROPS) compliant super funds in Australia (including self-managed super funds), so rolling super monies into a new fund may result in an unnecessary and unexpected tax bill for the client.

5. Disclosing any incidental costs

There may be additional costs to the member when rolling over their benefits to another fund such as investment switching, or fees imposed to sell down an investment. Such fees must be disclosed as part of your advice to the client.

Also, some funds impose a 'minimum rollover amount' rule and will transfer that minimum amount from their fund, regardless of a smaller amount being requested on the rollover request form. This may mean excess funds are being withdrawn at exit prices which then need to be reinvested at entry prices when the excess is returned, and in effect force surplus capital out of the market for a period of time.

Similarly, some funds may have a 'minimum balance' rule that may prevent a rollover from being processed. Often the super fund will require the member to either roll over the full balance of their account (if under the minimum balance) or reduce the amount that can be rolled over if the amount requested reduces the member's balance below the minimum threshold.

Other observations

Funding super-owned insurance cover via rollover has obvious appeal for clients and advisers alike. But as practitioners would appreciate, a super owned policy introduces complexity – both during the life of the policy and upon claim – that wouldn't necessarily exist if self-owned. The knock-on effects of a rollover listed above typify such complexities.

Remember, cash flow permitting, pre-tax contributions (i.e. personal tax deductible and salary sacrifice) remain a very tax effective way to fund super life cover. A pre-tax contribution strategy could in theory complement a rollover arrangement, providing the NOI rules are satisfied where relevant. Indeed, 'top-up' contributions will help replenish retirement savings, helping to ensure the client meets both their wealth protection and wealth accumulation goals.

It is increasingly important to review premium payment and insurance ownership structures well in advance so that the optimum outcome is achieved for clients, particularly with the backdrop of an ever-changing tax and super regulatory landscape.

Remember, a perceived quick win for clients by utilising an enduring rollover funding strategy for insurance will not always produce the best outcome – alternative strategies do remain viable and in some cases preferable.

1. It is acknowledged that some clients may not be in a position to submit an NOI at any given time given commercial/tax constraints.

2. A valid deduction notice will be limited to a proportion of the tax free component of the superannuation interest that remains after the roll-over or withdrawal. That proportion is the value of the relevant contribution divided by the tax free component of the superannuation interest immediately before the roll-over or withdrawal – refer to TR 2010/1 Example 10 for more information.

3. Pursuant to section 307-145 ITAA 1997.

Copyright © 2021 AIA Australia Limited (ABN 79 004 837 861 AFSL 230043). All rights reserved. This information is intended for financial advisers only and is not for wider distribution. This information is current at the date of distribution and is subject to change. This is general information in summary only, without considering the objectives, financial situation, needs or personal circumstances of any individual, and may not be exhaustive. It is not intended as financial, legal, medical, taxation or other advice. AIA Australia has prepared a Target Market Determination which describes the class of consumers that comprise the target market for this product. The Target Market Determination can be sourced at aia.com.au/tmds