

SMSFD 2009/D1 - Self Managed Superannuation Funds: can a trustee of a self managed superannuation fund purchase a trauma insurance policy in respect of a member and still satisfy the sole purpose test in section 62 of the Superannuation Industry (Supervision) Act 1993?

 This cover sheet is provided for information only. It does not form part of *SMSFD 2009/D1 - Self Managed Superannuation Funds: can a trustee of a self managed superannuation fund purchase a trauma insurance policy in respect of a member and still satisfy the sole purpose test in section 62 of the Superannuation Industry (Supervision) Act 1993?*

This document has been finalised by SMSFD 2010/1.

 There is a Compendium for this document: SMSFD 2010/1EC .



Draft Self Managed Superannuation Funds Determination

Self Managed Superannuation Funds: can a trustee of a self managed superannuation fund purchase a trauma insurance policy in respect of a member and still satisfy the sole purpose test in section 62 of the *Superannuation Industry (Supervision) Act 1993*?

Preamble

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which provisions of the *Superannuation Industry (Supervision) Act 1993*, or regulations under that Act, apply to superannuation funds that the Commissioner regulates: principally self managed superannuation funds.

Self Managed Superannuation Funds Determinations (whether draft or final) are not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to you than the final version of this determination indicates, the fact that you acted in accordance with the final version of this determination would be a relevant factor in your favour in the Commissioner's exercise of any discretion as to what action to take in response to a breach of that law. The Commissioner may, having regard to all the circumstances, decide that it is appropriate to take no action in response to the breach.

Ruling

1. Yes, a trustee can still satisfy the sole purpose test provided any benefits payable under the policy:

- are required to be paid to a trustee of the self managed superannuation fund (SMSF);
- are benefits that will become part of the assets of the SMSF at least until such time as the relevant member satisfies a condition of release; and
- the acquisition of the policy is not made to secure some other benefit for another person such as a member or member's relative.¹

¹ Refer to the examples provided in Appendix 1 of Self Managed Superannuation Funds Ruling SMSFR 2008/2.

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2. However, if a trustee purchases a trauma insurance policy that provides for benefits payable under the policy to be paid directly to someone other than a trustee of the SMSF (for example, the insured member or member's relative is the beneficiary of the policy) this would be inconsistent with the sole purpose test in section 62 of the *Superannuation Industry (Supervision) Act 1993* (SISA).² In these circumstances the trustee would contravene section 62.

Funds to which this Determination applies

3. This Determination applies to SMSFs³ and former SMSFs.⁴ References in the Determination to SMSFs include former SMSFs unless otherwise indicated.

Date of effect

4. It is proposed that when the final Determination is issued, the Determination will apply to years of income commencing both before and after its date of issue. However, the Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination.

Commissioner of Taxation

4 November 2009

² All legislative references in this Determination are to the SISA unless otherwise indicated.

³ As defined in section 17A.

⁴ A former SMSF is a fund that has ceased being a SMSF and has not appointed a registrable superannuation entity (RSE) licensee as trustee: see subsection 10(4).

Appendix 1 – Examples

① *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached.*

5. The purpose of setting out these examples is to demonstrate only the application of the sole purpose test in section 62. No inferences should be drawn about whether or not other SISA or Superannuation Industry (Supervision) Regulations 1994 (SISR) provisions apply to the examples.

Example 1

6. *The trustee of the Harry & Jane SMSF decides to use contributions from Harry and Jane to purchase trauma insurance in respect of Harry and Jane. The trustee considers that this would alleviate any financial stress on Harry and Jane in the event either one suffers a significant trauma which causes them to have time off work.*

7. *The trauma insurance policies are purchased in Harry and Jane's names and each policy stipulates that proceeds from the policies are to be paid directly to Harry and Jane respectively.*

8. *The trustee's purchase of trauma insurance provides a current day benefit to Harry and Jane (that is, they do not have to outlay the costs of premiums) and is inconsistent with the sole purpose test in section 62 and an overall objective of providing retirement benefits for Harry and Jane. The trustee contravenes section 62.*

Example 2

9. *A trustee of the J&J SMSF purchases a trauma insurance policy in respect of John, a small business owner and member of the fund. The trustee is the owner and beneficiary of the policy and the policy is an addition to the SMSF's existing portfolio of property and share investments.*

10. *The purchase uses a small portion of John's contributions relative to the overall size of the fund's assets and is in accordance with the trustee's overall investment strategy for providing benefits to John on retirement. There are no other benefits received by John from the insurance company upon the trustee's purchase of the policy or upon the occurrence of the insured event.*

11. *If John is diagnosed with a defined trauma which triggers a benefit from the policy, the proceeds would be paid to the SMSF trustee on John's account until John ultimately retires or satisfies another condition of release.*

12. *The trustee's purchase of trauma insurance is consistent with the sole purpose test and an overall objective of providing retirement benefits for John. On these facts the trustee does not contravene section 62.*

Appendix 2 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached.*

Background

13. The sole purpose test in section 62 prohibits trustees from maintaining an SMSF for purposes other than the provision of benefits specified in subsection 62(1). The core purposes specified in that subsection essentially relate to providing retirement or death benefits for, or in relation to, SMSF members.⁵ The SMSF trustee can maintain the fund for one or more of these purposes and other specified ancillary purposes, which relate to the provision of benefits on the cessation of a member’s employment and other death benefits and approved benefits not specified under the core purposes.⁶

14. Under a trauma insurance policy it is normally the policy owner that is paid a lump sum if the insured person is diagnosed with one of a range of critical illnesses or suffers injuries that are defined in the policy. Trauma conditions commonly covered include cancer, stroke, coronary bypass and heart attack.

15. A trauma insurance benefit is typically paid when the diagnosis is confirmed, provided the insured person survives the medical condition for a specified period. Payment is made regardless of whether the insured person ceases work or becomes permanently disabled because of the illness or injury suffered.

16. Although a trauma insurance benefit may be intended to assist financially with the effects of the trauma, including rehabilitation and lifestyle changes, the amount paid is not referable to expenditure incurred or income forgone.

Explanation

17. The sole purpose test in section 62 requires exclusivity of purpose and therefore a trustee who maintains an SMSF for any other purpose contravenes section 62.⁷ Matters relevant to determining if the maintenance of an SMSF is in accordance with the sole purpose test include how fund assets are acquired and invested, how fund assets are employed, and what benefits are provided by the SMSF.⁸

18. In determining whether to offer trauma insurance, trustees should consider their obligations to members generally and factors such as the proportion of contributions applied to purchase insurance cover. An unreasonable diversion of contributions to purchase premiums for the contingent trauma cover would be difficult to reconcile with the sole purpose test and the fundamental retirement objective of superannuation.

⁵ Paragraph 62(1)(a).

⁶ Paragraph 62(1)(b). See the discussion in SMSFR 2008/2.

⁷ See paragraph 7 of SMSFR 2008/2.

⁸ See paragraph 6 of SMSFR 2008/2.

19. The identity of the entity deriving a benefit and the timing of that benefit is particularly relevant. As explained in SMSFR 2008/2 (paragraph 14), subsection 62(1) specifies benefits that are to be provided to or in respect of an SMSF member on or after the member's retirement, employment termination or death. Benefits provided before a member's retirement, employment termination or death to the member or a related party (for example, a relative of the member or a related business) are, of their nature, more likely to raise questions about compliance with the sole purpose test. Such benefits are sometimes referred to as current day benefits. The relevance of the entity deriving the benefit and the timing of the benefit is consistent with the underlying object of the sole purpose test, being to ensure that the retirement income objective of SMSFs remains unqualified.

Beneficiary of the policy is a person other than a trustee of the SMSF

20. If a trustee of an SMSF pays premiums out of the SMSF's assets for a trauma insurance policy that provides for the insurer to pay any benefits payable under that policy to someone other than a trustee, (for example, the insured member or member's relative is the beneficiary of the policy), this is not consistent with the underlying object of the sole purpose test, being to ensure that the retirement income objective of an SMSF remains unqualified.

21. The trustee has sought out a direct and current day benefit for another person (such as a member or member's relative) alleviating the need for that person to pay for the insurance policy and ensuring that any payout under the policy is payable to that person. In other words the SMSF has taken on an obligation for which it receives no benefit at all.⁹ In these circumstances the trustee contravenes section 62. See Example 1 in Appendix 1.

Beneficiary of the policy is a trustee of the SMSF

22. If a trustee of an SMSF pays premiums out of the SMSF's assets for a trauma insurance policy that provides for the insurer to pay any benefits payable under that policy to a trustee of the SMSF for accumulation in the fund, then any benefit is remote from the member in the sense that any payout is to be made to a trustee of the SMSF.

23. A payout under a trauma insurance policy is normally made regardless of the insured person's age, working status, or whether the trauma causes permanent disability. If the receipt of the benefit by the SMSF trustee under the policy does not coincide with a member satisfying a condition of release¹⁰ the proceeds cannot be paid immediately to the member by the SMSF trustee and instead will need to be retained in the fund until the member subsequently satisfies a condition of release (for example retirement).

⁹ Other relevant considerations include the financial assistance prohibition in section 65 and the Commissioner's views as set out in SMSFR 2008/1 (in particular paragraphs 117 to 121). As explained at paragraph 97 of SMSFR 2008/2, an action (for example, the acquisition of a trauma insurance policy) that results in the trustee of an SMSF contravening one or more of the other regulatory provisions which complement the sole purpose test, may be indicative of circumstances establishing a breach of the sole purpose test.

¹⁰ The conditions of release of benefits and cashing restrictions are listed in Schedule 1 of the SISR. See also the payment standards in Part 6 of the SISR.

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24. There are two further considerations for a trustee of an SMSF. The first is whether the policy was acquired in order to secure some other benefit (for example, cheaper premiums on other policies) for a person such as a member or member's relative.¹¹ As explained in SMSFR 2008/2 (paragraph 5), determining the purpose for which an SMSF is being maintained requires a survey of all the events and circumstances relating to the SMSF's maintenance. Relevant factors to consider in determining whether the provision of a benefit that is not specified in section 62 is of such a nature so as to cause or contribute to a conclusion that the sole purpose test has been contravened are set out in paragraphs 12 and 13 of SMSFR 2008/2.

25. In addition, consideration must also be given by an SMSF trustee to compliance with the other regulatory provisions which complement the sole purpose test. A contravention of one or more of these provisions may be indicative of circumstances establishing a breach of the sole purpose test.¹²

26. In short, it is the Commissioner's view that the acquisition of a trauma insurance policy by a trustee of an SMSF does not automatically lead to the trustee contravening section 62. Consideration must be given to the matters discussed at paragraphs 23 to 26 of this draft Determination. See Example 2 in Appendix 1.

¹¹ Refer to the examples provided in Appendix 1 of SMSFR 2008/2.

¹² See paragraph 97 of SMSFR 2008/2.

Appendix 3 – Your comments

27. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

28. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	4 December 2009
Contact officer:	Julie Haar
Email address:	julie.haar@ato.gov.au
Telephone:	(08) 8208 1820
Facsimile:	(08) 8208 1898
Address:	Australian Taxation Office GPO Box 9977 Adelaide SA 5001

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

SMSFR 2008/1; SMSFR 2008/2

Subject references:

- breach of sole purpose
- self managed superannuation funds
- SMSF investments
- sole purpose
- superannuation

Legislative references:

- SISA 1993
- SISA 1993 10(4)
- SISA 1993 17A
- SISA 1993 62
- SISA 1993 62(1)
- SISA 1993 62(1)(a)
- SISA 1993 62(1)(b)
- SISR 1994
- SISR 1994 Pt 6
- SISR 1994 Sch 1

ATO references

NO: 1-1PE6QBP

ISSN: 1835-2154

ATOlaw topic: Superannuation Entities ~~ Self managed superannuation funds