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ZANACORP

Uncomplicating The Tax Treatment of Life Insurance

Have you recently purchased life insurance?

The type of cover, deductibility of premiums and treatment of claims make life insurance a complex topic for tax. It's a topic that individuals and businesses alike seek assistance from accountants.

The deductibility of premiums and treatment of claims payouts can be a complex, nuanced topic. The opportunities and traps hidden in those complexities are significantly amplified for professionals with higher incomes and greater-than-average wealth.

For professionals who want to structure their life insurance to optimise the balance between cash flow, tax treatment and robust protection, here's a high-level look at the issues.

Tax Considerations – Cover Outside Super

While premiums for death, TPD and trauma cover are not tax-deductible outside of superannuation, premiums for income protection and business expenses protection are.

On the flip side of that, claims payments from death, TPD and trauma policies are entirely tax-free, regardless of whom they are paid to, while income protection and business expense benefits are classed as income and need to be declared (business expenses payments would naturally offset the actual expenses they are intended to cover).

Special Tax Treatment Of Policies Held For Business Purposes

Some tax concessions are available to life insurance policies held for business purposes, including buy/sell agreements and those covering revenue lost in the event of the death or disablement of a key person.

In such cases, policies are generally held by the business with premiums tax-deductible to the business. However, claim payments are generally regarded as income or a capital gain, depending on the purpose of the cover, and therefore subject to appropriate tax. FBT can also apply where a business pays ownership protection premiums on behalf of individual owners.

Tax On Life Claims Paid Through Super

Death benefits paid through super are generally tax-free if paid to a dependent (a term strictly defined under the law). Benefits paid to non-dependents may include a tax-free component but are likely to be subject to tax on at least some of the balance. Depending on the circumstances, the applicable rate will either be 15 or 30 per cent.

With TPD lump sum benefits, a portion is likely to be assessed as tax-free, depending on the member's eligible service period. The remainder is subject to a tax rate that varies according to the member's age.

Other tax-optimisation strategies include taking benefits as an income stream to qualify for tax offsets, maximising the uplift in the tax-free portion of the benefit, and washing out taxable components.

For more information about tax and life insurance, consultation with a tax professional (like us) is advised. This can be a very complicated topic to discern, with many intricacies that you may require assistance with.