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Employee Death Benefits

The Simple Super casualties?

When the Federal Government announced its sweeping changes to superannuation in the May 2006 Budget, it placed a spotlight on super like never before. In most instances, the changes were positively received, resulting in record breaking inflows to super in the lead up to 30 June 2007.

The devil in the detail
Despite the positive amendments, hidden amongst the changes were new tax rules that apply harsh tax treatment to employee death benefits[1] funded through employer group insurance policies. It's a complex matter but let's see if we can summarise the effects of these changes.

Depending upon the age of the deceased employee, and the amount of insurance cover held, dependents could lose nearly half of the proceeds they would otherwise expect to receive.

How are employee death benefits usually arranged?
Typically, there are two ways in which employee death benefits are arranged in the workplace. One way is to house the death benefits in the employer default superannuation fund as a standard feature. The recent removal of the Reasonable Benefit Limits (RBLs) results in more favourable tax treatment of death benefits within super than before.

It is also quite common to have death benefits provided outside of super through a group insurance policy (usually funded and owned by the employer). This can represent a point of differentiation for organisations in how they structure their employee benefits. More recently, it has become a popular means of guaranteeing insurance cover for all employees – irrespective of their superannuation choice.

Prior to 1 July 2007, death benefit proceeds were treated as an eligible termination payment (ETP) and taxed in a similar manner to a superannuation death benefit. Now, from 1 July 2007, employer group insurance schemes are subject to significantly different tax treatment in the hands of beneficiaries of a deceased employee. ETPs have been replaced by employment termination payments. Under these arrangements, death benefits payable from an employer funded group insurance policy will now be taxed at 45%[2] on amounts over $140,000.

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Actions you may wish to consider
If your firm provides employee death benefits through a group insurance policy then you might want to reassess the appropriateness of continuing to pay for insurance premiums outside of your superannuation fund. In making such a decision, you should also consider other issues such as:

- the preservation of benefits inside superannuation (particularly for TPD);
- any product limitations of group insurance policies inside superannuation; and
- any employment contractual obligations and amendments that may be required.

These matters can be complex and there is no "one size fits all" solution. It is vital that you seek specialist advice as to your options and best course of action.

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[1] Reference to Death benefits can also include Total and Permanent Disablement (TPD) benefits
[2] Plus Medicare Levy