



Super options for the terminally ill

1 March 2020

There are a range of ways terminally ill clients can access super early, each with different pros and cons and strategic considerations.

Scott Brown, Technical Consultant

Overview

If a client is diagnosed with a terminal illness, they have a range of options in relation to their superannuation. While clients may be able to withdraw their entire benefit via a tax-free lump sum, cashing their benefit may not always be the best option.

The potential payment choices could be to access their super benefit as a lump sum, a pension, a combination of the two, or they could elect to retain the benefit in the accumulation phase.

Key issues to consider include the life expectancy of the client, eligibility to claim insurance proceeds, the tax treatment of payments, estate planning wishes and any potential impact on Social Security entitlements.

Based on the key issues and payment options available, it will need to be determined which condition(s) of release will provide the optimal outcome for the client. Electing the less beneficial condition of release could lead to the loss of insurance proceeds, reduction in Social Security entitlements or not minimising tax payable for both the affected client and their beneficiaries.

Table of contents

Conditions of release	1
Understanding the client's situation	2
Strategic considerations	3
Terminal illness strategies	5
Permanent incapacity strategies	6

Conditions of release

A terminally ill client could potentially be eligible for an early release of their super under either the terminal medical or permanent incapacity conditions of release.

Terminal medical condition

To satisfy the terminal medical condition of release¹:

- two registered medical practitioners must certify that the person suffers from an illness, or has incurred an injury, that is likely to result in their death within 24 months after the date of certification, and
- at least one of the registered medical practitioners is a specialist practicing in an area related to the illness or injury suffered by the person.

The Tax Act states that a superannuation lump sum member benefit paid to a member is not assessable income and is not exempt income if a terminal medical condition exists in relation to them when they receive the lump sum or within 90 days after receiving it².

The SIS terminal medical condition definition may not always match a terminal illness insurance product definition. For example, while there is a 24 month certification period in super, the insurance definition may be limited to 12 months. If a client's life expectancy is greater than 12 months, yet less than 24 months, the client may be required to wait 12 months before accessing the insurance proceeds.

1 SIS Reg 6.01A
2 ITAA 1997 S303.10

A client could access their entire super benefit as a lump sum, a pension, a combination of the two, or they could elect to retain the benefit in accumulation phase when they satisfy the terminal medical condition. However, the tax treatment will vary according to the payment options selected.

Any benefits that have accrued up to meeting this condition of release and any benefits that accrue within the certification period are classified as unrestricted non-preserved interests. Any benefits that accrue after the certification period are not covered by this condition of release.

Permanent incapacity

The permanent incapacity condition of release is often referred to as total and permanent disablement (TPD). However, TPD is an insurance term.

To satisfy the permanent incapacity condition of release, the person must satisfy the trustee that they are unlikely because of ill-health (physical or mental) to engage in gainful employment for which they are reasonably qualified by education, training or experience³. For the purposes of concessional tax treatment, the Tax Act also includes a requirement that two legally qualified medical practitioners certify the permanent incapacity⁴.

Any proceeds from a TPD policy owned in super are usually allocated to the member's super account and will form part of the taxable component. A permanent incapacity payment from super could therefore include funds received from a TPD insurance payment, as well as an accumulated balance.

A client who meets the permanent incapacity condition of release could access their entire super benefit as a lump sum, a pension, a combination of the two, or they could elect to retain the benefit in the accumulation phase. However, the tax treatment will vary according to the payment options selected.

Understanding the client's situation

Prior to preparing a strategy for a terminally ill client, it is important to understand the client's circumstances. These may include their current health status, income generating capacity, debt levels, Social Security entitlements, estate planning wishes, super balances and dependants. Potential payment options must be aligned with future objectives such as funding immediate expenses, leaving a spouse or minors with the option to continue or commence a pension and minimising tax payable.

Information required before developing a strategy	
Has the client initiated an application for early release of super on terminal medical condition grounds with the super trustee?	<ul style="list-style-type: none"> ▪ If the trustee is satisfied that the client has met the terminal medical condition of release, payment strategies are limited to those provided by a terminal illness benefit as explained on page 5. ▪ When the super trustee has not been informed, there is an opportunity to then determine whether the terminal medical or permanent incapacity condition of release is most appropriate. ▪ If a client is better off applying for terminal medical condition of release in a different super fund (if they have multiple funds), a rollover can take place before applying.
What life expectancy has client's doctor identified?	The time available may dictate which strategies are possible to implement.
Does the client hold insurance inside super?	<ul style="list-style-type: none"> ▪ If the policy has both a terminal illness benefit and a TPD benefit, they may have the opportunity to choose which benefit to claim. ▪ It may even be possible to claim both benefits, if allowed by the policy, and the applications are sequenced in an appropriate order and timeframes as explained on page 3. ▪ If there is insurance and there is an associated accumulation account it should not be closed, as this may cause the insurance cover to lapse.

3 SIS Reg 1.03C
4 ITAA 1997 S995.1

What are client's, spouse and dependant's marginal tax rates and ages?	<ul style="list-style-type: none"> For clients below age 60 and on high marginal tax rates, they may wish to maintain funds in accumulation phase rather than commencing a pension where the taxable component of income payments will be assessed at higher tax rates. Beneficiaries' and the members' age and marginal tax rate are important when determining taxation of death benefit pensions or considering non-super investments.
Who will the super death benefit be directed to and what are the income requirements for the client, their spouse and other beneficiaries?	<ul style="list-style-type: none"> Are beneficiaries listed? If so, do they align with the client's wishes and strategic considerations? Does the client wish to withdraw some funds prior to death to fund a family holiday, pay off debts or to fund ongoing medical treatment? Would it be beneficial for the surviving spouse to have access to an ongoing pension through a death benefit pension or would that potentially consume too much of their available transfer balance cap once they retire? Will there be any requirement to allow funds for expenditure on dependent children? For benefits left to dependent children, should the benefit be transferred to a testamentary trust via the estate or should a child death benefit pension commence? Are parents concerned about when children have control of funds? If benefit is to be paid to a non-dependant, it may be worthwhile withdrawing part or the entire benefit prior to death to minimise death benefit tax.
Is the client or their partner receiving a Centrelink payment?	<ul style="list-style-type: none"> Any amount that remains in super accumulation phase while a person is below Age Pension age will not be assessable for Social Security means testing purposes. Any amount that is used to commence a super pension will be assessable as an asset and the balance deemed under the income test. Any amount withdrawn from super may be assessable depending on how it is invested if not spent immediately.
Which payment options does the super trustee allow?	Does the fund mandate lump sum withdrawals only or can benefits be rolled over or a pension commenced?

Strategic considerations

Insurance considerations

It's important that a client claims any insurance policy which they are entitled to. A claim for insurance proceeds should be made, or enough benefit left in a fund, before an amount is rolled over or withdrawn for any other purpose.

Where a client has both a TPD and a terminal illness insurance policy they may, in time, be able to claim on both policies, especially since the terminal medical certification period has been extended from 12 to 24 months for SIS purposes. The sequence of claiming in this scenario, where product insurance definitions allow, would involve claiming the TPD policy first. Where the client has a life expectancy that will potentially enable them to survive a buy back or double TPD period, they could then claim the terminal illness policy. In some cases, this may double the insured benefit a client is entitled to receive.

It is important to understand that if the terminal illness insurance definition is limited to 12 months, a client may be able to access their super benefit with the longer 24 month certification period. However, the terminal illness policy may not yet be payable into the super fund. In this situation care should be taken to ensure the policy remains in force if any transactions on the super account are to be done.

It is also important to check with the superannuation trustees to ask if they have extended the terminal medical condition certification period from 12 to 24 months, as not all funds have updated their processes.

Which condition of release to apply for?

Once insurance proceeds, if any are claimable, have been paid into the super fund, the super trustee can be informed of which condition of release they wish to apply for, subject to possible product restrictions mentioned below.

When a terminally ill client wishes to receive their super benefit prior to death, it may be in the client's interest to apply for the terminal medical condition of release, as this will be paid as a tax free lump sum. Clients may wish to use the cash received to repay debts, fund medical expenses or a family holiday. They may also wish to eliminate death benefit tax for non-dependant beneficiaries or transfer assets prior to death to avoid potential estate challenges.

Please be aware that if a lump sum is withdrawn and invested personally, on death, the amount will be included as an estate asset, whereas if it was left in super with a valid nominated binding beneficiary, the amount would not be an estate asset.

The permanent incapacity condition of release may be suitable for a terminally ill client where the client:

- is under age 60 and wishes to commence a pension, where they will be entitled to a 15% tax offset on the taxable component of income payments, or
- wishes to rollover their benefit to another super fund after claiming any insurance proceeds where they may also have access to a tax free uplift⁵ that is applied to the entire rolled over amount.

More information can be found in our '**Permanent incapacity payment options**' article located in the [**Technical**](#) section of MLC AdviserOnline.

Rollover considerations

When a super trustee is satisfied that a member meets the terminal medical condition of release and is within the certification period, under tax law, there is no ability to rollover a terminal illness benefit⁶. A client may wish to rollover their super, if they have multiple accounts, or if they wish to commence a pension with another provider. However, for a terminally ill client when an amount is transferred from one super fund to another, it is treated firstly as a tax free lump sum payment to the client and then treated as a contribution. A rollover within the certification period is subject to the usual contribution limits in the new fund.

If the trustee has not been informed or satisfied that the client has met the terminal medical condition of release, they will rollover the client's benefit on request. Therefore, the timing of applying for the terminal medical condition is vitally important to ensure a rollover can take place if desired.

Where a client satisfies the permanent incapacity condition of release and then elects to rollover their benefit to another fund, the trustee will apply a tax free uplift formula on their entire benefit. This means the tax-free component may be increased to reflect any 'future service period'. The advantage of rolling over the benefit is that for any future income payments or commutations, the proportion of the tax-free component will increase and the taxable component will decrease.

Product restrictions

It is best practice for advisers to understand the product structure and product provider's processes before commencing an application for a terminally ill client. Aspects to understand could include:

- Does the fund mandate lump sum withdrawals only, can benefits be rolled over or can an income stream commence?
- If there is a terminal illness or TPD policy, how is it held in the super fund? For example, is there an attached accumulation account or is it a stand-alone product? If it is stand-alone, what payment options exist?
- Is an application for an insurance claim for terminal illness/TPD also used by the super trustee when determining if a super condition of release has been satisfied? If so, a terminal illness insurance claim will lead to a terminal medical condition of release being satisfied and likewise a TPD claim will likely lead to a release from super on permanent incapacity grounds. However, if the insurance claim and super claim are considered separately, claiming either a TPD or terminal illness insurance policy may not impact which super condition of release can be applied for.

⁵ ITAA 1997 S307-145

⁶ ITAR 1997 306.10.01

Social Security considerations

Where a client is in receipt of a Social Security entitlement, consideration is required as to whether a benefit should remain in super or be paid out as either a lump sum or as a pension. Any amount left in super accumulation phase while a client is below Age Pension age is not assessable for means testing purposes. Any lump sums withdrawn and not spent and any amount used to commence a pension will be means tested.

A client may therefore become entitled to a Social Security payment or a larger one where either the entire benefit (or a portion) is left in super. The client may also benefit from gaining access or maintaining access to the Health Care Card or Pensioner Concession Card. Any additional benefit from Social Security payments due to retaining funds in accumulation phase should exceed any potential tax payable on earnings in super accumulation phase.

Terminal illness strategies

Payment options available for clients who satisfy the terminal medical condition of release are outlined in the table below.

Strategy	Pros	Cons
Retain in accumulation phase	<ul style="list-style-type: none"> Maximise Social Security entitlements while below Age Pension age Make multiple tax free lump sum withdrawals Allows for death benefit pensions for eligible dependants (eg spouse and minors) Benefits that accrue within the certification period are unrestricted non-preserved 	<ul style="list-style-type: none"> Tax payable on death benefits paid to non-dependant beneficiaries Earnings in accumulation phase are taxed up to 15%
Lump sum withdrawal	<ul style="list-style-type: none"> Provides cash flow to fund expenses prior to death such as a family holiday or to fund medical treatment Allows for repayment of debts Provides for intergenerational transfer of funds prior to death through either transfer of cash or investing into a family trust to avoid potential challenges to the deceased estate No tax payable on benefits paid to non-dependant beneficiaries 	<ul style="list-style-type: none"> Possible loss of insurance benefit if not claimed first No option for dependant beneficiaries to commence a pension Any amount withdrawn and not immediately spent may be included in Social Security means testing and reduce entitlements Potentially more tax payable on earnings and gains from assets owned outside super for individuals in tax brackets above the superannuation tax rate of 15%
Commence a pension	<ul style="list-style-type: none"> Receive regular income Allows for death benefit pensions for eligible dependants (eg spouse and minors) Option to continue reversionary pension for eligible surviving dependants Can benefit from no tax on earnings 	<ul style="list-style-type: none"> Possible loss of insurance, if pension commenced prior to claim Taxable component of pension payments may be taxable at individual marginal rates (no tax concessions on income received after satisfying terminal medical condition) Pension balance assessable for Social Security asset test and deemed for income test
Lump sum withdrawal and retribution to immediately commence a pension	<ul style="list-style-type: none"> Possibility of converting taxable to tax free component Commencement of a tax free pension A pension commenced with entirely tax free component will mean no tax is payable when a death benefit is paid 	<ul style="list-style-type: none"> Depending on the client's health, the strategy may take too long to implement and complete Be careful of contribution limits, age, total super balance and transfer balance cap restrictions

Permanent incapacity strategies

Payment options available for clients who satisfy the permanent incapacity condition of release are outlined in the table below.

Strategy	Pros	Cons
Retain in accumulation phase, possibly undertake periodical withdrawals	<ul style="list-style-type: none"> ▪ If eligible, may maximise Disability Support Pension payments while below Age Pension age, as benefit will not be subject to means testing ▪ Tax-free uplift applied to lump sum withdrawals ▪ If the member is close to age 60, they may wish to wait until their next birthday when the entire benefit will become tax free ▪ Allows for death benefit pensions for eligible dependants (eg spouse and minors) 	<ul style="list-style-type: none"> ▪ Earnings in accumulation phase are taxed up to 15% ▪ While tax is withheld on the taxable component of lump sums at 22%, including Medicare levy, the actual tax rate could be lower depending on the client's taxable income in the relevant financial year ▪ Tax is payable on the taxable component of death benefits paid to non-dependant beneficiaries
Lump sum withdrawal of entire benefit	<ul style="list-style-type: none"> ▪ Tax-free uplift applied to lump sum withdrawals ▪ Provides cash to fund expenses such as a family holiday or to fund medical treatment ▪ Allows for repayment of debts ▪ Provides for intergenerational transfer of funds prior to death through either transfer of cash or investing into a family trust to avoid potential challenges to the deceased estate ▪ As opposed to funds retained in superannuation, no tax is payable on benefits paid to non-dependant beneficiaries 	<ul style="list-style-type: none"> ▪ Possible loss of insurance benefit if not claimed first ▪ Lump sum tax payable up to 22%, including Medicare levy on taxable component ▪ No option for dependant beneficiaries to commence a pension ▪ Any amount withdrawn and not immediately spent may be included in Social Security means testing and reduce entitlements ▪ Potentially more tax payable on earnings and gains from assets owned outside super for individuals in tax brackets above the superannuation tax rate of 15%
Commence a pension	<ul style="list-style-type: none"> ▪ Receive regular income ▪ Allows for death benefit pensions, including reversionary pensions, for eligible dependants (eg spouse and minors) ▪ Can benefit from no tax on earnings 	<ul style="list-style-type: none"> ▪ Possible loss of insurance, if pension commenced prior to claim ▪ No tax free uplift applied if paid from fund holding insurance ▪ Taxable component of pension payments may be taxable at individual marginal rates less a 15% offset until age 60 ▪ Pension balance assessable for Social Security asset test and deemed for income test
Lump sum withdrawal and retribution to immediately commence a pension	<ul style="list-style-type: none"> ▪ Possibility of converting taxable to tax free component ▪ Commencement of a tax free pension ▪ A pension commenced with no taxable component will mean no tax is payable on any death benefit paid ▪ Alternate to commencing a pension could be to contribute into spouse's super fund 	<ul style="list-style-type: none"> ▪ Lump sum tax payable up to 22%, including Medicare levy on taxable component ▪ Be careful of contribution limits, age, total super balance and transfer balance cap restrictions

Appendix – Tax payable on death benefits

If a benefit remains in super after a terminally ill client dies, a death benefit will be payable from the super fund. A death benefit lump sum can be paid to SIS dependants or when directed to the estate, to non-dependants. A death benefit pension can only be paid to specific dependants⁷.

Taxation of a lump sum death benefit

Beneficiary	Components	Maximum tax rate
Tax dependant	Tax free and Taxable	Tax-free
Non-tax dependant	Tax free	Tax-free
	Taxable (taxed element)	15% ⁸
	Taxable (untaxed element)	30% ⁸

Taxation of death benefit account based pensions

Age of deceased / beneficiary	Components	Maximum tax rate
Either aged 60 or over	Tax free	Tax-free
	Taxable (taxed element)	Tax-free
Both under age 60	Tax free	Tax-free
	Taxable (taxed element)	MTR, less 15% offset ⁹¹⁰

Note: Income payments received from capped DB pensions may be subject to additional rates of tax in certain circumstances.

Other resources

Additional technical articles and guides on supplementary topics are located in the [Technical](#) section of MLC AdviserOnline which includes:

- Permanent incapacity payment options
- Guide to superannuation death benefits
- Guide to accessing super

Contact details

For further information, please contact MLC Technical Services on **1800 645 597**.

Important information and disclaimer

This document has been prepared by GWM Adviser Services Limited (ABN 96 002 071 749, AFSL 230692) (GWMAS), part of the National Australia Bank group of companies. Any advice provided is of a general nature only. It does not take into account your objectives, financial situation or needs.

This document is solely for use by financial advisers and distribution to customers is prohibited. GWMAS, its related entities, agents or employees do not accept any liability which arises as a result of the provision of this document to customers and any reliance on its contents.

Information in this document is current as at March 2020. While care has been taken in its preparation, no liability is accepted by GWMAS or its related entities, agents or employees for any loss arising from reliance on this document. Any opinions expressed constitute our views as at March 2020.

Case studies are for illustration purposes only. Past performance is not a reliable guide to future performance. Any tax information provided is a guide only. It is not a substitute for specialised tax advice.

⁷ SIS Reg 6.21

⁸ Plus Medicare levy, unless paid to deceased's estate.

⁹ Plus Medicare levy.

¹⁰ Income will be tax free once beneficiary reaches age 60.