

INCOME TAX DEDUCTIONS FOR SUPERANNUATION FUNDS – TOTAL AND PERMANENT DISABILITY (TPD) PREMIUMS

In July 2012, the ATO released a finalised version of two previous draft taxation rulings on the deductibility of TPD insurance premiums paid by superannuation funds.

This paper details the rules applicable to the deduction for insurance premiums paid by SMSFs, following the changes in 2012.

Ruling

The ruling, [Taxation Ruling TR 2012/6](#), is titled 'Income tax: deductibility under subsection 295-465(1) of the Income Tax Assessment Act 1997 of premiums paid by a complying superannuation fund for an insurance policy providing Total and Permanent Disability cover in respect of its members'.

The ruling provides direction as to when a superannuation fund may claim a tax deduction for premiums paid to provide TPD cover for members and, in some instances, the percentages of deductions available.

Subsection 295-465(1) of the Income Tax Assessment Act 1997 (ITAA 1997), which is referred to in the title of the ruling, basically permits tax deductions for a range of insurance premiums paid by superannuation funds, some of which are fully deductible and some partly deductible (e.g. only 30% of the premiums paid for a 'whole of life' policy are deductible).

A 'disability superannuation benefit' is included in s 295-465(1) as one of the benefits for which a 100% tax deduction is available. Essentially, the term 'disability superannuation benefit' is defined in ITAA 1997 as:

- a) a benefit paid because a person suffers from physical or mental ill-health; and
- b) 2 medical practitioners have certified that the person is unlikely to be "gainfully employed in a capacity for which he or she is reasonably qualified because of education, experience or training."

The requirement under item b) above is generally referred to as the 'any occupation' requirement. In other words, the test is whether the person could work in any type of occupation for which they are reasonably qualified, not necessarily the occupation they held at the time of injury or illness (which is generally referred to as 'own occupation').

Prior to the July 2007 change for the taxation of superannuation, from the Income Tax Assessment Act 1936 (ITAA 1936) to ITAA 1997, the general practice was for deductions to be claimed for all TPD premiums paid by super funds. ITAA 1936 allowed deductions in respect of premiums paid to cover 'permanent disability', a term which was not defined in ITAA 1936.

Once ITAA 1997, with a rather narrow definition of 'disability superannuation benefit', became the governing legislation, the ATO determined that deductions were not available for all TPD premiums.

The Government subsequently introduced legislation which provided transitional relief by allowing deductions for all TPD

premiums paid by superannuation funds between 1 July 2007 and 30 June 2011. From 1 July 2011, the 'any occupation' definition has applied in regards to full deductibility of premiums, which prompted the ATO to issue its ruling. The ruling is effective from 1 July 2011.

In its ruling, the ATO states that a complying super fund "... can claim a deduction for an insurance premium on a TPD insurance policy paid for by the fund, if there is a connection between that payment and a current or contingent liability of the fund to provide a 'disability superannuation benefit' .. to its members."

The ATO further states that it is not necessary for the definition of TPD, in the insurance policy and/or the trust deed, to be the same as the definition of 'disability superannuation benefit' in ITAA 1997 for a deduction to be available in respect of the TPD premiums.

In other words, the premiums for a TPD policy will be fully deductible if there is certainty that the definition of 'disability superannuation benefit' (i.e. 'any occupation') will be met at the time a claim ('insured event') occurs.

If the TPD cover provides for the less restrictive 'own occupation' test, the degree of certainty that a benefit payment can be made at the time of a claim is diminished.

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The ruling covers the aspect of ‘certainty’ by reference to the sole purpose test in s 62 of the Superannuation Industry (Supervision) Act 1993 (SIS Act), which leads to the payment of benefits after a member has met a condition of release. The most likely condition of release which a member who has suffered a TPD insured event will meet is the ‘permanent incapacity’ condition.

The definition in the Superannuation Industry (Supervision) Regulations 1994 (SIS Regs) for ‘permanent incapacity’ is similar to the definition of ‘disability superannuation benefit’ in ITAA 1997.

Whilst there is a difference in the level of certification – 2 medical practitioners in ‘disability superannuation benefit’ compared to the trustee being reasonably satisfied in ‘permanent incapacity’ – the ‘any occupation’ requirement prevails in both.

Note: the ATO suggests in the ruling that the trustee should obtain certificates from 2 medical practitioners to meet the ‘reasonably satisfied’ component of the test under the SIS Regs.

Also, in Interpretative Decision ID 2015/11, the ATO provides guidance as to the types of practitioners who are deemed to be ‘medical practitioners’ for the purposes of such certification.

The ruling considers that trustees could not be certain of being able to pay a benefit under the appropriate condition of release if the TPD insurance covers the more popular ‘own occupation’ definition and, as a result, would not be entitled to a full deduction for the premiums paid.

Having determined that a 100% tax deduction is available for ‘any occupation’ TPD premiums, let us move to the tax treatment of premiums for ‘own occupation’ cover.

For a number of reasons, including the expectation that a proportion of people covered under ‘own occupation’ insurance will suffer an insured event to the extent they would meet the ‘any occupation’ definition, a partial deduction is available for ‘any occupation’ premiums.

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... premiums for a TPD policy will be fully deductible if there is certainty ... ‘any occupation’ will be met at the time a claim occurs.

The amount of the deduction is set out in a table introduced to the SIS Regs in 2011, as below, being:

Insurance policy coverage	Specified deductible proportion
TPD any occupation	100%
TPD any occupation with one or more of the listed inclusions	100%
TPD own occupation	67%
TPD own occupation with one or more of the listed inclusions	67%
TPD own occupation bundled with death (life) cover	80%
TPD own occupation bundled with death (life) cover with one or more of the listed inclusions*	80%

The ‘listed inclusions’ referred to in the table are:

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- (a) activities of daily living;
- (b) cognitive loss;
- (c) loss of limb; and
- (d) domestic (home) duties.

The ruling, TR 2012/6, contains a number of examples which illustrate the different scenarios in the table above.

Included in the examples is a situation where no deduction for premiums is permitted in the instance where cover is taken out (in conjunction with a limited recourse borrowing arrangement), to meet loan instalments in the event that contributions to the fund stopped because of illness or injury to a member.

As the ATO states there is no connection between the occurrence of an insured event and the fund's liability to pay a death or disability benefit to a member, it has determined the premium is not deductible under s 295-465(1).

Additionally, the ATO refers in the ruling to a situation where the trust deed of the superannuation fund limits the maximum amount of benefit the trustee may pay to a disabled member to an amount which is less than the amount of cover held under the policy.

In that scenario, according to the ATO, a deduction is only available for the premium relative to the amount the trustee could pay with certainty (i.e. the amount limited under the deed), so a proportioning of the premium for deduction calculation purposes, would be needed.

Industry innovations

As usually occurs when obstacles are imposed, innovation follows. A number of insurers have introduced 'split' policies (and premiums), whereby:

- a super fund holds TPD cover for a member on an 'any occupation' basis, and obtains a 100% deduction for its share of the premium paid; whilst
- the individual member owns the portion of the policy which covers them for 'own occupation', with their share of the premium also being tax deductible to them.

If, as a result of a claim being made, the 'any occupation' conditions will be met, the super fund will receive the claim proceeds, from which it pays the member. Alternatively, if the degree of disability would meet the 'own occupation' conditions but not those for 'any occupation', the benefit is paid direct to the individual.

Required action

The first step should be a review of any TPD cover held by an SMSF for its members, to ascertain whether the cover relates to 'any occupation' or 'own occupation'. If 'own occupation', refer to the table above for the percentage of premium available to be deducted in the super fund annual returns, commencing from the 2011/12 financial year.

The SMSF trust deed should also be reviewed. Particular emphasis should be placed on any directions contained in the deed regarding the type of cover to be initiated on behalf of members (such as 'own occupation' or 'any occupation'), and whether that will potentially cause difficulties, if and when a claim event occurs, without the ability of the fund to pay the benefit to the member.

The Topdocs SMSF trust deed provides discretion to the trustee as to the type and amount of cover it initiates and maintains for members of the relevant fund.

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Note: Subsequent to the issue of TR 2012/6, the Government introduced legislation, and made regulations, limiting the type of disability insurance (and other insurances) that a SMSF may obtain for its members. Further details are available in the Topdocs article 'SMSFs and Insurance - remember the new rules'.

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