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MAKE A DIFFERENCE insurance

Tax Deduction for TPD Premiums - SMSFs

For many years, SMSF Trustees who have taken out Total and Permanent Disability (TPD) insurance for members have been able to claim a full tax deduction for the premiums paid. On the 1st of July 2011, this changed depending on which type of policy you take out and additional provisions will also apply from July 2014.

The Tax Act (ITAA 1997) basically states that TPD premiums are deductible to the extent that they relate to a “superannuation disability benefit".

The Act defines a "superannuation disability benefit" if:

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

Many of the definitions of TPD used in both SMSF trust deeds and various insurance policies do not strictly adhere to the above definition of a superannuation disability benefit, and as such a full deduction for the premiums should not have been available. Whilst common industry practice has overlooked this in the past, the Government decided as of 1st July 2011, to tighten this scenario.

Changes from 1 July 2011

In 2010, the ATO issued a draft ruling which outlined their proposed approach. Essentially, Trustees will only be able to claim a deduction of that part of a TPD premium that relates to the provision of benefits that strictly meet the above definition of a "superannuation disability benefit".

This definition is similar to the definition of permanent incapacity as a condition of release from a super fund, so you can see it starts to make logical sense.

So essentially, any TPD policy that provides benefits in a broader range of circumstances than that stated in the definition, will have premiums only partly deductible. An actuarial certificate will be needed to determine the portion for which a tax deduction can be claimed.

So What Does This Mean?

In practice, it all comes down to the type of TPD policy you take out, and what else you include. There are generally two main types of TPD definitions used:

1. Any occupation, and;

2. Own occupation.

The "any occupation" definition is generally one where due to ill health you are unlikely to be employed in ANY occupation for which you are reasonably qualified. This is generally regarded as meeting the definition of a "superannuation disability benefit" - that is, you should be able to deduct 100% of the premium.

As the name suggests, "own occupation" is where due to ill health you are unlikely to ever be employed in your OWN occupation again. This is considered a more generous definition than the "any" occupation and therefore these premiums will not be fully deductible. See the table below.

The other point to make here about "own occupation" TPD inside a SMSF is that because of the more narrow definition, you can be in a situation where an event has happened (eg. the loss of a limb) where you qualify for a payout of the insurance (the SMSF receives the money) but because the disability is not sufficient to qualify under the tighter definition of "permanent incapacity" under the 'condition of release' rules, the money may be stuck in your SMSF and you won't be able to get it out until another condition of release is met.

Hence there is an argument for having "own occupation" TPD insurance outside of super.

Adding Definitions to a Policy

Sometimes there are other definitions that are added to a TPD policy which will affect the above scenarios.

Loss of Sight or Limbs Where an "any occupation" TPD policy is enhanced with a definition that says that you are deemed to be totally and permanently disabled if you lose both limbs, or the sight of both eyes, or lose one limb and one eye, the premium will not be 100% deductible (see table below). This is due to the fact that it is not certain that such events will lead to a member meeting the "superannuation disability benefits" definition.

Activities of Daily Living On the other hand, a TPD policy can be enhanced with a definition around the loss of independence in daily living. This might typically say that you have lost independence if you cannot perform two or more activities (such as bathing / showering, eating and drinking, getting dressed, etc) unassisted.

In this situation, it is accepted that it is highly unlikely that the person would be able to work again in any occupation for which they are qualified, and as such it would meet the superannuation disability benefit" definition, and the premiums would be 100% deductible.

Insurance Policy	Specified Proportion
TPD - any occupation	100%
TPD any-occupation, with one or more of the following inclusions: activities of daily living, cognitive loss, loss of limb	100%
TPD own-occupation.	67%
TPD own-occupation, with one or more of the following inclusions: activities of daily living, cognitive loss, loss of limb	67%
TPD own-occupation bundled with death (life) cover.	80%
TPD own-occupation bundled with death (life) cover, with one or more of the following inclusions: activities of daily living, cognitive loss, loss of limb	80%

Other points

The ATO draft tax ruling makes a number of references to the terms of the fund trust deed being able to provide a 'disability superannuation benefit' to a member. Check what is stated in your trust deed and make sure you don't have a mismatch there.

Some insurance providers have made changes to accommodate the above for an "own occupation" policy, whereby cover is split into two linked policies. The own "own occupation" definition policy is held inside the SMSF, while the balance is held outside super. This allows full deductibility within the SMSF and enables you to maintain a full overall "own occupation" cover.

New provisions to apply from 2014

New regulations have been released that will limit the types of insurance that you can hold in super funds, subject to some transitional provisions.

The thrust is that insurance cover will only be allowed where it is consistent with a superannuation condition of release such as death, a terminal medical condition, permanent incapacity, and temporary incapacity. So it appears this means no more "own occupation" TPD at all.

These provisions will only apply to those who join their fund from 1 July 2014, as well as to existing fund members who did not already have these types of insurances in place as at 1 July 2014. If you joined a fund and were covered by these types of policies before 1 July 2014, the new provisions will not apply.

In other words, if you already had “own occupation” TPD in your fund prior to 1 July 2014, it will be allowed to continue beyond 1 July 2014. Not only that, you’ll be able to vary your level of cover (either up or down) after 1 July 2014.

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