

***TR 2011/D6 - 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***

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## Draft Taxation Ruling

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

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## What this Ruling is about

1. This draft Ruling is concerned with issues relating to the deductibility under subsection 295-465(1) of the *Income Tax Assessment Act 1997* (ITAA 1997)<sup>1</sup> of premiums paid by a complying superannuation fund for insurance policies which provide total and permanent disability (TPD) cover in respect of the fund's members.
2. In particular this draft Ruling deals with:
  - The Commissioner's view on how subsections 295-465(1), 295-465(1A) and 295-465(1B) together with paragraph 295-460(b) applies to such premiums;

<sup>1</sup> All legislative references are to the ITAA 1997 unless otherwise indicated.

- The relationship between the deductibility of the premiums and the rules for the provision of benefits by a complying superannuation fund to its members as set out in the *Superannuation Industry (Supervision) Act 1993 (SISA)* and the *Supervision Industry (Supervision) Regulations 1994 (SISR)*; and
  - The interaction of the relevant ITAA 1997 provisions with the relevant Income Tax Assessment Regulations 1997 (ITAR).
3. The relevant provisions applied in this draft Ruling are:
- Section 295-460;
  - Section 295-465;
  - Section 995-1; and
  - Regulation 295-465.01 of the ITAR
4. This draft Ruling does not explain the deductibility of premiums paid by a fund for life insurance policies on the death of a member,<sup>2</sup> premiums paid for temporary disablement policies<sup>3</sup> and premiums paid for terminal illness cover<sup>4</sup> or the cost of self insurance.<sup>5</sup>
5. This draft Ruling also does not deal with the application of former section 279 of the *Income Tax Assessment Act 1936* (ITAA 1936) and the transitional provisions that extend the definition of ‘disability superannuation benefits’ for the purposes of subsection 295-465(1) of the ITAA 1997 for the 2007-2008 to 2010-2011 income years.<sup>6</sup>

## Definitions

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### ‘TPD insurance policy’

6. In this draft Ruling TPD insurance policy means an insurance policy purchased by the trustee of a superannuation fund from an insurance company to insure the fund’s liability to provide benefits to members of the fund by reason of their total and permanent disability. For the purpose of this draft Ruling a TPD insurance policy may, in addition to insuring the liability of the fund to provide permanent disability benefits, also insure the fund’s liability to provide other benefits to or in respect of members, for example death benefits.

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<sup>2</sup> Paragraph (a) of section 295-460.

<sup>3</sup> Paragraph (c) of section 295-460.

<sup>4</sup> Paragraph (aa) of section 295-460

<sup>5</sup> Subsection 295-465(2).

<sup>6</sup> Section 295-466 of the *Income Tax (Transitional Provisions) Act 1997*.

**‘TPD benefits’**

7. In this draft Ruling the term TPD benefits means benefits paid under the terms of a TPD insurance policy when an insured event occurs to a member.

**‘insured event’**

8. A TPD insurance policy will specify certain events, the occurrence of which will give rise to the insurer’s liability and the insured’s right to claim a benefit under the policy.

9. For example, an insured event under a TPD insurance policy could include a member of the superannuation fund suffering an illness or injury such that it is unlikely the member will ever be able to perform the duties of any occupation, business, profession or employment for which the person is reasonably suited by education, training or experience.

**‘complying superannuation fund’**

10. In this draft Ruling the term complying superannuation fund means a complying superannuation fund within the meaning of section 45 of the SISA.<sup>7</sup>

**‘disability superannuation benefit’**

11. ‘Disability superannuation benefit’ is defined in section 995-1 of the ITAA 1997 as follows:

a \*superannuation benefit if:

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

**‘preserved benefits’**

12. In this draft Ruling the term preserved benefits has the meaning in Subdivision 6.1.2 of Part 6 of the SISR. A member’s preserved benefits in a regulated superannuation fund may only be cashed on or after the satisfaction by the member of a condition of release.

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<sup>7</sup> Refer to the definition in subsection 995-1(1).

## **‘condition of release’**

13. In this draft Ruling the term condition of release means a condition of release specified in Column 2 of Schedule 1 to the SISR.

## **Ruling**

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### **Deductibility of premiums under subsection 295-465(1)**

14. A complying superannuation 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’ referred to in paragraph 295-460(b) to its members.

15. The premium paid for the TPD insurance policy may be wholly or partly in respect of the provision of ‘disability superannuation benefits’. The extent to which a premium will be in respect of the fund’s liability to provide ‘disability superannuation benefits’ is determined by reference to the nature and scope of the insured event(s). Also whether upon the occurrence of those events there is a current or contingent obligation on the trustee to provide a disability superannuation benefit to the member in accordance with the terms of the trust deed.

16. The likelihood of the insured event occurring does not affect the deductibility of premiums paid by the fund. This is made clear by the reference to contingent liability in subsection 295-465(1). Premiums will be deductible even though it is most likely that a payout may never be made under the policy because the insured event may not occur.

17. The degree of certainty of the requirements of the ‘disability superannuation benefit’ definition being met as a consequence of an insured event occurring is critical to determining the extent to which an insurance premium paid by a complying superannuation fund for a TPD insurance policy will be deductible. In addition, where the TPD insurance policy has insured events referable to the provision of other benefits listed in section 295-460, it will be equally critical to determine the degree of certainty of the relevant test in section 295-460 being met as a consequence of an insured event occurring.

***Sole purpose***

18. The sole purpose test in section 62 of the SISA prohibits trustees from maintaining a complying superannuation fund for purposes other than the provision of benefits specified in subsection 62(1) of the SISA. Consistent with the sole purpose test, subregulation 6.18(1) of the SISR provides that a member's preserved benefits in a complying superannuation fund may be cashed on or after the satisfaction by the member of a condition of release.

19. A member must satisfy the condition of release for permanent incapacity (item 103 of Schedule 1 to the SISR) in order for a superannuation fund to provide a 'disability superannuation benefit'.

20. The degree of ill-health that the trustee of a fund must be reasonably satisfied exists in order that a member meets the definition of permanent incapacity under subregulation 6.01(2) of the SISR is identical to that which two medical practitioners must certify for the payment of a 'disability superannuation benefit'.

***Alignment with definition of 'disability superannuation benefit'***

21. The insurance policy does not need to define total and permanent disability using the same words as, or by referring to, the definition of 'disability superannuation benefit' for a deduction to arise under subsection 295-465(1). Where there is alignment between an insured event under the policy and the requirements for the provision of a 'disability superannuation benefit' by the fund, this will ensure that a deduction is available under item 5 in the table in subsection 295-465(1) for that part of a premium that is specified for such an event.

22. It is also not necessary for the definition of total and permanent disability in the policy to be the same as the wording in the fund's trust deed giving rise to the current or contingent liability to provide disability benefits in order for a deduction to arise under subsection 295-465(1). It will suffice if the occasion of the insured event gives rise to a liability under or in accordance with the terms of the fund trust deed to provide a 'disability superannuation benefit' to the member.

***Deduction for specified part of the premium under item 5 in the table in subsection 295-465(1)***

23. A deduction for the whole of the premium paid under a TPD insurance policy will be allowed under item 5 in the table in subsection 295-465(1) where the occurrence of an insured event specified in the policy is certain to result in a fund liability, pursuant to the terms of the fund trust deed:

- (a) to provide a 'disability superannuation benefit' to a member; and

- (b) the insured events under the policy are otherwise exclusively for the provision of benefits covered by section 295-460<sup>8</sup> that the superannuation fund has a liability to provide to the members pursuant to the trust deed (refer to Examples 4, 6 and 7 at paragraphs 69 to 75, 87 to 93 and 94 to 102 respectively of this draft Ruling).

24. Where a premium is paid to cover more than one insured event for permanent disability and:

- (a) the occurrence of one or more of the insured events specified in the policy is certain to result in a fund liability, pursuant to the terms of the fund trust deed, to provide a 'disability superannuation benefit' to a member; and
- (b) the policy specifies the part of the premium paid that relates to those particular insured events; and
- (c) the occurrence of other insured events specified in the policy is not certain to result in a fund liability, pursuant to the terms of the fund trust deed, to provide a 'disability superannuation benefit' to a member

then item 5 in the table in subsection 295-465(1) will apply to allow a deduction for the part of a premium that is referred to in subparagraph 24(b) of the draft Ruling.

25. Subsection 295-465(1A) provides that any amount of the premium which cannot be deducted under item 5 in the table in subsection 295-465(1) may still be deductible under item 6 in the table in subsection 295-465(1).

### ***Deduction for part of the premium under item 6 in the table in subsection 295-465(1)***

26. Where it is unclear whether the occurrence of an insured event under a TPD policy will result in a fund liability to provide a 'disability superannuation benefit', or other benefits referred to in section 295-460, to a member, it will be necessary to apportion premiums paid by the fund under item 6 in the table in subsection 295-465(1).

27. Subsection 295-465(1B) provides that, for the purposes of item 6 of the table, the regulations<sup>9</sup> may specify the proportion of a premium for a specified insurance policy that may be treated as being attributable to the liability of the fund to provide benefits referred to in section 295-460.

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<sup>8</sup> Paragraph (a) of section 295-460 refers to 'a superannuation death benefit', paragraph (aa) of section 295-460 refers to an amount payable because a 'terminal medical condition' exists and paragraph (c) of section 295-460 refers to a benefit paid due to a temporary inability to engage in gainful employment.

<sup>9</sup> Subdivision 295-G of the Income Tax Assessment Regulations 1997 (ITAR 1997)

28. The table in subregulation 295-465.01(1) of the ITAR sets out the deductible proportion of premiums for certain types of TPD insurance policies. The terms used in the table, including descriptions of the various insurance policies, are defined in subregulation 295-465.01(5) of the ITAR.

29. The proportion specified in the table in subregulation 295-465.01(1) of the ITAR is deductible only where the terms of the TPD insurance policy are either more restrictive than or have substantially the same meaning as the conditions described in subregulation 295-465.01(5) of the ITAR for the same type of policy.<sup>10</sup> This means that it is not necessary for the terms of a TPD insurance policy to be expressed in exactly the same language as the conditions described in subregulation 295-465.01(5) of the ITAR. However the language used to describe the cover provided under the insurance policy must not produce a greater range of insured events than can come within the conditions described in subregulation 295-465.01(5) of the ITAR. It follows that the occurrence of an event which satisfies the conditions in an insurance policy must also result in the satisfaction of the conditions described in subregulation 295-465.01(5) of the ITAR for the same type of policy.

30. If an insurance policy contains additional criteria to be met to that specified in the definition of the policy in subregulation 295-465.01(5) of the ITAR, the additional criteria may be disregarded for the purpose of applying the relevant deductible proportion.<sup>11</sup>

31. The specified proportion in the table in subregulation 295-465.01(1) of the ITAR is also not affected by the inclusion in the policy of cover for a terminal medical condition.<sup>12</sup>

32. The fund may choose to deduct a proportion other than that specified in the table in subregulation 295-465.01(1) of the ITAR. However, to do so, the fund must obtain an actuary's certificate in accordance with subsection 295-465(3).

33. Where the fund holds an insurance policy which is not specified in the table in subregulation 295-465.01(1) of the ITAR, the fund must obtain an actuary's certificate in order to claim a deduction under item 6 in the table in subsection 295-465(1).

34. The actuarial task is to determine that part of the premium paid by a fund that is attributable to the likelihood that, upon the occurrence of an insured event that gives rise to a payout under the policy, the fund will have a liability to provide a 'disability superannuation benefit' to a member.

<sup>10</sup> Subregulation 295-465.01(2) of the ITAR 1997

<sup>11</sup> Subregulation 295-465.01(3) of the ITAR 1997

<sup>12</sup> Subregulation 295-465.01(4) of the ITAR 1997



***No deduction***

35. An insurance premium is not deductible at all if it is certain that the requirements of each of the relevant benefit tests in section 295-460 will not be met as a consequence of any insured event occurring under the policy. Any such premium payment clearly has no connection to a current or contingent liability of a fund to provide a benefit referred to in section 295-460 (refer to Example 2 at paragraphs 46 to 56, and Example 9 at paragraphs 116 to 119 of this draft Ruling).

***Effect of superannuation fund trust deed***

36. The possibility and likelihood of a member electing not to receive a benefit that is otherwise payable under the terms of the trust deed will not in itself deny deductibility of that insurance premium. The likelihood of a member electing not to receive a benefit, where the permanent incapacity condition of release has been met and the payment if made would satisfy the 'disability superannuation benefit' definition requirements, does not affect whether the trustee has a contingent liability to provide the 'disability superannuation benefit' at the time the insurance premium is paid.

37. If the amount payable by the insurer under a policy in respect of a member is greater than the benefit permitted to be paid out by the fund under the trust deed in relation to permanent incapacity condition of release, there will need to be an apportionment of the premium. The fund will have no current or contingent liability to provide a benefit in excess of that permitted to be paid pursuant to the terms of the trust deed. That part of the premium paid that relates to the excess will not be deductible under subsection 295-465(1).

## **Examples**

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**Example 1: deduction for own occupation under item 6 in the table in subsection 295-465(1)**

38. A complying superannuation fund (the fund) purchases an insurance policy from an insurance company (Insurance Co) to cover its liabilities to its members in the event of the members suffering total and permanent disability.

39. The terms of the fund's trust deed provide that the fund trustee may provide either a superannuation lump sum or a superannuation income stream to a member where the trustee believes the member, having suffered an illness or injury, would satisfy the permanent incapacity condition of release (as in force at that time under the SISA and SISR).

40. The insurance policy provides own occupation cover and has the following clauses in relation to this cover:

- (a) The insured suffers from an injury or illness (whether physical or mental) and
  - (i) as a result of that illness or injury the insured has been unable to be gainfully employed in their own occupation continuously for a period of at least 6 months; and
  - (ii) taking into account medical and other professional evidence the insured is unlikely ever to be gainfully employed in their own occupation.
- (b) Own occupation means the occupation the insured predominantly performed in the 12 months prior to the injury or illness.

41. In considering the full range of insured events that could possibly give rise to a payout to the fund under the own occupation cover provided in the policy, it is not certain that the occurrence of an insured event will always result in a liability for the fund to provide a 'disability superannuation benefit' to the member. In this regard it is recognised that in some circumstances the member will not be able to perform their own occupation but will still be able to be engaged in other gainful employment for which they are reasonably qualified by education, training or experience.

42. In circumstances where an insured event that occurs under the own occupation cover leads to a payout to the fund but the member does not satisfy the requirements of a 'disability superannuation benefit' the fund will have no current or contingent liability to provide a 'disability superannuation benefit' to the member. The insurance payout will therefore be retained in the fund until the member satisfies a condition of release, such as retirement.

43. As the own occupation cover held by the fund does not relate wholly to the fund's liability to provide a 'disability superannuation benefit' the premium will not be deductible under item 5 in the table in subsection 295-465(1). Accordingly, deductibility of the premium paid by the fund will fall for consideration under item 6 in the table in subsection 295-465(1).

44. The terms of the own occupation cover in the insurance policy are more restrictive than the relevant definition in subregulation 295-465.01(5) of the ITAR for that type of policy. Therefore in accordance with subsection 295-465(1B), the trustee of the fund is entitled to claim a deduction for the proportion of the premium paid for its TPD own occupation cover that is specified in subregulation 295-465.01(1) of the ITAR. This proportion is 67 per cent.

45. If the trustee wishes to claim a deduction for a proportion other than that specified in the regulations, then in accordance with subsection 295-465(3), an actuary's certificate must be obtained, before the fund lodges its income tax return for the year. The certificate must certify that portion of the premium paid that is attributable to the fund's liability to provide a 'disability superannuation benefit' referred to in paragraph 295-460(b).

**Example 2: deduction for any occupation and own occupation under item 5 in the table in subsection 295-465(1)**

46. After several years, the fund wishes to change its existing insurance policy with Insurance Co by exercising an option to vary the terms of cover (from those held in Example 1 at paragraphs 38 to 45 of this draft Ruling) in its next policy.

47. The new policy provides any occupation cover plus an own occupation cover option. The add-on of the optional own occupation cover to the any occupation cover under this new policy is intended to extend the any occupation cover to replicate the full range of circumstances that would give rise to a payout under the previous policy.

48. The total premium payable under the insurance policy covers the cost of both the any occupation cover and the own occupation cover option, with the two amounts being separately specified within the policy.

49. Insurance Co's any occupation cover in the new policy has the following clauses:

The insured suffers from an injury or illness (whether physical or mental) and

- (a) as a result of that illness or injury the insured has been unable to be gainfully employed in any occupation continuously for a period of at least 6 months; and
- (b) taking into account medical and other professional evidence the insured is unlikely ever to engage in gainful employment for which they are reasonably qualified by education, training or experience.

50. Own occupation cover retains its definition from the insurance policy that was in place in Example 1 at paragraphs 38 to 45 of this draft Ruling in the previous year.

51. Under the terms of the policy the fund will receive only one payout upon the occurrence of an insured event, even if an insured event occurs that would satisfy both the any occupation and the own occupation cover. A payout received by the fund under the any occupation cover will reduce the member's entitlement to the own occupation benefit by the same amount. Conversely, a payout received by the fund under the own occupation cover will reduce the member's entitlement to a future any occupation benefit by the same amount.

52. The any occupation cover within the policy is consistent with the fund's current or contingent liability, under the terms of the fund trust deed, to provide a 'disability superannuation benefit'. The fund will only receive a payout under this cover if the occurrence of the insured event results in the member being unlikely to ever engage in gainful employment for which the member is reasonably qualified by education, training or experience.

53. It is therefore certain that the occurrence of an insured event under the any occupation cover would also give rise to a liability under the fund trust deed for the trustee to provide a 'disability superannuation benefit' to the member at that time.

54. In this case, the premium separately specified within the policy for any occupation cover is fully deductible under item 5 in the table in subsection 295-465(1), being wholly for the fund's liability to provide a 'disability superannuation benefit' referred to in paragraph 295-460(b). This is the case even though the definition of the any occupation cover in the policy does not use the same words as those for the requirements for the provision of a 'disability superannuation benefit' (refer to paragraphs 21 to 22 of this draft Ruling).

55. Under the terms of the policy's own occupation cover the fund will only receive a payout in respect of a member if the occurrence of the insured event results in the member being unlikely ever to engage in their own occupation. Accordingly, where a claim under the policy only arises under the own occupation cover, the member will not have satisfied the policy conditions in relation to the any occupation cover as it is likely that the member could still engage in other gainful employment for which they are reasonably qualified by education, training or experience. In these circumstances the occurrence of the insured event giving rise to a payout under the own occupation cover will not also result in the member satisfying the 'disability superannuation benefit' definition referred to in paragraph 295-460(b).

56. As the premium paid for the add-on of own occupation cover has no connection with the fund's liability to provide benefits referred to in section 295-460, the premium separately specified in the policy for own occupation cover is not deductible under subsection 295-465(1).

**Example 3: deduction for own occupation and loss of limbs and/or sight under item 6 in the table in subsection 295-465(1)**

57. A complying self managed superannuation fund (the fund) purchased an insurance policy from an insurance company (Insurance Co) to cover its liability in the event of its members becoming totally and permanently disabled.

58. The terms of the fund's trust deed require the trustee, at the request of the member, to pay a benefit to that member where the trustee reasonably believes that due to accident or illness the member is totally and permanently disabled leaving them unlikely ever to be able to engage in any regular remunerative work for which they are reasonably suited by education, training and experience.

59. The fund's insurance policy with Insurance Co contains own occupation and loss of limbs and/or sight combined cover.

60. Under the terms of the policy own occupation cover is defined as follows:

- (a) as a result of accident or injury, the insured is completely unable to work at their own occupation continuously for a period of at least 4 months and after considering medical and other evidence are unlikely ever to be able to do so again.
- (b) own occupation means the occupation the insured was engaged in at the time of the insured application for this insurance.

61. Loss of limbs and/or sight cover is defined in the policy as:

The insured has suffered the total and permanent loss of:

- (a) the use of both hands;
- (b) the use of both feet;
- (c) the use of one hand and one foot;
- (d) the use of one hand or one foot and the sight in one eye; or
- (e) the sight in both eyes.

62. Under the terms of the insurance policy, the fund will receive only one payout even if the occurrence of an insured event would satisfy more than one of the defined types of cover. A payout received by the fund under the loss of limbs and/or sight cover will reduce the amount of any payout entitlement under own occupation cover by that same amount.

63. In considering the full range of insured events that could possibly give rise to a payout to the fund under the own occupation cover and loss of limbs and/or sight cover provided under the terms of the policy with Insurance Co, it is not certain that the occurrence of an insured event will result in a liability for the fund to provide a 'disability superannuation benefit' to a member. It is recognised that in some circumstances a member, having suffered an accident or illness, whether or not resulting in loss of limbs and/or sight, will not be able to perform their own occupation. However they may otherwise still be able to be engaged in gainful employment for which they are reasonably qualified by education, training or experience.

64. In some circumstances where an insured event that occurs under the own occupation or loss of limbs and/or sight cover leads to a payout to the fund by the insurer, the fund will have no liability to provide a 'disability superannuation benefit' to the member as at that time the relevant conditions have not been met. Any insurance payout will therefore be retained in the fund until the member satisfies a condition of release, such as retirement.

65. As the own occupation and loss of limbs and/or sight cover held by the fund does not relate wholly to the fund's liability to provide a 'disability superannuation benefit' under paragraph 295-460(b), the premium for the insurance policy with Insurance Co will not be deductible under item 5 in the table in subsection 295-465(1).

66. Accordingly, deductibility of the premium paid by the fund will fall for consideration under item 6 in the table in subsection 295-465(1).

67. The terms of the own occupation cover and the terms of the loss of limb and/or sight cover in the policy are more restrictive than or have substantially the same meaning as the associated definitions in subregulation 295-465.01(5) of the ITAR. Therefore in accordance with subsection 295-465(1B), the trustee of the fund is entitled to claim a deduction for the proportion of the premium paid for its TPD own occupation and loss of limbs and/or sight combined cover that is specified in subregulation 295-465.01(1) of the ITAR. This proportion is 67 per cent.

68. If the trustee wishes to claim a deduction for a proportion other than that specified in the regulations, then in accordance with subsection 295-465(3), an actuary's certificate must be obtained, before the fund lodges its income tax return for the year, certifying that portion of the premium paid that is attributable to the fund's liability to provide a 'disability superannuation benefit' referred to in paragraph 295-460(b).

**Example 4: deduction for any occupation and domestic duties under item 5 in the table in subsection 295-465(1)**

69. A complying superannuation fund (the fund) purchases an insurance policy from an insurance company to cover its liability in the event its members become totally and permanently disabled.

70. The terms of the fund's trust deed provide that the fund trustee may provide either a superannuation lump sum or a superannuation income stream to a member where the trustee believes the member, having suffered an illness or injury, would satisfy the permanent incapacity condition of release (as in force at that time under the SISA and SISR).

71. The insurance policy includes any occupation and domestic duties cover. A single premium paid for this combined cover is specified in the policy. The any occupation cover is defined as:

The insured suffers from an injury or illness (whether physical or mental) and

- (a) as a result of that illness or injury the insured has been unable to be gainfully employed in any occupation continuously for a period of at least 6 months; and
- (b) taking into account medical and other professional evidence the insured is unlikely ever to engage in gainful employment for which they are reasonably qualified by education, training or experience.

72. Domestic duties cover is defined as:

If the insured has the sole occupation of maintaining a family home and they suffer an illness or injury and:

- (a) the illness or injury wholly prevents them from engaging in any normal domestic duties for at least 3 consecutive months; and
- (b) since becoming ill or injured they have been under the regular care and attention of a medical practitioner for that illness or injury; and
- (c) in the insurer's opinion, as a result of the illness or injury the insured is incapacitated to such a degree they are unlikely to ever again be able to engage in domestic duties or engage in any occupation.

73. It is certain that the occurrence of an insured event under the any occupation cover would give rise to a liability under the fund trust deed for the trustee to provide a 'disability superannuation benefit' to the member.

74. It is accepted that the occurrence of an insured event under the domestic duties cover would give rise to a liability under the fund trust deed for the trustee to provide a 'disability superannuation benefit' to the member, as it would be unlikely that a member with this level of disability would ever be gainfully employed in a capacity for which they were reasonably qualified because of education, experience or training.

75. Accordingly the single premium specified within the policy for any occupation and domestic duties cover is fully deductible under item 5 in the table in subsection 295-465(1) as the premium is wholly for the fund's liability to provide a 'disability superannuation benefit'. This is the case even though the definition of the domestic duties cover in the policy does not use the same words as those for the requirements for the provision of a 'disability superannuation benefit' (refer to paragraphs 21 to 22 of this draft Ruling).

**Example 5: deduction for any occupation and loss of limbs and/or sight under item 6 in the table in subsection 295-465(1)**

76. A complying superannuation fund (the fund) purchases an insurance policy to cover its liabilities to its members in the event they become totally and permanently disabled. The TPD insurance policy includes any occupation and loss of limb and/or sight combined cover.

77. The terms of the fund's trust deed authorises the trustee to pay out a superannuation lump sum or superannuation income stream where the member meets a condition of release in accordance with the SISR. A benefit may be paid by the trustee if the payment does not change the fund's status as a complying superannuation fund under the SISA.

78. Any occupation is defined under the fund's policy as:

The insured has been unable to engage in any occupation, profession or business as a result of the insured's injury or sickness:

- (a) for at least 6 consecutive months; and
- (b) the insured is unlikely ever again to engage in any occupation, profession or business for which they are reasonably qualified as result of education, experience or training.

79. Loss of limbs and/or sight is defined in this policy as:

The insured has suffered the total and permanent loss of:

- (a) the use of both hands;
- (b) the use of both feet;
- (c) the use of one hand and one foot;
- (d) the use of one hand or one foot and the sight in one eye; or
- (e) the sight in both eyes.

80. A single premium is paid under the policy for both the any occupation and loss of limb and/or sight cover. The policy does not specify how much of the premium relates to each cover. The fund will receive two separate payouts under the policy in circumstances where an insured event occurs that will satisfy both the any occupation and loss of limb and/or sight policy definitions. A payout received by the fund under the any occupation cover will not reduce the fund's entitlement to a loss of limbs and/or sight payout and vice versa.

81. It is certain that the occurrence of an insured event under the any occupation cover would also give rise to a liability under the fund trust deed for the trustee to provide a 'disability superannuation benefit' to the member.



82. In considering the insured events that could possibly give rise to a payout to the fund under the loss of limbs and/or sight cover it is not certain that the occurrence of an insured event will always result in a liability for the fund to provide a 'disability superannuation benefit' to a member.

83. It is recognised that in some circumstances a member, having suffered an accident or injury resulting in loss of limbs and/or sight, will not be able to engage in any occupation, profession or business for which they are reasonably qualified as result of education, experience or training. In these circumstances, a liability will arise under the fund trust deed for the trustee to provide a 'disability superannuation benefit' to the member.

84. However in other circumstances, despite the loss of limbs and/or sight, the member may still be able to be engaged in gainful employment for which they are reasonably qualified by education, training or experience. Therefore, the cost to the fund of obtaining loss of limbs and/or sight cover does not relate wholly to the fund's liability to provide a 'disability superannuation benefit' under paragraph 295-460(b).

85. Since the premium paid by the fund for each type of cover is not specified separately in the policy, no deduction is allowed under item 5 in the table in subsection 295-465(1). Therefore, the premium paid has to be apportioned in accordance with item 6 in the table in subsection 295-465(1).

86. The terms of the any occupation cover and the terms of the loss of limb and/or sight cover in the policy are more restrictive than or have substantially the same meaning as the associated definitions in subregulation 295-465.01(5) of the ITAR. Therefore in accordance with subsection 295-465(1B), the trustee of the fund is entitled to claim a deduction for the proportion of the premium paid for its TPD any occupation and loss of limbs and/or sight combined cover that is specified in subregulation 295-465.01(1) of the ITAR. This proportion is 100 per cent.

**Example 6: deduction for any occupation and loss of independence under item 5 in the table in subsection 295-465(1)**

87. A complying superannuation fund (the fund) purchases an insurance policy to cover its liabilities to its members in the event of them becoming totally and permanently disabled.

88. The terms of the fund's trust deed require the trustee, at the request of the member, to pay a benefit to that member where the trustee reasonably believes that due to accident or illness the member is totally and permanently disabled leaving them unlikely ever to be able to engage in any regular remunerative work for which they are reasonably suited by education, training and experience.

89. The insurance policy includes any occupation and loss of independence cover. A single premium paid for this combined cover is specified in the policy. The any occupation cover is defined as:

The insured suffers from an injury or illness (whether physical or mental) and

- (a) as a result of that illness or injury the insured has been unable to be gainfully employed in any occupation continuously for a period of at least 6 months; and
- (b) taking into account medical and other professional evidence the insured is unlikely ever to engage in gainful employment for which they are reasonably qualified by education, training or experience.

90. Loss of independence cover is defined under the policy as:

The insured has lost independence if, as a result of sickness or injury, they are totally and irreversibly unable to do two or more of the following groups of daily activities without physical help from someone else:

- (a) bathing or showering;
- (b) dressing;
- (c) moving from place to place, in and out of bed, and in and out of a chair;
- (d) eating and drinking; or
- (e) using the toilet.

91. It is certain that the occurrence of an insured event under the any occupation cover would give rise to a liability under the fund trust deed for the trustee to provide a 'disability superannuation benefit' to the member.

92. It is accepted that the occurrence of an insured event under the loss of independence cover would give rise to a liability under the fund trust deed for the trustee to provide a 'disability superannuation benefit' to the member, as it would be unlikely that a member with this level of disability would ever be gainfully employed in a capacity for which they were reasonably qualified because of education, experience or training.

93. Accordingly, the single premium specified within the policy for any occupation and loss of independence cover is fully deductible under item 5 in the table in subsection 295-465(1), being wholly for the fund's liability to provide a 'disability superannuation benefit' referred to in paragraph 295-460(b). This is the case even though the definitions of both the any occupation cover and the loss of independence cover in the policy do not use the same words as those for the requirements for the provision of a 'disability superannuation benefit' (refer to paragraphs 21 to 22 of this draft Ruling).

**Example 7: deduction for any occupation and death benefit under item 5 in the table in subsection 295-465(1)**

94. A complying superannuation fund (the fund) purchases an insurance policy to cover its liabilities to its members in the event of their death or if they become totally and permanently disabled.
95. The terms of the fund's trust deed require the trustee to pay a benefit in relation to a member on the member's death.
96. The terms of the fund's trust deed also require the trustee, at the request of the member, to pay a benefit to that member where the trustee reasonably believes that due to accident or illness the member is totally and permanently disabled leaving them unlikely ever to be able to engage in any regular remunerative work for which they are reasonably suited by education, training and experience.
97. The insurance policy includes death benefit and any occupation cover. A single premium paid for this combined cover is specified in the policy.
98. The death benefit cover is defined under the policy as providing a benefit on the death of the person insured, being the member of the superannuation fund.
99. The any occupation cover is defined under the policy as:  
The insured suffers from an injury or illness (whether physical or mental) and
- (a) as a result of that illness or injury the insured has been unable to be gainfully employed in any occupation continuously for a period of at least 6 months; and
  - (b) taking into account medical and other professional evidence the insured is unlikely ever to engage in gainful employment for which they are reasonably qualified by education, training or experience.
100. It is certain that the occurrence of the insured event under the death benefit cover would give rise to a superannuation death benefit under paragraph 295-460(a).
101. It is also certain that the occurrence of an insured event under the any occupation cover would give rise to a liability under the fund trust deed for the trustee to provide a 'disability superannuation benefit' referred to in paragraph 295-460(b) to the member.
102. Accordingly the single premium specified within the policy for the death benefit and any occupation cover is fully deductible under item 5 in the table in subsection 295-465(1), as the premium is wholly for the fund's liability to provide benefits referred to in section 295-460.

**Example 8: deduction for own occupation bundled with death benefit under item 6 in the table in subsection 295-465(1)**

103. A complying self managed superannuation fund (the fund) purchases an insurance policy to cover its liabilities to its members in the event of their death or if they become totally and permanently disabled.

104. The terms of the fund's trust deed require the trustee to pay a benefit in relation to a member on the member's death.

105. The terms of the fund's trust deed also require the trustee, at the request of the member, to pay a benefit to that member where the trustee reasonably believes that due to accident or illness the member is totally and permanently disabled leaving them unlikely ever to be able to engage in any regular remunerative work for which they are reasonably suited by education, training and experience.

106. The insurance policy is for combined life insurance and TPD insurance, with the level of cover for TPD the same as the level of death cover. A single premium paid for this combined cover is specified in the policy.

107. The TPD section of the policy provides own occupation cover, and has the following terms in relation this cover:

- (a) as a result of accident or injury, the insured is completely unable to work at their own occupation continuously for a period of at least 4 months and after considering medical and other evidence are unlikely ever to be able to do so again.
- (b) own occupation means the occupation the insured was engaged in at the time of the insured's application for this insurance.

108. Under the terms of the policy, if a TPD benefit is paid, the death cover is automatically reduced by the amount of that payment to nil that is, the fund will receive only one payout upon the occurrence of an insured event.

109. It is certain that the occurrence of the insured event under the death benefit cover would give rise to a superannuation death benefit under paragraph 295-460(a).

110. In considering the full range of insured events that could possibly give rise to a payout to the fund under the own occupation cover provided under the terms of the insurance policy, it is not certain that the occurrence of an insured event will result in a liability for the fund to provide a 'disability superannuation benefit' to a member. It is recognised that in some circumstances a member, having suffered an accident or illness will not be able to perform their own occupation. However they may otherwise still be able to be engaged in gainful employment for which they are reasonably qualified by education, training or experience.

111. In some circumstances where an insured event that occurs under the own occupation cover leads to a payout to the fund by the insurer, the fund will have no liability to provide a permanent incapacity benefit to the member as at that time the relevant conditions have not been met. Any insurance payout will therefore be retained in the fund until the member satisfies a condition of release, such as retirement.

112. As the own occupation held by the fund does not relate wholly to the fund's liability to provide a 'disability superannuation benefit' under paragraph 295-460(b), the premium for the combined life insurance and TPD insurance will not be deductible under item 5 in the table in subsection 295-465(1).

113. Accordingly, deductibility of the premium paid by the fund will fall for consideration under item 6 in the table in subsection 295-465(1).

114. The terms of the own occupation cover in the insurance policy are more restrictive than the associated definition in subregulation 295-465.01(5) of the ITAR. Therefore in accordance with subsection 295-465(1B), the trustee of the fund is entitled to claim a deduction for the proportion of the premium paid for its combined TPD own occupation cover and death cover that is specified in subregulation 295-465.01(1) of the ITAR. This proportion is 80 per cent.

115. If the trustee wishes to claim a deduction for a proportion other than that specified in the regulations, then in accordance with subsection 295-465(3), an actuary's certificate must be obtained, before the fund lodges its income tax return for the year, certifying that portion of the premium paid that is attributable to the fund's liability to provide a benefit referred to in section 295-460.

**Example 9: no deduction for additional death and TPD insurance where no connection to a current or contingent liability of a fund to provide a 'disability superannuation benefit'**

116. The same fund as in Example 8 (at paragraphs 103 to 115 of the draft Ruling) enters into a limited recourse borrowing arrangement.

117. At the encouragement of the lender, the fund takes out additional death and TPD insurance with an insurance company connected to the lender, to cover its liabilities in relation to the repayment of this debt, should contributions to the fund cease, or be significantly reduced, in the event of a member's death or disablement. A single premium is paid for this additional insurance cover. It is intended that this cover be reduced each year in line with the reduction in the debt, such that, if an insured event occurs, no excess of proceeds over remaining debt would be received by the trustee in any year.

118. The fund's trust deed is silent on how insurance proceeds can be dealt with, but it is the trustee's intention that, in the event of the member's death or permanent disablement, the proceeds from the original insurance policy will be used to pay to the member, or in respect of the member, a benefit referred to in section 295-460. The proceeds from the additional insurance policy will be used to repay the fund's debt in relation to the limited recourse borrowing arrangement.

119. As there is no connection between the occurrence of an insured event under the additional policy and the fund's current or contingent liability to pay a death or disability benefit to a member, the premium paid for the additional insurance policy is not deductible under subsection 295-465(1).

## **Date of effect**

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120. When the final Ruling is issued, it is proposed to apply from 1 July 2011 and later income years.

121. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

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**Commissioner of Taxation**

7 December 2011

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## Appendix 1 – Explanation

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**❶** *This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the proposed binding public ruling.*

### Background

122. Superannuation funds commonly take out insurance policies in respect of their liability to provide benefits to members. Often these policies will be a type of group policy, whereby a single policy provides coverage in respect of all of the members of the fund or an identified sub-class of those members. In other cases the policies will be taken out in respect of an individual member.

123. The term total and permanent disability (TPD) will be defined in the insurance policy. There are currently a wide range of definitions of totally and permanently disabled used in insurance policies for the purposes of determining when a benefit will be payable under the policy.

124. TPD cover is often sold as an add-on to term life insurance policies that provide a payment on the death of the insured. Alternatively, TPD cover can be provided under a separate insurance policy.

### **Legislative history – the ITAA 1936**

125. Former section 279 of the ITAA 1936 allowed a deduction for a premium paid (in whole or in part) in respect of a current or contingent liability of a superannuation fund to provide death or disability benefits for the members of the fund.

126. The definition of ‘death or disability benefit’ in former section 267 of the ITAA 1936 included at paragraph (b) ‘a benefit provided to the member in the event of the permanent disability of the member’.

127. The term ‘permanent disability’ was not defined. Consequently, insurers and superannuation funds interpreted the term according to its ordinary meaning, resulting in a wide range of TPD definitions in insurance policies taken out by funds on behalf of their members.

128. Our understanding is that industry practice was to claim a full deduction for TPD premiums regardless of whether a policy covered any occupation, own occupation, loss of independence, home duties, or loss of limb and/or sight benefits.

129. This view focused on the insurer’s liability to the fund rather than the fund’s liabilities to members.

130. The provisions regarding deductibility of TPD insurance premiums were rewritten and transferred from former section 279 of the ITAA 1936 to Division 295 of the ITAA 1997 with effect from the 2007-2008 income year.

#### ***Transitional provisions and other amendments to the law***

131. In response to concerns raised by the superannuation and insurance industry that the ATO view of the deductibility of TPD insurance premiums did not accord with industry practice, amendments were made to the tax law to ensure that complying superannuation funds could deduct in full the insurance premiums commonly regarded as TPD policy premiums for the income years from 2004-05 to 2010-11.<sup>13</sup>

132. Further amendments were made to simplify the process for complying superannuation funds to claim a partial deduction for premiums paid on insurance policies in the 2011-12 income year and later income years.<sup>14</sup> These amendments are discussed at paragraph 139 of this draft Ruling.

#### ***Division 295***

133. Division 295 (of which section 295-460 and section 295-465 form a part) contains special rules in relation to the taxation of complying superannuation funds.

134. Under subsection 295-465(1), a complying superannuation fund can deduct the proportion of premiums it pays for insurance policies that are wholly or partly for current or contingent liabilities of the fund to provide benefits referred to in section 295-460 for its members.

135. Section 295-460 specifies particular types of benefits a superannuation fund may provide to either a member for example, a 'disability superannuation benefit' or another person for example, a superannuation death benefit.

136. The premium paid for a TPD insurance policy may be deductible under item 5 or item 6 in the table in subsection 295-465(1).

137. Under item 5 in the table in subsection 295-465(1) the fund can deduct the part of the premium that is specified in the policy as being wholly for the liability to provide benefits referred to in section 295-460.

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<sup>13</sup> These transitional provisions will be repealed on 1 January 2017.

<sup>14</sup> *Tax Laws Amendment (2011 Measures No 4) Act 2011*



138. Under item 6 in the table in subsection 295-465(1) the fund can deduct so much of other insurance premiums as are attributable to the liability to provide benefits referred to in section 295-460. If item 5 in the table applies to only a part of an insurance policy premium, item 6 of the table applies to the rest of the premium as if item 5 did not apply to the premium.<sup>15</sup>

139. Applicable to insurance policy premiums paid in the 2011-12 income year and later years, for the purpose of deducting amounts under item 6 in the table in subsection 295-465(1) new subsection 295-465(1B) provides that the regulations<sup>16</sup> may specify the proportion of a premium for a specified insurance policy that may be treated as being attributable to the liability to provide benefits referred to in section 295-460. If an insurance policy held by a superannuation fund is of a type specified in the regulations the fund may deduct the specified proportion of the premium. Where the fund claims a deduction in accordance with the regulations, an actuary's certificate will not be required.<sup>17</sup>

140. The fund may deduct an amount under item 6 other than the specified proportion of the premium in the regulations but must obtain an actuary's certificate in accordance with subsection 295-465(3) in order to do so.

### ***Deductibility of premiums under subsection 295-465(1)***

141. Subsection 295-465(1) states that a complying superannuation fund can deduct in an income year:

...the proportions specified in this table of premiums it pays for insurance policies that are (wholly or partly) for current or contingent liabilities of the fund to provide benefits referred to in section 295-460 for its members.

142. Paragraph (b) of section 295-460 refers to a 'disability superannuation benefit' as being one of the benefits to which section 295-465 applies.

143. A 'disability superannuation benefit' is defined in subsection 995-1(1) to mean a superannuation benefit where:

- (a) the benefit is paid to a person because he or she suffers from ill-health (whether physical or mental); and
- (b) 2 legally qualified medical practitioners have certified that, because of the ill-health, 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.

<sup>15</sup> Subsection 295-465(1A) of the ITAA 1997

<sup>16</sup> Refer to Subdivision 295-G of the ITAR 1997

<sup>17</sup> Subsection 295-465(3A)

144. The term 'gainfully employed' is also defined in subsection 995-1(1) as meaning:

employed or self employed for gain or reward in any business, trade, profession, vocation, calling, occupation or employment.

145. There has been no judicial consideration of the meaning of the term 'disability superannuation benefit' as defined in subsection 995-1(1). This draft Ruling does not particularise the circumstances that would result in satisfaction of the requirement that 'a person is unlikely to ever be gainfully employed in a capacity for which he or she is reasonably qualified because of education, experience or training'. However, by way of background the following comments from various Court and Superannuation Tribunal decisions involving permanent disability claims may be of some assistance:

- it is not a question of whether the person can perform their current occupation, it is whether they are reasonably qualified to perform any 'gainful employment' by reason of education, training or experience;<sup>18</sup>
- transferable skills may enable a person to undertake work, even if it is different work;<sup>19</sup>
- consideration needs to be given as to whether it is reasonable in the circumstances that the person would be able to obtain employment;<sup>20</sup> or
- in considering whether the person is reasonably qualified, it is whether at the time of assessment they have the skills to do the proposed work not whether they can be retrained.<sup>21</sup>

146. An insurance premium is consideration provided by or on behalf of the insured to the insurer in return for the insurer undertaking to pay the insured a sum of money or an equivalent benefit on the happening of a specified event, the occurrence or timing of which is uncertain (*Prudential Insurance Company v. Commissioners of Inland Revenue* [1904] 2 KB 658).

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<sup>18</sup> See for example *Edwards v. The Hunter Valley Co-op Dairy Co Ltd* (1992) 7 ANZ Insurance Cases 61-113 and *White v. The Board of Trustees* [1997] 2 Qd R 659.

<sup>19</sup> *Alessi v. National Mutual Life Association of Australasia Ltd* (1982) 2 ANZ Insurance Cases 60-481.

<sup>20</sup> *Nile v. Club Plus Superannuation Pty Ltd and Anor* [2005] NSWSC 55.

<sup>21</sup> *Cavill Power Products Pty Ltd v. Royle* (1991) 42 IR 229.

147. In *Community Development Pty Ltd v. Engwirda Construction Co* (1969) 120 CLR 455, Owen J referred to *Sutherland (decd) v. Inland Revenue Commissioners* [1961] 3 All ER 855 where Lord Reid said the following in regard to the meaning of contingent liability:

... 'contingent liabilities', which must mean sums, payment of which depends on a contingency, that is, sums which will only become payable if certain things happen, and which otherwise will never become payable.<sup>22</sup> ... The essence of a contingent liability must surely be that it may never become an existing legal liability because the event on which it depends may never happen.<sup>23</sup>

148. Where a superannuation fund takes out an insurance policy in relation to its members, the relationship between the parties is complicated by the fact that the fund is the entity entering into the contract of insurance. The fund pays the premium and receives the payout on the insured event occurring to the member concerned.

149. At the time a superannuation fund pays an insurance premium for a policy in respect of one or more of its members, it is uncertain what the outcome will be. Specifically, it is uncertain whether the member will ever satisfy the requisite degree of ill-health for a 'disability superannuation benefit'. The possibility and likelihood of the insured event occurring does not deny the deductibility of premiums paid by the fund. This is made clear by the reference to 'contingent liability' in section 295-465. Premiums will therefore be deductible even though it is most likely that a payout may never be made under the policy because the insured event may not occur.

150. The trustee of a complying superannuation fund will have a current or contingent liability to provide a benefit to or in respect of a fund member where, upon the happening of a specified event or the occurrence of a particular situation, the terms of the fund trust deed impose an obligation upon the trustee to provide that benefit.

151. Whether a deduction can be claimed by a complying superannuation fund for a premium it pays for TPD insurance is not determined solely by the nature or scope of the events which will lead to a payout being made under the policy. However the events insured against do impact on the basis on which a deduction can be claimed under section 295-465 (refer paragraphs 167 to 196 of this draft Ruling).

152. For a TPD insurance premium paid by a complying superannuation fund to be deductible under subsection 295-465(1), the law requires a connection between the payment and the current or contingent liabilities of the fund to provide benefits referred to in section 295-460. The benefit must be a benefit contemplated by the sole purpose test.

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<sup>22</sup> All ER at p 859.

<sup>23</sup> All ER at p 860.

153. Subsection 295-465(1) by referring to ‘the proportions’ and ‘wholly or partly’ explicitly contemplates that some insurance premiums may be attributable to insurance cover outside of the fund’s liability to provide benefits referred to in section 295-460. The premium will not be deductible to the extent to which it is not in relation to a liability to provide a benefit referred to in section 295-460.

### ***Sole purpose***

154. An integral feature of the superannuation regulatory regime<sup>24</sup> is the sole purpose test in section 62 of the SISA. Under the sole purpose test, a regulated superannuation fund must generally be maintained solely for the purpose of providing retirement and certain related benefits, including benefits payable on or after the occurrence of earlier contingencies such as death and permanent incapacity.

155. Section 295-460 sets out four types of benefits for which insurance premium deductions may be available under section 295-465: a superannuation death benefit, a benefit for a terminal medical condition, a disability superannuation benefit and a benefit for temporary inability to engage in gainful employment. The four types of benefits set out in section 295-460 can be contrasted with other types of superannuation member benefits that may be provided to members by complying superannuation funds, such as benefits provided by a fund to members on retirement or reaching age 65.

156. The general rules on payment of a member’s benefits from a superannuation fund are set out in Division 6.2 of the SISR. Under Division 6.3 of the SISR, the payment of a member’s benefits may be compulsory or voluntary.

157. Consistent with the sole purpose test, a complying superannuation fund can only provide a member’s preserved benefits on or after the time when a member satisfies a condition of release (regulation 6.18 of the SISR). Schedule 1 to the SISR identifies the conditions of release for these purposes together with any restrictions that apply to the provision of benefits when certain release conditions have been met.

158. The provision of a ‘disability superannuation benefit’ to a member is determined by reference to the entitlements of the member under the trust deed, and more particularly, the operation of the conditions of release in Schedule 1 to the SISR. Accordingly, the matter of when and to what extent a member receives a benefit referable to the payout under an insurance policy is not determined solely by the occurrence of the insured event and the receipt of a payout by the trustee of a fund under the insurance policy.

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<sup>24</sup> Under the SISA and the SISR.

159. The permanent incapacity of a member is listed in item 103 of Schedule 1 to the SISR as one of the conditions of release under which a superannuation fund can provide a benefit to a member and is the relevant condition of release that would have to be satisfied in order for a superannuation fund to provide a 'disability superannuation benefit'.

160. Subregulation 6.01(2) of the SISR defines permanent incapacity in relation to a member as:

ill-health (whether physical or mental), where the trustee is reasonably satisfied that the member is unlikely, because of the ill-health, to engage in gainful employment for which the member is reasonably qualified by education, training or experience.

161. In our view the degree of ill-health that the trustee of a fund must be reasonably satisfied exists in order that a member meets the definition of permanent incapacity under subregulation 6.01(2) of the SISR is for all practical purposes identical to that which two medical practitioners must certify for the payment of a 'disability superannuation benefit'.

162. It is possible that in limited cases a trustee may be reasonably satisfied that the permanent incapacity condition of release under the SISR is met without the certification of the same by two medical practitioners as required under the definition of 'disability superannuation benefit'. We also consider that an even rarer situation may occur where two medical practitioners would not certify the satisfaction of the permanent incapacity condition of release where a fund trustee is reasonably satisfied that the permanent incapacity condition of release is satisfied. While in strict terms there may be a need to take these situations into account in determining deductibility of TPD insurance premiums, our view is that the practical impact is at most negligible.

### ***Alignment with definition of 'disability superannuation benefit'***

163. It is not necessary for the definition of insured events in a TPD insurance policy to exactly align with the definition of a 'disability superannuation benefit' in subsection 995-1(1) in order for a deduction to arise under subsection 295-465(1). For example, the terms of the policy may use different terms in regard to the certification required from medical practitioners, however, it is expected that the tests will be at least equivalent to those in the definition of a 'disability superannuation benefit'..

164. The relationship identified in subsection 295-465(1) is between insurance premiums paid by a fund and that fund's liabilities to provide 'disability superannuation benefits' or other benefits referred to in section 295-460 to its members.

165. The recognition in subsection 295-465(1) that premiums may be paid for policies that are wholly or partly for current or contingent fund liabilities to provide section 295-460 benefits supports this position.

166. However, alignment between an insured event and section 295-460 benefit requirements will ensure that a deduction is available under item 5 in the table in subsection 295-465(1) for that part of a premium that is specified for such an event.

***Deduction for specified part of the premium under item 5 in the table in subsection 295-465(1)***

167. An insurance premium payment for a TPD insurance policy is deductible under item 5 in the table in subsection 295-465(1) where the policy documentation specifies that part of the premium that is wholly for the liability to provide a 'disability superannuation benefit'. That part of the premium may be specified as an amount or a proportion or percentage.

168. Where an insurance premium or part of a premium is specified as being for an insured event that aligns with the 'disability superannuation benefit' definition the premium or relevant part of the premium will be fully deductible under item 5 in the table in subsection 295-465(1). In this case it is certain that where the insured event occurs the fund will have a liability to provide a 'disability superannuation benefit' to the member pursuant to the terms of the fund trust deed. There is a necessary connection between the insurance premium paid and the liability of the fund to provide a section 295-460 benefit.

169. Where it is certain that the 'disability superannuation benefit' definition will be met following the occurrence of any of the insured events covered by an insurance policy, the premium will be fully deductible irrespective of whether the policy dissects the premium and identifies each part of the premium applying to the different insured events that are covered under the TPD insurance policy.

170. Where it is uncertain that the 'disability superannuation benefit' definition, or any other relevant benefit test in section 295-460, will be met following the occurrence of some insured events under the policy but the policy identifies those parts of the premiums paid that relate to events where it is certain that a condition of release will be met, item 5 in the table in subsection 295-465(1) will apply in relation to those parts of the premium that are specified as being wholly for a liability to provide section 295-460 benefits. Item 6 in the table in subsection 295-465(1) may apply to the remainder of the premium (refer to paragraphs 186 to 198 of this draft Ruling).

171. In the context of common TPD insurance policy cover, where the insured event comes under any occupation cover it will be certain that where such an event occurs to a member the fund will have a liability to provide a 'disability superannuation benefit' to that member (refer to Example 2 at paragraphs 46 to 56 of this draft Ruling).

172. A policy providing any occupation cover defines disability in terms of the person being unlikely to be able to ever perform the duties of any occupation, business, profession or employment for which the person is reasonably suited by education, training or experience.

173. This definition is based on the same conditions required to establish permanent incapacity under subregulation 6.01(2) of the SISR, which we consider to be equivalent to the 'disability superannuation benefit' definition.

174. The definition of the any occupation insured event may vary in different TPD insurance policies, but we consider that this variation would not affect our view on the deductibility of premiums provided the conditions to be met in the policy are either more restrictive than, or have substantially the same meaning as, the conditions in the definition in subregulation 6.01(2) of the SISR.

175. There is insurance coverage for other insured events in TPD insurance policies which adopt narrower and often more specific objective event conditions. However, the key requirement to be considered when determining whether the premium for this type of insurance cover is deductible is still whether there is certainty that a 'disability superannuation benefit' or other relevant benefit test will be met if the insured event occurs.

176. The most common example is the insured event for 'loss of independence' cover contained in some TPD insurance policies.

177. A policy providing loss of independence cover will define disability as the total and permanent inability to perform at least 2 out of 5 activities of daily living without assistance. The 5 activities of daily living include washing, dressing, feeding, continence and mobility.

178. The degree of disability required to meet the definition of loss of independence would mean that it is unlikely that a member with this level of incapacity will ever be gainfully employed in a capacity for which they are reasonably qualified because of education, experience or training. Accordingly, a benefit payable under a loss of independence cover would usually satisfy the definition of a 'disability superannuation benefit'.

179. The home or domestic duties cover in TPD insurance policies is another example of insurance cover where it is considered that the 'disability superannuation benefit' definition would be met for most policies providing this kind of benefit.

180. A policy providing home or domestic duties cover will generally define disability in terms of the person being unlikely to be able to ever perform normal home or domestic duties. In some cases the policy may also impose a requirement that the member also be unlikely to ever be able to engage in any occupation for which they are reasonably suited by education training or experience in order for a home or domestic duties benefit to be payable.

181. Home or domestic duties may be defined in insurance policies as including activities such as cleaning the person's home, shopping for food and household items, meal preparation and laundry duties. Insurance policies may also include the inability to undertake activities such as looking after dependant children or providing full time care for invalid family members under the home or domestic duties cover.

182. The degree of disability required in relation to the home or domestic duties cover would in most cases mean that it is unlikely that a member with this level of incapacity will ever be gainfully employed in a capacity for which they are reasonably qualified because of education, experience or training. Accordingly, a benefit payable under a home or domestic duties cover would in most cases satisfy the definition of a 'disability superannuation benefit'.

183. However, depending on the definition of home or domestic duties in the insurance policy, it is possible in limited cases that a person will meet the definition of home or domestic duties in a TPD insurance policy while at the same time not satisfying the definition of a 'disability superannuation benefit'. Where this is the case, the deduction will be considered under item 6 in the table in subsection 295-465(1).

***Deduction for part of the premium under item 6 in the table in subsection 295-465(1) based on apportionment***

184. As stated at paragraph 153 of this draft Ruling, subsection 295-465(1) contemplates that there may be a portion of the insurance premiums paid by the fund which will not be for a fund's liability to provide benefits referred to in section 295-460. Under item 6 in the table in subsection 295-465(1), a fund can deduct so much of other insurance premiums as are attributable to the liability to provide benefits referred to in section 295-460.

185. Where it is uncertain whether any insurance payout will be reflected in a liability to pay a 'disability superannuation benefit' to a member, deductibility of the premium will be considered under item 6 in the table in subsection 295-465(1).

186. In these circumstances, this uncertainty will be reflected in the possibility that the benefits attributable to an insurance payout made by the insurer to the fund on meeting the insured event have the potential to be retained within the fund until a condition of release is subsequently met. The premium for the insurance coverage is therefore considered to only partly relate to the fund's liability to provide benefits listed in section 295-460.



187. In order to simplify the process for funds to claim a deduction for a proportion of the insurance premium under item 6, new subsection 295-465(1B), which applies in relation to premiums paid in the 2011-12 income year and later years, provides that the regulations may specify the proportion of a premium for a specified insurance policy that may be treated as being attributable to the liability to provide benefits referred to in section 295-460.

188. If an insurance policy held by a fund is of a type specified in the regulations, the fund may deduct the specified proportion of the premium. Where the fund claims a deduction in accordance with the regulations, an actuary's certificate will not be required

189. The table in subregulation 295-465.01(1) of the ITAR sets out the deductible proportion of premiums for certain types of TPD insurance policies. The terms used in the table, including descriptions of the various insurance policies, are defined in subregulation 295-465.01(5) of the ITAR.

190. For example, in the context of TPD insurance policies, the standard own occupation definitions focus on the capacity of a member to continue in the particular employment that he or she was last engaged in at the time of the relevant injury or illness.

191. Under an own occupation policy, a payout could be made to the fund because the insured event has occurred but the member may still be able to engage in another occupation. A policy providing own occupation cover generally defines disability in terms of the person being unlikely to be able to perform the usual and customary duties of the occupation, business, profession or employment that they were engaged in when they suffered the illness or injury. Own occupation cover is usually provided in relation to a person engaged in a professional occupation or undertaking senior management duties.

192. In the case where the member would not satisfy the 'disability superannuation benefit' definition or the permanent incapacity condition of release under subregulation 6.01(2) of the SISR, the payment will be retained in the fund until a condition of release such as the retirement of the member is satisfied.

193. However, if the member is assessed as being unlikely to engage in any occupation for which they are reasonably qualified by education, training or experience, it follows that the member is unlikely to engage in the occupation that they were last engaged in at the time of the injury or illness. In this case, a payout may be made to the fund under an own occupation policy in circumstances where the member of the fund satisfies the permanent incapacity condition of release under subregulation 6.01(2) of the SISR and a benefit can then be paid to the member under that condition (refer to Example 1 at paragraphs 38 to 45 of this draft Ruling).

194. It is therefore uncertain whether a 'disability superannuation benefit' under paragraph 295-460(b) will arise as a result of the occurrence of the insured event under an own occupation policy.

195. In these circumstances the insurance premiums are only partly deductible and it is necessary to apportion the premiums under item 6 in the table in subsection 295-465(1) in accordance with the extent to which the premium is attributable to the provision of a 'disability superannuation benefit'.

196. Item 3 in the table in subregulation 295-465.01(1) of the ITAR specifies that the proportion treated as being attributable to a fund's liability to provide a 'disability superannuation benefit' in respect of an own occupation policy is 67%.

197. A policy for loss of limbs and/or sight cover is also an example of a policy where apportionment of the premiums may be necessary.

198. A policy providing loss of limbs and/or sight cover will generally insure against the total and permanent loss of either the use of two limbs, the sight of both eyes, or the use of one limb and the sight of one eye.

199. The question of whether payouts under the loss of limbs and/or sight cover will lead to a 'disability superannuation benefit' will among other things depend on the nature of the occupation for which the relevant member is reasonably qualified.

200. Due to the uncertainty of the 'disability superannuation benefit' conditions being met, it is necessary to apportion the premiums under item 6 in the table in subsection 295-465(1) of the ITAR.

201. In policies where this cover is included with any occupation cover, the table in subregulation 295-465.01(1) of the ITAR specifies that 100% of the premium will be deductible.

202. Where the loss of limbs and/or sight cover is included with own occupation cover, the proportion specified in the table in subregulation 295-465.01(1) of the ITAR is 67%.

203. The proportions specified in the table in subregulation 295-465.01(1) of the ITAR are deductible only if the conditions to which the associated insurance policy is subject are either more restrictive than or have substantially the same meaning as the conditions described in subregulation 295-465.01(5) of the ITAR.<sup>25</sup> This means that the language used to describe the cover provided under the insurance policy may differ from that used to define the conditions in subregulation 295-465.01(5) of the ITAR provided that no greater range of insured events can come within the language of the insurance policy. This is exemplified by a comparison of the definition of domestic duties cover in Example 4 at paragraph 72 of this draft Ruling and the terms of the domestic (home) duties definition in subregulation 295-465.01(5) of the ITAR. Whilst the wording used in the respective definitions differs, it is no easier to come within the domestic duties cover in the insurance policy than to come within the domestic (home) duties definition in subregulation 295-465.01(5) of the ITAR.

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<sup>25</sup> Subregulation 295-465.01(2) of the ITAR

204. Provided that the conditions in the insurance policy otherwise correspond with the definition of the relevant policy in subregulation 295-465.01(5) of the ITAR, any additional conditions or criteria that a member would be required to meet in relation to the policy may be disregarded for the purpose of applying the relevant deductible proportion.<sup>26</sup> The existence of additional criteria in a policy would mean that a stricter test must be met than that in the associated definition in the regulations. It follows then that the satisfaction of the conditions in the insurance policy would result in the satisfaction of the conditions described in the regulations for the same type of policy.

205. Additionally, the specified proportion in the table is not affected by the inclusion in the policy of cover for a terminal medical condition.<sup>27</sup>

206. Alternatively, the fund may deduct a proportion other than that specified in the regulations but which is based upon an actuary's certificate obtained in accordance with subsection 295-465(3).

207. The actuary's certificate must be obtained prior to lodging the return and claiming the apportioned deduction. An actuary is defined in subsection 995-1(1) for these purposes as a 'Fellow or Accredited Member of the Institute of Actuaries of Australia'.

208. The actuarial task is to determine that part of the premium paid by a fund that is attributable to the fund's liability to provide a benefit referred to in section 295-460.

209. The actuary will also need to take into account the potential for overlap in event definitions and how this is dealt with in any payouts under the policy. For example, a fund providing permanent disability benefits may take out an insurance policy that provides benefits in relation to significant loss of limbs or sight events and also any occupation benefits (Refer to Example 5 at paragraphs 76 to 86 of this draft Ruling).

### ***No deduction***

210. An insurance premium is not deductible at all if it is certain that none of the insured events covered by that particular premium payment would result in a liability of the fund to provide a 'disability superannuation benefit' or other benefits referred to in section 295-460.

211. Any such premium payment clearly has no connection to a current or contingent liability of a fund to provide a benefit referred to in section 295-460 pursuant to the terms of the fund's trust deed.

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<sup>26</sup> Subregulation 295-465.01(3) of the ITAR

<sup>27</sup> Subregulation 295-465.01(4) of the ITAR

212. There may be instances where a trustee takes out insurance for death or TPD cover in respect of its members, or a particular member, to cover its liabilities in relation to the repayment of a limited recourse borrowing, should contributions to the fund cease, or be significantly reduced, in the event of a member's death or disablement. In these circumstances, the premium for such a policy, or that part of a policy, would not be deductible under subsection 295-465(1) as there is no connection between the payment and a current or contingent liability of the fund to provide a benefit referred to in section 295-460.

***Effect of superannuation fund trust deed***

213. In some circumstances, upon the happening of the specified event or the occurrence of a particular situation, the terms of the fund trust deed may, rather than requiring the trustee to provide the benefit, give to the member the right to make an election to receive that benefit.

214. The possibility and likelihood of a member electing not to receive a benefit in circumstances where an insured event has occurred and the member has satisfied both the permanent incapacity condition of release and the requirements of the 'disability superannuation benefit' definition will not in itself deny deductibility of any premium paid for that insurance. This is due to the fact that, despite the possibility and likelihood of a member electing not to receive a benefit, the trustee has a contingent liability to provide the 'disability superannuation benefit' at the time the insurance premium is paid.

215. Each superannuation fund has its own governing rules found within its trust deed. The trust deed will in most cases contain rules regarding the payment of benefits to members for TPD. The trustee must ensure that these rules are not wider than those provided for in the SISR. However, the governing rules of the fund may be narrower than those provided for in the SISR.

216. Whilst it is not expected to occur in many cases, there may be additional limitations imposed by trust deeds or fund rules on the ability of a fund trustee to provide 'disability superannuation benefits' to fund members. If the benefit payable by the insurer under a policy in respect of a member is greater than the benefit permitted to be paid out by the fund under the trust deed in relation to a 'disability superannuation benefit', there will need to be an apportionment of premium payments to the extent those payments relate to the excess. To the extent that the premium relates to this excess, the premium will not be deductible under subsection 295-465(1).

## Appendix 2 – Your comments

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217. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

218. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- be published on the Australian Taxation Office website at [www.ato.gov.au](http://www.ato.gov.au).

Please advise if you do not want your comments included in the edited version of the compendium.

|                         |   |
|-------------------------|---|
| <b>Due date:</b>        | <b>3 February 2012</b>  |
| <b>Contact officer:</b> | <b>Damian Byrnes</b>  |
| <b>Email address</b>    | <b>Damian.Byrnes@ato.gov.au</b>   |
| <b>Telephone</b>        | <b>(07) 3213 3484</b>   |
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| <b>Address:</b>         | <b>Australian Taxation Office<br/>PO Box 9977<br/>Upper Mt Gravatt QLD 4122</b> |

## **Appendix 3 – Detailed contents list**

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TR 2010/D9

### *Related Rulings/Determinations:*

TR 2006/10

### *Subject references:*

- complying superannuation funds
- deduction & expenses
- self managed superannuation funds
- superannuation benefits
- superannuation funds- death or disability premiums

### *Legislative references:*

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