

Changes to the tax deductibility of total and permanent disability premiums in Super

There have been a number of recent developments which will have implications for the tax treatment of total and permanent disability (TPD) insurance premiums paid by super funds.

From 1 July 2011, a superannuation fund trustee will only be able to claim a tax deduction for the component of a TPD premium that would result in the fund being liable to provide a 'disability superannuation benefit' as defined in the tax act. This definition effectively requires that a person must be unlikely to be gainfully employed in any occupation for which they are reasonably qualified.

As a result where a TPD insurance policy has an "own occupation" definition there is the potential that a portion of the premium may not be tax deductible.

Life insurance cover and Super

Superannuation trustees often purchase life insurance cover to provide ancillary benefits from the fund in the event of a fund member:

- dying, or suffering a "terminal medical condition"
- suffering "permanent incapacity" or
- suffering "temporary incapacity".

"Permanent incapacity", is a condition of release for the payment of benefits and is defined in the Superannuation Industry (Supervision) (SIS) Regulations as meaning in relation to a member, 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.

This concept of "permanent incapacity" very loosely corresponds with the concept of "total and permanent disability" or "TPD" in life insurance. However, while "permanent incapacity" is a narrow concept with a fixed meaning (because it is defined), the scope of "TPD" as a concept always depends on the actual words used in the particular insurance policy being considered.

Some examples of total and permanent disability which are often covered by TPD insurance are:

- a disability that is likely to result in an inability ever to work in any occupation for which the person is reasonably qualified by education, training or experience (called "any occupation" cover – this broadly corresponds with "permanent incapacity" in the SIS Regulations)
- a disability that is likely to result in an inability ever to work again in the person's own occupation (called "own occupation" cover)
- a disability that results in a substantial reduction in the person's capacity to do one or more daily activities without the assistance of another person,

an animal or equipment that alleviates the effect of the disability (called "loss of independence" cover)

- for a person who is engaged in home duties, a disability that is likely to result in an inability ever to engage in the majority of those home duties (called "home duties" cover),
- a permanent loss of either or both of the use of one or more limbs, feet or hands, or sight in one or both eyes (called "loss of limbs and/or sight" cover)

In purchasing life insurance cover, the trustee needs to consider:

- the circumstances in which the proceeds of a claim under the insurance policy can be paid out of the fund,

For example where a TPD benefit is paid to the Trustees of a superannuation fund under an "own occupation" cover, it is possible that the member may not necessarily satisfy the permanent incapacity condition of release in the superannuation rules (ie. they are "own occupation" TPD but not "any occupation" TPD).

While this would see the life insurance proceeds payable to the superannuation fund, the proceeds may not be able to be paid to the member until they satisfy a condition of release, which may be retirement after their preservation age.

- whether, and if so to what extent, the fund can claim a tax deduction for the insurance premiums. Deductibility is explored over page.

[\(Cont'd over page\)](#)

Also in this issue...

Superannuation Contributions 2010-11	3
Flood Levy	4
Private Unit Trusts and Taxation	4



Changes to the Tax Deductibility of Total and Permanent Disability Premiums in Super (Cont'd)

Recent developments

Over recent months developments have included:

- Changes to law to provide transitional relief to complying super funds until the end of the 2010-11 income year in relation to deductions for TPD premiums.
- A draft taxation ruling (TR 2010/D9) issued by the Australian Taxation Office in December 2010 outlining the Commissioner's preliminary view on TPD premium deductibility from 1 July 2011.

Transitional relief

The widespread view of the super industry has been that premiums paid by a super fund for any typical TPD cover would be fully tax deductible regardless of TPD definition. However, it was never intended that existing tax legislation would allow superannuation funds full deductibility of premiums for benefits that exceeded, or could not be released in accordance with the superannuation laws.

In 2007 as part of the Simpler Super reforms a clarification of the correct interpretation of the relevant tax legislation was issued which confirmed that premiums pertaining to that part of the TPD benefit which is 'own occupation' should not be deductible to the superannuation fund. In November 2010 in response to industry concerns the Government legislated transitional relief that enables complying superannuation funds to continue past industry practices until 30 June 2011. The transitional relief effectively deferred the commencement of the stricter regime for the deductibility of TPD insurance premiums from the 2007-08 income year until the 2011-12 income year.

Draft Ruling TR 2010/D9

Draft Taxation Ruling TR 2010/D9 *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* sets out the ATO's views on the circumstances in which, and the extent to which, a complying superannuation fund will be able to claim a tax deduction for premiums paid to purchase TPD insurance cover in the 2011-12 and later income years. This ruling will be finalised following review of industry comment.

The 35 page draft Ruling also discusses the deductibility of insurance premiums in the context of 8 TPD examples:

1. own occupation
2. any occupation and own occupation
3. own occupation and loss of limbs and/or sight
4. any occupation and domestic duties
5. any occupation and loss of limbs and/or sight
6. any occupation and loss of independence
7. any occupation, and
8. any occupation and death benefit.

From the examples it is generally the own occupation definitions where full deductibility will not apply. The ruling does indicate that loss of independence or domestic duties TPD will likely result in an any occupation TPD so deductibility should apply.

For some of the examples an actuary's certificate will be required to confirm the deductibility percentage. We expect this certification will be provided by insurers with premium notices.

The "own occupation" examples confirm that only the element which aligns with SIS - "any occupation" - is deductible. Where the proportions can be separately identified, the amount which is attributable to 'any occupation' is deductible without the need for an actuary's certificate. 'Own occupation' benefits are normally priced as a factor or loading on 'any occupation' benefits. For example, the 'any occupation' premium might be \$1,000 pa, with 'own occupation' available at a loading of 50%, providing a total premium of \$1,500. Therefore \$1,000 would be deductible, and \$500 non-deductible to the fund.

For SMSFs this does not make the superannuation fund non-compliant, it simply means there is an expense of the superannuation fund which is non-deductible.

What are the options

Where an "own occupation" TPD benefit is required a simple alternative would be to purchase own occupation TPD benefits outside the superannuation environment.

Another option which life insurance companies have begun to introduce is a split cover approach with cover split between two linked policies. The own occupation TPD policies is outside of super and linked to life insurance policies held within superannuation. By structuring policies this way, you can access premium rates which are generally lower than they would be if the policies were issued independently (standalone). It also ensures maximum deductibility and for individuals desiring own occupation cover ensuring any benefit payable will be immediately accessible by the insured person.

It may be timely for clients to review their TPD cover with their financial advisers. Where funds have insurance renewals falling due near the end of the financial year payment of premiums by 30 June 2011 will ensure full deductibility this financial year.

Bastion Group Life Pool

For the majority of clients that have arranged their SMSF insurance cover through the Bastion Group Life Pool there will be no major change to the deductibility of insurance premiums as most participants have an "any occupation" TPD definition.

Participants with an "own occupation" definition will be affected as there is a 50% loading of TPD premiums component for this type of cover.

We will advise further on deductibility when premium notices are forwarded in June 2011.

Superannuation Contributions 2010-11

The amount of contributions that can be made to superannuation on behalf of an individual depends on a member's age and the contribution caps.

The contribution eligibility rules are illustrated in the table below.

Age	Member's Employer	
	Superannuation Guarantee	Voluntary
Under Age 65	Allowable	Allowable
Age 65 - 69	Allowable	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 70 - 74	Not allowed	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 75 and over	Not allowed	Not allowed

Member	
Under Age 65	Allowable
Age 65 - 69	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 70 - 74	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 75 and over	Not allowed

Member's Spouse	
Under Age 65	Allowable
Age 65 - 69	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 70 - 74	Not allowed
Age 75 and over	Not allowed

The table below summarises the main types of concessional and non-concessional contributions and limits for 2010/11 year as well as the penalties for breaching the caps:

Type of Contribution	Consists of	Annual Limit 2010-11	Breach of Cap
Concessional Contributions	<p>Employer contributions (includes superannuation guarantee and salary sacrifice)</p> <p>Personal contributions where a tax deduction is claimed</p> <p>Certain amounts allocated from a reserve unless the allocation meets the exemptions</p>	<p>\$25,000 if aged under 50</p> <p>\$50,000 if aged 50 or over on 30 June 2011</p>	<p>Additional tax of 31.5% applies to amounts in excess of the cap in addition to the contributions tax of 15%, making total tax of 46.5%</p> <p>These amounts also count towards the non concessional cap and if that cap is breached can be taxed twice.</p>
Non-concessional Contributions	<p>Personal contributions for which the individual does not claim a tax deduction</p> <p>Contributions made by a spouse</p> <p>Amounts in excess of the concessional contribution cap</p>	<p>\$150,000</p> <p>Members under age 65 at any time in the financial year may contribute up to \$450,000 by bringing forward up to two future years' entitlements</p>	<p>Tax of 46.5% applies to amounts in excess of the cap</p>

Personal injury contributions may also be permitted.

In addition certain payments made into superannuation are also treated as contributions. Previously they have generally been referred to as "rollovers". These include:

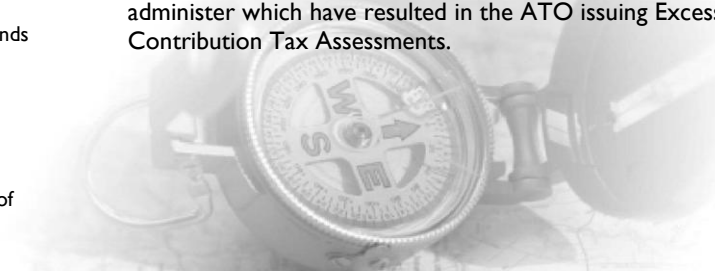
- Capital gains and capital proceeds from disposal of small business active assets transferred into superannuation under the CGT small business lifetime cap of \$1,155,000.
- Foreign termination payments transferred from overseas funds after a person has taken up residence in Australia.
- Directed employer termination payments made into superannuation under the transitional \$1,000,000 employer termination payment cap.

Please contact our office if you need information on these types of contributions.

Breach of Caps

Punitive taxation applies where the contribution caps are breached so care must be taken to ensure contributions to an SMSF are within the caps.

We have seen a number of instances where the contribution caps have been breached in the funds we administer which have resulted in the ATO issuing Excess Contribution Tax Assessments.



Flood levy to be imposed on taxable incomes

The Government announced on 27 January 2011, that it will introduce a flood levy for the 2011-12 income year to assist affected communities recover from the recent floods and rebuild essential infrastructure.

The levy will apply to individual taxable income only in the 2011-12 financial year. The details of the proposed levy are:

- no levy will apply on taxable incomes of \$50,000 or less
- a levy of 0.5 per cent will be applied on that part of an individual's taxable income between \$50,001 and \$100,000
- a levy of one per cent will be applied on taxable income above \$100,000

Exempted groups from the flood levy include:

- Taxpayers who received an Australian Government Disaster Recovery Payment (AGDRP) for a disaster that occurred in 2010-11
- Taxpayers who are ineligible for an AGDRP, but have been affected by a disaster declared under the National Disaster Recovery and Relief Arrangements and meet certain other criteria.

Taxpayers will not have to do anything extra to pay the levy. People will make their levy payments through the tax taken out of their regular income in the same way that people pay the Medicare levy.

Pay As You Go (PAYG) Instalment taxpayers will have the levy charged in their PAYG instalments. People who are exempt from the levy can seek a variation to their instalment payment so that they do not have the levy taken out of their pay.

As the levy will be applied to individual taxpayers persons under age 60 taking lump sum superannuation payments will need to consider the impact of the flood levy on any benefits taken, Similarly people under age 60 receiving superannuation pensions will also pay the levy.

Some SMSFs with units in private unit trusts may be taxed at 46.5%

The High Court decision in the Bamford case and some other developments over the past 12 months could result in a significant risk that the ATO will argue that the income distributed from a private unit trust to the trustee of the superannuation fund is "non arms length" income. This type of income is taxed at the top marginal rate of 46.5%.

Income distributed to the trustee of the super fund from a unit trust is non-arms length income if:

- the super fund does not have a "fixed entitlement" to the income and capital of the unit trust; or
- the dealings between the trustees of the unit trust and super fund are not on an arm's length basis.

The ATO has made it clear that, in its view, most private unit trusts do not qualify as fixed trusts. For example, the ATO considers that a unit trust will not be a fixed trust if:

- units can be issued or redeemed at a value that is not determined in accordance with applicable accounting standards;
- the trust deed allows for different classes of units;
- the trustee has power to make gifts; or
- the trust deed can be amended without the unanimous consent of all unit holders.

As well as ensuring all dealings between the trustees of the unit trust and the super fund are on arms-length terms basis a SMSF trustee should have the unit trust deed reviewed and amended as necessary to ensure the ATO cannot take the view it is not a fixed trust.

About Bastion Superannuation Solutions

Bastion Superannuation Solutions specialises in the provision of administration and compliance services to self managed superannuation fund trustees and advisers.

For further information on our range of services please see our web site.

Our range of services include:

- Self managed superannuation fund establishment
- Fund Administration including preparing financial accounts and maintaining member records
- Superannuation compliance and technical guidance
- Group Life Insurance Pool for superannuation fund members
- Assistance with updating self managed superannuation fund trust deeds

Bastion Superannuation Solutions Pty Ltd
AFSL 278 280 ABN 70 105 016 984
Level 3, 400 Queen Street, Brisbane
GPO Box 1859 Brisbane Qld 4001



Phone: (07) 3004 1100
Facsimile: (07) 3221 9811
Email: info@bastionsuper.com.au
Website: www.bastionsuper.com.au

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