Deductibility of insurance premiums in an SMSF

15 October 2014

Background

Life insurance and total permanent disability (TPD) premiums paid by a self-managed superannuation fund (SMSF) prior to 1 July 2007 had always been fully deductible.

However the 'Simpler Super' changes which came into effect from 1 July 2007 introduced (possibly inadvertently) a definition of TPD which was not in the previous legislation. The effect of this addition is that only premiums for insurance policies which contain a TPD definition at least as narrow as the definition in the tax act will be fully deductible.

A four year transition period from 1 July 2007 to 30 June 2011 was put in place to allow the industry time to adjust to this change. During this transition period, the pre 2007 rules continued to apply, so that TPD premiums remained fully deductible.

This means that from 1 July 2011:

- If the TPD definition matches the Tax Act definition the premium will be fully deductible.
- If the TPD definition is broader than the definition in the Tax Act the premium will only be partly deductible, with the deductibility either as certified by an actuary, or based on standardised deductible proportions.

Life insurance premiums remain fully deductible.

TPD definitions

The tax act definition of permanent disability is:

(a) The benefit is paid to a person because he or she suffers from ill health (whether physical or mental); and

(b) Two 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.

This type of definition is typically characterised as an 'any occupation' definition because to meet this definition you need to be unfit not only for your current occupation but for any other occupation you could reasonably hold.

In practice, the definitions of TPD in your insurance policy won't always match the definition in the tax act. Some of the common definitions of TPD you might find include:

- Any occupation – you can no longer work in any occupation (which would be consistent with the Tax Act).
- Own occupation – you can no longer work in your current occupation but you can work in some other occupation.
- Loss of limbs – you have lost the use of the specified limb(s), e.g. one arm and one leg.
- Activities of daily living – you require assistance to complete activities such as dressing, washing and feeding.
- Domestic (home) duties – you require assistance with cleaning, cooking, shopping and caring for children.

Each of the last four definitions above are broader than the tax act definition, and therefore may require an actuary to certify the proportion of the TPD insurance premium that is deductible.

Relevant regulations

The government recognised that the requirement to obtain actuarial certification for the deductibility is potentially onerous. Therefore it has put in place new regulations that allow standardised deductible proportions for the more common TPD definitions.

The standardised deductible proportions of TPD insurance premiums are:

TPD Definition	Deductible Part
Any occupation	100%
Any occupation plus: (a) Activities of daily living; (b) Cognitive loss; (c) Loss of limb; (c) Domestic (home) duties.	100%
Own occupation	67%
Own occupation plus: (a) Activities of daily living; (b) Cognitive loss; (c) Loss of limb; (c) Domestic (home) duties.	67%
Own occupation bundled*	80%
Own occupation bundled*, plus: (a) Activities of daily living; (b) Cognitive loss; (c) Loss of limb; (c) Domestic (home) duties.	80%

*with an amount of cover less than or equal to the amount of death cover.

Under the new regulations, you still have the option of asking an actuary to certify the deductible proportion.

A common practical problem that can arise is that the insurance policy may include both life insurance and TPD cover, and charge a single premium for both. The proposed new legislation recognises this issue, and provides for 80% deductibility of a bundled death and TPD premium if an own occupation definition applies.

These regulations were made law on 6 October 2011.

What you can do now

Here are some practical steps that you can take where you have an SMSF which holds a TPD insurance policy:

1. Check the TPD definition in your policy and consider how this compares to the definition in the tax act.
2. Talk to your insurer. Are they willing to advise your life insurance and TPD insurance premiums separately? And will their actuary certify the deductible proportion of the TPD premium?
3. Consider if it makes sense to switch to a TPD policy with a different definition.

Tax act references:

See sections 295-460 and 295-465, contained in volume 6 of the Income Tax Assessment Act 1997. The definition of disability superannuation benefit is in section 995-1 of volume 8.

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