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EXPOSURE DRAFT

SUPERANNUATION LEGISLATION AMENDMENT
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EXPLANATORY MATERIAL

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Glossary

The following abbreviations and acronyms are used throughout this explanatory material.

<i>Abbreviation</i>	<i>Definition</i>
ATO	Australian Taxation Office
Commissioner	<i>Commissioner of Taxation</i>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
IT(TP) Act	<i>Income Tax (Transitional Provisions) Act 1997</i>
SIS Regulations 1994	<i>Superannuation Industry (Supervision) Regulations 1994</i>
TPD	total and permanent disability

Chapter #

Superannuation — Transitional relief for income tax deductibility of total and permanent disability insurance premiums paid by superannuation funds

Outline of chapter

1.1 Schedule 1 and clause 4 of this exposure draft provide transitional relief for income tax deductibility of total and permanent disability (TPD) insurance premiums paid by superannuation funds by amending the *Income Tax (Transitional Provisions) Act 1997* (IT(TP) Act) and the *Income Tax Assessment Act 1997* (ITAA 1997).

1.2 The transitional relief will provide complying superannuation funds, for the 2004-05 to 2010-11 income years, with a greater scope to deduct premiums paid for insurance cover commonly regarded as TPD insurance.

Context of amendments

Insurance provided through superannuation funds

1.3 Superannuation funds commonly take out death and disability insurance policies to insure their risk for a liability they may incur to their members. How a fund insures that risk (for example, in whole or in part, with or without other risks) may vary among funds and policies.

1.4 Superannuation funds obtaining death and disability insurance for this purpose is consistent with the key objective of superannuation. That is, to provide benefits to members in retirement or, in the event of the member's death, to the member's beneficiaries.

1.5 Disability insurance taken out by superannuation funds includes TPD insurance. The definition of the TPD cover provided can vary across insurance policies. For example, insurance policies can include TPD cover based on a definition of 'permanent disability' as the inability of the member to perform 'any occupation', or as the inability

of the member to continue to perform his or her 'own occupation'. Other TPD cover is known as 'loss of independence', 'home duties' or 'loss of limbs/sight'.

1.6 As the fund contracts with an insurance provider, any payout under the insurance policy due to the occurrence of an insured event will be made to the fund.

1.7 A fund can only provide a benefit referable to that payment (and any other preserved benefits) to the member if a condition of release of benefits has been satisfied. These conditions are contained in the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations 1994), and include retirement, attaining the age of 65, death, permanent incapacity and temporary incapacity.

1.8 There may be circumstances where, as a consequence of the definition of 'permanent disability' used in the policy, a fund receives an insurance payment due to the occurrence of an insured event but no condition of release has been satisfied. In these cases, the fund will retain the proceeds of the insurance payment in the fund until a condition of release is met.

Example 1.1

Bill is a member of ABC Super which took out a TPD insurance policy to cover its members in the event of them being permanently disabled by a 'loss of limb'. Bill had an accident which resulted in a loss of limb, but after a period of rehabilitation could still perform his regular employment duties.

ABC Super received a payout under the insurance contract. However, it could not pay this amount to Bill immediately as the permanent incapacity condition of release had not been met. ABC Super could pay the money to Bill only in the event of a condition of release, for example, retirement.

Outline of existing law

ITAA 1997

1.9 As part of the 2007 *Better Super* reforms, the provisions regarding deductibility of TPD insurance premiums paid by superannuation funds were transferred from Division 3 of Part IX of the *Income Tax Assessment Act 1936* (ITAA 1936) to Division 295 of the ITAA 1997, with effect from the 2007-08 income year.

1.10 Subsection 295-465(1) of the ITAA 1997 provides a tax deduction for all or part of a TPD insurance premium paid by a complying superannuation fund in certain circumstances. A fund is allowed to deduct a premium paid for an insurance policy for a liability of the fund to provide a **disability superannuation benefit**. This is defined in the ITAA 1997 to mean a ‘superannuation benefit’ if:

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

1.11 This definition is similar to the definition of ‘permanent incapacity’ in the SIS Regulations 1994 which is a condition of release of benefits.

1.12 Where part of an insurance premium is specified in the policy as wholly giving rise to a liability of the fund to provide a ‘disability superannuation benefit’, as defined, a fund can fully deduct that portion of the premium.

1.13 Partial deductibility arises where the TPD definition in the insurance policy differs from the definition of ‘disability superannuation benefit’ in the ITAA 1997. Under subsection 295-465(3), if apportioning is required, an actuary’s certificate must be obtained which specifies how much of the policy premium is attributable to the liability of the fund to provide disability superannuation benefits.

ITAA 1936

1.14 The now repealed provisions of the ITAA 1936 allowed a deduction for the whole or part of the premium for ‘death or disability benefits’, if the whole or part of the premium is specified in the policy as being wholly attributable to a liability of the fund to provide disability benefits to members. An actuary’s certificate was required if no amount was specified or if only part of the amount specified was attributable to the liability of the fund to provide death or disability benefits to members.

1.15 In the ITAA 1936, **death or disability benefits** was defined to include a benefit provided to the member in the event of the permanent

disability of the member. No definition of ‘permanent disability’ was provided.

Summary

1.16 The current law provides that disability superannuation benefit insurance premiums are deductible only to the extent the policies have the necessary connection to a liability of a fund to provide permanent incapacity benefits. Where proportioning is necessary, an actuary’s certificate is required to support the deduction claimed. This was also the case under the previous ITAA 1936 provisions.

Industry views and practice

1.17 Industry representatives have indicated they consider that, under the ITAA 1936 provisions, the premium was fully deductible if paid for a policy insuring against some form of permanent disability. Industry has advised that this practice has continued after the 2006-07 income year under the provisions of the ITAA 1997.

1.18 Industry has raised concerns about the application of the provisions of the ITAA 1997. For example, for industry practice to become aligned with the law, changes to insurance policies, premiums, systems, disclosure and actuarial certification practices would be necessary.

Consistency with retirement income policy objectives

1.19 Under the ITAA 1997, a tax deduction is provided in relation to TPD benefits that would satisfy the ‘permanent incapacity’ condition of release (or in effect provide benefits in retirement). This is consistent with one of the underlying objectives of retirement income policy — that superannuation funds must generally be maintained for the sole purpose of providing benefits on a member’s retirement (or on or after the occurrence of earlier contingencies such as death or ill-health).

1.20 It appears industry’s practice under the ITAA 1936 was to claim deductions for premiums relating to TPD policies — notwithstanding that, in some cases, claims under such policies may result in payouts to the fund trustee in circumstances where the member could not satisfy the ‘permanent incapacity’ release condition.

1.21 In such cases, the moneys are held in the fund until the member satisfies a condition of release, such as retirement at or after preservation age (see Example 1.1). This results in a tension with retirement income policy, as it provides a tax concession to a fund for

that portion of the cost of an insurance policy that may give rise to payments to the funds which are not directly or immediately related to a liability of the fund to provide death and disability benefits to members.

Announcement of transitional relief

1.22 The Government has recognised the concerns raised by industry regarding its ability to immediately begin deducting TPD premiums in accordance with the ITAA 1997.

1.23 On 13 October 2009, the Minister for Financial Services, Superannuation and Corporate Law announced amendments to the tax law to provide transitional relief to complying superannuation funds for the deduction of TPD insurance premiums. The Minister noted that the transitional relief will minimise disruption to the industry and allow enough time for funds to make the necessary administrative changes.

Summary of new law

1.24 Schedule 1 and clause 4 of this exposure draft amend the ITAA 1997 and the IT(TP) Act, and contain stand alone provisions altering the operation of the ITAA 1936, to provide transitional relief for income tax deductibility of TPD insurance premiums paid by superannuation funds for the income years from 2004-05 to 2010-11.

1.25 The transitional relief allows complying superannuation funds to deduct in full the insurance premiums commonly regarded as TPD policy premiums. This is achieved by allowing, in the transitional period, broader definitions of ‘death or disability benefits’ in the ITAA 1936 and ‘disability superannuation benefits’ in the ITAA 1997 to the extent they relate to the deductibility of TPD insurance premiums.

1.26 For the transitional relief to apply to a TPD insurance policy premium, the insured permanent disability must be one that is described in regulations made for the purposes of the transitional provisions.

1.27 The amendments do not limit the operation of the current law. The current provisions of the ITAA 1997 will apply throughout the transitional period; however, the definition of ‘disability superannuation benefit’ will be broadened by the transitional arrangements.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
For the transitional period (the income years from 2004-05 to 2010-11), complying superannuation funds may claim a deduction for TPD insurance premiums that provide cover for the permanent disability of the member. Permanent disabilities will be described in regulations.	Complying superannuation funds can claim an income tax deduction for premiums to the extent that the policy has the necessary connection to a liability of the fund to provide permanent incapacity benefits.
For the transitional period, the meanings of 'disability superannuation benefit' and 'death or disability benefits' will be broadened by regulation.	A fund is able to deduct a premium paid for an insurance policy for a liability of the fund to provide a 'disability superannuation benefit' (in the ITAA 1997) or 'death or disability benefits' (in the ITAA 1936).
For the transitional period, a policy that has specified a portion of a premium to be for the liability to provide TPD benefits under the <i>broader meaning</i> , will not require actuarial certification to claim a deduction for the specified TPD insurance premium.	When an unknown part of a specified amount of a premium is attributable to the liability of the fund to provide the above benefits to members, an actuary's certificate is required to support the deduction claimed as an actuary is required to determine the deductible amount.

Detailed explanation of new law

1.28 Schedule 1 and clause 4 of this exposure draft provide transitional relief for income tax deductibility of TPD insurance premiums paid by superannuation funds. The transitional relief will provide complying superannuation funds, for the 2004-05 to 2010-11 income years, with a greater scope to deduct premiums paid for insurance cover commonly regarded as TPD insurance.

1.29 This is achieved by amending the IT(TP) Act and the ITAA 1997, and enacting stand alone provisions altering the operation of the ITAA 1936.

1.30 A new section 295-466, inserted into the IT(TP) Act, provides an expanded meaning for the term, 'disability superannuation benefit' with effect for the income years from 2007-08 to 2010-11. [*Schedule 1, item 5*]

1.31 The stand alone provisions in Schedule 1 of this exposure draft, provide an expanded meaning for the term ‘death or disability benefits’ with effect for the income years 2004-05 to 2006-07. *[Schedule 1, item 1]*

Scope of the transitional arrangements

1.32 The transitional relief applies to a complying superannuation fund if the fund pays a premium for a TPD insurance policy in the income years 2004-05 to 2010-11. The policy must be wholly or partly to cover the liabilities of the superannuation fund, whether they are current or contingent, to provide benefits to members. *[Schedule 1, subitem 1(1) and item 5, subsection 295-466(1)]*

Operation of the transitional arrangements

The expanded meaning of ‘disability superannuation benefit’ and ‘death or disability benefits’

1.33 The terms ‘disability superannuation benefit’, in the ITAA 1997, and ‘death or disability benefits’, in the ITAA 1936 are expanded for the transitional period 2004-05 to 2010-11. *[Schedule 1, subitem 1(2) and item 5, subsection 295-466(2)]*

1.34 A benefit is to be treated as a ‘disability superannuation benefit’ if it is a superannuation benefit that is conditional on the disability of the members and the disability to which it relates is described as a permanent disability in regulations made for the purposes of the new section 295-466 of the IT(TP) Act. *[Schedule 1, item 5, subsection 295-466(2)]*

1.35 The scope of the expansion of the meaning of ‘death or disability benefits’ in the ITAA 1936 is exactly the same as that for ‘disability superannuation benefit’ in the ITAA 1997. Benefits are treated as ‘death or disability benefits’ if they are conditional on the disability of the members and the disability is described as a permanent disability for the regulations made for the purposes of section 295-466 of the IT(TP) Act. *[Schedule 1, subitem 1(2)]*

1.36 Regulations made for the purpose of section 295-466 of the IT(TP) Act will describe particular *permanent disabilities*. The regulations will be drafted after consultation with industry and cover meanings of ‘disability’ commonly considered permanent disabilities in TPD insurance policies in the relevant incomes years, 2004-05 to 2010-11. *[Schedule 1, item 1, paragraph (2)(b) and item 5, paragraph 295-466(2)(b)]*

Example 1.2

Extra Super Fund pays premiums to Bonus Insurance in the income years 2004-05 to 2010-11. The policy specifies that a certain portion of the insurance is to cover Extra's liabilities to its members in the event of the permanent disability of Extra's members. The insurance contract between Extra and Bonus states that 'permanent disability' means a disability which prevents a member performing his or her occupation.

A disability that prevents a member from performing his or her own occupation is described as a permanent disability in regulations made for the purposes of section 295-466 of the IT(TP) Act.

Comment [asz1]: This is to be confirmed after industry consultation regarding common meanings of the term 'permanent disability' to go in regulations.

For the income years 2004-05 to 2010-11, under the transitional arrangements, Extra will be able to claim a deduction for the whole premium. This is because the meaning of 'permanent disability' given in the policy corresponds to the expanded meanings of 'death or disability benefits' in the ITAA 1936 and 'disability superannuation benefit' in the ITAA 1997. The same would apply if 'permanent disability' in the insurance contract had encompassed any disability described as a permanent disability in the regulations made for the purposes of section 295-466 of the IT(TP) Act.

Entitlement to deduction

1.37 The expanded meanings of 'disability superannuation benefit' and 'death or disability benefits' apply to the sections of the ITAA 1997 and the ITAA 1936 which allow superannuation funds to deduct TPD insurance premiums. *[Schedule 1, item 5, section 295-466, and item 1]*

1.38 Overall, the broadening of the terms 'disability superannuation benefit' and 'death or disability benefits' allows complying superannuation funds to claim deductions for insurance premiums for the 2004-05 to 2010-11 income years under the expanded meanings of these terms. By expanding these terms to broadly align with industry's view of 'permanent disability', the requirement for superannuation funds to obtain extra actuarial certification when claiming a deduction for TPD benefits is removed. A superannuation fund will be required to obtain actuarial certification when no amount is specified in the policy and there is no current apportionment by an actuary in line with the broader definition. *[Schedule 1, subitem 1(3) and item 5, subsection 295-466(3)]*

Example 1.3

FunTime Super Fund takes out specific TPD insurance policies to cover its members in the event of them being permanently disabled. The definition of permanently disabled in the policy covered members for 'loss of limb'.

'Loss of limb' insurance is not clearly aligned with the SIS Regulations 1994 permanent incapacity condition of release.

For FunTime to correctly claim a deduction under the *current law*, FunTime must engage an actuary to determine how much of the policy premium relates to the narrow definition of 'disability superannuation benefit' under the ITAA 1997 (item 6 in the table in subsection 295-465(1) of the ITAA 1997).

However, under the *transitional provisions*, 'loss of limb' is considered a permanent disability for the purposes of the expanded meaning of 'disability superannuation benefit'. This means that the whole of FunTime's premium is deductible. Hence, under the transitional provisions, FunTime's situation falls under item 5 in the table in subsection 295-465(1) of the ITAA 1997 as the policy specifies the amount of premium and no actuarial certification is necessary.

Comment [asz2]: To be confirmed after industry consultation regarding regulations.

Nexus between deductibility and insured events under the transitional arrangements

1.39 In effect, the current law provides that premiums for a TPD policy will only be deductible if an event that triggers a payout under the insurance policy would also trigger the permanent incapacity condition of release of benefits in SIS Regulations 1994. (For more details, see 'Context of amendments'.)

1.40 The transitional provisions ensure that there would not be a necessary nexus between the payout by the insurer to the fund and the satisfaction of the permanent incapacity condition of release of benefits to members.

1.41 For the purposes of applying former subsections 279(1) and (3) of the ITAA 1936, the benefits are to be treated as 'death or disability benefits', in broader circumstances than the former law allowed, as the term 'death or disability benefits' has an extended meaning. That is, the member being permanently disabled — according to the disability described in the regulations as permanent disability — is a necessary but not a sufficient condition for the release of benefits to the member. [Schedule 1, subitems 1(2), including its note, and (3)]

1.42 Similarly, for the purposes of applying subsection 295-465(1) and paragraph 295-460(b) of the ITAA 1997, the benefits are to be treated as a 'disability superannuation benefit' to the extent that the disability on which the policy is conditional is described in the regulations as a permanent disability. [Schedule 1, item 5, subsections 295-466(2), including its note, and (3)]

1.43 Thus the transitional arrangements ensure there is no requirement that a permanent disability event, which triggers an insurance payout, also trigger an immediate liability of the fund to pay benefits to a member of the fund. Rather, other events might have to occur after the permanent disability of the members before the fund pays the benefits to the members. For example, the members might have to satisfy a condition of release of benefits specified in a standard made under paragraph 31(2)(h) of the *Superannuation Industry (Supervision) Act 1993*, such as attaining age 65 or reaching preservation age.

Example 1.4

Triple D Super Fund takes out TPD insurance policies with Help Insurer to cover its liabilities to its members in the event of them being permanently disabled and unable to perform their 'own occupation'.

Comment [asz3]: To be confirmed after industry consultation regarding regulations.

Nina is a member of Triple D. The premium for the insurance policy relating to an injury Nina might suffer was paid by Triple D to Help in the income years 2005-06 to 2008-09.

Nina is a hairdresser. In a nasty accident she loses three fingers from her right hand. The injury prevents Nina from performing her own occupation; however, Nina takes up a role as a sales representative for hair products.

Nina's accident triggers a payout under the policy by Help to Triple D. Triple D does not make a payment to Nina because she has not retired. The monies remain in the fund until Nina retires at the age of 65.

The event of Nina's accident triggered an insurance payout, but did not immediately trigger a liability of Triple D to provide benefits to Nina. Despite this, the whole of the premium relating to TPD is tax deductible by Triple D Super fund under the transitional arrangements as applied to section 279 of the ITAA 1936 and as they apply to subsection 295-465(1) of the ITAA 1997.

Relation between the transitional arrangements and the current law

1.44 The transitional measure explicitly does not limit the operation of the current law. It merely broadens the circumstances in which superannuation funds may claim a tax deduction for a premium paid for a TPD insurance policy. [*Schedule 1, item 1, paragraph (3)(b), and item 5, paragraph 295-466(3)(b)*]

1.45 A fund that has been applying the current law and specifying what portion of a policy premium, for a TPD insurance policy, is wholly for the liability to provide 'disability superannuation benefits' under the

narrower meaning in the current law will not be disadvantaged. Such a fund will be able to claim a greater deduction if a greater portion of the policy is for the liability to provide ‘disability superannuation benefits’ due to that term’s expanded meaning. However, if there is no way of working out the amount of the extra deduction by the information specified in the policy, the fund will be required to obtain actuarial certification. This is because the situation will fall under item 6 of the table in subsection 295-465(1).

Example 1.5

Sunshine Super Fund takes out TPD insurance policies to cover its liabilities to its members in the event of them being unable to continue performing their ‘own occupation’. ‘Own occupation’ insurance is not clearly aligned with the SIS Regulations 1994 permanent incapacity condition of release.

Sunshine engages an actuary who estimates under item 6 of subsection 295-465(1) that 80 per cent of the payouts would relate to conditions where the member can be re-employed in another occupation for which they are reasonably qualified by education, experience and training and only 20 per cent would satisfy the SIS Regulations 1994 permanent incapacity condition of release which requires that the member cannot be re-employed in another occupation for which they are reasonably qualified. Thus the proportion of the insurance premium that relates to a liability of the fund to provide TPD benefits is 20 per cent.

Sunshine Super Fund has been applying the current law and claiming only 20 per cent of the TPD insurance premium as a deduction in line with the actuarial estimate.

Under the transitional arrangements, Sunshine Super Fund could continue to deduct 20 per cent in line with its established practice. Alternatively, it could claim the full deduction for the income years 2004-05 to 2010-11 since a disability that prevents a member from performing his or her own occupation is described in the regulations made for the purposes of section 295-466 of the IT(TP) Act as a permanent disability.

Comment [asz4]: To be confirmed after industry consultation regarding regulations.

Example 1.6

Rainbow Super Fund takes out TPD insurance policies to cover its liabilities to its members in the event of them being unable to perform ‘any occupation’. The ‘any occupation’ permanent disability event is aligned with the SIS Regulations 1994 permanent incapacity condition of release. Rainbow Super Fund has been claiming a full deduction for the premiums.

Both under the transitional arrangements and the current law Rainbow Super Fund has correctly been claiming the full deduction. No actuarial certificate has been or will be required.

This is because under the current law, Rainbow had specified in the policy a premium which aligned with the narrow definition of 'disability superannuation benefit'. The expanded meaning of 'disability superannuation benefit' in the transitional provisions will not affect a narrow policy such as the policy Rainbow has for its liability to provide benefits to members.

Amendment of assessments

1.46 Section 170 of the ITAA 1936 limits the ability of the Commissioner of Taxation (Commissioner) to amend tax assessments. By the time these transitional arrangements receive Royal Assent, the four-year period for making amended assessments for the 2004-05 income year will have closed and will be near closing for the 2005-06 income year. Thus, section 170 would prevent superannuation funds, which have claimed a deduction for past years in accordance with the current law, from choosing the broader deduction allowed under the transitional provisions.

1.47 To counter this, the transitional amendments preclude the application of section 170 to allow a superannuation fund to claim the broader tax deduction allowed by the expanded definition of 'permanent incapacity'. Section 170 is precluded if the amendment is made for the purpose of giving effect to the transitional arrangements, the original assessment was made before the commencement of the transitional arrangements, and the amendment is made within two years of commencement of the transitional arrangements. A window of two years after Royal Assent of the transitional provisions provides a reasonable time for amended assessments to be made. *[Clause 4 and Schedule 1, item 5, subsection 295-466(4)]*

Consequential amendments

1.48 A note is inserted after paragraph 295-460(b) of the ITAA 1997 alerting the reader to transitional provisions in the IT(TP) Act. *[Schedule 1, item 1]*

1.49 Item 5 in the table, subsection 295-465(1) is permanently amended, to clarify the operation of the item in the table. Under item 5, a deduction will be allowed for a premium specified in the policy as being wholly for the liability to provide *certain benefits*, if those benefits are referred to in section 295-460. Hence all that is needed to be specified in a policy are the *type* of benefits, not that the benefits are

literally ‘wholly for the liability to provide benefits referred to in section 295-460. *[Schedule 1, item 3]*

1.50 The heading of section 295-465 of the IT(TP) Act is amended to accommodate the insertion of the transitional provisions contained in this exposure draft and to make the headings in the IT(TP) Act consistent with the headings in the ITAA 1997. *[Schedule 1, item 4]*

Commencement

1.51 Commencement is to be by proclamation which will be timed to coincide with the commencement of the regulations. *[Clause 2, item 2, table item 2]*

1.52 This is appropriate as the extended meanings of the terms ‘disability superannuation benefit’ (in the ITAA 1997) and ‘death or disability benefits’ (in the ITAA 1936) are dependant on the description of ‘permanent’ disability which will be contained in regulations.

Repealing provision

1.53 The transitional amendments to the IT(TP) Act and the note inserted in paragraph 295-460(b) of the ITAA 1997 will be repealed on 1 January 2017. By such time any amendments to tax assessments for the period that the transitional arrangements apply (2004-05 to 2010-11 income years) will have been made, given the four year amendment period for tax assessments,. Such tax assessments will no longer be amendable by the Commissioner. *[Schedule 1, items 6 and 7, note 2, paragraph 295-460(b) ITAA 1997, and section 295-466 IT(TP) Act]*

