Did you know?

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Total and permanent disability insurance inside super – conditions of release

Over the past two and a half years, the life insurance industry has seen an increase in total and permanent disability insurance (TPD) being written within superannuation. Due to the elimination of reasonable benefit limits (RBLs) on 1 July 2007, more people have recognised the attractiveness of funding life insurance premiums through this vehicle.

Affordability is just one consideration when analysing the appropriateness of TPD insurance inside super. In September 2009, the ATO issued new guidelines on what conditions must be satisfied for a member of a super fund to meet a condition of release, and obtain the tax concessions, as a superannuation disability benefit (i.e. TPD benefit) (ATO ID 2009/108, ATO ID 2009/109, & ATO ID 2009/125). These guidelines provide some interesting insights.

A disability superannuation benefit meets a condition of release when: two medical practitioners have certified, and the trustee is reasonably satisfied, that the member is unlikely, because of ill-health (whether physical or mental), to engage in gainful employment for which the member is reasonably qualified by education, training or experience. (s995-1 ITAA1997; SIS Regulations 6.01(2)).

Two questions have been raised by this legislation:

1. If a member only withdraws part of the benefit, do they need to “requalify” if they wish to withdraw additional lump sum payments from super?
2. After the first partial lump sum benefit is paid, if a member either recovers from their injury or illness, or is retrained so they can return to work, do they need to “requalify” for subsequent lump sum TPD benefits?

In both cases, it depends. The following examples help to explain how the legislation is applied in practice.

Example 1

A member does not need to requalify for the TPD benefit if the fund pays a series of lump sum benefits. The provision made by the ATO was that the lump sum benefits were all paid in the same financial year, and there was no expectation that the member’s medical condition would improve in that time frame to such an extent that the original opinions from the medical practitioners would have changed. If there was a considerable time between lump sum payments (i.e. years rather than a couple of months) then it may be necessary to submit new medical certificates to receive additional TPD lump sum benefits.

Example 2

The member is an accountant and due to a head injury sustained in a traffic accident he is unable to work as an accountant. He is paid a partial lump sum TPD benefit from his super fund (he only needed part of the fund for his immediate needs). He later finds paid employment as a car park attendant. He would be able to withdraw subsequent lump sum TPD benefits.

Example 3

The member is an accountant and due to a head injury sustained in a traffic accident he is unable to work as an accountant. He is paid a partial lump sum TPD benefit from his super fund (he only needed part of the fund for his immediate needs). After a couple of years he makes a miraculous full recovery and returns to work as an accountant. He will not be able to withdraw additional lump sum amounts under the superannuation disability benefit (TPD) condition of release. He may be able to withdraw additional lump sum payments if he meets some other condition of release.

Taxation of benefits

When a lump sum superannuation disability benefit (TPD) is paid from a super fund to the member, it is necessary to understand that there may be a tax liability (between 0% and 21.5%). The amount of tax depends upon the age of the member, service period start date, and date of TPD. If the member owns a personal insurance TPD policy outside superannuation, the entire TPD benefit will be paid tax free.

Ordinary TPD (outside super)

Loss of limbs and sight, loss of independent existence, and the “own occupation” definition of TPD do not automatically meet the SIS requirements for condition of release from super. Clients need to be aware that even if the insurance company has paid the TPD benefits to the super fund, if a condition of release has not been met they will not receive any payment. When a client owns an ordinary TPD insurance policy (outside superannuation), they only have to meet the insurance definition to receive their benefit, not the more restrictive SIS definitions.

Summary

Although tax deductibility of premiums within superannuation is attractive, it is important to note the conditions of release and taxation of superannuation disability benefits (TPD). Advisers should consider all of the advantages and disadvantages when determining if TPD insurance is placed inside or outside super.