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Holding TPD insurance via super

This article discusses the implications of holding TPD insurance inside super.

Background

Considerations when holding Total and Permanent Disablement (TPD) insurance in a super fund include:

- upfront tax benefits
- access to insurance proceeds
- multiple payment options, and
- tax on payments.

Clients must satisfy their TPD insurance definition for the proceeds to be paid into their super account. They must also satisfy a full condition of release, such as permanent incapacity, to access their super benefits (including insurance proceeds).

Generally, a super based TPD insurance policy has more restrictive terms and conditions compared to a non-super based policy. Advisers can opt for a super-linked option which combines both a super based and non-super based policy to provide a more comprehensive level of cover. Super-linked policies require part of the premiums to be funded from non-super. As super-linked policies vary between providers, ensure that you are familiar with the provider's particular arrangements.

Cash flow benefits

Holding the cover in super can be attractive if the client cannot, or would prefer not to, buy it outside super for cashflow reasons. This could be attractive to clients who are running a business that is in the start-up or early stage, where cashflow constraints may be high.

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Although clients who fund insurance without making additional contributions to cover the premiums will use up some of their retirement savings, this may be a better outcome than not having insurance.

Restricted insurance cover through super

Super fund trustees can only purchase new TPD policies that satisfy the permanent incapacity condition of release, which aligns to the any occupation definition. This effectively means that for a client to make a successful claim on their policy they need to satisfy their fund trustee they are unlikely because of ill-health (physical or mental), to engage in gainful employment for which they are reasonably qualified by education, training or experience.

Grandfathering arrangements exist for pre 1 July 2014 TPD policies purchased in super that may have less restrictive terms and conditions. Super funds can continue to hold any existing pre 1 July 2014 insurance policies and the level of cover can increase or decrease with the premiums adjusted accordingly.

Advice tip

Clients who have own occupation TPD cover, should ensure their cover does not unintentionally cease due to the rollover of benefits to another fund. A grandfathered pre-1 July 2014 policy cannot be recommenced in another fund. They should also consider that insurance proceeds paid under an 'own occupation' claim may be trapped in the super fund if they do not meet the permanent incapacity condition of release (or other relevant condition of release).

Tax concessions for TPD policies held in super

When looking at the tax deductibility of TPD premiums held via super, consider:

- whether the super fund can claim a tax deduction for the premium, and
- where applicable, tax deductibility of the contribution funding the premium.

Employer super contributions and personal super contributions for which tax deductions are claimed are included in the assessable income of the super fund and generally taxed at 15% (commonly referred to as contributions tax).

Individuals with Division 293 (Div 293) income including low tax contributions (concessional contributions excluding excess concessional contributions) of more than \$250,000 in a financial year, pay an additional 15% tax (Div 293 tax) on low tax contributions exceeding this threshold. For additional information on Div 293 tax, refer to [Division 293 tax explained](#).

Tax deductibility of TPD premiums for super funds

The premiums paid by your client for personal TPD insurance (owned outside of super) are generally not tax deductible. In contrast, premiums for certain TPD insurance owned via super may be tax deductible to the super fund.

Super contributions and existing super interests can be used to fund premiums. Funding insurance premiums with concessional contributions is tax effective as tax deductions can be claimed by the employer or the member making a personal tax-deductible super contribution. It is important after making a personal contribution to super, to submit the notice of intent (NOI) to claim a tax deduction form and receive acknowledgement from the super fund within required timeframes. Failure to follow the correct sequence can result in a personal tax deduction being denied or reduced.

For additional information on personal tax-deductible super contributions, refer to our [Steps to claiming a deduction for super contributions](#) article.

While these contributions are assessable income to the super fund, tax deductions for TPD premiums (as fund expenses) may be claimed by the super fund to reduce its taxable income. Structuring TPD insurance via super may make insurance more affordable and reduce the risk of underinsurance.

The extent to which TPD premiums are tax deductible to the super fund is determined by the degree of certainty of a 'disability super benefit' being paid because of the insured event happening¹. See table below.

Where different TPD insurance cover is provided (generally under a pre- 1 July 2014 arrangement) and the insurance policy does not specify the deductible portion of the premium, super funds must either:

- obtain an actuarial certificate, or
- use a percentage specified in regulations, outlined in the following table.

¹ Tax Ruling 2012/6

Policy type	Deductible portion of premium ²
TPD any occupation	100%
TPD any occupation with one or more of:	100%
1. activities of daily living	
2. cognitive loss	
3. loss of limb	
4. domestic (home) duties	
TPD own occupation	67%
Own occupation with one or more of:	67%
1. activities of daily living	
2. cognitive loss	
3. loss of limb	
4. domestic (home) duties	
TPD own occupation bundled* with death (life) cover	80%
TPD own occupation bundled ³ with death (life) cover with one or more of:	80%
1. activities of daily living	
2. cognitive loss	
3. loss of limb	
4. domestic (home) duties	

Contributions tax and tax-deductible premiums

It is important to know whether the super fund passes the full or partial benefit of the tax deduction to the client's account. The differences are explained below.

Individual member gets the full benefit of the tax deduction

Premiums funded via concessional super contributions

Where the super fund allocates the full tax benefit resulting from the tax deduction claimed for insurance premiums to the member, the member's contributions tax on concessional contributions may be reduced (depending on the deductible portion of the premium). Effectively, the client pays part or all premiums from pre-tax income.

Premiums funded via after-tax super contributions or existing super benefits

Where premiums are funded via after-tax super contributions or existing super benefits, advisers should contact the super fund to determine whether the client will benefit from the tax deduction. Some super funds reduce the premium payment or provide a credit to the member's super account.

Tax deduction is accounted for across all members of the super fund

Some super funds may account for the tax deduction across all the members of the super fund. This means that your client will not get the full benefit from the tax deduction claimed by the super fund for the insurance premiums.

² Proportion of TPD premiums that are deductible in super

³ Bundled means where the TPD and death components of the premium are not separately identified and the TPD sum insured does not exceed the death cover

Payment of a TPD benefit

To receive a benefit payment from a super fund, a member must satisfy a condition of release, such as reaching age 65, retiring after age 60, meeting permanent incapacity or a terminal medical condition. For further information on permanent incapacity or the terminal medical condition, refer to our articles [Maximising tax-free TPD super benefits](#) and [Planning considerations for terminally ill clients](#).

Taxation consequences of receiving a TPD benefit from a super fund

TPD insurance proceeds from non-super policies are generally received tax free by the life insured or their close relative.

Insurance proceeds for a super owned TPD policy are paid into the super fund and if a condition of release is satisfied, benefits can be received as a super lump sum and/or income stream. Typically, if the permanent incapacity condition of release is satisfied, a disability super benefit can be paid.

A person receives a disability super benefit if:

- they have suffered physical or mental ill-health or injury, and
- two legally qualified medical practitioners certify the person is unlikely to be gainfully employed in a capacity for which they are reasonably qualified due to education, experience or training.

A person is gainfully employed if they are employed or self-employed for gain or reward in a business, trade, profession, vocation, calling, occupation or employment.

A disability super benefit may be paid as a lump sum or income stream (subject to the transfer balance cap) or a combination of both. Furthermore, some or all of the benefit can remain in the accumulation phase of super. Retaining funds in the accumulation phase may be advantageous for Centrelink purposes if the person is under age 67 and applying for Disability Support Pension.

Disability super benefits

An increase in the tax-free component (referred to as a tax-free uplift) applies where a disability lump sum is paid to the member or a disability rollover occurs (full or partial).

Advice tip

Most super funds **do not** increase the tax-free amount when commencing an income stream within the same product. Some funds may create it by rolling to another super accumulation interest first. You should contact the super fund to understand their process.

The tax-free uplift represents the client's 'future service period' and is calculated by applying the following formula:

$$\text{Tax-free uplift} = \text{Benefit amount} \times \frac{\text{Days to retirement}}{\text{Days in the period from start date to the last retirement date}}$$

This amount is added to the existing tax-free component (capped at the benefit amount). The remainder of the benefit is the taxable component.

Benefit amount is the disability lump sum paid to the member or rolled over from the super fund.

Days to retirement is the number of days from the day the person stopped being capable of being gainfully employed to their last retirement date.

Last retirement date is the age at which a person's employment or office would have terminated or the date where the person would have completed a particular period of service; or in any other case the day on which the person would turn 65.

Generally, there is no tax-free uplift for clients who have reached age 65 when they stopped being capable of being gainfully employed.

Start date of the fund is the earlier of the:

- date the member joined the fund
- start date of a rollover benefit received by the fund; and
- start date with an employer that has contributed to the fund.

MLC TechConnect Calculator

To calculate the tax-free component of a disability lump sum, you can access our “Lump sum disability super benefits” calculator in our online adviser library.

Consolidating multiple super interests or changing the way super based insurance premiums are funded may result in an earlier start date and underinsurance (a reduced tax-free uplift may increase tax payable on benefit payments before age 60). Funding super based insurance premiums via personal contributions (including personal tax-deductible super contributions) will not change the start date of the fund.

Advice tip

Once a member has met the permanent incapacity condition of release and their benefits are non-preserved, these amounts will remain non-preserved and accessible even if circumstances change. However, any future contributions and earnings in accumulation phase may be preserved. Depending on the circumstances and time elapsed, a trustee may require new medical evidence to non-preserve the additional earnings/contributions or to apply tax concessions to future withdrawals, rollovers or pension commencements.

Tax payable on a disability lump sum paid to the member

The tax-free component is received tax free and the following maximum tax rates are payable on the taxable component – taxed element of the lump sum withdrawal:

Age	Tax on lump sum withdrawal (taxable component – taxed element)
Below age 60	Up to 20% plus Medicare levy/surcharge where applicable
Aged 60 and older	0%

Advice tip

Where the client is below age 60, the taxable component – taxed element is included in the client’s assessable income and tax offsets apply to reduce total tax payable to the maximum 20% tax rate (plus Medicare levy/surcharge where applicable).

Consider the impact of the withdrawal on any tax or Social Security measures based on assessable or taxable income (eg Family Tax Benefits, Higher Education Loan Program repayments, Government co-contribution, Division 293 tax). Refer to our adviser article [‘Income definitions’](#) for more information.

Where the client is below age 60, the super fund paying the taxable component – taxed element, will withhold 22% tax from the taxable (taxed) component (where the client’s TFN is provided). If total tax withheld is greater than total tax payable by the client, they may receive a refund of some or all the tax withheld.

Advice Tip

If your client is less than age 60, consider:

- delaying a lump sum member benefit to after age 60 where the taxable (taxed) component is received tax-free.
- whether spreading the lump sum across multiple financial years can reduce tax payable.

Disability super income stream

A person receiving a disability super income stream before reaching age 60 receives a 15% tax offset on the taxable component (taxed element) of each pension payment. The tax free portion of each pension payment is received tax free. A disability super income stream counts towards the transfer balance cap, for more information refer to our [Guide to the transfer balance cap](#).

The following table shows the tax treatment of a disability super income stream.

Component	Age	Tax treatment
Tax free	Any	Nil
Taxable (taxed element)	Under age 60	Marginal tax rate ⁴ . A 15% tax offset applies if commenced as a disability super income stream.
	60 years and above	Nil

Advice tip

The super fund must receive the appropriate medical evidence to increase the tax-free component of a super disability lump sum or to commence a disability super income stream, which entitles the client to receive a 15% tax offset on the taxable component (taxed element) pension payment, where under age 60.

Combining pension payments and lump sums to reduce tax

If a client is under age 60, amounts for large one-off expenses may be more tax effective if taken as an account-based pension payment or a combination of a pension payment and lump sum super withdrawal. This is because the 15% tax offset for a disability account-based pension exceeds the tax offset, which reduces the maximum tax payable for a lump sum to 20% where taxable income is \$135,000 or less. The client may also consider drawing down across multiple financial years. The following table compares the tax offsets for a pension compared to a lump sum withdrawal (taxable taxed element) paid in the 2026/27 financial year.

Personal income tax thresholds (resident) – 2026/27	Personal marginal tax rate [#]	Tax offset if taken as a pension payment	Tax offset if taken as a lump sum withdrawal (less than age 60)	Highest tax offset - lump sum or pension?
\$0 - \$18,200	0%	15%	0%	Pension
\$18,201 - \$45,000	15%	15%	0%	Pension
\$45,001 - \$135,000	30%	15%	10%	Pension
\$135,001 - \$190,000	37%	15%	17%	Lump sum
\$190,001+	45%	15%	25%	Lump sum

[#] Not inclusive of Medicare Levy.

To target \$135,000 of taxable income with a pension payment, apply the formula:

$(\$135,000 - \text{other taxable income}) / \text{taxable (taxed) \% of the account-based pension}$.

Any additional capital requirements can be taken as a lump sum or deferred to a later financial year.

⁴ The Medicare levy and Medicare levy surcharge may also be payable.

Example – combining pension payment and lump sums

Selena (37) took out a super based life and TPD insurance policy four years ago. She had a successful TPD claim and insurance proceeds of \$1.25m was paid into her super fund bringing her super balance up to \$1.5m (all taxable taxed).

- Days to retirement = 10,012
- Service days plus days to retirement = 16,152

If Selena takes a disability lump sum of \$600,000:

- the increased tax-free component is $\$600,000 \times 10,012 / 16,152 = \$371,917$
- the taxable (taxed) component is $\$600,000 - \$371,917 = \$228,083$.

If Selena has no other income, tax payable on the \$228,083 taxable (taxed) component would be:

Personal income tax thresholds (resident)	Personal marginal tax rate [#]	Tax payable	Tax offset if taken as a lump sum withdrawal (less than age 60)	Tax offset
\$0 - \$18,200	0%	$\$18,200 \times 0\% = \0	0%	$\$18,200 \times 0\% = \0
\$18,201 - \$45,000	15%	$\$26,800 \times 15\% = \$4,020$	0%	$\$26,800 \times 0\% = \0
\$45,001 - \$135,000	30%	$\$90,000 \times 30\% = \$27,000$	10%	$\$90,000 \times 10\% = \$9,000$
\$135,001 - \$190,000	37%	$\$55,000 \times 37\% = \$20,350$	17%	$\$55,000 \times 17\% = \$9,350$
\$190,001+	45%	$\$38,083 \times 45\% = \$17,137$	25%	$\$38,083 \times 25\% = \$9,521$
Total		\$68,507		\$27,871

[#] Not inclusive of Medicare Levy.

- Tax payable less tax offsets = $\$68,507 - \$27,871 = \$40,636$
- Medicare levy = $\$228,083 \times 2\% = \$4,562$
- Total tax payable = $\$40,636 + \$4,561 = \$45,197$
- Net lump sum withdrawal = $\$600,000 - \$45,197 = \$554,803$

Alternatively, Selena can take a combination of a disability pension payment (assuming the increased tax-free component applied) and a disability lump sum. The components at commencement of the disability pension would be:

- the increased tax-free component of $\$1,500,000 \times 10,012 / 16,152 = \$929,791.98$
- the taxable (taxed) component of $\$1,500,000 - \$929,791.98 = \$570,208.02$

To target \$135,000 of taxable income with a pension payment, apply the formula:

$$(\$135,000 - \text{other taxable income}) / \text{taxable (taxed) \% of the account-based pension} \\ = (\$135,000 - \$0) / (\$570,208.02 / \$1,500,000) = \$355,134 \text{ pension payment.}$$

The balance, \$244,866 (which is $\$600,000 - \$355,134$) is taken as a lump sum commutation from the disability pension and has a taxable (taxed) component of \$93,083.

Taxable income will include \$135,000 from the account-based pension payment and the taxable component of the super lump sum \$93,083 (a total of \$228,083). Tax payable would be:

Personal income tax thresholds (resident)	Personal marginal tax rate [#]	Tax payable	Tax offset	Tax offset
\$0 - \$18,200	0%	\$18,200 x 0% = \$0	15% (pension)	\$18,200 x 15% = \$2,730
\$18,201 - \$45,000	15%	\$26,800 x 15% = \$4,020	15% (pension)	\$26,800 x 15% = \$4,020
\$45,001 - \$135,000	30%	\$90,000 x 30% = \$27,000	15% (pension)	\$90,000 x 15% = \$13,500
\$135,001 - \$190,000	37%	\$55,000 x 37% = \$20,350	17% (lump sum)	\$55,000 x 17% = \$9,350
\$190,000+	45%	\$38,083 x 45% = \$17,137	25% (lump sum)	\$38,083 x 25% = \$9,521
Total		\$68,507		\$39,121

[#] Not inclusive of Medicare Levy.

- Tax payable less tax offsets = \$68,507 - \$39,121 = \$29,386
- Medicare levy = \$228,083 x 2% = \$4,562
- Total tax payable = \$29,386 + \$4,562 = \$33,948
- Net pension payment/lump sum withdrawal = \$600,000 - \$33,948 = \$566,052.

By taking a combination of a disability pension payment and a disability lump sum, Selena has increased her tax offsets, therefore increasing her net benefit by \$11,249 (\$566,052 - \$554,803).

Commencing a disability account-based pension with current super provider or a new pension provider

The following table shows the pros and cons of commencing an account-based pension with the current super provider or a new pension provider.

Commence an account-based pension with:	Pros and Cons
Current super fund	Pros: ▪ The fund already has the member's medical evidence and can commence a disability account-based pension with a 15% tax offset on the taxable component if a person is under age 60. If the TPD insurance policy was acquired before 1 July 2014, additional medical evidence may be required. ▪ May have capital gains tax advantages. For a super master trust, there may be a super to pension transfer bonus, which represents a return of tax provisioning for unrealised capital gains as the assets will no longer be disposed in accumulation phase. Similarly, assets in an SMSF or super wrap will not be disposed in accumulation phase. The capital gains tax advantages may be more important for non-insurance super benefits as they have been invested for longer. Cons: ▪ The increased tax-free calculation may not be applied to the commencement of the account-based pension (check with the pension provider). This may result in a negative tax outcome for persons aged under 60.

New account-based pension provider

Pros:

- The tax-free component of a disability rollover is increased using the formula for a disability lump sum. This may significantly reduce the tax payable on pension payments if under age 60. Ensure that a disability rollover is requested with an increased tax-free component.

Cons:

- The new fund will require medical evidence to commence a disability pension with a 15% tax offset. The new super fund must be satisfied that the client is still permanently incapacitated (eg the client may have undergone new training, education or employment or some time has elapsed after the date of the medical evidence and the new super fund may require more current medical evidence). Two current medical certificates must be provided to the super trustee to commence a disability pension. Some funds allow the medical evidence to be provided prior to receiving the rollover and provide the member with an indicative decision as to whether they would satisfy permanent incapacity. For funds that do not allow an indicative decision, you could make a small rollover to the fund and then apply for a decision.
- The CGT implications of leaving the existing super fund must be considered eg CGT payable for an SMSF, super wrap or loss of super to pension transfer bonus for a super master trust. This may be more important for non-insurance super benefits as they have been invested for longer.

Grossing up the level of cover

The insurance needs of the client should be established before deciding whether the insurance policy should be held inside or outside of super or a combination of both through a super-link style product. The tax implications of insurance held in super must be considered. The level of cover may be grossed up where necessary (otherwise the client may be underinsured). Your licensee may provide guidelines about grossing up cover.

Inside or outside of super?

The super-link combines a super based policy with a non-super based policy providing a comprehensive level of cover. A portion of the premium is funded through super with the balance funded from non-super money. Commonly, any claim will be determined under the super based policy first then the non-super based policy.

Any grandfathered super based insurance policies (existing insurance arrangements prior to 1 July 2014) may have a more comprehensive level of cover and the payment terms and conditions may differ from the super conditions of release. In some circumstances, an insurance benefit may be paid to the super fund but a condition of release may not be satisfied to allow the release of the benefits to the member.

Super-only policies acquired from 1 July 2014 must align their payment terms and conditions with the super conditions of release. Generally, the terms and conditions of these policies will provide a reduced level of cover when compared to a super-link or non-super based insurance policy.

The attraction of a super-based insurance policy or super-linked style policy is the ability to tax effectively fund at least part of the insurance premium. Often, even after grossing up the level of cover to account for potential taxation on the benefit payment from super, the effective cost of funding insurance inside super or via a super-link option is less than a non-super based policy.

Additional benefits by having the insurance inside super include cashflow, access to super based income streams, protection against bankruptcy and potential social security advantages.

The ability for your client to make super contributions and/or roll benefits to fund the insurance premiums, the impact on their contribution caps and their retirement funding are also important considerations.

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