
PROFESSIONAL STANDARD 405

COST OF DEATH AND DISABILITY BENEFITS IN SUPERANNUATION FUNDS

March 2020

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1. INTRODUCTION

1.1 Application

1.1.1 This Professional Standard applies to a Member preparing an actuarial certificate under section 295-465(3) of the Income Tax Assessment Act 1997 (Cth) to enable a trustee to obtain a tax deduction for part of their insurance premiums and/or part or all of the cost of self-insured death and/or disability benefits.

1.1.2 A Member who provides advice performed under this Professional Standard:

- i) must be an Eligible Actuary; and
- ii) must exercise his or her independent professional judgement and give impartial advice.

Work performed under this Professional Standard is designated as an Applicable Service. As such, the Member's attention is directed towards the requirements of Practice Guideline 1 (General Actuarial Practice).

1.1.3 This version of the Professional Standard incorporates additional conformance changes to align with the Institute's new Code (effective 31 March 2020).

1.2 About this Professional Standard

1.2.1 This Professional Standard:

- (a) has been prepared in accordance with the Institute's Policy for Developing Documents to Guide and Regulate Professional Practice;
- (b) must be applied in the context of the Code;
- (c) binds Members of the Institute when they perform work that the Standard covers; and
- (d) defines the Institute's requirements for all work the Standard covers.

1.2.2 If a Member believes that this Professional Standard is ambiguous or wishes to seek clarification of it, then they may consult the Institute's Professional Standards Committee for an interpretation.

1.2.3 If a Member finds that they cannot carry out their work in a way that complies with this Professional Standard then they must either:

- (a) decline to carry out the work; or
- (b) end their agreement to do so.

1.2.4 If a Member does not comply with this Professional Standard, then that may constitute Misconduct under the Institute's Disciplinary Scheme.

1.2.5 This Professional Standard does not constitute legal advice. Any interpretation or commentary within this Professional Standard regarding specific legislative or regulatory requirements reflects the expectations of the Institute but does not guarantee compliance under applicable legislation or regulations. Accordingly, Appointed Actuaries should seek clarification from the relevant regulator and/or seek legal advice in the event they are unsure or require specific guidance regarding their legal or regulatory obligations

1.3 Other relevant documents

1.3.1 This Professional Standard must be applied in the context of the relevant law, and relevant accounting and auditing standards.

1.3.2 A reference to legislation or a legislative provision in this Professional Standard includes any statutory modification, or substitution of that legislation or legislative provision and any subordinate legislation issued under that legislation or legislative provision. Similarly, a reference to a Professional Standard includes any modification or replacement of that Professional Standard.

1.3.3 Apart from the Code, from legislation or from regulatory standards, no other document, advice or consultation (including Practice Guidelines of the Institute) can be taken to modify or interpret the requirements of this Professional Standard.

1.3.4 If there is a conflict between this Professional Standard and any legislation, then the legislation takes precedence and any differences must be documented in the actuarial certificate provided under section 295-465(3). In this context, legislation includes regulations, prudential standards, subordinate standards, rules issued by government authorities and standards issued by professional bodies which have the force of law.

1.3.5 Taxation Ruling TR 2012/6 titled "Income tax: deductibility under sub-section 295-465(1) of the Income Tax Assessment Act 1997 of premiums paid by a Plan for an insurance policy providing Total and Permanent Disability cover in respect of its members" explains the Australian Taxation Office's view on how sub-sections 295-465(1), 295-465(1A) and 295-465(1B), together with section 295-460(b), apply to such premiums.

1.4 Background

1.4.1 In this Professional Standard, benefits for which a tax deduction is available are referred to as death and/or disability benefits. Section 295-460 defines them to include:

- (a) a superannuation death benefit (as prescribed);
- (b) a terminal medical condition benefit (as prescribed);
- (c) a disability superannuation benefit (as prescribed); or

- (d) income stream benefits payable because of a plan member's temporary inability to engage in gainful employment (as prescribed).

1.4.2 Trustees must obtain an actuarial certificate prior to lodging a Plan's income tax return in order to deduct:

- (a) the amount the Plan could reasonably be expected to pay in an arm's length transaction to obtain an insurance policy to cover it for that part of its current or contingent liabilities to provide benefits referred to in section 295-460 for which it does not have insurance coverage; or
- (b) the proportion of insurance policy premiums attributable to the liability to provide benefits referred to in section 295-460, unless:
 - (i) the proportion is already specified in section 295-465(1) (items 1 to 5); or
 - (ii) only the proportion of the premium specified in the Regulations in accordance with section 295-465(1B) is being deducted.

2. COMMENCEMENT DATE

This Professional Standard applies to actuarial certificates under section 295-465(3) of the Act issued on or after 31 March 2020.

3. DEFINITIONS AND INTERPRETATION

3.1 In this Professional Standard:

'Accrued Retirement Benefit' means the amount of a prospective retirement benefit attributable to past membership or service determined in accordance with Professional Standard 402 (Determination of Accrued Benefits for Defined Benefit Superannuation Funds).

'Act' means the Income Tax Assessment Act 1997 (Cth).

'Applicable Professional Services' means Services provided by a Member in a professional capacity

'Code' means the Code of Conduct of the Institute.

'Disciplinary Scheme' means the document of that name prepared by the Institute setting out the rules and procedures governing professional discipline of Member, as amended by Council from time to time.

'Eligible Actuary' means:

- (a) a Fellow or Accredited Member of the Institute; or

- (b) a Member who is eligible to act in an actuarial capacity pursuant to a requirement under legislation.

'Material' means important or essential in the opinion of the Member. For this purpose, 'Material' does not have the same meaning as in Australian accounting standards.

'Plan' means a complying superannuation fund.

'Regulations' mean the Income Tax Assessment Regulations 1997 (Cth).

'Vested Benefit' means the amount determined in accordance with Professional Standard 400 (Investigations of the Financial Condition of Defined Benefit Superannuation Funds).

- 3.2 A word that is derived from a defined word has a corresponding meaning.
- 3.3 Other capitalised terms used in this Professional Standard have the same meaning as set out in the Code.
- 3.4 A reference in this Professional Standard to a section number is, unless stated otherwise, a reference to that section number of the Act.

4. LIABILITY TO PROVIDE BENEFITS

- 4.1 Irrespective of whether the certificate is being prepared for the purpose of section 295-465(1) (item 6) or section 295-465(2) of the Act, it is necessary to calculate the liability to provide benefits referred to in section 295-460 of the Act. Liability for the purposes of these sections excludes the funded retirement portion of these benefits.
- 4.2 For the purpose of section 295-465(2) of the Act, to determine the liability to provide death and/or disability benefits where no insurance cover has been effected, a Member must define the unfunded element of the benefit on death and/or disability.

5. MAXIMUM LIABILITY

- 5.1 For the purposes of claiming a deduction under sections 295-465(1) (item 6) or 295-465(2), and subject to clause 5.3 of this Professional Standard, the maximum amount of insurance cover, or notional insurance cover, for lump sum benefits is the death, terminal medical condition and/or disability benefit less the lesser of the Vested Benefit and the Accrued Retirement Benefit, unless the Member certifies that a greater amount of insurance cover or notional insurance cover is required. This maximum applies for each Plan member.
- 5.2 In the case of a Plan providing death, terminal medical condition and/or disability benefits in pension form, or where the retirement benefit is a pension, an additional factor is required to allow for the lump sum value of the pension benefit. The lump sum value of the pension benefit must be calculated consistently with Professional Standard 400 (Investigations of the Financial Condition of Defined Benefit Superannuation Funds).

- 5.3 Where the disability benefit is an income stream because of temporary inability to engage in gainful employment, the disability benefit will not usually include any funded element. In this case, it is not necessary to deduct the amount of the lesser of the Vested Benefit and Accrued Retirement Benefit in determining the maximum insurance cover or notional insurance cover.
- 5.4 Circumstances where a greater amount of insurance cover or notional insurance cover is reasonable include Plans where the aggregate of the lesser of each member's Vested Benefit and Accrued Retirement Benefit exceeds the value of Plan assets. The amount insured or notionally insured would be calculated by deducting a funded element (such as a discounted Accrued Retirement Benefit) from the death and/or disability benefit, where the funded element is defined so that the aggregate of the funded elements is not Materially different from the value of the Plan assets.

6. ARM'S LENGTH PREMIUM

- 6.1 Section 295-465(2) provides that the amount a Plan could reasonably be expected to pay in an arm's length transaction (the "arm's length premium") to obtain an insurance policy to cover that part of its current or contingent liabilities to provide death, terminal medical condition and/or disability benefits (for which it does not have insurance coverage) is an allowable deduction.
- 6.2 In determining the underlying premium rates to be used in the calculation, it is not a requirement to seek quotations from insurers provided due consideration is given to:
- (a) the definition of "arm's length" in section 995-1; and
 - (b) if available, the circumstances and experience of the Plan or, if not available, other relevant circumstances and experience.
- 6.3 If the Member has a Material doubt as to the rates to be used, quotations must be obtained where possible and used in determining an arm's length premium. Insurance policies sometimes allow a Plan to share the profits with the insurer if experience is favourable and, where this is the case, the arm's length premium rates must exclude any profit sharing component.
- 6.4 In calculating the arm's length premium, allowance must be made for changes in Plan membership throughout the year of income on an appropriate basis.
- 6.5 Not all death, terminal medical condition and/or disability benefits paid from a Plan may meet the definition in section 295-460 of the Act. Where this occurs, either:
- (a) the amount of premium must reflect the portion of the death, terminal medical condition and/or disability benefits that do meet the definition; or
 - (b) where the disability definition is specified in Regulation 295-465.01, the Member may decide to use the approach in sub-clause 6.5(a) or alternatively to calculate

the amount of premium that reflects the entire amount of the death, terminal medical condition and/or disability benefit (including that portion that does not meet the definition in section 295-460), and the Member must state what proportion of the premium is deductible based on the Regulations.

7. APPORTIONMENT OF PREMIUM

7.1 Section 295-465(1) (item 6) relates to insurance policies that are not included in items 1 to 5 of that section. An actuarial certificate is required by item 6 where a deduction is claimed other than the proportion of the premium specified in Regulation 295-465.01. To provide a certification under section 295-465(1) (item 6), it is necessary to determine the part of the premium that is attributable to the liability to provide death, terminal medical condition and/or disability benefits. The basis of such apportionment must recognise the underlying premium basis and produce results consistent with those which would be produced if the arm's length premium approach had been adopted.

8. USE OF SECTION 295-465(2)

8.1 Section 295-465(2) can be applied to the extent for which the Plan does not have insurance coverage for the liabilities to provide death, terminal medical condition and/or disability benefits. Use of section 295-465(2) is appropriate where a Plan elects to self-insure either part or all of the liabilities in respect of death, terminal medical condition and/or disability benefits, for example where:

- (a) the Plan does not insure the first \$x of "liability" per Plan member;
- (b) all or certain Plan members are not covered by insurance; or
- (c) a stop loss or catastrophe arrangement is in place.

8.2 If the level of insurance cover for a Plan is less than that specified under clauses 5.1 to 5.4 above, it is permissible for the Plan to also seek a deduction under section 295-465(2) for self-insurance of the difference between the maximum specified in clauses 5.1 to 5.4 above and the actual amount of insurance cover.

8.3 Where a Plan has stop loss or catastrophe insurance in place that is wholly or partly for current or contingent liabilities to provide benefits referred to in section 295-460, it is appropriate to claim a deduction for:

- (a) all or part of the premium for the stop loss/catastrophe insurance as appropriate under section 295-465(1) (table items 5 or 6 as appropriate); and
- (b) the residual amount of the self-insurance arm's length premium (after deducting the amount claimed under section 295-465(1)) under section 295-465(2).

9. ACTUARIAL CERTIFICATE

9.1 Where a deduction is being claimed for self-insurance under section 295-465(2), the actuarial certificate must provide the following:

- (a) the name of the Plan covered by the certificate;
- (b) the name of the trustee of the Plan (if an entity) or the full name of one of the trustees of the fund;
- (c) the year of income covered by the certificate;
- (d) that the deduction is being claimed under section 295-465(2);
- (e) a description of the data on which the actuarial certificate is based;
- (f) the amount of the Plan's liability to provide death, terminal medical condition and/or disability benefits not covered by an insurance policy, and the basis of determining that amount;
- (g) a statement of the underlying rates used in the calculation of the arm's length premium and a brief explanation of the basis of determining these rates;
- (h) a statement whether the arm's length premium is only in respect of Plan benefits that meet the definition in section 295-460 or, if this is not the case, what proportion of the premium is deductible in accordance with Regulation 295-465.01;
- (i) a statement that, in the Member's opinion, the arm's length premium is reasonable (if the Member cannot make this statement, the Member must not sign the certificate);
- (j) a statement that the certificate has been prepared consistently with this Professional Standard;
- (k) the name, address and qualifications of the Member signing the certificate;
- (l) the date of the certification; and
- (m) the Member's signature.

9.2 Where a deduction is being claimed under section 295-465(1) (item 6) and:

- (a) a deduction is being claimed for part of the insurance policy premium and the Plan has chosen to deduct a proportion other than that specified in the table in Sub-Regulation 295-465.01(1); or
- (b) the insurance policy is not specified in the table in Sub-Regulation 295-465.01(1),

the actuarial certificate must provide the following information:

- (i) all the information required by clause 9.1 above (except sub-clauses 9.1(d), 9.1(f), 9.1(g), 9.1(h) and 9.1(i));
- (ii) that the deduction is being claimed under section 295-465(1) (item 6);
- (iii) the total amount of premiums paid which are partly in respect of current or contingent liability of the fund to provide death, terminal medical condition and/or disability benefits;
- (iv) the portion of those premiums that relate to the death, terminal medical and/or disability benefits as defined in section 295-460; and
- (v) the basis of apportionment.

END OF PROFESSIONAL STANDARD 405