

14 February 2011

Mr Damian Byrnes
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Dear Mr Byrnes

TR 2010/D9

The Association of Superannuation Funds of Australia (ASFA) is making this brief submission in response to the above draft taxation ruling that considers the deductibility under subsection 295-465(1) of the *Income Tax Assessment Act 1997* of premiums paid by a complying superannuation fund for an insurance policy providing total and permanent disability (TPD) cover in respect of its members.

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our membership, which includes corporate, public sector, industry and retail superannuation funds, accounts for more than 5.7 million member accounts and over 80% of superannuation savings.

General Comments

ASFA has reviewed the paper and considers that generally it appropriately reflects the law. However we consider there is a legal interpretation error with regards to Example 7. We also note that the paper does not address the cost of self insurance for TPD.

Our comments are limited to the content of the draft TD and do not re-raise the policy issues around the capacity of superannuation funds, and particularly defined benefit funds, to amend trust deeds in a manner that would reduce the rights and entitlements of existing members so as to avoid the need for an actuarial certificate.

In making this submission we are mindful of the need to balance the requirements of section 295-465(1) of the *Income Tax Assessment Act 1997* with the need to minimise compliance costs for taxpayers, including complying superannuation funds.

Specific Comments

Paragraph 111 of the ruling notes that transitional provisions were introduced by the government covering the income years 2004-05 through to 2010-11 to permit the industry to address the divergence in opinion between industry and the ATO on the operation of the rules. ASFA would like it to be noted that this draft ruling, which is the first detailed expression of the ATO view on the operation of the rules, indicates that the divergence in views is wider than was previously

contemplated. One outcome of this is that funds that have taken the opportunity to review their insurance arrangements may need to revisit those arrangements.

ASFA is concerned that the transitional provisions will have expired before the ruling is finalised and fund trustees and their insurers have certainty as to the operation of the law. It will only be after finalisation of the ruling that superannuation fund trustees will be in a position to determine what adjustments need to be made to the insurance costs applied to member accounts and what amendments need to be made to product disclosure statements. However, all administration arrangements need to be in place by 30 June 2011 so that member exits from 1 July 2011 can be treated appropriately. ASFA requests that, in view of the delays and uncertainties and the 'yet to be finalised' administrative tasks for funds, that the transitional relief be extended for a further reasonable period.

ASFA supports the guidance provided by paragraphs 28 and 29 of TR 2010/D9 that the insurance policy does not need to define total and permanent disability using the same words as, or by referring to, the definition of 'disability superannuation benefit' in subsection 995-1(1) of the Act, as both reasonable and valuable.

We also support the acceptance by the ATO in paragraph 65 of the draft ruling that the occurrence of an insured event under the domestic duties cover would be likely to satisfy the requirement that the member not be able to ever (again) be engaged in a capacity for which they are reasonably qualified. We agree with the ATO's conclusion in this regard.

ASFA's principal concerns with the ruling relate to the 'loss of limbs' (or 'specific loss') test. This is a common additional test in many 'any occupation' TPD policies held by superannuation funds.

The ATO concludes that there are instances in which a member may satisfy the requirement for payment under the 'loss of limbs' test but not actually be prevented from working in a capacity for which they are reasonably qualified. ASFA, while accepting this as a theoretical possibility has been advised by ASFA members that the practical experience is that a payment is only very rarely made under the 'loss of limbs' test, and that even where it is, only a minority of successful claims would be, at the same time, unsuccessful under the 'any occupation' test.

A similar situation arises with Example 7. The draft ruling argues that "the occurrence of some of the insured events that give rise to payouts under the policy may not give rise to a liability under the fund's trust deed to provide a disability benefit to the member. While this may be true, the likelihood of a member not complying with the medical care requirement prior to making a claim is so negligible that it warrants being ignored. ASFA considers it highly likely that almost all disabled members will be under medical care and as such, the fund has, at a minimum, an ongoing contingent liability to provide a superannuation benefit once the member satisfies the six month treatment requirement.

Following on from this, concern has been raised by ASFA members on three issues related to the practical application of the ATO's interpretation of the law in this area:

- Availability of relevant data on which to base actuarial certificates.
- Cost of actuarial advice relative to the reduction non-deductible portion of the premium.
- Absence of a de minimis rule.

Availability of data for actuarial calculations

ASFA has been advised by an insurance company of their understanding that no insurance company is currently recording which part of a definition of TPD a claim is paid under. Absent

such information, it would appear that there is no readily available data on which an actuary would be able to prepare and issue actuarial certificates.

To obtain the relevant information would require a manual investigation of claim files using 'cause of claim' as a guide. This process would be lengthy, time consuming and costly to undertake.

This creates an immediate practical issue for the superannuation industry where apportionment of the premium is required.

Cost of actuarial advice

As indicated above, there is an absence of readily available data from which an actuary could prepare and issue an actuarial certificate. This creates a cost issue for the superannuation industry where apportionment of the premium is required. It is entirely conceivable that the cost of the actuarial certificate, which would be tax deductible, could far exceed any reduction in the premium amount claimable. ASFA considers this to be inappropriate outcome in tax administration terms.

Absence of a de minimis rule

ASFA has sought insurance claims information from a large industry superannuation fund with a TPD insurance offering that includes cover for both 'any occupation' and 'loss of limbs and/or sight'. The premium payable in respect of each type of cover is not specified separately. This scenario is covered in Example 5 (paragraphs 67 to 77).

The initial response from the fund is that the insurer has no collated data on which limb of the TPD definition claims have been paid. Despite this, the insurer was able to state that:

- They could confidently say that 99% of the TPD claims paid are under the 'any occupation' definition. Most claims that qualify under the 'loss of limbs' definition and the 'activities of daily living' (domestic duties) definition would qualify under the 'any occupation' definition. Only in rare cases would someone qualify under loss of limbs' or 'activities of daily living' and not meet the 'any occupation' definition.

Additionally, advice from two insurance companies is that they will be specifying, in future policies, should the deductible proportion is 100% and that they will not reduce premiums should the 'loss of limbs' definition be removed.

Based on this, it would appear that, as stated above, any reduction in the deductible amount would be extremely small. It may even be that for many funds the cost of the actuarial certificate may approach or exceed the reduction in the deductible amount.

ASFA submits that the compliance cost involved in requiring trustees to obtain actuarial certificates certifying the portion of the premium that is attributable to 'specific loss' claims that do not satisfy the 'any occupation' test is not warranted. There is likely to be a high proportion of trustees who will be required to obtain an actuarial certificate for only the 'specific loss' test, and the adjustments to the portion of the premium that is deductible will be very minor. In fact, the adjustment is likely to be far exceeded by the value of the deduction for the cost of obtaining the actuarial certificate.

There will also be significant administration and communication costs involved for funds. Any change in the deductible amount will need to be reflected on the member's account and communicated to members by way of a supplementary product disclosure statement.

ASFA considers that it would be reasonable for the ATO to conclude that the instances in which the loss of limb test will result in a claim being admitted that does not meet the 'any occupation' test is negligible. Based on this, and in the interest of balancing the compliance costs with the benefit, ASFA seeks amendment of the draft Taxation Ruling to remove the requirement for a

trustee to obtain an actuarial certificate to determine the portion of the premium that is not deductible due to an insurance policy definition including a 'specific loss' clause.

ASFA suggest that this be implemented by the Commissioner, with respect to claims which fall under item 6 in the table, consider establishing a de minimis rule that a superannuation fund could apply, going forward, based on claims history.

This would largely overcome the first two issues set out above.

Should you require any additional information please contact ASFA's principal policy adviser, Robert Hodge at rhodge@superannuation.asn.au or on (02) 8079 0806.

Yours Sincerely,

David Graus

General Manager Policy and Industry Practice