

TAXATION TREATMENT OF MILITARY SUPERANNUATION DISABILITY INVALIDITY PENSIONS

The recognition by the Government that the Federal Court decision in the Commissioner of Taxation v. Douglas adversely impacted financially on ADF veterans, and the announcement that legislation will be introduced to enable impacted veterans to individually elect to have their taxation calculated as either a lump sum or income stream will address some of the unintended consequences of the Federal Court's decision.

The Commissioner of Taxation acknowledged in the ATO Decision Impact Statement at Annex A, that the Federal Court considered that the rules of both the DFRDB Scheme and MSB Scheme under which the invalidity benefits are paid, did not satisfy subregulation 1.06(2) of the Superannuation Industry Supervision Regulations (SISR) 1994 and did not ensure that:

- a. The pension is paid at least annually throughout the life of the primary beneficiary or reversionary beneficiary, and
- b. The size of payment of benefits in a year is fixed, allowing for variation only as specified in the governing rules.

The Federal Court effectively found that invalidity benefits under both the DFRDB Scheme and the MSB Scheme for all veterans in receipt of disability invalidity pensions, did not conform with subregulation 1.06(2) of the SISR 1994 as both schemes could be cancelled (due to the invalidity classification being reviewed), did not ensure that the benefit was paid at least annually throughout the lifetime of the primary beneficiary and the size of the invalidity payment were not fixed, subject to variation contemplated by the scheme rules.

However, the Commissioner of Taxation accepted that it was open to the Court to decide that the DFRDB Scheme and MSB Scheme rules under which the invalidity benefits were paid satisfied the requirements for taxation as either a superannuation lump sum or income stream but failed to identify to the Court the potentially harmful financial implications for many veterans as identified in the announcement by the Minister for Veterans' Affairs.

As a result, and despite both military superannuation schemes not complying with subregulation 1.06(2) of the SISR 1994, the Federal Court determined that invalidity pensions paid under the DFRDB Scheme and the MSB Scheme which commenced on or after 20 September 2007 would be taxed as superannuation lump sums, rather than as superannuation income streams. The Court determined that invalidity pensions provided under the DFRDB Scheme and the MSB Scheme that commenced before 20 September 2007 would be taxed as superannuation income stream benefits.

The Federal Court decision appears to be the result of unforeseen taxation implications following the introduction of the Tax Laws Amendment (Simplified Superannuation) Act 2007, which has resulted in differing taxation treatment options for veterans who have been medically discharged from the ADF under the same DBRDB Scheme and MSB Scheme Legislation.

However, the Federal Court decision that ***“drew a line in the sand”*** resulting in disability invalidity pensions that started on or after 20 September 2007 being treated as lump sum payments for taxation purposes also has the potential to adversely impact financially on veterans in receipt of DFRDB Scheme and MSB Scheme disability invalidity pensions that commenced before 20 September 2007.

DFRDB Scheme and MSB Scheme veterans in receipt of disability invalidity pensions that commenced before the 20 September 2007, may have their pension invalidity classifications reviewed by the relevant Authority and the invalidity classification permanently confirmed, not subject to any further review. The subsequent invalidity pension cannot be cancelled, is paid annually throughout the remaining life of the primary beneficiary and the size of the pension is fixed, allowing for variation only as specified in the governing rules.

Accordingly, that assessment contradicts the assessment by the Federal Court and implies that DFRDB Scheme and MSB Scheme disability invalidity pensions that commenced before 20 September 2007 that were permanent and not subject to reclassification between Class A and Class B should also be considered as a lump sum for taxation purposes.

I was medically discharged from the Royal Australian Air Force on the 4 June 2001 and pursuant to the DFRDB Act 1973 was awarded an invalidity classification of Class A and received invalidity pension payments subject to review at a later date.

On 25 November 2004, my DFRDB Scheme invalidity classification was reviewed at the direction of the DFRDB Authority and the delegate for the DFRDB Authority advised that: ***“further review of your invalidity classification should be deferred indefinitely.”*** I was further advised that: ***“Your pension is being paid at the maximum rate under the DFRDB legislation and will be increased periodically in accordance with that legislation.”***

As a result, from the 25 November 2004, my DFRDB invalidity pension is paid for the remainder of my life with no further reviews and the size of the pension benefits is fixed and only varied as specified in the DFRDB Scheme rules and complies with SIS subregulation 1.06(2) and should be taxed as a superannuation lump sum benefit.

Accordingly, I consider that the Government and the Commissioner of Taxation should recognize the inequitable treatment of DFRDB Scheme and MSB Scheme veterans in receipt of invalidity pension payments commencing before the 20 September 2007, in particular those veterans with a permanent, non-reviewable invalidity classification. All veterans should have their invalidity benefits treated as lump sum payments for taxation purposes, irrespective of the commencement date of the invalidity benefit and relevant changes incorporated into the legislation proposed by the Minister for Veterans' Affairs.

All veterans deserve to be treated with fairness and equality and the Government may consider revisiting the Tax Laws Amendment (Simplified Superannuation) Act 2007 legislation to ensure equitable treatment of taxation for all veterans in receipt of disability invalidity pension from the DFRDB Scheme and the MSB Scheme.

Yours faithfully

Colin Wade

5 August 2022

Annex A. ATO Decision Impact Statement, Commissioner of Taxation v Douglas.