



DEFENCE FORCE WELFARE ASSOCIATION

05 August 2022

DFWA SUBMISSION TO TREASURY

TREASURY LAWS AMENDMENT (MEASURES FOR A LATER SITTING) BILL 2022: TAXATION OF MILITARY SUPERANNUATION BENEFITS EXPOSURE DRAFT LEGISLATION

About the Defence Force Welfare Association

The Defence Force Welfare Association (DFWA) is an Australia wide organisation, formed in 1959, for the purpose of promoting and protecting the welfare and interests of serving and former members of the Australian Defence Force and their families.

Our advocacy areas include:

- Rehabilitation of injured veterans
- Compensation for Service-related injuries
- ADF pay and conditions
- Retirement and superannuation
- Improving service delivery
- Veteran recognition

Since formation, successive Australian Governments have supported and appreciated this important role.

DFWA has Branches or representation in each State and Territory, with the National Office located in Canberra.

DFWA is a non-partisan, not-for-profit organisation – we advocate for good policy.

Introduction

DFWA welcomes the opportunity to make a submission to Treasury on the exposure draft of the *Treasury Laws Amendment (Measures for a Later Sitting) Bill 2022: Taxation of Military Superannuation Benefits*.

The proposed legislation follows the Federal Court decision in *Douglas*¹ which found that invalidity benefits paid under the Defence Force Retirement and Death Benefit Scheme² (DFRDB) or under

¹ *Commissioner of Taxation v Douglas* [2020] FCAFC 220

² *Defence Force Retirement and Death Benefits Act 1973* (Cth)

the Military Superannuation Benefit Scheme³ (MSBS), which commenced on or after 20 September 2007, are *superannuation lump sum* payments, rather than *superannuation income stream* benefits.

While most veterans impacted by *Douglas* are better off, there is a not-insignificant number of veterans who have been negatively affected.

DFWA has had an active role in supporting the veteran challenge of the nature of invalidity benefits since 2015. When test case litigation funding was provided, the DFWA Qld Branch Legal Advisor represented Mr Douglas. DFWA also provided support during the stressful Administrative Appeals Tribunal and Federal Court hearings, for all three veterans.

DFWA's stated position on this matter is that we support action that provides relief to those veterans who have been negatively impacted by the decision in *Douglas*; however, we absolutely oppose any action that removes any tax or other benefits flowing from the decision in *Douglas*.

DFWA is also of the view that the benefits of the *Douglas* decision—particularly the tax modification for *disability superannuation benefits*—should be extended to those DFRDB Invalidation Pay and MSBS Invalidation Pension recipients, whose benefits commenced prior to 20 September 2007. The same beneficial tax treatment should also be extended to contemporary veterans receiving Invalidation Benefits under ADF Cover.

Discussion

For the purposes of this submission, the following terms will be used:

Affected invalidity benefit – DFRDB invalidation pay, and MSBS invalidation pensions, that commenced on or after 20 September 2007.

Affected reversionary benefit – the pension paid to a spouse or child, on the death of a member in receipt of an *affected invalidity benefit*.

Superannuation Income Streams for Income Tax Purposes

Schedule X – 1

The amended *ITAR 2021*⁴ s 307-70.02(1)(b) specifies that defined benefit pensions, paid from defined benefit funds or exempt public sector schemes, that commenced on or after 20 September 2007, are *superannuation income streams* for the purposes of *ITAA 1997*⁵ s 307-70(2).

The amended provision specifically excludes *affected invalidity benefits*, so that those invalidity benefits remain *superannuation lump sum* payments.

While this is consistent with our position that the benefits of *Douglas* should be retained, we are of the view that this goes beyond what is necessary to achieve that aim; and may close the door to the same beneficial interpretation being applied to ADF Cover invalidity benefit recipients.

³ *Military Superannuation and Benefits Act 1991* (Cth)

⁴ *Income Tax Assessment (1997 Act) Regulations 2021* (Cth)

⁵ *Income Tax Assessment Act 1997* (Cth)

Schedule X – 2

The amended *ITAR 2021* s 307-70.02(1A) has the effect that *affected reversionary benefits*, are treated as *superannuation lump sum* payments.

DFWA welcomes this extension.

Veterans' Superannuation (Invalidity Pension) Offset

Schedule X – 5 to 7

The amended *ITAA 1997* s 301-275 creates a new non-refundable tax offset: the *Veterans' Superannuation (Invalidity Pension) Offset* (VSIP).

The VSIP Offset is available to those taxpayers receiving *affected invalidity benefits* or *affected reversionary benefits*. The offset is equivalent to the reduction in the taxpayer's liability, had treating the invalidity benefit as a *superannuation income stream* resulted in a lower liability.

Importantly, those veterans who became eligible for taxable income assessed benefits such as Family Tax Benefits or childcare subsidy, because of *Douglas*, will retain those benefits.

DFWA welcomes this approach.

Lump Sum Payment in Arrears Rebate

Veterans who receive lump-sum in-arrears payments of *affected invalidity benefits*, such as in the case of a "retrospective medical discharge", are currently taxed as having received a single *superannuation lump sum*. They do not receive the benefit of the Lump Sum Payment in Arrears (LSPIA) Rebate.⁶

This is despite those arrears payments being for invalidity benefits that accrued in prior tax years.

The proposed VSIP Offset explicitly considers the LSPIA rebate in the offset calculation, at the amended *ITAA 1997* s 301-275(2)(a)(ii).

DFWA is aware that, because of a taxpayer objection, the Australian Taxation Office (ATO) is in the process of forming a precedential ATO view as to whether *affected invalidity* and *reversionary benefits* that are treated as *superannuation lump sums* are eligible payments for the purposes of the LSPIA rebate.^{7,8} ATO have advised that they do not currently have a view on this interpretation.

DFWA is of the view that *affected invalidity and reversionary benefits*, when treated as *superannuation lump sum* payments, in the case of arrears payments, are eligible payments for the purpose of the LSPIA rebate. This view is consistent with the intent and purpose of that rebate. However, it is inconsistent with the how LSPIA rebate is currently applied by ATO and reported by the Commonwealth Superannuation Corporation.

⁶ *Income Tax Assessment Act 1936* (Cth) Subdivision AB of Division 17

⁷ *Income Tax Assessment Act 1936* (Cth) s 159ZR

⁸ The basis of the objection is that DFRDB and Military Super payments are eligible payments for the purposes of LSPIA rebate, due to the inclusion of payments covered by the *Income Tax Assessment Act 1997* (Cth) Div 55.

The specific inclusion of the LSPIA rebate in the proposed amendment at *ITAA 1997* s 301-275(2)(a)(ii), suggests that there is an intention that *affected invalidity and reversionary benefits*, when treated as either *superannuation lump sum* payments or *superannuation income streams*, are eligible for the rebate. However, that intention will not crystallise in the case of *superannuation lump sums* if the payment is not an eligible payment for the purposes of LSPIA rebate.

DFWA is of the view that this legislation should explicitly confirm that *affected invalidity and reversionary benefit superannuation lump sum* payments are eligible for the LSPIA rebate.

Summary

1. The provisions in Schedule X – Item 1 go beyond what is necessary to ensure “no veteran pays higher income tax because of ... *Douglas*”⁹ and may close the door to the same beneficial interpretation being applied to ADF Cover invalidity benefit recipients.
2. The benefits of the *Douglas* decision—particularly the tax modification for *disability superannuation benefits*—should be extended to those DFRDB Invalidation Pay and Military Superannuation Invalidation Pension recipients, whose benefits commenced prior to 20 September 2007.
3. The same beneficial tax treatment should also be extended to contemporary veterans receiving Invalidation Benefits under ADF Cover.
4. This legislation should explicitly confirm that *affected invalidity and reversionary benefit superannuation lump sum* are eligible payments for the purposes of the LSPIA rebate.

⁹ The Hon Stephen Jones MP, The Hon Matt Keogh MP. (25 July 2022) *Exposure Draft Legislation: Taxation of Military Superannuation Benefits*.