

Decision impact statement

Commissioner of Taxation v Douglas

Court citation(s):	[2020] FCAFC 220
Venue:	Federal Court of Australia
Venue reference no:	QUD 103 of 2020 QUD 114 of 2020 QUD 115 of 2020
Judge names:	Griffiths, Davies and Thawley JJ
Judgment date:	4 December 2020
Appeals on foot:	No
Decision outcome:	Partly favourable to the Commissioner

Impacted advice



The Commissioner has updated the ATO webpage to reflect the Court's decision.

Précis

This Decision impact statement outlines the ATO's response to this case which concerns whether certain invalidity benefits paid from pensions to individuals under the Military Superannuation and Benefits Scheme (MSB Scheme) and the Defence Force Retirement and Death Benefits Scheme (DFRDB Scheme) are superannuation income stream benefits or superannuation lump sum payments.

Brief summary of facts

The decision concerns three appeals brought by the Commissioner with respect to invalidity benefits paid from pensions to Mr Douglas under the DFRDB Scheme and to Mr Walker and Mr Burns under the MSB Scheme.

While there are differences in the rules between the two superannuation schemes, an individual will qualify to receive invalidity benefits while they are classified as either Class A or Class B with respect to their incapacity. An individual will also qualify to receive invalidity benefits under the DFRDB Scheme when classified as Class C with respect to their incapacity. The rules of the schemes allow for the individual's rate of incapacity to be reviewed which may result in their entitlement to invalidity benefits being varied or cancelled.

On 4 November 2014, Mr Douglas was classified by the Commonwealth Superannuation Corporation (CSC) as having a Class A invalidity, and the CSC determined that the effective date of that classification was 2 September 2002. Mr Douglas received a lump sum arrears payment on 10 December 2014, calculated by reference to the effective date of 2 September 2002. Following the determination of invalidity on 4 November 2014, he also received ongoing invalidity benefits.

Mr Walker was classified on 13 November 2009 as having a Class A invalidity from that date and became entitled to an invalidity pension. That classification remained the same during the relevant income years.

Mr Burns was originally classified as having Class A invalidity from 13 December 1994. He was subject to reclassification on multiple occasions, including a period when his invalidity pension was cancelled. Relevantly, he was reclassified as Class B from 14 October 2003, at which time he again became entitled to an invalidity pension, and then subsequently as Class A on 11 August 2008.

Issues decided by the Court

A superannuation income stream benefit under subsection 307-70(1) of the *Income Tax Assessment Act 1997* (ITAA) is a superannuation benefit specified in the *Income Tax Assessment Regulations 1997* (ITAR) that is paid from a superannuation income stream. A superannuation benefit that does not satisfy these requirements defaults to be a superannuation lump sum under subsection 307-65(1) of the ITAA.

The cases considered three broad issues:

1. whether the ITAR did specify superannuation benefits to be superannuation income stream benefits
2. whether the invalidity benefit pension was a superannuation income stream under subparagraph 995-1.01(1)(a)(ii) of the ITAR because it was a pension under the *Superannuation Industry (Supervision) Act 1993* (SISA Act) where the rules under which the benefits were paid complied with the pension standards set out in the *Superannuation Industry (Supervision) Regulations 1994* (SISR), and
3. in the cases of Mr Burns and Mr Douglas, whether the invalidity pension was a superannuation income stream under paragraph 995-1.01(1)(b) of the ITAR because it was an income stream that had commenced before 20 September 2007.

1. Specification of superannuation benefits to be superannuation income stream benefits

The Court accepted the Commissioner's argument that the definition of 'superannuation income stream benefit' contained in the ITAR during the relevant timeframes did provide the requisite specification for superannuation benefits to be superannuation income stream benefits (at [87] and [106]). While acknowledging some concerns with the drafting, the Court observed that this position was consistent with the purpose of the definition in the ITAR. The text of the definition regulation did not preclude the Court from giving effect to the purpose of the 2007 amendments to both the ITAA and the ITAR which brought in the concept of a superannuation income stream benefit (at [98]).

In making this finding, the Court was not required to consider issues concerning the application of amendments made to the ITAR in 2018 which were made with retrospective application to specify superannuation benefits to be superannuation income stream benefits.

2. Superannuation income stream – pension standards test

The Court held that the rules of the MSB Scheme (the MSB rules) under which the invalidity benefits were paid do not satisfy the pension standards in the SISR. In order to satisfy the relevant standard in subregulation 1.06(2) of the SISR, the MSB rules had to ensure:

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

The Court found that the MSB rules do not ensure the benefit is payable for the lifetime of the recipient (at [125]). The fact that the pension could be cancelled (due to their invalidity classification being reviewed) meant that the MSB rules do not ensure that the pension was paid at least annually throughout the life of the primary beneficiary (at [133]), nor were the size of the payments fixed, subject to variation as contemplated by the MSB rules (at [141]). The Court came to a similar conclusion with respect to the rules of the DFRDB Scheme (the DFRDB rules) that the DFRDB rules do not ensure that the benefit is paid at least annually or at least annually for the person's lifetime (at [168] to [169]).

3. Superannuation income stream – pension that started before 20 September 2007

The Court found that under the MSB rules, once a person is retired on the ground of invalidity, from the point in time that the person is first classified as Class A or Class B, that person becomes entitled to an 'invalidity pension' – namely 'invalidity benefits' under Class A or Class B – the amount of which will vary according to the terms of the MSB rules (at [130]). The invalidity pension payments were an 'income stream' (at [140]). Accordingly, a pension that commenced before 20 September 2007 that was subject to reclassification between Class A and Class B (and was not cancelled and recommenced) meets the definition of a superannuation income stream. This was the case with respect to Mr Burns (at [148] to [149]).

The Court found that the arrears payment made to Mr Douglas under the DFRDB Scheme was part of an income stream that was a pension within the meaning of the SISA Act (at [156]). However, Mr Douglas was subject to a determination made by the CSC on 4 November 2014 that created an entitlement to invalidity payments that were taken to have commenced on 2 September 2002. The Court found that the entitlement to the arrears payment did not arise until 4 November 2014 (at [161]).

The 'statutory fiction' under section 37 of the *Defence Force Retirement and Death Benefits Act 1973* (DFRDBA) that Mr Douglas was taken to have been retired on the ground of invalidity or of physical or mental incapacity to perform his duties from 2 September 2002 did not extend to the application of the ITAA. Accordingly, the deeming which operated by reason of section 37 of the DFRDBA did not create or deem an income stream for the purposes of the ITAR to have commenced before 20 September 2007.

ATO view of decision

The Commissioner accepts that it was open to the Court to decide that the MSB rules and the DFRDB rules under which the invalidity benefits were paid did not satisfy the requirements of subregulation 1.06(2) of the SISR. Accordingly, invalidity benefits paid under pensions provided under the MSB Scheme or the DFRDB Scheme that commenced on or after 20 September 2007 are superannuation lump sum benefits. Invalidity benefits paid under pensions provided under the MSB Scheme or the

DFRDB Scheme that commenced before 20 September 2007 are superannuation income stream benefits.

Implications for impacted advice or guidance

The Commissioner has updated the ATO webpage to reflect the Court's decision.

Further details are available at [Tax on benefits](#) and [Treatment of military invalidity benefits](#). These pages will be updated as required.

Date issued:

11 February 2021

Legislative references

Income Tax Assessment Act 1997

307-65(1)

307-70(1)

Income Tax Assessment Regulations 1997

995-1.01(1)(a)(ii)

995-1.01(1)(b)

Supervision Industry (Supervision) Act 1993

Supervision Industry (Supervision) Regulations 1994

1.06(2)

Defence Force Retirement and Death Benefits Act 1973

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Other references

[Tax on benefits](#)

[Treatment of military invalidity benefits](#)

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