



Australian Government
Department of Social Services

Submission to Senate Community Affairs Legislation Committee Inquiry into the Social Services and Other Legislation Amendment (Military Invalidation Payments Means Testing) Bill 2024

Department of Social Services

MARCH 2024





Table of Contents

Introduction.....	2
Means testing for income support.....	2
Impact of the <i>Douglas</i> decision.....	2
Objectives of the Bill	3
Key Elements of the Bill	4
Military invalidity pension income stream	4
Special reduction amount	4
Validation provisions	5
Consequential amendments	5
Impacts.....	6
No impact on existing Government response to the <i>Douglas</i> decision	6
No impact on family law treatment of military invalidity pensions	7
Financial impacts	7
Conclusion.....	8
Consultation.....	8

Introduction

The Department of Social Services (the department) welcomes the opportunity to provide a submission to the Senate Community Affairs Legislation Committee Inquiry (the Committee).

This submission provides the Committee with information to assist its consideration of the Social Services and Other Legislation Amendment (Military Invalidity Payments Means Testing) Bill 2024 (the Bill), introduced into Parliament on 15 February 2024.

The Bill amends the *Social Security Act 1991* (SS Act) and the *Veterans' Entitlements Act 1986* (VE Act) to provide a clear legal basis for the treatment of military invalidity pensions affected by the Full Federal Court decision in *Commissioner of Taxation v Douglas* [2020] FCAFC 220 (the *Douglas* decision) within the social security and veterans' entitlements means test.

The Bill was referred to the Committee for inquiry on 29 February 2024. The Committee is due to publish its report by 10 April 2024.

Means testing for income support

The purpose of the income support system is to provide support for basic living expenses to people who cannot fully support themselves. The system uses means testing to target support to those who need it most, and aims to provide similar levels of support to people with similar levels of income or assets.

In line with these key principles of the system, income support payments and benefits are subject to means testing. The means test consists of an income test and an assets test. The test that results in the lower rate of payment is the one that applies for a particular individual.

For the purposes of the SS Act and VE Act, an income stream is a regular series of payments made directly from superannuation or purchased with a lump sum. This definition may differ from the definition used in taxation law.

Income streams may be assessed under the income test only, or under the income test and the assets test, depending on the features of the income stream and the way it is categorised and treated under the two Acts. This determines what impact the income stream can have on a person's income support payment rate if the person seeks assistance through the income support system.

Impact of the *Douglas* decision

The *Douglas* decision found that military invalidity benefits paid under the Military Superannuation and Benefits Scheme and the Defence Force Retirement and Death Benefits Scheme (the affected invalidity payments) commencing on or after 20 September 2007 should be taxed as superannuation lump sums rather than superannuation income streams. Prior to the *Douglas* decision, the affected payments were taken to be superannuation income streams for tax purposes.

The *Douglas* decision is highly complex, and it has taken considerable time to identify and clarify the additional consequences of the decision on the SS Act and

VE Act. It is now clear the decision prevents the affected invalidity payments from being treated as “defined benefit income streams” or “assets test exempt income streams” under the two Acts.

However, that is how the affected invalidity payments have been treated historically.

This outcome follows from the Court’s finding that the affected payments may not be “taken to be a pension” for the purposes of the *Superannuation Industry (Supervision) Act 1994* under the *Superannuation Industry (Supervision) Regulations 1993*. A defined benefit income stream under the SS Act and VE Act must meet this requirement.

In addition, in light of *Douglas* the payments can no longer be taken to satisfy the lifetime income stream requirements necessary for them to be regarded as assets-test exempt income streams under the two Acts.

No appropriate alternative classification can be identified in the Acts. As a result, there is no clear legal basis for the treatment of the affected invalidity payments in the means test.

Amendments to legislation are required to ensure there is a fair and clear legal basis for assessing the income from these payments when people seek assistance through the income support system.

Objectives of the Bill

The Bill will establish a clear legal basis for means testing the affected military invalidity payments when recipients also seek support through the income support system.

While the existing legislative framework can no longer be applied to these invalidity payments for technical reasons due to the *Douglas* decision, the outcomes of historical means test assessments under that framework remain appropriate and consistent with income support principles.

The characteristics of the payments relevant to their assessment in the means test have not been changed by the *Douglas* decision. The payments continue to provide a regular fortnightly income, the gross amount of the payments has not been reduced and in most cases, veterans have more disposable income because they pay less tax on their invalidity payments.

The Bill therefore aims to ensure veterans and their partners continue to receive income support at a rate that is consistent with income support principles and the entitlements of other income support recipients, including other veterans who receive retirement benefits from the same military superannuation schemes (retirement benefits are unaffected by the *Douglas* decision).

These provisions will apply in determining income support payment rates for existing social security recipients with income from an affected invalidity payment, as well as new applicants, from the day after the Bill receives Royal Assent.

The Bill also includes provisions to validate past assessments of the affected invalidity payments under the means test for income support, which may be invalid in light of the *Douglas* decision.

These provisions will be administered by Services Australia and the Department of Veterans' Affairs.

Key Elements of the Bill

Military invalidity pension income stream

The Bill introduces a new category of income stream into the two Acts, to be known as a *military invalidity pension income stream*. The new category will include the affected invalidity payments.

The assessment of a military invalidity pension income stream within the income test is designed to produce the same result as the historical assessments of the affected invalidity payments. Military invalidity pension income streams will also be exempt from the assets test, consistent with the historical treatment applied to the affected invalidity payments.

These provisions are intended to ensure veterans with income from a military invalidity pension income stream receive income support at the same rate they were always intended to receive, and consistent with outcomes for other veterans.

The Bill includes an instrument making power that provides for the Secretary of the Department of Social Services, or the Repatriation Commission, to specify an income stream as a military invalidity pension income stream by making a legislative instrument under the SS Act or VE Act respectively.

The instrument making power will allow for certain incapacity payments provided by a small number of legacy superannuation schemes to be treated on the same basis as military invalidity pensions affected by the *Douglas* decision. These payments may also fail to meet the requirements for being treated as a defined benefit income stream in the means test, for reasons independent of *Douglas*. The need to include arrangements for these schemes was identified in consultations with the Department of the Treasury.

Special reduction amount

To assess the amount of income a person is taken to receive from a military invalidity pension income stream each year, a “special reduction amount” will be subtracted from the annual gross payment provided by the income stream.

The special reduction amount is defined to be the sum of the amounts that would be the tax-free components of the income stream payments under the *Income Tax Assessment Act 1997*, if it were assumed that the payments are a superannuation income stream within the meaning of that Act.

This definition is intended to produce the same assessment of income as was obtained prior to the *Douglas* decision, when the affected payments were taken to be asset-test exempt defined benefit income streams under the two Acts and were taken to be superannuation income streams for tax purposes.

Validation provisions

The findings of the *Douglas* decision make the legal basis for the historical treatment of the affected payments in the means test unclear. Despite this, the historical means test assessments reflect the intended policy outcomes and are consistent with outcomes for other veterans within the income support system.

To resolve this uncertainty, the Bill contains validation provisions to preserve the validity of past means test assessments that were made on the basis that the affected invalidity payments could be treated as assets-test exempt defined benefit income streams under the two Acts.

It is highly unlikely that any veteran and/or their partner would be detrimentally affected by the operation of the validation provisions, because the validation provisions deem the historical treatment of the affected payments in the means test to be valid and effective, and to have always been valid and effective.

The provisions do not operate retrospectively to change anything that occurred in the past, including the income assessments for the affected invalidity payments performed by Services Australia or the Department of Veterans' Affairs, and the rates of income support veterans and/or their partners received on the basis of these assessments. The provisions cannot result in any debts arising for past periods.

The validation provisions will have the same effect in the event that a person's assessable income from the affected invalidity payments is worked out after the Bill commences, but for periods prior to the commencement of the Bill. This will ensure the person's assessed income will be the same as if it had been worked out at that past time and in line with the operation of relevant legislation as it was then applied.

These provisions preserve the validity of historical income and asset assessments relating to the affected payments, without removing rights of review or appeal in cases where decisions may have been invalid for other reasons.

Consequential amendments

As a consequence of the amendments contained in the Bill, two legislative instruments in the social security portfolio will require minor amendments. These are technical changes required to support the administration of the amendments in the Bill. They do not prevent the Bill's passage.

The Social Security (Obtaining Information to Verify Claims – Income Stream Recipients) Specification 2017 requires superannuation providers to give information about a class of persons to the department for certain purposes, including the basic information required for the means test. The instrument will be amended to include appropriate references to the new category of military invalidity pension income stream. The power to amend this instrument is with the Minister for Social Services.

The Social Security (Family Law Affected Income Streams) Principles 2022 provides the decision-making principles the Secretary (or delegate) must have regard to when working out the income and assets resulting from various forms of "family law affected income streams". These are income streams that must be "split" between the former members of a couple after a divorce or separation due to a decision of the Family Court.

This instrument references most of the income stream categories recognised in the SS Act and is reviewed and updated from time to time. It will be amended to include appropriate references to military invalidity pension income streams. The power to amend the instrument rests with the Secretary or his delegate in the department.

Impacts

Approximately 850 current income support recipients are veterans with income from an affected invalidity payment, or their partners. While more than 16,000 veterans in total are receiving an affected invalidity payment from the Commonwealth Superannuation Corporation, the payments usually provide income at a level that has always precluded people from income support.

In almost every case, the amendments in the Bill will result in no change to the rate of income support veterans or their partners are currently receiving. The Bill is designed to ensure the affected invalidity payments can be assessed in the means test in a way that delivers the same outcomes for veterans as the pre-*Douglas* arrangements.

As a result of Administrative Appeals Tribunal (AAT) processes in the period since the *Douglas* decision was handed down, the Department is aware of a very small number of individuals, less than 5, currently receiving an income support payment at a rate higher than they will be entitled to after the Bill takes effect.

The AAT's decisions in this period were made in the context of the *Douglas* decision and the uncertainty of its impact on means testing. However, there is no appropriate treatment of the affected invalidity payments under the current legislation. Outcomes in the AAT since *Douglas* have been inconsistent because the law is genuinely unclear.

The Bill will address this uncertainty by providing a clear legal basis for the treatment of the affected payments in the means test.

After the commencement of the Bill, these individuals' income support payment rates will be reset to a level consistent with what was always intended by policy and legislation, and with the rates provided to other veterans, including those receiving retirement benefits from the same military superannuation schemes. No debts will be incurred by these individuals.

No impact on existing Government response to the *Douglas* decision

While the *Douglas* decision meant most veterans would have a favourable end of year tax treatment, a small number were made worse off. It also resulted in some veterans facing unfavourable tax withholding on a fortnightly basis.

In June 2023, the Government passed legislation, *Treasury Laws Amendment (2022 Measures No. 4) Act 2023* ('*Taxation of military superannuation benefits*') (the *Douglas* response legislation), to ensure that affected veterans would not face adverse tax outcomes as a result of being taxed as lump sums by providing a new tax offset, the 'veterans' superannuation (invalidity pension) tax offset'.

The *Douglas* response legislation also maintained the tax benefits of the decision for those who received more favourable end of year tax treatment. These changes also apply to Spouse and Children's pensions paid to a spouse or child following the death of a member of the Military Superannuation and Benefits Scheme and the Defence Force Retirement and Death Benefits Scheme affected by the *Douglas* decision.

The Bill has no impact on these existing tax benefits for veterans. It also has no impact on the benefits that flow from any changes to their taxable income in areas such as Family Tax Benefit or Childcare Subsidy. These and other family payments are provided under family assistance law. Eligibility is based on *adjusted taxable income* rather than the income and assets tests used in the income support system.

The amendments in the Bill make no changes to family assistance law and will have no impact on a veteran's adjusted taxable income or their eligibility for payments that depend on it.

No impact on family law treatment of military invalidity pensions

The amendments in the Bill do not change the family law treatment of the affected military invalidity pensions.

For the purposes of family law, military invalidity pensions are a form of superannuation and are treated as property which can be split as part of a family law property division. This was confirmed in the decision in *Campbell v Superannuation Complaints Tribunal* [2016] FCA 808. Parliament's intention was for these types of pensions to be subject to family law superannuation splitting, and the legislation governing these schemes explicitly provides for this.

A family law court will only split an invalidity pension with a former spouse where the court finds that it is just and equitable to do so. The court takes into consideration the contributions that each party has made to the relationship (including financial and non-financial) and the future requirements of each party (including whether they have care of any children).

The outcome of the *Douglas* decision in taxation law has not affected the power of the family court to split an invalidity pension as part of a family law property settlement. This is because the *Family Law (Superannuation) (FLS) Regulations 2001* rely on a broader definition of 'pension' than what was considered in the *Douglas* decision. The FLS Regulations provide that for the purpose of family law superannuation splitting, pensions, including military invalidity pensions, which can be varied, suspended, or cancelled, are lifetime pensions or pensions payable for the life of the member spouse.

The income support system will continue to respond appropriately to family law orders relating to the affected invalidity payments.

Financial impacts

The amendments in the Bill have a financial impact of \$11.9 million (departmental cost) over the period from 2023-24 to 2027-28.

Conclusion

The Bill responds to uncertainties introduced by the *Douglas* decision by providing a clear legal foundation for the assessment of affected military invalidity payments in the means test for income support.

The provisions in the Bill are intended to ensure veterans and their partners continue to receive assistance through the income support system at a level consistent with income support outcomes for other veterans, and with the intent of legislation and policy before the *Douglas* decision.

The department notes the Bill has a commencement date of the day after Royal Assent.

Consultation

The Department of Veterans' Affairs, the Department of the Treasury and the Attorney-General's Department were consulted and provided input to assist in the preparation of this submission.