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Military invalidity pensions - Douglas decision

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Military invalidity pensions – Douglas decision

Work out if your military invalidity pension is affected by the *Douglas* decision and what it means for your tax.

Advising you of your options
We're writing to veterans affected by the *Douglas* decision who will receive a new tax offset or are yet to request a review of their prior year tax returns to advise on their options. See We're contacting some veterans.

On this page

The *Douglas* decision

The Federal Court decision in Commissioner of Taxation v Douglas [2020] FCAFC 220 (the *Douglas* decision) found that, from 1 July 2007, certain invalidity pension payments for veterans and their beneficiaries are superannuation lump sums, and not superannuation income stream benefits.

The vast majority of veterans will be in a better tax position due to the *Douglas* decision – paying less tax. Tax will increase for a small number of veterans.

As a result of the *Douglas* decision:

- a new veterans' superannuation (invalidity pension) tax offset (VSTO) has been introduced to ensure veterans and their beneficiaries don't pay more tax because of the *Douglas* decision
- a simplified review process is available to amend prior year tax assessments for veterans – whether you pay less tax following the *Douglas* decision or are entitled to a VSTO amount.

Who is affected by the *Douglas* decision?

You are affected by the *Douglas* decision if you're a veteran or their beneficiary and your invalidity pension payment:

- started on or after 20 September 2007, and
- is paid by the Commonwealth Superannuation Corporation (CSC) under either
  - the Defence Force Retirement and Death Benefits (DFRDB) scheme
  - the Military Superannuation and Benefits scheme (MSBS).

You will enter your military invalidity pension payment amount at question 8 Australian superannuation lump sum payments in your tax return.

Note: if you stopped receiving payments for a period of time, you may have a new start date for your invalidity pension.

Find out how the decision affects you.

If your invalidity pension does not meet the above 2 conditions, you're not affected by the *Douglas* decision and your payments were correctly taxed as superannuation income stream benefits (recorded at question 7 Australian annuities and superannuation income streams in your tax return).

When your invalidity pension started

You're only affected by the *Douglas* decision if your invalidity pension start date was on or after 20 September 2007. Your pension start date will be shown on documents provided to you by the CSC.

The start date will generally align with when you were classified as having either a Class A or B incapacity.

Example: invalidity pension started before 20 September 2007

Sandra was discharged on 2 July 2007. On 24 July 2007, she was determined by CSC as having a Class B incapacity and started receiving invalidity pension payments. The classification has remained the same since.

As Sandra's invalidity pension started before 20 September 2007, she is not affected, and her invalidity pension payments were correctly taxed as superannuation income stream benefits.

If your date of discharge was on or after 20 September 2007, any invalidity pension will always start on or after 20 September 2007.

There may have been a gap between your discharge date and your invalidity pension start date. Whether you're affected will depend on when your invalidity pension started, not your discharge date.

Example: invalidity pension started on or after 20 September 2007

Bryce was discharged on 15 September 2007. On 19 November 2007, he started receiving invalidity pension payments in accordance with being determined by CSC as having a Class A incapacity – the classification has remained the same since.

Even though Bryce was discharged before 20 September 2007, his invalidity pension started after 20 September 2007. As such, he is affected by the *Douglas* decision and his invalidity pension payments are taxed as superannuation lump sums.

Reclassification of your invalidity pension

Reclassification of your invalidity pension can determine if you are affected by the *Douglas* decision.

If you were reclassified on or after 20 September 2007 from:

- a retirement pension to an invalidity pension, you are affected by the *Douglas* decision because your invalidity pension start date is after 20 September 2007
- one DFRBD invalidity pension class that started before 20 September 2007 to another invalidity pension class, you are not affected by the *Douglas* decision because your invalidity pension start date doesn't change
- one MSBS invalidity pension class that started before 20 September 2007 to another invalidity pension class, and your payment stops and restarts
  - if it's backdated to the date the payments stopped, it's not affected by the *Douglas* decision because your invalidity pension start date doesn't change
  - if it's not backdated, you are affected by the *Douglas* decision because your new invalidity pension start date is after 20 September 2007.

Example: reclassification with a new start date

Shane received an invalidity pension from the MSBS that started in August 2005.

In July 2008, Shane's invalidity pension status is subsequently reviewed and ceased. CSC reviews Shane's circumstances in October 2010 and determines that he is eligible for a new invalidity pension.

As Shane started a new pension after 20 September 2007, the *Douglas* decision applies to Shane's invalidity pension payments from October 2010.

A classification (or reclassification) with a retrospective effective date does not change the date that the invalidity pension started.

Example: classification to Class A with backdated effect

Roger was discharged on administrative grounds on 2 October 2005. On 14 October 2005, he started receiving retirement benefits and was not considered eligible for an invalidity pension.

On 19 May 2010, CSC determined that Roger should have been discharged on medical grounds and classified as having a Class A incapacity. The effective start date for the invalidity pension is 14 October 2005.

While the effective start date is 14 October 2005, CSC started paying the invalidity pension (including a lump sum payment in arrears) on 14 June 2010.

Roger is affected by the *Douglas* decision as the invalidity pension started for tax and superannuation purposes after 20 September 2007. His invalidity pension payments are taxed as superannuation lump sums from 14 June 2010 onwards only.

How the decision affects you

How the *Douglas* decision affects your tax position depends on a range of factors, including your age and whether you receive a disability superannuation benefit (DSB) or have service days before 1 July 1983.

The vast majority of veterans and their beneficiaries will pay less tax. A small number of veterans and their beneficiaries would pay more tax without the new tax offset.

When you will pay less tax

You are most likely to pay less tax because of the *Douglas* decision if you are a:

- veteran under 60 years old – as your invalidity pension is taxed more concessionally as a super lump sum
- veteran 60 years old or older who either
  - receives a disability superannuation benefit (DSB), or
  - has service days before 1 July 1983.

If you receive a DSB or have service days before 1 July 1983, this increases your tax-free component. When you combine this with the changes due to the *Douglas* decision, you will generally pay less tax overall.

If you are paying less tax because of the *Douglas* decision, you may want to amend prior year tax assessments (back to the 2010–11 income year) using our simplified review process. You may be entitled to a refund.

Example: does not pay more tax because of the Douglas decision

Dev receives an invalidity pension from the MSBS that started in January 2008. Dev is under 60 years old and is not eligible for DSB tax status and has no pre-July 1983 service days.

The *Douglas* decision means Dev's invalidity pension is treated as a superannuation lump sum for income tax purposes but there is no change to the amount included in his taxable income.

As a result, his taxable income will not change. Because Dev is under 60 years old, his invalidity pension is taxed more concessionally as a super lump sum.

Dev is paying less tax because of the *Douglas* decision. He signs up to participate in the simplified review process to amend his 2010–11 to 2019–20 tax returns. He will also need to lodge an objection to amend his 2007–08, 2008–09 and 2009–10 returns.

Example: disability super benefit tax status

Graham is 65 years old and receives an invalidity pension from the DFRDB scheme, which started on 13 March 2010. Graham is also eligible for DSB tax status.

The *Douglas* decision applies to his invalidity pension, which is now taxed as a super lump sum – which also increases his tax-free component.

Graham not only receives more favourable tax treatment because his pension is being treated as a lump sum but also a decrease in his taxable income because of the tax concessions due to his DSB status.

Graham may wish to participate in the simplified review process to amend his prior year returns.

When you would pay more tax

You are likely to pay more tax because of the *Douglas* decision if you are 60 years old or older and one or both of the following apply:

- you don't have service days before 1 July 1983
- your invalidity pension is not classed as a DSB.

The veterans' superannuation (invalidity pension) tax offset (VSTO) will offset any additional tax you would have paid because of the *Douglas* decision.

Example: additional tax offset by the VSTO

Lottie receives a modest invalidity pension from the DFRDB scheme that started on 15 January 2015 but is not eligible for DSB tax status.

Lottie is over 60 years old and was previously eligible for a 10% superannuation tax offset on the untaxed component of the benefit because it was a superannuation income stream for income tax purposes. However, because of the *Douglas* decision, Lottie's invalidity pension is now considered to be a superannuation lump sum for income tax purposes.

So, Lottie's invalidity pension is no longer eligible for the 10% superannuation income stream tax offset. But she is now eligible for a superannuation lump sum tax offset. The superannuation lump sum tax offset is capped at 15% but varies depending on how much income a person receives. In Lottie's case, the superannuation lump sum tax offset she is entitled to is less than the 10% superannuation tax offset she would have been eligible for but for the *Douglas* decision.

This means she would pay more tax following the *Douglas* decision.

Lottie is eligible for the VSTO, ensuring she is in exactly the same income tax position as she would have been before the *Douglas* decision.

We're contacting some veterans

We are progressively writing to some veterans who are affected by the *Douglas* decision.

We are writing to veterans who are entitled to a veterans' superannuation (invalidity pension) tax offset (VSTO) amount greater than $0. These letters outline what we are doing to apply the VSTO to your tax returns, including for prior year assessments and future tax returns.

In February, we commenced inviting some veterans to participate in the simplified review process. Personalised letters advise how to apply for a review of your tax assessments that include invalidity benefits for the 2010–11 to 2019–20 income years.

We're committed to finalising reviews as quickly as possible – see Process and timeframes.

Veterans' superannuation (invalidity pension) tax offset

The veterans' superannuation (invalidity pension) tax offset (VSTO) is a non-refundable tax offset that ensures veterans and their beneficiaries do not pay more tax because of the *Douglas* decision. It applies from the 2007–08 income year.

All veterans affected by the *Douglas* decision are eligible for the VSTO. However only a small number of veterans will be entitled to a VSTO amount because the *Douglas* decision has resulted in them paying more tax.

You don't need to apply for the VSTO. We will work out if you are entitled to a VSTO amount after you lodge your tax return. Your notice of assessment will include any VSTO amount you are entitled to and how it was applied.

We are writing to veterans who are entitled to an amount of the VSTO. See We're contacting some veterans.

VSTO for prior year tax returns

If you want to be assessed for a VSTO entitlement for any tax returns you lodged for the 2010–11 to 2019–20 income years, you need to participate in the simplified review process. As part of this process, we will work out if you're entitled to a VSTO.

If you have already participated in the simplified review process, we will work out if you are entitled to a VSTO for any years we have already reviewed.

How we work out the tax offset

After you lodge your tax return each year, we will work out your entitlement to any VSTO amount. We are unable to advise you what this amount will be before you lodge your tax return.

We work it out as follows:

> Your income tax liability if your invalidity pension is treated as a super income stream
>
> minus (−)

Your income tax liability if your invalidity pension is treated as a super lump sum

equals (=)

Your VSTO amount (if greater than zero).

In most cases, the offset calculation will be part of the normal tax return processing timeframes. However, it may take longer to work out your VSTO (extending the processing time), if you have any of the following complex circumstances:

- special professional averaging
- foreign residency
- employment termination payments or 'lump sum A' payments
- primary production averaging
- lump sum payment in arrears.

How the VSTO is applied

If you're entitled to a VSTO amount, we will use it to reduce any tax you need to pay. If your tax is reduced to zero, we will use any remaining VSTO amount to reduce any Medicare levy, or Medicare levy surcharge you may need to pay.

Any VSTO amount remaining can't be refunded to you, transferred, or carried forward into future income years.

Any offset amount you are entitled to will be shown on your notice of assessment.

Example: How the VSTO amount is applied

Andrew is 62 years old and receiving an invalidity pension from the MSBS that commenced in March 2019. His invalidity payments are affected by the *Douglas* decision.

When processing Andrew's 2022 tax return, we work out:

- Andrew's tax payable would be $950 before applying the VSTO
- Andrew is exempt from paying the Medicare levy and Medicare levy surcharge
- Andrew would pay more tax due to the *Douglas* decision and is entitled to a VSTO amount of $900.

We use Andrew's VSTO amount to reduce his tax payable to $50.

The CSC withheld $2,200 in tax from Andrew's invalidity payments. As his tax payable is now $50 and he has no other outstanding debts, we will refund $2,150 to Andrew.

Your notice of assessment

Information about your VSTO entitlement if any, and how it was applied, will be included with your notice of assessment.

Your tax returns

If you're affected by the *Douglas* decision, when you lodge your tax return:

- your military invalidity pension payment will be treated as a superannuation lump sum payment
- we will work out any VSTO amount you are entitled to and use it to reduce your tax and Medicare liabilities
- details of any VSTO entitlement will be included with your notice of assessment.

You need to include your military invalidity pension payment amounts in your tax return at question 8 Australian superannuation lump sum payments. These amounts will be shown in your CSC payment summary. If you lodge using myTax, we will normally pre-fill this amount in your tax return. If it's not pre-filled, you will need to manually include it.

If you reached your preservation age or turned 60 years old during the income year, you will get 2 payment summaries from CSC:

- one showing 1 July as the date of payment for all payments made to you before you reached preservation age or turned 60 years old
- a second showing your most recent birthday as the date of payment or 30 June for all payments made to you after you reached preservation age or turned 60 years old, reflecting the way this income is taxed when this happens.

2020–21 and 2021–22 tax returns

If you included your military invalidity pension payment amounts in your 2020–21 and 2021–22 tax returns at question 8 Australian superannuation lump sum payments, we will determine if you are entitled to a VSTO amount.

If you are entitled to a VSTO amount greater than $0, we will amend your tax assessment. You will receive an amended notice of assessment which will include the amount of VSTO and how it was applied. In most cases this will be sent to your myGov Inbox.

We're committed to amending your tax returns as quickly as possible, but each person's circumstances are different and some amendments can take some time to complete. See Process and timeframes.

Simplified review process for 2010–11 to 2019–20

Our simplified review process will amend your tax assessments in line with the *Douglas* decision.

If you participate, we will amend your tax assessments for the 2010–11 to 2019–20 income years.

To be eligible for the review process, you must:

- be affected by the *Douglas* decision
- have lodged all overdue tax returns – check and lodge any outstanding returns.

Before participating in our review process, it's important you understand:

- the potential outcomes of a review
- the process and timeframes.

To participate in our simplified review process, complete the form Request for objection – for recipients of certain invalidity benefits (NAT 75383). This authorises us to review and amend your tax assessments for the relevant income years to reflect the correct taxation position. See We're contacting some veterans.

Potential outcomes of a review

It's important to consider the likely outcomes before deciding whether to participate. You may wish to seek professional financial advice to understand how a change in your taxable income affects your circumstances, including your superannuation and other payments and obligations.

The outcome of your review will depend on your personal circumstances, and may result in any of the following:

- a credit assessment – but your refund may be reduced by any debt you owe to us or another Australian Government agency (see Offsetting your credit or refund)
- a debit assessment, that is you will be liable to pay more tax – in which case we'll contact you to discuss your options including a payment arrangement with favourable terms
- no change to your tax outcome overall
- a change to your taxable income with financial impacts on other payments and obligations, such as
  - family tax benefits
  - child care subsidy
  - parental leave payment
  - child support (see, Services Australia website for information on Act of Grace payments (PDF 165KB))
  - other government support payments that take into account your taxable income.

Process and timeframes

We're committed to finalising reviews as quickly as possible, but each person's circumstances are different. If you do participate in this process, it could take time to determine any refund owing to you, but we will keep you informed along the way.

Complex cases can take longer due to circumstances such as:

- receiving disability superannuation benefits
- if you have lump sum payment in arrears
- multiple super schemes
- being party to a family law split
- bankruptcy
- multiple income years to amend.

We will work out any VSTO you may be entitled to when we review your assessments. If you are entitled to a VSTO amount, your amended notice of assessment will advise how much you're entitled to and how it was applied.

Once the review process is complete, we'll send you an amended notice of assessment. In most cases this will be sent to your myGov inbox.

Disability superannuation benefits

If you believe you qualify to have your military invalidity pension taxed as a DSB, you can apply to CSC for a determination.

If CSC reclassifies your benefit as a DSB, they will inform the ATO so we can ensure you're taxed correctly. We use DSB data, provided to us monthly from CSC, to amend your tax returns. This process can take up to 3 months.

Review of 2007–08 to 2009–10 tax returns

The streamlined review process does not apply to the 2007–08 to 2009–10 income years. You can request a review of your income tax assessments for these years through the normal objection process.

As part of your objection request, you'll need to:

- include a written request for an extension of time as these tax periods are outside the period of review
- provide the necessary evidence that supports any amendments to your assessments for these years. You should be able to obtain this information from CSC.

PAYG withholding

Your fortnightly invalidity pension payments are subject to the pay as you go (PAYG) withholding system. The amount withheld depends on, among other things, whether your payments are either:

- super income stream benefits
- super lump sum payments.

If your invalidity pension payments are affected by the *Douglas* decision and are therefore super lump sum payments, you don't need to do anything. CSC has determined which rates apply to you and is withholding the updated amounts from your fortnightly payment. Your withholding amounts will take into account the tax-free threshold and Medicare levy exemption if you have claimed them.

The withholding rates are set out in the Tax table for super lump sums but with a modification that may reduce the amount if you have claimed the tax-free threshold from CSC.

If you're not affected by the *Douglas* decision, the Tax table for super income streams continues to apply.

Different PAYG withholding tax tables apply depending on your personal circumstances. Individuals with the same invalidity pension payment per fortnight may have different amounts of PAYG withheld and, therefore, different take home amounts.

Adjust your PAYG withholding

Depending on your personal financial circumstances, you may want to consider:

- whether you claim the tax-free threshold for your invalidity pension payments from CSC
- varying your PAYG withholding
- claiming an exemption from the Medicare levy.

Reversionary beneficiaries

You're affected by the *Douglas* decision if both of these apply:

- you're a reversionary beneficiary of a deceased veteran
- at the time they died, the deceased veteran was receiving an invalidity pension that
  - was paid under the DFRDB scheme or MSBS
  - started on or after 20 September 2007.

If you're affected by the Douglas decision

If you are a death benefit dependant under tax law, your reversionary pension is non-assessable and non-exempt income.

This means:

- you don't need to pay tax on your reversionary pension
- you're entitled to a refund of amounts CSC withheld from these pension payments dating back to the 2007–08 income year.

Your 2021–22 tax return

We'll refund any amounts CSC has withheld from your reversionary pension payments during the 2021–22 income year, after you lodge your tax return. This will be in the original tax assessment, or we will issue an amended assessment.

The payment summary CSC sent you includes the amounts withheld from your reversionary pension. You should prepare your return as usual based on the payment summary. We'll also pre-fill your tax return based on the payment summary.

At the same time, we'll amend any other relevant returns within your period of review. For most taxpayers with simple affairs, the amendment period of review is 2 years from the day we issue you with an assessment.

Amending returns outside your period of review

You will need to lodge an objection to amend any tax returns outside your period of review that included your reversionary pension payments – back to the 2007–08 income year.

Before lodging an objection, you need to understand how it may affect you:

- If you have an existing debt with us or another Australian Government agency, any credits will be offset against that debt before any remaining amounts are refunded to you.
- An objection will result in changes to your assessable income on your notice of assessment, which may have financial impacts on other payments and obligations, including
  - family tax benefits
  - child care subsidy
  - child support payments to or from an ex-spouse
  - paid parental leave payments
  - other government support payments that take into account your taxable income.

Seek professional financial advice if you're unsure how an objection to earlier assessments may impact you.

To lodge an objection, see How to object to a decision and get a copy of Objection form – for taxpayers.

> On the objection form clearly state the following:
>
> *I am a reversionary beneficiary of a veteran who was receiving an invalidity pension provided under the MSBS or DFRDB scheme affected by the Full Federal Court decision in Commissioner of Taxation v Douglas [2020] FCAFC 220.*

We've worked closely with CSC and in most cases you will not need to provide any additional information. If we do need additional information, we'll contact you.

Superannuation changes

We used the information from CSC to identify people who are affected by the *Douglas* decision and took action to:

- ensure that payments which are now super lump sum payments are not counted towards your transfer balance cap
- adjust your total super balance as required.

When we adjusted your total super balance, we also checked if this has any impact on whether you had previously exceeded your contributions caps and made corrections where required. We also checked whether the adjustment to your total super balance affected your entitlement to co-contributions or the low income super tax offset.

Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.