



## Newsletter

# Family Law and Invalidity Pensions –a discussion paper

specialising in superannuation valuations for family law purposes since 2003

## Abstract

A soldier returns from Afghanistan and suffers from post traumatic stress disorder. His marriage fails. He is discharged from the Army and awarded an invalidity pension of \$60,000 pa. The family law value (FLV) is about \$1.2m. The wife gets half and enjoys a pension of about \$33,000 for life (she is two years older). The soldier is left with \$30,000 pa. The soldier's health improves and his pension is reduced to \$15,000 as a result. Further health improvements result in the pension being ceased.

The above scenario raises questions of justice and equity. The invalidity pension is mainly compensation for injuries, yet part of the compensation element has been split to the wife. This newsletter looks at the issues associated with splitting invalidity pensions.

With all invalidity cases, the family law value is worth dramatically more the day after the member receives an invalidity pension than it was the day before. In the case of the military, it is not unusual for the superannuation to be worth up to 10 times more! This newsletter will provide the practitioner with enhanced understanding and practical arguments to assist in the negotiation of a just and equitable outcome.

Other occupations facing similar issues with invalidity or hurt on duty pensions are police and fireman. These recipients tend to be older than the typical Defence nvalidity pensioners and as such, the compensation package is smaller. Whilst this newsletter focuses on the military, the same issues can apply to some other occupations.

## Special Characteristics of Defence Superannuation

Defence personnel shared a superannuation scheme with Commonwealth public servants from 1922 until 1948. There were no special invalidity provisions. The Defence Forces Retirement Benefit Act was introduced in 1948 and addressed injury compensation for the ADF. Previous compensation for injuries for ADF personnel was dependent on meeting the criteria for warlike service under the Veteran Entitlement legislation.

For the first time, service personnel would be compensated for injuries during peace time irrespective of whether those injuries originated as a consequence of employment or whilst off duty. Furthermore, due to the high level of fitness required for military service, retirement on invalidity grounds could result from a relatively minor impairment through to significant incapacity



The 1948 Defence Force Retirement Benefits Scheme introduced the concept of a tiered approach to invalidity. ADF members could be classified either as class A - (60% or more incapacity), or class B - (30 to 59% incapacity) or class C, - less than 30% incapacity. The tiered approach compensated Defence members according to the level of their capacity to undertake the civilian employments for which they were deemed to have the qualifications and/or experience. The percentage of incapacity is not a measure of whole of body impairment. Pension benefits are only paid to those classified A or B, with Class C attracting a lump sum at retirement at or after preservation age.

The dual purpose of Defence superannuation - being for retirement and for compensation - has been reproduced in all subsequent defence superannuation schemes. The following example demonstrates this duality of purpose. If an ADF member pulls a mower over his foot while mowing his own lawn and is discharged from the military as a result, his only form of compensation might be a Class A or B or C invalidity benefit. This is in lieu of income from Defence until his retirement. Furthermore, if he was initially granted a Class A pension, he would be subject to review and if his health improved, he would be reduced to a Class B or, worse still, a Class C benefit. Note that for the pension classification to change it is not necessary for the condition to improve. Gaining additional qualifications allow other employment kinds to be taken into account and this may be sufficient to trigger a reclassification. For example, a member with a physical injury and only unskilled laboring experience could be a Class A. If the member obtains accountancy qualifications, incapacity for such employment will be significantly less and a reclassification may be warranted.

In 1991, the Military Superannuation and Benefits Scheme (MSBS) Act introduced the

concept of actual and prospective service. The prospective service is the compensation element. The younger the age, the higher the compensation element as the invalidity benefit assumes an age 60 retirement age. With previous superannuation schemes, the pension benefit was based on a notional 40 years service irrespective of when the member joined the ADF – even if he or she joined at age 45!

The reviewable nature of the invalidity pension precludes payment of lump sums for military invalidity retirees. Some private sector schemes do pay a lump sum but the person must be totally and permanently incapacitated to access it. Such invalidity cases typically involve chronic injuries with very limited life expectancy and no possibility of ever working again.

### **What are the Defence Benefits for Invalidity – Military Super**

If a member joined when he or she was 18 and had an accident or suffered a disability at says 25, the benefits would be one of the following:

**Class A:** - a pension based on the 7 years actually served and a further 35 years of prospective service plus a lump sum of contributions and earning for the 7 years. The ADF member is being compensated for the 35 years that he or she is unable to work. But the benefit is subject to periodic review. The family law values for such pensions range from \$800,000 to \$1.8m.

**Class B:** - as above but the pension is reduced by 50%.

**Class C:** - a lump sum based on own contributions and earning for the 7 years.

### **Splittable Payments – Schemes other than Defence**





Are payments made from an invalidity pension splittable payments? In common with many aspects of family law, the answer is, “ It depends ”.

For those schemes that have approved SSFs, such as the military schemes, payments are splittable in exactly the same way that a retirement pension is splittable. The benefit payable to the non-member spouse is a life time CPI adjusted pension

Where default provisions apply, the issue becomes more complex. *Family Law (Superannuation) Regulations 2001*, Division 2.1, Reg 12 (1) (c), states that any payment for an invalidity pension of less than 2 years duration is not a splittable payment if total and permanent incapacity has not been established.

### **Is a Clean Break Established When an Invalidity Payment is Split? - Schemes other than Defence**

This is an area that requires special attention. Where there are SSFs, the split will result in a clean break.

For those superannuation schemes that have not changed their trust deed to provide for a clean break, any payment to the non-member spouse will cease on the death of the invalid pensioner (assuming no reversionary beneficiary).

For those schemes that have changed their trust deed to allow for a clean break, it cannot be assumed that clean break provisions will automatically apply to invalidity pensioners. For example, the Victorian Emergency Services Scheme creates a clean break for most super splits but applies discretionary powers for payments made in respect of a reviewable invalidity pensions.

### **What Happens to the Non-Member Spouse's Pension if the Defence Member's Health Improves?**

Assume that the wife in my example was allocated 50% of the invalidity pension. The question that needs to be addressed is what happens to her entitlement if the member is subsequently assessed for a lesser pension as a consequence of improvement to health or employment opportunities.

*The Superannuation (Family Law - Superannuation Act 1976) Orders 2004*, provide for a clean break between the parties as a consequence of a splitting order. This means that neither party influences the superannuation holdings of the other. An improvement in the health position or employability of the husband will not result in a diminished benefit for the wife. She retains her entitlement even if the husband suffers a diminished pension.

On the other hand, if the husband does have a 50% superannuation split imposed, and his health or his employability improve, his Class A pension may be reduced to a Class B pension. In these circumstances, his invalidity pension would be reduced by 75% relative to its current position. There would be a 50% reduction by virtue of the superannuation split and a 50% reduction by virtue of improved health.

If the husband continues to improve, he may be left with no pension whatsoever. This is the Class C benefit structure for an invalidity member in MSBS. The Class C benefit is only the member contributions and earnings. This relatively small lump sum benefit is fully preserved and cannot be accessed until the husband is at least aged 60. In the meantime, the wife would have the security of a non-reviewable lifetime CPI indexed pension.





## Is Double Counting Involved Where Superannuation Features Both as an Asset and an Income Stream?

The invalidity pension is paid because the member cannot work any more. If the member had still been at work, his or her wages would not have been capitalised, so is it double counting to count the invalidity pension as both an asset and an income stream? This was the issue considered by the Full Court in DJ & AJ [2006] FamCA 961.

Circumstance: - This appeal case involved a husband who was on an invalidity pension of \$52,146 pa. The husband objected to his super being included in his income asserting that it was double counting to include it as an asset and as income. The wife's income was \$40,000. The family law value (FLV) of the husband's superannuation in the growth phase was \$407,000 and \$865,000 in the payment phase.

Outcome: - The Full Court of Bryant Finn & Coleman dismissed the appeal. The Court ruled that the nature of the "income" is different. The wife earned her income by her own labour whereas his income was through superannuation. The husband does not have to work for his income – the wife does!

Importantly, there was no argument presented in this case that sought to identify the compensation component of the invalidity pension. Compensation for personal injuries has rarely been shared equally between the parties.

### Precedent Cases

Precedent cases support the contention that the real nature of the superannuation interest should be understood and quantified. The authority to look behind the family valuation is first addressed.

The following passages are from the judgment of the majority (Bryant CJ, Finn and Coleman JJ) in the well-known case of Coghlan and Coghlan [2005] FamCA 429; (2005) FLC 93-220:

*67. If this approach is adopted, ..., the real nature of the superannuation interests in question can also be taken into account, both in consideration of the s 75(2) matters and in the final assessment of whether the ultimate order is just and equitable.*

*68. When we refer to "the real nature" of the relevant superannuation interest, we are referring to the fact that notwithstanding that its value according to the Regulations may well be calculated to be a very significant amount, that superannuation interest may be no more than a present or future periodic sum, or perhaps a future lump sum, the value of which at date of receipt is unknown."*

Paragraph 67 and 68 of the above quote refers to the real nature of superannuation. For a military invalidity pension, the real value needs to be assessed in terms of the nature, form and characteristic of superannuation payment.

### Other Cases

The case of Hanlon & Edgar [2008] FamCA 194 (26 March 2008) is also relevant.

First, at paragraph 202, table titled Pool I, a compensation amount of \$39,000 was determined to have a zero value for the purpose of determining the asset pool.

Second, and more importantly, the major asset in this case, valued at \$960,162 is a Class A invalidity pension.

Paragraph 255 states:





*“...The husband commenced to contribute to his superannuation fund in 1983. His entitlement to that fund arises out of his illness. The wife has made no contributions to the fund, although contributions were made by the husband to that fund during the period of the marriage. ...The husband points to the fact that Mr R’s evidence would indicate that the stability of the income stream could change from time to time depending on reassessment. The husband’s entitlement to a pension is not fixed, it is variable, if there is a subsequent review.”*

The outcome in this case was for the wife to be allocated 15% of the pension. The modest allocation of the super relative to other assets (56% to the wife) presumably reflects the above quoted comments - ie the reviewable nature of the Class A pension. Note that the marriage period was 5.25 years.

### **What Information is Provided by Trustees for an Invalidity Pension?**

The superannuation information form provides exactly the same information as for a retirement pension except that the pension is noted to be an invalidity pension. There is no information useful for the family law practitioner in the superannuation information form. The practitioner must look elsewhere.

### **Family Law Valuations (FLV)**

The FLV report will not contain any information that the practitioner can use. The valuation report will simply quantify the capitalised value of the invalidity pension. For those superannuation schemes that make use of scheme specific factors (SSF - see my newsletter dated 31 January 2012 for an explanation of SSF), the family law value is about 15% to 20% less than a normal retirement pension. This reflects the lower life expectancy for invalids.

### **So What Information Source Should the Practitioner Use?**

The most relevant information comes from the trustees but only on request. The member may also be able to provide useful information.

The first issue to establish is whether the pension is reviewable. For long-term invalidity pensioners, the trustees may issue notification that he or she will not be subject to further review. Whilst a non-reviewable invalidity pension diminishes the scope of arguments, the inclusion of compensation still provides a powerful argument for a distribution that favours the member.

For all other invalid pensioners, the pension is most likely to be subject to review. The unpredictable nature of the income stream is a factor to consider.

For those members granted an invalidity pension in recent times (say the last 5 years), documents that give a statement of reasons as to why the invalidity pension was granted could provide information on the long term prognosis and the likelihood of improvement. Recent medical report might also assist.

Quantification is necessary and this is addressed in the next section.

### **Peeling back the Onion**

The increase in the FLV relative to the day before receipt of the invalidity pension is due to a sole event – an injury or sickness preventing continuation of employment. The question arises as to how can practitioners isolate the compensation part of the FLV.

The courts have not given any guidance – reflecting the fact that the argument probably has not been run.





Options to quantify the amount of compensation include:

1. Compare the FLV before the invalidity pension (it would then be in the growth phase) with the FLV of the invalidity pension,
2. Exclude from the FLV of the invalidity pension the prospective years of service,
3. Calculate the component of the pension that would be payable after age 65.

There are pros and cons for each approach and much would depend on the circumstances of the case. For presenting an argument to the other side, the practitioner might only present the most beneficial argument. However, if the matter proceeds to a hearing, all 3 methods could be presented and a mid point selected.

The most important consideration in these cases is to present evidence of the quantification of the compensation component.

The compensation component will be large for a younger member due to the length of their prospective service to age 60. It is also large because the benefit is payable now whereas the normal retirement benefit is only a promise to pay at age 60 and is therefore discounted to take into account the time value of money.

## Two Paths

If the client has received a notice advising that the pension is not subject to further reviews, the matter is more straightforward as the sole argument is to isolate how much of the pension is due to compensation.

If the client is still subject to review, substantially more arguments are available. The first is to assess the likelihood of improvement in health or job prospects. These events could lead to cessation of the invalidity pension. Source documents would include the trustees' reasons

for granting the invalidity pension and supporting medical documentation. Isolating any reasons for improvements adds to the argument that the invalidity pension is uncertain in duration and amount. To give certainty to the non-member spouse through a split and place all the risk of future continuity on the member is manifestly questionable.

## What Has Gone Wrong?

When the invalidity provisions were designed for Defence personnel, the concept of superannuation splitting for family law purposes was not considered. It was not even raised as a possible scenario.

Had the superannuation splitting regime been known at the time of the design of the scheme, it is my view that the compensation aspects would be outside of the superannuation regime so that the member's compensation is not diluted through a superannuation split. In other words, the compensation aspects would be treated as they are for any Veterans Entitlement or Defence Compensation Entitlements. These are not splittable payments although they may be financial resources.

## Conclusion

Invalidity pensions require special consideration. Substantive arguments supported by logical quantification will materially assist the member spouse.

## Other Readers

If you would your colleagues to receive this email, click [here](#) with their email addresses.

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