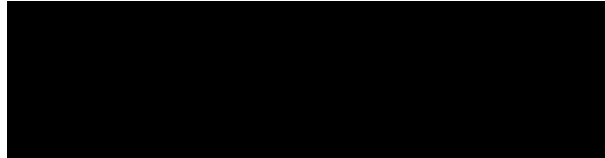


Richard McCullagh



7 August 2016



The Executive Director
Australian Law Reform Commission
GPO Box 3708
SYDNEY NSW 2001

Submission to the elder abuse inquiry

Social Security Act 1991 (Cth) (the **Act**), s 1147(1D)(b)(ii), (the **subsection**), and
Guide to Social Security Law paragraphs 4.6.4.50 and 4.6.4.60, and
Centrelink 'Granny Flats' FIS027.0911 (the **guidelines**, copies attached)

Unintended elder financial abuse - the financial and familial perils of pursuing pension preservation via a 'granny flat interest'

SYNOPSIS

The Act and guidelines encourage age pensioners - in this context, usually a parent - to give their house to, or buy a house in the name of, their child so they can live together and care for each other. Amongst other things, this avoids what would otherwise be deemed to be a gift for the purposes of the means test. The parent's pension entitlements are thus preserved.

However, if circumstances change for the worse, this can be disastrous for the parent, being potentially evicted and left bereft of funds with which to afford alternative accommodation. One way to reduce this risk is to allow for a loan from parent to child in respect of a granny flat interest to be exempt from the definition of a 'financial asset', subject to being limited to the current market value of the house transferred or purchased, or the cost of renovations carried out to accommodate the parent.

A handwritten signature in blue ink, consisting of a stylized 'M' followed by a flourish.

SUGGESTED REFORMS

Firstly, revise the treatment of loans as follows:

- amend s 1147(1D)(b)(i) by inserting the following words shown in italics:
 ‘unless subparagraph (ii) applies – the amount paid *or lent*, or agreed to be paid *or lent*, for the interest, or’
- amend the definition of ‘financial asset’ in 9(1) by inserting the following words shown in italics:
 ‘(e) a loan that has not been repaid in full (*except as referred to in section 1147(1D)(b)(i))*’

Secondly, in guideline paragraph 4.6.4.50,¹ issued pursuant to the subsection, under the heading ‘How to value a granny flat interest’, at the end of the third bullet point,

- Delete the full stop and substitute, ‘, OR’
- Add underneath a fourth bullet point as follows:
 - ‘makes a loan to the person representing the unencumbered market value of the dwelling transferred or purchased or the cost of renovations carried out current at the time of the transfer, purchase or renovation, as the case may be, and subject to interest at a rate not exceeding 4% per annum above the cash rate published by the Reserve Bank of Australia from time to time’.

Thirdly, revise the guidelines under the subsection to give clearer guidance and examples of arrangements that do and do not constitute a ‘granny flat interest’ under the Act, including exemption of loans for granny flat interests.

1. ASSET DEPRIVATION IN GENERAL

This submission does not question the general rules against asset deprivation for the age pension. The pension should be payable to those who need it. Apart from the eligibility criteria of age and residency, need is largely determined by the application of the income and assets test to individuals (**means test**).²

As a general proposition, citizens are not permitted to transfer their financial responsibilities after retirement from employment onto taxpayers by divesting

¹ http://guidesacts.fahcsia.gov.au/guides_acrs/ssg/ssguide-4/ssguide-4.6

² *Social Security Act 1991* (Cth) (**SSA**) ss 55(a) & 1064

themselves of assets for no, or less than market, consideration (**gifting**).³ If they do, then for a five year period⁴ they are deemed, for pension purposes, to still own those assets and also to receive income deemed to have been earned on the current market value of those divested assets.⁵ In this way, gifting is ignored under the means test, and entitlement to the pension, if any,⁶ is determined accordingly.

This submission suggests reforms to address the counter-intuitive risks attaching to gifting when in the form a 'granny flat interest' under the Act, especially when regard is had to the guidelines issued under the subsection.

2. GRANNY FLAT ARRANGEMENTS IN GENERAL

It is trite to observe that older Australians, far more than previously predicted, are now living longer and needing more care, while having accumulated more private wealth than prior cohorts. The point for present purposes is that this has seen granny flats become an increasingly popular accommodation option for the elderly.

This typically involves a parent, or parents, living with one of their children (or their only child) and that child's own family, if any, in a private dwelling. Were there no transfers of substantial monies or title in land from parent to child involved here, then there would be no problems to address for the purposes of this submission. Any change in the domestic circumstances warranting a cessation of cohabitation of parent and child could be achieved with little financial or legal disruption and, hopefully, a minimum of family disharmony.

Such simple arrangements are, it is submitted, uncommon. More likely is an intergenerational intermixing of money and property, and this is specifically recognized under the Act and as a form of permitted gifting under the subsection and the guidelines. It is an example of where a gift in common parlance is not a 'gift' in pension parlance.

However, the cessation of cohabitation for any reason, including the case of death of the parent, in this context can cause extreme financial, legal and family problems, as outlined below.

3. 'GRANNY FLAT INTERESTS' IN PARTICULAR

The Act recognizes as a 'granny flat interest' a pensioner living in a private dwelling as his or her principal home, owned by another person, provided the

³ SSA ss 1123 & 1124

⁴ SSA ss 11(10), 1126AB, 1126AD & 1127

⁵ SSA s 1082

⁶ SSA s 44(1)

pensioner has a right to accommodation for life in the residence⁷ with reasonable security of tenure.⁸ A life interest is also permitted but that is not the concern of this submission.

Where that is the case, the following 'gifts' by the parent to the child will not be counted under the means test for age pension purposes:⁹

- (a) the transfer by the parent of the whole legal ownership of his or her dwelling to the child for nil consideration; or
- (b) the acquisition of a dwelling by the parent in the child's name to the exclusion of that of the parent but paid for by the parent to the exclusion of the child; or
- (c) payment by the parent to the child for, and only for, the cost of renovations to a dwelling in the child's name to accommodate the parent in the dwelling; or
- (d) Any other payment instead of or in addition to the above by the parent to the child that does not exceed the 'reasonableness test amount'.¹⁰

Clearer cases of a divestment of assets are hard to imagine. Under (a) and (b) the parent has given away all right and title to land - a roof over their head - in exchange for no money or any right to retrieve that money back. He or she has made a major investment in real estate, including under (c), over which they have absolutely no further legal control.

All the parent may have achieved is the preservation of his or her entitlement to the pension that prevailed prior to entering into the granny flat interest and a mere promise of a right of residence.

From a commonsense and legal point of view, this is a perilous position for the parent to be in and a windfall for the child.

4. GRANNY FLAT ARRANGEMENTS ENDING

Despite the best of intentions, granny flat arrangements can come to a premature end for all sorts of everyday reasons (**terminating events**).

- The child, for example, may experience a change in
 - financial circumstances by,
 - borrowing funds from a commercial lender using the dwelling as security for the loan, defaulting with the lender

⁷ Social Security Act 1991 (Cth) s 12A

⁸ Social Security Act 1991 (Cth) s 11A(10)

⁹ Guideline paragraph 4.6.4.50

¹⁰ Guideline paragraph 4.6.4.60

- then forcing the sale of the property to recoup the principal and interest outstanding,
 - becoming unable to pay for rates, maintenance or insurance premiums for the dwelling due to sickness, unemployment or bankruptcy, or
 - wanting to relocate to pursue, or to allow their own children to pursue, educational or employment opportunities elsewhere; or
- domestic circumstances by,
 - ending his or her relationship with a domestic partner and the court making an order adjusting their property interests requiring the sale of the dwelling,
 - entering into a domestic relationship with a (new) partner who will not tolerate sharing the residence with the parent,
 - becoming unable or unwilling to provide, or to arrange for the provision of, the care the parent needs in order to stay in the dwelling, or
 - dying.
- The parent may
 - enter, or wish to enter, into a domestic relationship with a partner whom the child (or child's family) cannot tolerate,
 - want to relocate to alternative accommodation for any reason,
 - need to move into permanent residential aged care, or
 - die.

5. PERILS OF A 'GRANNY FLAT INTEREST' ENDING

Where a parent has entered into a 'granny flat interest' under the Act and the arrangement ends at the instigation of the child as outlined above, the parent is potentially in a most vulnerable position. Their financial investment in the dwelling lacks any of the standard legal protections that would normally accompany such an investment, such as

- (a) co-ownership of the legal title commensurate with the respective financial contributions of the purchasers as tenants in common,
- (b) a secured loan for the market value of the property transferred into the child's name, or for the share of the parent's contribution that exceeds his or her share in the legal title, or
- (c) a registered lease under which to occupy the dwelling (or part of it).

Without such protections, a court order obtained by a lender or former domestic partner of the child may result in the parent being evicted with no legal recourse. Similarly, a change of mind on the part of the child may have the same results.

Conversely, if the parent wants or needs to move, how can he or she be sure they can retrieve their investment in order to pay for alternative accommodation?

If the parent dies in the dwelling and there are other siblings or beneficiaries under the will, or entitled in the absence of a valid will – how will they receive their inheritance when much, or perhaps all, of the parent's wealth has already been divested to one child ahead of the others?

It is not suggested that it is the role of Centrelink staff to give financial advice but the Act and guidelines should be amended so that the attraction of a granny flat interest is less perilous for the parent. With the minor amendments suggested above, the risks need not be so great.

6. SHORTCOMINGS OF THE GUIDELINES

The main problem with the guidelines is that they encourage a parent to preserve their pension by divesting themselves of substantial money or property in exchange for an inexpensive, but insecure, right of residence for life. The guidelines, in the writer's view, irresponsibly divert attention away from standard legal protections. None of the terminating events alluded to above, and the consequences for the parent, are highlighted at all.

In terms of ownership, the Act and the guidelines encourage an 'all or nothing approach'. In order to preserve pension entitlements the parent can either

- (a) pay for and occupy their own home to obtain the principal residence exemption,¹¹ or
- (b) pay fully for, but have no ownership in, the child's home in order to have the benefit of the non-gifting rule under a granny flat interest.

It is submitted an intermediate co-ownership position is highly appropriate and should be encouraged to afford better protection to the parent (see below).

The guidelines¹² allow for the exemption to continue if the granny flat interest ends within 5 years provided the reason was not reasonably foreseeable when the interest commenced. Which of the terminating events above would be within or beyond this category is far from clear and no doubt highly dependent on the facts of the particular case, eg how old the parent was and thus how likely the imminent need for residential aged care might be. If reasonably foreseeable, the asset deprivation rules will then apply for the balance of the 5 years since the interest commenced.

This adds considerable uncertainty and the guidelines could be revised to provide clearer guidance.

¹¹ SSA s1118(1)(a) & (b)

¹² FIS027.0911, page 1 of 4

The guidelines also allow for compensation¹³ to be payable in the case of at least some of the terminating events listed earlier in respect of the premature loss of the right of residence – unless this can be and is transferred to the child's next dwelling. Again, the guidelines should provide for how such compensation is to be calculated and paid.

The guidelines finally allow the initial premises to be sold by the child subject to the continuing right of residence for life of the parent.¹⁴ This is, frankly, ridiculous. The market for a dwelling to be shared with an elderly non-relative will be very small indeed. The presumed appeal of this arrangement for the abandoned parent is laughable.

7. SHORTCOMINGS OF ORTHODOX LEGAL PROTECTIONS

Some of the legal protections referred to above are problematic in their availability under a granny flat arrangement.

Co-ownership

Anecdotally, co-ownership is generally not tolerated by traditional lenders who do not want a non-income earning occupier on the title, nor the odium of evicting an elder owner in the case of default.

Loan

Where co-ownership is not feasible, a parent could lend to their child the money for the purchase of the dwelling or cost of renovations, or representing the value of the transfer of title. If co-habitation ends due to any of the terminating events outlined above, the child then has a legal obligation to repay the money owing. Parent and child can move on without the parent's pension entitlement being affected by the ending of the right of residence.

It is submitted that such a loan should be exempted from being deemed to be a financial asset under a granny flat interest provided it represents the current market value for the property transferred or purchased or the cost of renovations carried out. So much already applies to a loan to the operator of the retirement village for a lease of a dwelling in a village.¹⁵

A loan also has the great merit that it may be expressed to continue for the benefit of the parent's estate, so that the reasonable expectations of siblings or other beneficiaries are not compromised by the kind of 'accelerated inheritance' that the guidelines encourage.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ SSA ss 12

Lease

A lease affords a parent far better security of tenure than a mere promise of a right of residence for life in relation to most of the terminating events outlined above. Amongst other things, the document can provide that the loan is repayable on termination of the lease.

8. EQUITABLE PROTECTIONS

Equitable doctrines of resulting trusts and constructive trusts are often readily applicable where a granny flat arrangement is terminated. However, it may cost around \$100,000 in legal costs to pursue in the Equity Division of the Supreme Courts in Australia. This may well outweigh the merits of the parent seeking recovery of the funds advanced or title relinquished. It may also cause great family anguish.

9. CAPITAL GAINS TAX

In passing, the child may incur an unexpected liability to pay capital gains tax in respect of the market value of the property transferred to or purchased in his or her name and subject to a right of residence in favour of the parent.¹⁶

10. CONCLUSION

It is submitted that a 'granny flat interest' as currently provided for under the Act and guidelines is something of a siren to pensioners and their families. So simple a strategy by which to preserve pension entitlements is fraught with terminating events that may surface to thwart a parent wanting or indeed needing to move out with at least the funds or equity they contributed.

Worse, the child may experience the less appealing vicissitudes of life that see the parent's funds or equity lost to court orders in favour of lenders on default under a loan to the child or property adjustments to a former domestic partner of the child.

The parent may have been able to enjoy uninterrupted pension entitlements and a warm and fuzzy feeling of familial comity but subject to unnecessarily high risks which could be reduced if a loan at market value were deemed not to be a financial asset for age pension purposes.

Richard McCullagh



¹⁶ ATO TR 2006/14 at paragraph 108 and Income Tax Assessment Act 1997 (Cth) s 116.30(3)