

Social security – Granny flat rights

A *granny flat right* is an arrangement under which a person is provided a legal right to occupy a property owned by someone else, in exchange for cash or other assets. This differs from a 'granny flat' which, in real estate terms, means a separate physical structure. A granny flat right is a legal right rather than a physical asset.

How it works

Different granny flat arrangements

Depending on the circumstances, there are a number of ways a granny flat right could be established. While it *may* be a granny flat in the traditional sense of the word, being a secondary dwelling on a property, the arrangement can take on many forms.

Some of the most common granny flat rights are arrangements where:

- title of the individual's existing home is transferred to another person in return for a right to occupy the dwelling for life,
- an individual is granted the right to occupy a dwelling owned by another person, in return for cash or other assets, or
- the individual provides some or all of the purchase price required for a new home, where the dwelling is owned legally in the name of another person.

In all cases, in exchange for the transfer or purchase of an asset for another, a right to accommodation is received in a property owned by the other person.

A granny flat right is not established where that individual has legal ownership of the dwelling in part or in full (i.e. their name appears on the ownership title). This is because an owner, regardless of the ownership percentage, has a right to occupy the dwelling due to legal ownership.

Who can enter into a granny flat right?

Most commonly, a granny flat right is entered into between family members. However, this is not a requirement.

Granny flat rights may enable families to provide much needed support to each other and can assist with ensuring a required level of care is provided, while also helping to retain some independence.

Even where these arrangements are entered into between family members, it is important for everyone involved to individually obtain legal, tax and financial planning advice. All parties to the arrangement need to understand their rights, obligations and financial implications prior to the granny flat right being established. It is recommended that the agreement is in writing with provisions to allow the arrangement to come to an end, particularly if it is not working for the parties or if circumstances changes (such as a need for residential aged care).

Important considerations when determining the agreement

The terms of the agreement

It is strongly recommended that the terms of the arrangement be documented formally in writing, under the advice of a legal specialist. All parties to the agreement should receive independent legal, tax and financial advice prior to entering into any arrangement.

Although there are fees and costs involved in obtaining advice, it is crucial that all parties understand this is an important step in the process. Things can go wrong in any family, regardless of how amicable things may

be at the outset. It is also possible that circumstances may change after the arrangement is entered into. This could include:

- the need for a higher level of care than what was anticipated, which may include a need for residential aged care,
- the property no longer being appropriate based on changing care needs or mobility,
- the person who granted the right needing to sell the property to access funds, or a requirement to move locations,
- marriage or relationship breakdown, and
- the arrangement not working out, particularly where extended family move in together.

Below are some questions you should ask yourself and issues that should be explicitly addressed in the agreement:

- whether or not you are expected to make additional financial contributions to the maintenance of the dwelling, payment of utility bills or household expenses, or payment of rent?
- what degree of care and support has been agreed to be provided and what will happen if care needs increase?
- under what circumstances it is anticipated that the arrangement will come to an end, or when either party can terminate the agreement (for example, where the person needs full time residential care, or where an adult child's marriage breaks down)?
- if the agreement is terminated are you entitled to any compensation?
- agreement relating to any requirement to provide accommodation and care in another dwelling, where the original home is sold?
- if the right to reside is in a separate dwelling, are there any requirements for that property (such as single level, within a particular area)?
- whether or not the client is entitled to receive any amount upon exiting of the granny flat?
- What if the person with whom the granny flat right is established passes away or wants to sell the property?
- If moving in with an adult child, what is the 'Plan B' if their own marriage breaks down?
- Can your other beneficiaries be catered for as desired, based on your remaining financial resources once the right is established?
- Should all family members be consulted, and their sentiment towards the arrangement be formally captured, to avoid future potential disputes?
- If your care needs increase and modifications need to be made to the dwelling based on mobility and accessibility requirements, who will pay for this?
- If you need residential aged care, how will care fees be paid? Will any family members assist in covering this cost? This is important as significant assets may have been transferred and the ability to cover fees in your preferred facility may be difficult with remaining income and assets.

Tax and social security implications

A registered tax agent can assist in ensuring that any tax implications, both upfront and in the future, are understood. A financial planner can assist in understanding the social security and aged care implications of the arrangement. It is important for these professionals to work together to assist in all aspects being addressed which would require your permission.

Estate planning considerations

It is important to understand that once the cash or assets are transferred to establish the granny flat right, the person who made the transfer no longer has any legal entitlement to these funds. Particularly where a significant amount of a person's total asset holdings are transferred, it is important to consider the impact on estate planning arrangements.

For example, if a person enters into a granny flat right with one of their adult children, it is important to consider the impact on their existing Will, and the ability to meet their estate planning goals, which is likely to include a provision for other adult children and any other dependants.

Social security assessment

For social security purposes, limits apply to the amount of cash and other assets that a social security recipient is able to gift or transfer and have disregarded when calculating social security entitlements. The gifting rules are explained in more detail below.

When certain requirements are met, the value of cash or assets transferred in respect of the granny flat right may be exempt from social security assessment and will not be treated as a gift when determining entitlements. It is important to understand how these rules apply to your specific circumstances and to determine any impact on your benefits before entering into the arrangement.

Centrelink will assess the arrangement, including the amount paid for the granny flat right, and the type of arrangement entered into. Based on the circumstances, they will determine a value for the granny flat right. This value will be compared to the value of the cash and assets transferred in return for the right. This will then be used to determine whether for the person being granted the right:

- is assessed as a homeowner or non-homeowner, and
- the transfer of assets is treated as a gift with the possible triggering of the gifting rules.

This treatment may also flow through to aged care as many of the assessment rules for determining aged care fees are similar to social security rules.

How is the value of the right calculated?

A granny flat right has a value which is either the:

- amount paid or value of asset/s transferred, or
- Services Australia determine another value using a formula known as the 'reasonableness test'.

The value of the granny flat right compared to the amount paid (i.e. assets transferred) needs to be determined to ascertain if gifting or deprivation applies to the arrangement. Deprivation is triggered if a person reduces their income or assets without adequate consideration.

Where the amount paid is the value

In some circumstances, the value of a granny flat right can be readily determined based on the valuation of the assets transferred.

Common examples include:

- the title of an existing home is transferred, where the market value is accepted as the valuation,
- if a new home is purchased in another person's name, the purchase price of the new home is accepted as the valuation, or
- the construction costs are paid for a separate structure to be built on another person's property, where the construction cost paid is accepted as the valuation.

Generally, in the above situations, provided other assets or cash are not also transferred in addition, the accepted valuation is considered equal to the value of the granny flat right and no gifting or deprivation applies, meaning that the amount transferred is disregarded for the purpose of means testing and determining entitlements.

However, in other situations the valuation is not readily determined, or additional assets are provided beyond the value of the property transferred, purchased or constructed. In these circumstances the 'reasonableness test' applies to determine the value of the right, and whether any gifting is deemed to have occurred (explained below).

Where the reasonableness test determines the value

The reasonable test is a legislative formula which determines the value of a granny flat right for social security purposes in certain scenarios. Generally, it applies in cases where:

- the true value of the interest is not clearly demonstrated or identifiable (for example, a person is granted the right to occupy an existing room in someone else's home, as it is difficult to accurately value certain living spaces in an existing home),
- the value of the interest would ordinarily have been accepted as the amount paid except for the fact that the person being granted the right has transferred additional cash or assets (e.g. where the title of the person's existing home is transferred, in addition to a cash amount),
- in certain circumstances where a person enters into multiple granny flat arrangements.

The reasonableness test is based on a formula which varies based on the age of the person being granted the granny flat right. This is a complex calculation and specific advice should be sought from a financial planner.

Generally, the value determined under the formula is compared to the value of assets transferred. If the reasonableness test valuation is *less than* the value of assets transferred, the difference may be a gift and deprivation may apply (see below for additional information on gifting and deprivation).

Gifting and deprivation

Gifting is when a person or their partner gives away assets or transfers them for less than their market value. However, there are rules that apply to limit how much can be gifted and disregarded from assessment when determining entitlement to certain payments and benefits from Centrelink/Department of Veterans' Affairs (DVA).

Amounts gifted that exceed the allowable thresholds are treated as 'deprived assets' and will continue to be assessed for 5 years when calculating entitlements under the income and assets tests. The allowable thresholds are:

- \$10,000 each financial year;
- but no more than \$30,000 over a rolling five-year period.

These figures also represent the total combined amount that a couple can give away before the deprivation rules are triggered.

If more than the allowable limit is gifted, the excess is assessed by Centrelink/DVA as a 'deprived asset'. A deprived asset continues to count under the assets test and be deemed for income test purposes for five years from the date of the gift.

When applying for a Centrelink/DVA payment or aged care fees are being calculated, any gifts made in the previous five years are also assessable and excess amounts will be captured as a deprived asset.

NOTE: Please refer to the *Understanding Series – Social Security – Gifting* for additional information on the general gifting and deprivation rules.

Exiting the granny flat right arrangement

There may come a time when the granny flat right arrangement needs to be terminated, or the person granted the right needs to vacate the dwelling. This could be because care and support requirements have changed, or there is a need to move to a residential care facility. More broadly, circumstances may have changed meaning that the arrangement is no longer suitable for any or all parties involved.

The documented agreement will assist in determining the steps when ending the arrangement depending on the reason. For example, if there is a need to move to residential care, the arrangement could mean

that it ends based on that personal need. Alternatively, if ending due to no longer suiting the parties, then the agreement may include a provision to return some or all of the cash or other assets originally transferred. This may be important to ensure that future accommodation and care expenses can be met.

Depending on the reason for ending the arrangement, Centrelink may review and re-evaluate the assessment already made. If the circumstances indicate that the reason for vacating the interest that could reasonably have been expected at the time the right was created, the value of the granny flat right is assessed under the deprivation rules. An example is if the deteriorating health would likely result in the need for aged care within five years. However, if the need for aged care was due to an unexpected circumstance, such as significant fall or accident, this would not be reasonably foreseeable.

Where a re-assessment is undertaken by Centrelink, this may result in the deprivation provisions applying. This could mean the loss or reduction in income support entitlement.

This could also impact aged care fees, regardless of whether the person is in receipt of Age Pension or another social security benefit. When a person enters residential aged care, some of their aged care fees are determined based on their income and assets. A deprived amount is also assessed as an asset for aged care fee purposes and deemed income on the amount is also assessed. This means that if deprivation is taken to have occurred, aged care fees may be increased.

Cost considerations

Depending on the circumstances, the costs (both direct and indirect) may outweigh any net financial benefits of entering into a granny flat agreement. On the contrary, in other circumstances, any upfront financial costs may be considered to be well worth certain non-financial benefits derived.

Potential costs may include:

- professional advice from a solicitor, registered tax agent and financial planner
- capital gains tax
- stamp duty
- land tax, and
- other incidental transfer costs.

The need for professional advice is important to ensure both current and proposed legislation is considered as part of the arrangement.

NOTE: In the 2020/21 Federal Budget, the Government proposed to remove capital gains tax from certain granny flat right arrangements. However, at this time legislation has not been passed to effect this measure and proposed to only apply to documented arrangements entered into on or after 1 July 2021.

Benefits

A granny flat right may:

- enable a person to continue living in their own home for as long as possible with ongoing support
- allow a change in living arrangements, such as moving closer to family, for provision of ongoing support
- provide an early estate planning opportunity to provide assets directly to beneficiaries

If you are receiving income support, you may continue receiving those payments from the Services Australia/Department of Veterans' Affairs (DVA) depending on how the right is established.

Ordinarily, if you give away cash or assets without receiving adequate consideration, this is assessed as a gift for social security purposes, however certain granny flat arrangements may enable you to gift cash or assets, without being assessed under these rules.

Risks, consequences and other important things to consider

These include:

- Once your home or other assets are transferred, it is important to understand that you no longer have legal ownership of the asset/s. This means that you no longer have access or control over these assets. Consideration should be given to the impact on your ability to fund known and potential future expenses.
- The rights and obligations of all parties involved should be documented with the assistance of a solicitor. Issues to consider include the length of time the arrangement will last, the property on which the right is provided (or characteristics on the property) as well as ending the arrangement.
- The granny flat right arrangement may not work out as planned by the parties involved and the documented agreement should clearly state how this is solved. There is also the risk that your personal relationship with those you established the granny flat right may be impacted.
- The costs associated with establishing the granny flat right may be significant, which includes professional advice fees from a solicitor, accountant and financial planner and tax implications, including capital gains tax, stamp duty, land tax and associated costs.
- Future tax consequences may arise from establishing the granny flat right, possibly for all parties.
- Gifts are usually subject to allowable limits for Centrelink purposes, and amounts gifted above these limits are treated as deprived assets and assessed for means-testing for five years from the date of the gift. Where a granny flat right is entered into, the granting of a life interest is considered to be valuable consideration, and the gifting rules may not apply. However, if deprivation does apply, this may impact your social security entitlement and future calculation of aged care fees.
- You must ensure that the reason for entering the granny flat arrangement is not solely for the purpose of gaining a social security advantage. Centrelink indicates that in circumstances where a granny flat right is entered into solely for the purpose of gaining a social security advantage, deprivation may be deemed to have occurred.
- Where a granny flat right is established and vacated within five years, Centrelink will undertake a re-assessment of circumstances. Where it is found that a care need could have been reasonably foreseen at the time of establishment, the deprivation rules may be applied, which could lead to a reduction in benefits and entitlements and may also impact aged care fees.
- Aged care costs can be significant. It is crucial that when a granny flat arrangement is entered into, the ability to fund future care costs is considered and planned for. Reducing aged care fees at the 'cost' of transferring significant amounts of wealth may not be worthwhile. In some cases, it may result in an inability to afford the preferred care facility.
- Generally, granny flat rights involve the transfer of significant amounts of wealth and consideration must be given as to how this impacts your overall estate planning strategy. Therefore, it is recommended that your Will is updated with the assistance of a solicitor.

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