National Seniors
AUSTRALIA

29 April 2021

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Personal and Small Business Tax Branch
Individuals and Indirect Taxation Division
The Treasury
Langton Crescent
PARKES ACT 2600

**Supporting older Australians -**
**exempting granny flat arrangements from Capital Gains Tax (CGT)**

Thank you for the opportunity to comment on the Supporting older Australians - exempting granny flat arrangements from Capital Gains Tax (CGT) exposure draft and explanatory notes.

National Seniors strongly supports any initiatives which improves the delivery of care and support to people as they age. We are particularly interested in reducing the risk of older people moving into residential aged care when this is not in their best interests.

A key factor in supporting older people in this way, is access to stable and secure housing.

Most older people (aged 55 and over) live "as singles or couples in owner-occupied separate houses—most with three or more bedrooms".[1] While this housing may suit younger seniors, it will likely pose problems as people age and their mobility and cognitive capacity decline – especially if their homes lack accessibility features.

National Seniors has long promoted the idea of downsizing as one way to enable older people to remain in their homes as they age, however, research suggests many barriers to this practice[2]. Availability of suitable housing, cost, pension impacts and other considerations inhibit downsizing.

[1] Australian Housing and Urban Research Institute 2010. Howe well do older Australians utilize their homes? AHURI Research and Policy Bulletin Issue 126, May 2010. https://www.ahuri.edu.au/__data/assets/pdf_file/0019/3079/AHURI_RAP_Issue_126_How-well-do-older-Australians-utilise-their-homes.pdf

[2] Rees, K. & McCallum, J. (2017). Downsizing: Movers, planners, stayers. Brisbane: National Seniors. https://nationalseniors.com.au/research/housing/downsizing-movers-planners-stayers

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**Improving the formalisation of granny flat agreements**

The ability to pool financial resources with family members or friends to maintain safe and secure housing is one option available to older people. This has been facilitated by exemptions from gifting rules for older people entering a granny flat agreement.

Participants can gain many benefits from these arrangements. It makes the provision of informal care by family and friends easier, while also conferring financial benefits from the pooling of resources.

However, there can also be negative outcomes from these arrangements. Problems can occur if:

- they are not carefully considered,
- if the circumstances of participants change, (e.g. an acrimonious divorce) and
- if the details of these arrangements are not clearly documented.

This can lead to family conflict and abuse or exploitation, which undermines the wellbeing of older people in these situations. It can also lead to homelessness and early entry into residential aged care.

The draft amendment addressing CGT exemptions in the *Income Tax Assessment Act 1997* is designed to reduce the current disincentive to formalising a granny flat agreement. National Seniors supports this endeavour.

It is based on the underlying assumption that formal granny flat agreements reduce the risk of harm to those who are party to such agreements. This assumption is made explicit in the explanatory note, where the intent of the draft amendment is defined in the following way:

> "[to] encourage the formalisation of granny flat arrangements to support the stable and long term housing arrangements of older people and people with disabilities, and to reduce the risk of financial abuse or exploitation…"

Given this assumption and the explicit intent outlined in the explanatory note, National Seniors believes the draft amendment should be assessed, not only on whether it encourages documentation of an agreement (for taxation purposes) but more importantly whether it promotes adequate protections which reduce the risk of "financial abuse or exploitation".

**Requirements for CGT exemption**

Central to the draft amendment are the requirements that must be met to confer a CGT exemption. According to the explanatory note there are five requirements that must be met to confer a CGT exemption.

1. The individual having the granny flat interest has reached pension age or has a disability,
2. An individual owns the dwelling where the granny flat interest is held, or is to be held, under the arrangement.
3. Both the individual holding the granny flat interest, and the individual owning the dwelling where the granny flat interest is to be held, are parties to the arrangement.

4. The arrangement is in writing and indicates an intention for the parties to be legally bound by the agreement.
5. The arrangement is not of a commercial nature.

National Seniors supports requirements 1, 2, 3 and 5 listed above. However, we believe there is a lack of detail in the draft amendment regarding requirement 4.

**Requirement for the arrangement to be in writing**

According to the explanatory note,

> "The fourth requirement is that the arrangement must be in writing and indicate an intention for the parties to be legally bound by it".

This is dealt with in two instances in the draft amendment.

Under Section 137-15, it states a CGT event does not happen if a new granny flat arrangement is in writing.

> *137-15 CGT event does not happen when a certain kind of granny flat arrangement is entered into*
>
> *A *CGT event does not happen, to the extent it relates to creating a *granny flat interest in a *dwelling under an *arrangement by entering into the arrangement at a particular time (the start time), if:*
>
> *(d) the arrangement:*
>
> *(i) is in writing;*

Under Section 137-20, a CGT event does not happen when an arrangement is varied and is in writing.

> *137-20 CGT event does not happen when a certain kind of granny flat arrangement is varied*
>
> *A *CGT event does not happen, to the extent it relates to creating or varying a *granny flat interest in a *dwelling under an *arrangement by varying the arrangement at a particular time (the variation time), if*
>
> *(d) the arrangement (as varied):*
>
> *(i) is in writing;*

On face value, and based on the assumption outlined above, requiring a written granny flat agreement to be eligible for CGT exemption appears positive.

By enshrining the right to a CGT exemption when an agreement is formally written this will provide documentary evidence that can be used to remove doubt over the existence of an agreement.

It will also likely encourage parties to discuss the terms of an agreement and gain a greater understanding and appreciation for the needs and expectations of each of the parties. In theory, this will increase the likelihood the terms are acceptable to all parties.

In practice, however, while it may result in greater use of formal agreements, this alone may not necessarily increase protections for older people. There is a valid question in this regard, as to whether simply requiring a written agreement will result in a sound agreement.

A formal agreement, if poorly considered or drafted, may still fail to account for future events or unforeseen changes in circumstances. Worse it may actively be used to perpetuate situations of elder abuse if there is no guidance or oversight.

While guidance documents and educational resources and templates should be made available to help parties understand what a sound document might look like, there will likely be situations where these resources are not consulted or used.

Insisting a formal agreement be in place to confer CGT exemption does not in itself, ensure the quality of these agreements, unless attention is paid to the process used to draft a formal agreement.

In this regard, there is a question about the threshold used to determine the validity of any written agreement used to ascribe a granny flat interest.

Would, for example, an agreement written on the back of napkin suffice under the definition and would an agreement of this nature meet community standards?

There is also no guidance on the requirements under which such arrangements should be made, to ensure that parties who enter a granny flat arrangement have adequately discussed and understood these matters.

As stated in the explanatory note, there is no requirement under the draft amendment for a formal granny flat agreement to "take a specific form or include specific terms" but simply an "expectation" they deal with "basic matters" such as defining the "parties to the arrangement", "circumstances in which the arrangement could be varied or terminated" and guidance as to "what happens on variation or termination". While this is intended to reduce barriers (e.g. costs) to the use of written agreements and to provide flexibility so they are responsive to differing needs and circumstances, this may undermine the effectiveness of the legislation. Under the draft amendment, some agreements will be responsive to the needs and expectations of the parties, and others will not.

The concern is that people with diminished capacity or vulnerability may enter a formal agreement which is not suitable, or which heightens the "risk of financial abuse or exploitation".

In attempting to provide flexibility, the amendment may also betray a level of protection or safety, which it does not provide. This is an important point.

National Seniors regularly hears from older people who have entered retirement villages, believing the existence of specific retirement village legislation gives them some level of consumer protection. Later, they come to realise their contracts, while adhering to the legislation, are not always in their best interests and they should have obtained legal and financial advice before signing.

It is therefore important that granny flat legislation includes adequate requirements that protect older Australians, otherwise it has the potential to undermine confidence in granny flat agreements in the future.

**Oversight of agreements**

A key omission of the legislation is a requirement for any oversight when formulating an agreement. In the legislation governing other similar arrangements (e.g. power of attorney, wills or advance care directives), there are basic oversight requirements pertaining to the process of drafting these documents. These are generally included to protect those with diminished decision-making capacity.

For example, under state based Enduring Power of Attorney (EPOA) legislation there is generally a requirement to have these documents signed in the presence of an 'eligible witness'.

An eligible witness in the case of Queensland's EPOA legislation is[3]:

- a justice of the peace (JP)
- commissioner for declarations
- notary public
- lawyer.

In witnessing a signature, an 'eligible witness' certifies that a person entering the agreement has demonstrated the capacity to make an EPOA.

As stated in the Queensland EPOA legislation (see exert of legislation in Appendix 1)[4], the onus is on ensuring the principal:

- is capable of making an EPOA;
- is entering into this agreement freely and voluntarily; and
- understands the nature and effect of the EPOA.

However, the draft amendment conferring a CGT exemption does not offer similar protection to the person entering a granny flat agreement as a requirement of a creating a formal agreement.

[3] Queensland Government 2021. *Power of Attorney* Accessed online 20 April 2021 https://www.qld.gov.au/law/legal-mediation-and-justice-of-the-peace/power-of-attorney-and-making-decisions-for-others/power-of-attorney#completing-the-document
[4] Queensland Government 2021. Powers of Attorney Act 1998. Current from 30 November 2020. https://www.legislation.qld.gov.au/view/html/inforce/current/act-1998-022#sec.41

This potentially undermines the quality of any formal agreement, limiting the effectiveness of the legislation in reducing "the risk of financial abuse or exploitation" – which is the stated intent of the draft legislation.

It is crucial all parties entering these arrangements fully understand their rights and obligations, and the likely pitfalls of these arrangements. While a formal document might increase the chance of this, it is no surety.

This is problematic given the CGT exemption. While a CGT exemption is likely to be seen by parties as the natural extension of the exemption applying to the principal place of residence, this should not be used as a justification for excluding a basic level of competency in the drafting of an agreement - otherwise it will not address the intent of draft amendment.

While the draft amendment requires each of the parties to be signatories to the agreement to indicate "an intention for the parties to the arrangement to be legally bound by it", National Seniors believes it should also be a requirement to have an independent, suitably qualified person act as a witness to the agreement to ensure an agreement is adequately prepared and understood by those signing.

Requiring a competent person to witness an agreement, as is done with EPOA, would increase the likelihood that an agreement was of a basic quality and provide a check to ensure that an older person does not have diminished capacity.

It would also provide a means of delivering educational materials[5] to prospective parties to help them consider the ramifications of such arrangements. This would be a small price to pay for the financial benefits of CGT exemption and would make the CGT benefit commensurate with the risks.

Granny flat agreements should be on par with other similar legal documents such as an EPOA, given the significant financial interests involved and the likelihood of family conflict.

The issue of capacity is of particular concern where there is a variation of the agreement. There is a material question about the interplay between a granny flat interest and an EPOA.

What protections exists for a person with a granny flat interest when the individual who owns the dwelling where the granny flat interest is held, also holds an Enduring Power of Attorney to make financial decisions because of diminished capacity?

In these situations, the person with Power of Attorney would be making an agreement with themselves which could create a conflict of interest in specific situations (see example in Appendix 1). What could be done in these situations to ensure they have acted in the best interests of the person holding the granny flat interest?

[5] It may be best to create a standardised agreement templates to provide guidance to enhance the protection of parties, including references to the general operation of an agreement (e.g. "this agreement permits life-time occupation or until the occupant chooses to move out.")

**In conclusion**

While the requirement of a written granny flat agreement to be eligible for CGT exemption appears positive because it will encourage parties to create documentary evidence to validate a granny flat interest claim, National Seniors is concerned this does not adequately address the intent of the legislation to protect older people from "financial abuse or exploitation".

If the CGT exemption acts as an inducement to entering a granny flat agreement and the threshold for assessing the validity of written agreement doesn't require careful consideration, adequate drafting and appropriate oversight (to ensure capacity of the person entering a granny flat interest), this could result in agreements that are little better than those that are not written or worse could facilitate abuse or exploitation.

Without a qualified independent witness to confirm the older party does not have diminished capacity or is not subject to coercive control, the best interests of the older person could be overlooked resulting in serious ramifications.

Strengthening the draft amendment to include a requirement for an independent witness to be a requirement of the CGT exemption would bring the legislation in line with other similar legislation, ensuring better outcomes for older Australians entering a formal granny flat agreement.

Yours sincerely

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**Appendix 1: Exert from Queensland Powers of Attorney Act 1998 – Principal's capacity to make an enduring power of attorney**

***41 Principal's capacity to make an enduring power of attorney***

*(1) A principal has capacity to make an enduring power of attorney only if the principal—*

*(a) is capable of making the enduring power of attorney freely and voluntarily; and*
*(b) understands the nature and effect of the enduring power of attorney.*
*Note—*
*Under the general principles, an adult is presumed to have capacity.*
*See section 6C, general principle 1.*

*(2) Understanding the nature and effect of the enduring power of attorney includes understanding the following matters—*

*(a) the principal may, in the power of attorney, specify or limit the power to be given to an attorney and instruct an attorney about the exercise of the power;*
*(b) when the power begins;*
*(c) once the power for a matter begins, the attorney has power to make, and will have full control over, the matter subject to terms or information about exercising the power included in the enduring power of attorney;*
*(d) the principal may revoke the enduring power of attorney at any time the principal is capable of making an enduring power of attorney giving the same power;*
*(e) the power the principal has given continues even if the principal becomes a person who has impaired capacity;*
*(f) at any time the principal is not capable of revoking the enduring power of attorney, the principal is unable to effectively oversee the use of the power.*

*Note—*
*If there is a reasonable likelihood of doubt, it is advisable for the witness to make a written record of the evidence as a result of which the witness considered that the principal understood these matters.*

**Appendix 2: Example**

At 67, Harriet retires and enters a granny flat agreement to contribute $200,000 to her daughter Millie for the right to reside in her home. After six years, Millie seeks to vary the existing granny flat agreement - increasing the contribution by $300,000 to a total of $500,000 from superannuation held by her mother claiming this is to cover the additional cost of care.

After another two years, Harriet is diagnosed with dementia and Millie applies to My Aged Care to be an authorized representative to manage her affairs. Millie then applies to have her mother assessed for residential aged care.

Harriet is only 75 and will live out her life in residential care without access to the funds that she once had to support her life.

There is a question about whether Harriet was suffering dementia before the agreement was varied, which would mean she may have entered the agreement without fully understanding the implications of the agreement.

Given she has left the property within five years and the dementia diagnosis was unexpected, gifting rules may not apply.

Would the requirement for a witness to the variation of the agreement to assess capacity, better protect Harriet's interests?