

30 April 2021

Mr. Bede Fraser  
Assistant Secretary  
Personal and Small Business Tax Branch  
Individuals and Indirect Taxation Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [grannyflats@treasury.gov.au](mailto:grannyflats@treasury.gov.au)

Dear Bede,

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

CPA Australia represents the diverse interests of more than 168,000 members, working in over 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

The Government is seeking stakeholder views on exposure draft *Treasury Laws Amendment (Measures 4 for Consultation) Bill 2021: Exempting granny flat arrangements from CGT (the Exposure Draft)* and accompanying *Explanatory Materials* that propose amendments that would give effect to the targeted capital gains tax (CGT) exemption for granny flat arrangements (**the granny flat exemption**).

All legislative references are to the *Income Tax Assessment Act 1997 (ITAA 1997)* unless otherwise indicated.

We support the intent to support older and disabled Australians by removing the perceived tax consequences to parties having a formal granny flat arrangement in place. In order to improve the scope and integrity of the proposed legislation, we make the following comments:

- We suggest that the Government reconsiders the first requirement of reaching Age Pension age to access the granny flat exemption given the broad range of circumstances that can lead to retirement. Instead, we recommend the use of a more inclusive threshold such as the preservation age for superannuation.
- We support the Board of Tax's suggestion<sup>1</sup> that the exemption be extended to certain veterans not of Age Pension age.
- We hold some concerns about the integrity of the granny flat exemption, in particular:
  - The broad eligibility criteria for an individual with a disability. We suggest that the legislation reference existing requirements under other regimes.
  - The potential for pressure to be exerted, particularly on the elderly, to invest capital in the granny flat arrangement, beyond that needed for the care and security provided during their occupancy, in order to create a future tax benefit. We suggest an upper threshold cap or reasonableness test be introduced.
  - The continued access to the granny flat exemption once sections 137-15 and 137-20 are satisfied, even when the arrangement is contravened, or the property is disposed of without the agreement of the interest holder/s. We suggest that the Commissioner of Taxation (**the Commissioner**) is provided with the power to revoke the exemption in certain circumstances.

<sup>1</sup> Australian Government (2019), *Review of Granny Flat Arrangements*, The Board of Taxation, November, p.33

- The continued access to the granny flat exemption until the interest is terminated, regardless of changes in circumstances, such as recovery from disability. We suggest that the partial main residence exemption, instead of a full exemption, should be considered in such circumstances.
- Clarity should be provided such that prior to the creation and after the termination of the granny flat interest, the existing CGT rules will apply where the main residence or granny flat was, or is then, rented out or used for commercial activities.

Our detailed responses are contained in the Attachment.

If you have any queries about this submission, contact Elinor Kasapidis, Senior Manager Tax Policy on +61 3 9606 9666 or [elinor.kasapidis@cpaaustralia.com.au](mailto:elinor.kasapidis@cpaaustralia.com.au).

Yours sincerely,



Dr Gary Pflugrath  
Executive General Manager,  
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## 1. Pension age is not necessarily the most appropriate threshold to use to define the elderly, or those in retirement

In the Explanatory Materials, pension age is defined as the age threshold used to determine eligibility for the Age Pension, currently **set** at 67 years for those born on or after 1 January 1957. While we understand the Government's intention for the granny flat exemption to target older Australians, we believe that the age threshold for the Age Pension does not necessarily cater for the broad range of circumstances that lead to an individual's retirement. Research<sup>2</sup> shows that individuals in certain occupations, such as manual labour or roles involving high levels of physical exertion, are less likely to be able to continue working up to the Age Pension age due to the nature of their work.

We also note that the age threshold for the Age Pension continues to be increased which will lead to a growing number of individuals currently participating in granny flat arrangements being ineligible for the granny flat exemption. This potentially exposes these individuals to abuse.

Therefore, we recommend that the definition of pension age is changed to the preservation age used for superannuation purposes which provides access for a larger number of retired Australians. We also suggest that veterans in receipt of an **age service pension** should be eligible.

## 2. Disability

Disability, as defined in the Exposure Draft, requires that the individual must have an ongoing disability that causes them to require assistance in carrying out most day-to-day activities, and that they continue to need that assistance for at least 12 months. There is no further information as to how the individual might demonstrate such a disability, nor what evidence is required to substantiate their eligibility.

We suggest that the Government could reference existing regimes to better define and refine the eligibility criteria which will bolster the integrity of the exemption, as well as reduce the burden on potentially eligible individuals from obtaining different evidence for different regimes. We hold concerns that a self-assessment approach to ascertaining eligibility may lead to uncertainty with regards to the ATO's interpretation and administration of the criteria or potentially undermine the integrity of the exemption.

We also note that the Board of Tax Review of Granny Flat Arrangements identified certain veterans, as well as the disabled, as potential beneficiaries of the exemption. While the Government has included individuals with a disability, it has not extended the provisions to veterans.

To this end, we recommend that the Government consider the following criteria to determine eligibility under paragraph 137-10(2)(b), where the individual:

- satisfies the **medical rules**<sup>3</sup> for the disability support pension (**DSP**)
- is in receipt of support from the National Disability Insurance Scheme (**NDIS**)
- satisfies the medical requirements for early access to superannuation due to **temporary incapacity, permanent incapacity** or a **terminal medical condition**.
- is in receipt of the **invalidity service pension** and/or,
- is in receipt of or eligible for the Special Rate of disability pension (T&PI) under the **Veterans' Entitlements Act 1986** (VEA) or the Special Rate Disability Pension (SRDP) under the **Military Rehabilitation and Compensation Act 2004** (MRCA).

## 3. Disability – recovery after 12 months

Under the Exposure Draft, a CGT event does not occur on the termination of a granny flat interest arrangement if a CGT event did not occur upon the entering into or the varying of the granny flat arrangement (sections 137-15 or 137-20). This means that once the eligibility criteria are satisfied, the exemption applies until the termination of the arrangement regardless of changes in circumstances.

While most individuals will access the exemption appropriately, the design of the legislation raises concerns that it may be exploited to gain a tax benefit. To the extent that the application of the general anti-avoidance rules may be problematic, the Government should consider the inclusion of specific clauses to maintain the integrity of the exemption.

For example, where an individual who has previously satisfied paragraph 137-10(2)(b) makes a recovery to the extent that they no longer need assistance, consideration should be given to whether a partial main residence exemption should instead apply.

<sup>2</sup> Centre for Retirement Research at Boston College (2020), Blue-collar workers often retire early, 19 November; Jacobs, Lindsay (2019), Occupations and Work at Older Ages: Varied Responses to Policy, Retirement & Disability Research Center, Center for Financial Security, University of Wisconsin-Madison, December, pp.1-2

<sup>3</sup> For clarity, we do not believe that access to the granny flat exemption should require satisfaction of the **non-medical rules** for the DSP.

The concern is that CGT on a separate self-contained dwelling can be avoided under the guise of a granny flat arrangement. This is akin to the identified gaming of the First Homeowners Grant where individuals access the grant by moving into the property within 12 months of purchase and “live” in it for between six and twelve months before then renting out the property.

Further, we do not believe that it is necessarily appropriate that an individual residing in a granny flat who no longer needs assistance is able to retain access to the exemption, when an individual with similar capacity but who was not previously disabled is not.

We therefore suggest that the Government considers providing a partial main residence exemption where the individual recovers from a disability or recovers from a disability within a certain time frame (e.g., five years or less). This would better maintain the equity and integrity of the exemption. Specific integrity provisions should also be considered to protect revenue, prevent abuse of the elderly and disabled and enable effective administration.

#### **4. Threshold cap or reasonableness test**

We recommend that the Government considers introducing an upper threshold cap or reasonableness test on the value of the granny flat interest that can be transferred and to which the granny flat exemption applies.

The social security rules<sup>4</sup> include a reasonableness test to ensure the advance of monies for a granny flat interest will not affect the pension, as long as the advance is not greater than required to properly create the “granny flat” accommodation. These rules could be adapted to limit the CGT benefit by including the use of the reasonableness test where the person is using the granny flat arrangement to gain a tax advantage.

The adoption of a threshold cap or introduction of a reasonableness test will ensure the total of the funds, assets and properties that can be invested for creating the granny flat arrangement is not excessive and is not used to create an inappropriate tax benefit.

#### **5. Termination of arrangement or sale of property in the event of abuse or relationship breakdown**

While the granny flat exemption removes a barrier to the establishment of formal arrangements, we believe that the potential for elder abuse remains, due to the potential tax benefit that can be obtained.

We recommend that the Government considers providing the Commissioner with the power to revoke or limit access to the granny flat exemption in cases of elder abuse, relationship breakdown or where an inappropriate tax benefit is obtained.

For example, a parent enters into an arrangement with their child for an interest in a granny flat and monies for construction, maintenance and ongoing care are given to the child by the parent. At the time of entering the arrangement the eligibility criteria are satisfied and any capital gains become tax exempt. The child then contravenes the arrangement and sells the property, netting a substantial capital gain on the granny flat that is exempt from tax. The parent is now without a home and may not have the means to seek redress through the legal system.

We believe that the Commissioner should be able to revoke the exemption where the owner removes the granny flat interest on sale of the property, and:

- did not include the right for the elderly or the disabled to live there for life as a condition of sale
- did not transfer the elderly or the disabled’s granny flat interest to another property, or
- did not give money or assets to the elderly or the disabled in return for giving up their granny flat interest.

This power should also apply where an elderly or disabled individual is expelled from the granny flat in contravention of the arrangement, but the property is not sold.

#### **6. Treatment of capital gains where main residence and/or granny flat rented out prior to or after the arrangement**

To ensure clarity, we believe the Explanatory Materials should confirm that the exemption only applies for the period of the arrangement and that activities prior to and after the arrangement are subject to the existing CGT rules.

For example, when an arrangement is terminated due to the death of the individual interest holder and the granny flat is subsequently rented out, the days apportionment method to calculate the partial CGT exemption will apply for the period when the granny flat was income producing.

Similarly, where the main residence has been previously rented out prior to being used in a granny flat arrangement, the main residence cannot be fully exempt from CGT on disposal. The days apportionment method to calculate partial CGT exemption would apply for the period when the home was income producing, in line with the application of CGT rules under the **main residence exemption**.

<sup>4</sup> Australian Government (2021). 4.6.4.50 Granny flats - features, rights & interests, Social Security Guide Version 1.281, 1 April