
**TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL
2021: EXEMPTING GRANNY FLAT ARRANGEMENTS FROM CGT**

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

| <i>Abbreviation</i> | <i>Definition</i> |
|----------------------------|--|
| Bill | Treasury Laws Amendment (Measures for Consultation) Bill 2021: Exempting granny flat arrangements from CGT |
| CGT | capital gains tax |
| ITAA 1997 | <i>Income Tax Assessment Act 1997</i> |

Chapter 1

Exempting Granny Flat Arrangements from Capital Gains Tax

Outline of chapter

1.1 Schedule # to the Bill amends the CGT provisions in the *Income Tax Assessment Act 1997* to provide a targeted CGT exemption in relation to granny flat arrangements.

1.2 The exemption will operate by providing that no CGT event arises on entering into, varying or terminating a granny flat arrangement if the arrangement satisfies the requirements of the provisions.

Context of amendments

1.3 The Australian Law Reform Commission released a report in 2017 which examined elder abuse in Australia (*Elder Abuse—A National Legal Response*, ALRC Report 131, 2017). In particular, the Australian Law Reform Commission examined the prevalence of elder abuse in relation to granny flat arrangements.

1.4 A granny flat arrangement has a particular legal meaning, derived from the term ‘granny flat interest’ in social security law. It describes an arrangement rather than a type of accommodation, and can arise whenever money or other consideration is given in exchange for a right to accommodation for life.

1.5 In a typical case, granny flat arrangements occur when an older person transfers some sort of consideration (often title to property or proceeds from the sale of property) to their adult child in exchange for the promise of ongoing care, support and housing. They can be formal, but more often than not they are informal.

1.6 These arrangements can be beneficial to all parties involved. When operating effectively, they can provide benefits to the adult child in the way of property or funds, and benefits to the older person in the way of care, support and housing.

1.7 However, the older person tends to be in a more vulnerable position and can suffer serious consequences if circumstances change. Problems can arise as a result of the adult child pre-deceasing the older person, relationship breakdowns between the adult child and their partner, or the adult child becoming bankrupt. Contingencies are often not

considered if these types of events happen and this, combined with the common informality of granny flat arrangements, can make it difficult for the older person to establish, assert or enforce their rights under the arrangement.

1.8 Perceived tax consequences are one barrier to parties having a formal granny flat arrangement in place. CGT events could arise on entering into, varying or terminating a granny flat arrangement, depending on the circumstances. Informal agreements can make it easier for a taxpayer to argue there are no formal rights in existence, and therefore no assets that could be subject to CGT.

1.9 The Board of Taxation examined these issues, and the tax issues that arise from granny flat arrangements, and delivered a report to Government in November 2019.

1.10 The Government responded to the Board of Taxation's report by bringing forward a measure in the 2020-21 Budget to provide a targeted CGT exemption for granny flat arrangements that provide accommodation for older Australians or people with disabilities where there is a formal written agreement in place.

Summary of new law

1.11 A CGT event does not happen on entering into, varying or terminating a granny flat arrangement if certain requirements are met. These requirements include that the individual having the granny flat interest has reached pension age or has a disability, and that the arrangement is in writing and is not of a commercial nature.

1.12 The CGT event does not happen only to the extent that it relates to the creation, variation or termination (as the case may be) of a granny flat interest.

1.13 A granny flat interest in a dwelling under this measure is a right to occupy that dwelling for life.

Detailed explanation of new law

1.14 All references to legislation are to the ITAA 1997 unless otherwise specified.

1.15 The intent of this measure is 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.

1.16 Schedule # to the Bill inserts a new Division into Part 3-3 of Chapter 3 to provide a targeted CGT exemption to granny flat arrangements to encourage the formalisation of such arrangements.

1.17 The amendments define what a granny flat interest is for the purposes of the measure, and outline a set of requirements that must be satisfied in order to access the exemption.

1.18 The effect of the amendments is that a CGT event does not happen on entering into, varying or terminating a granny flat arrangement if the requirements are satisfied, but only to the extent that it relates to the granny flat interest under the arrangement. It is also intended that the amendments do not affect the application of the main residence exemption in Subdivision 118-B.

Key terms

1.19 An individual has a granny flat interest under an arrangement if the arrangement confers on that individual the right to occupy a dwelling for life. [*Schedule #, item 1, section 137-10(1)*]

1.20 The concept of granny flat interest has been drawn from the recognition in the social security law of family arrangements that provide support for older people. It is essentially a right to live in a specific home for life.

1.21 A granny flat interest does not have to relate to properties often referred to as ‘granny flats’ as it is not a description of the type of property. An individual can have a granny flat interest in a wide range of properties, such as a family home or a family’s rental property or holiday home.

1.22 **Dwelling** is an existing concept in tax law. It generally captures a unit of accommodation, such as a residential home, and includes the land beneath the home. In this measure, the term refers to the dwelling that the individual has the right to occupy because of the granny flat interest.

1.23 While the term dwelling refers to the unit of accommodation, adjacent land and structures are also included as part of the term as a granny flat interest could exist in relation to these components too. [*Schedule #, item 1, section 137-10(3)*]

1.24 Eligibility to hold a granny flat interest for the purposes of the CGT exemption is restricted to individuals who have reached pension age or who have a disability that means they require assistance for most day-to-day activities for at least 12 months. [*Schedule #, item 1, section 137-10(2)*]

The targeted exemption

The core provisions

1.25 A CGT event does not happen if an arrangement is entered into that creates a granny flat interest, if the requirements of the provisions are satisfied. Similarly, a CGT event does not happen if an arrangement is varied to create or vary a granny flat interest, if similar requirements are satisfied. *[Schedule #, item 1, sections 137-15 and 137-20]*

1.26 A CGT event does not happen on the termination of an arrangement if a CGT event did not happen on the entering into or varying of the arrangement because section 137-15 or 137-20 applied. *[Schedule #, item 1, section 137-25]*

1.27 In all cases, the CGT event does not happen only to the extent that it relates to the creation, variation or termination (as the case may be) of a granny flat interest. Other transactions that may be associated with the granny flat interest, but do not relate to its creation, variation or termination, will continue to be subject to the CGT, unaffected by the granny flat interest exemption.

The requirements

1.28 There are requirements that need to be satisfied for the CGT event not to happen.

1.29 The first requirement is the eligibility for a granny flat interest. As noted above, an individual is eligible for a granny flat interest if the individual has reached pension age or has a disability that means they require assistance for most day-to-day activities for at least 12 months. *[Schedule #, item 1, sections 137-15(a) and 137-20(a)]*

1.30 Pension age is the same age threshold that is used in determining eligibility for the Age Pension. Sections 12(5A), (5B), (5C) and (5D) of the *Social Security Act 1991* provide the thresholds for pension age. Those who are above pension age are the ones most likely to require the care and support this measure is aimed at encouraging.

1.31 Disability takes its ordinary meaning. The individual needs to have an ongoing disability that causes them to require assistance in carrying out most day-to-day activities. It is not intended that an individual be able to access the exemption because of short-term injuries that have a quick recovery time.

1.32 The provision applies to test eligibility at the time of entering into or varying the arrangement. This means that the ability to recover from a disability is not an impediment to accessing the CGT exemption. The ability to undertake employment while having the disability is also not an impediment.

1.33 The second requirement is that an individual owns the dwelling where the granny flat interest is held, or is to be held, at the time of entering into or varying the arrangement, or agrees to acquire such a dwelling under the arrangement. *[Schedule #, item 1, sections 137-15(b) and 137-20(b)]*

1.34 Parties to a granny flat arrangement need not own the dwelling where the granny flat interest is to be held at the time of entering into the arrangement. Parties are able to enter into an arrangement and agree that one party will acquire a dwelling where the other party is to hold their granny flat interest at a future time.

1.35 The third requirement is that both the individual who is to hold the granny flat interest, and the individual who owns, or agrees to acquire, the dwelling where the granny flat interest is to be held, are parties to the arrangement. *[Schedule 1, item 1, sections 137-15(c) and 137-20(c)]*

1.36 An individual who is to hold a granny flat interest can enter into a granny flat arrangement with any party. For example, the individual can enter into such arrangements with their family, family friends or members of their cultural community, and these people do not need to own the dwelling. However the individual who does own, or is to own, the dwelling, needs to be a party to the arrangement.

1.37 The fourth requirement is that the arrangement must be in writing and indicate an intention for the parties to be legally bound by it. *[Schedule #, item 1, sections 137-15(d) and 137-20(d)]*

1.38 There is no requirement that a granny flat arrangement must take a particular form or include specific terms. This allows parties flexibility to ensure an arrangement can be entered into with terms that best suit the circumstances, and avoids unnecessary requirements from being a barrier to entering into such arrangements. However, it is expected that a formal arrangement would deal with basic matters such as the parties to the arrangement, the circumstances in which the arrangement could be varied or terminated, and what happens on variation or termination.

1.39 The fifth requirement is that the arrangement is not of a commercial nature. *[Schedule #, item 1, sections 137-15(e) and 137-20(e)]*

1.40 The commerciality of an arrangement would need to be determined on a case by case basis, considering the terms of the arrangement and circumstances of each case.

1.41 An arrangement requiring the holder of the granny flat interest to pay rent to occupy the accommodation could be an indicator that the arrangement is of a commercial nature.

1.42 On the other hand if the individual who holds the granny flat interest merely contributes to the costs of running the household that they are part of, this could be more in the nature of a reimbursement of

household expenses and suggest that the arrangement is not of a commercial nature.

1.43 The nature of any consideration for the granny flat interest could also be a factor in determining whether the granny flat arrangement is of a commercial nature.

Example 1.1

Edith is an 80 year old widow. Living by herself in the family home is too much for her to manage. She intends to sell the home and move in with her daughter Christine and her family. Christine's house is not big enough for Edith to live in comfortably and it is decided that Edith will contribute to the costs of building a self-contained flat on the property. Edith and Christine enter into a written agreement under which Edith contributes \$200,000 towards building the flat on Christine's property and acquires a right to live in the flat for life. The agreement also provides that it will terminate should Edith permanently vacate the unit in order to move into a residential care facility.

Under the exemption, the CGT event D1 that would otherwise have arisen from the creation of Edith's contractual right to live on Christine's property, will not happen. In addition, should Christine sell the property, the existence of the agreement, and Edith's separate use of the flat, would not affect Christine's or Edith's ability to claim the main residence exemption.

Other amendments

1.44 The amendments insert a provision that provides a summary of what Subdivision 137-A is about. [*Schedule #, item 1, section 137-1*]

1.45 Definitions of *eligible for a granny flat interest* and *granny flat interest* have been inserted into the dictionary in section 995-1(1). [*Schedule #, item 2, section 995-1(1)*]

Application and transitional provisions

1.46 The amendments in Schedule # to the Bill apply in relation to events that happen on or after the amendments commence that would, apart from the provisions contained in the amendments, be CGT events. This is the case even if the arrangements the events relate to were entered into before, on or after that commencement. [*Schedule #, item 3, section 137-10 of the Income Tax (Transitional Provisions) Act 1997*]