



**Rahul Singh, Challenger**

Rahul Singh is a technical services manager at Challenger. He has been in the industry since 2004, commencing his career with Clearview and working in technical services teams at AMP, ANZ and MLC prior to joining Challenger in 2019. Rahul is passionate about supporting advisers to deliver technical solutions to retail clients.

# Guide to granny flat interests

Rahul Singh

**T**here are a number of accommodation options for older people who require assistance and may not want to live by themselves. While residential aged care homes generally suit those with high care needs who cannot manage on their own, granny flats can be a suitable option for people looking to maintain some independence and have support and assistance from family and friends.

## What is a granny flat interest?

A granny flat is often considered to be a self-contained unit connected to a family home. While this is the real estate definition of a granny flat, the Centrelink definition of a 'granny flat interest' differs.

According to Centrelink, the term granny flat interest describes an agreement for accommodation for life, not a description of the type of dwelling. A granny flat interest can include various types of living situations that help people to care for elderly family members.

Centrelink considers a granny flat interest as one where someone:

- 'pays' for a life interest or life tenancy, and
- the life interest or life tenancy is in a private residence, that will be the person's principal home.

Centrelink also considers there to be two ways to have a lifetime right in a property:

- Life tenancy—the right to live in the property
- Life interest—the right to use and benefit from the property as the person wishes.

For Centrelink purposes, it is not possible for someone to have a granny flat interest in a property they own or part-own. This is because they

already have a right to live in their home because of their ownership.

The granny flat rules enable a person to transfer assets over the allowable gifting limits, of \$10,000 per financial year and \$30,000 over any rolling five-year financial year period, to another person in exchange for a right to accommodation for life in residential property.

## How is a granny flat interest valued?

The value of a granny flat interest is the amount paid or transferred by a person who:

- transfers the title of their home to a person and receives a life interest in return, or
- pays for the construction of accommodation on another person's property and receives a life interest in return, or
- purchases a property in another person's name in return for a life interest.

Centrelink deprivation rules do not apply in these situations.

However, where assets are transferred in addition to one of the situations above, the *Social Security Act 1991* determines the granny flat interest to be valued at a different amount under the 'reasonableness test' rules.

## The reasonableness test

The reasonableness test uses conversion factors to determine the amount a person of a certain age could reasonably pay for a life interest.

The value of the granny flat interest is then the greater of the cost for the home and the reasonableness test amount.

Importantly, in cases where the amount paid is above the value of the granny flat interest, the excess amount is treated as a 'gift' by Centrelink.

Reasonable value = combined annual partnered pension rate x conversion factor where:

- The combined annual partnered pension is a standard rate—that is, it is used irrespective of the person's marital status or actual pension received.

The current rate used is \$37,341.20.

- Conversion factors are based on a person's age on their next birthday, as outlined in Table 1.

### Example 1

Margaret, 75, transfers the title of her house worth \$1,200,000 to her son in exchange for a life interest in the house. She does not transfer any additional assets. The reasonableness test is not triggered because no additional assets were transferred. The value of the granny flat interest is \$1,200,000 and no amount is treated as a gift.

### Example 2

Joe, 77, pays \$300,000 for the construction of a self-contained unit on his daughter's property and pays \$200,000 cash on top in exchange for a life tenancy in the unit. Since assets in addition to the home have been transferred, the reasonableness test is triggered.

The reasonable value is \$424,569 ( $\$37,341.20 \times 11.37$ ). The value of the granny flat interest is, therefore, \$424,569 because this is greater than the \$300,000 paid for construction of the unit. As a result, the amount paid above the granny flat value of \$75,431 ( $\$500,000 - \$424,569$ ), is treated as a gift. This may be reduced by up to \$10,000 if the gifting limits have not already been met.

### Example 3

Aphrodite, 71, purchases a home in her daughter's name for \$700,000 and pays \$100,000 in cash for a life interest in that property. Since assets in addition to the home have been transferred, the reasonableness test is triggered.

The reasonable value is \$588,871 ( $\$37,341.20 \times 15.77$ ). The cost for the home is \$700,000. The value of the granny flat interest is the greater of the cost of the home and the reasonable value, which in this case is \$700,000.

As a result, \$100,000 ( $\$800,000 - \$700,000$ ) is treated as a gift. This may be reduced by up to \$10,000 if the gifting limits have not yet been used.

### Example 4

Martin, 80, pays \$100,000 to convert his son's property to suit his needs and pays an additional \$150,000 in cash for a life tenancy in the property.

The reasonable value is \$351,381 ( $\$37,341.20 \times 9.41$ ), which will be the value of the granny flat because it is more than the \$100,000 Martin paid for the fit-out of the property. No amount is treated as a deprived asset by Centrelink because the \$250,000 Martin paid in total is less than the value of the granny flat.

## Homeownership status

To determine whether a granny flat interest recipient is a homeowner, the entry contribution (EC) amount and the extra allowable amount (EAA) need to be calculated.

The EC is equal to the value of the granny flat interest.

The EAA is the difference between the pension homeowners' and non-homeowners assets test limits when the granny flat interest is created. Currently, this is \$214,500.

Table 2 summarises the rules for determining the homeowner status of a granny flat interest recipient.



### The quote

*A granny flat interest can include various types of living situations that help people care for elderly family members.*

**Table 1. Reasonableness test conversion factors**

Age next birthday	Conversion factor	Age next birthday	Conversion factor	Age next birthday	Conversion factor
65	21.48	77	12.07	89	5.26
66	20.64	78	11.37	90	4.87
67	19.80	79	10.70	91	4.52
68	18.98	80	10.04	92	4.19
69	18.16	81	9.41	93	3.89
70	17.36	82	8.80	94	3.63
71	16.56	83	8.21	95	3.40
72	15.77	84	7.65	96	3.19
73	15.01	85	7.11	97	3.01
74	14.25	86	6.60	98	2.86
75	13.50	87	6.13	99	2.72
76	12.78	88	5.68	100+	2.60

Note: for a couple, the youngest partner's age on their next birthday is used.

**Table 2. Granny flat homeowner status**

	EC ≤ EAA	EC > EAA
Homeownership status	Non-homeowner	Homeowner
Entry contribution	Assessed as an asset	Exempt

**Example 5**

Morgan pays \$120,000 for the construction of a self-contained unit on his son's property and receives a life interest in the property. As \$120,000 is less than the EAA of \$214,500, Morgan is treated as a non-homeowner. \$120,000 will count as an asset, but will not be deemed.

**Example 6**

Theresa's daughter buys a home for \$600,000 to which Theresa contributes \$250,000 in exchange for a life tenancy in the home. Theresa is a homeowner and the \$250,000 she paid is exempt from Age Pension assessment.

**Vacating the granny flat interest**

If a person stops living in a granny flat interest less than five years after the time the interest was created, the deprivation rules may apply if the reason they left could have been anticipated. As there is no clear definition of what constitutes an unforeseeable event, Centrelink will assess each case individually.

If a person is in reasonable health when the granny flat interest is created, deprivation may not apply if the person must move within five years.

However, if a move to residential aged care is imminent at the time the granny flat interest is created, then deprivation rules may apply when the person leaves the granny flat to move into an aged care facility soon after. If deprivation applies, it will continue until the end of the five-year period from the day the granny flat interest was first created.

**Considerations**

There are some other important factors to weigh up before setting up granny flat arrangements. Some of these are included in the following discussion.

Consider drawing up a formal legal agreement to protect the recipient from any breakdown in family relationships and to provide clarity on the details of the arrangement.

For example:

- Will the arrangement be a life interest or life tenancy?
- What happens if the owner of the home decides to sell? Will the life interest continue in a new home, or will the recipient be compensated financially?
- Which party is responsible for the upkeep of the property?
- What provisions will there be if the recipient moves into an aged care facility?

There could be capital gains tax (CGT) implications for the provider of the granny flat, as set out in taxation ruling TR 2006/14 *Income tax: capital gains tax: consequences of creating life and remainder interests in property and of later events affecting those interests*. As such, it is important that specialist tax advice is sought before the life interest is created.

From 1 July 2021, in certain situations, there could be a CGT exemption for the creation, variation or termination of formal written granny flat arrangements. This covers granny flat interests for those who have reached Age Pension age or have a disability with care needs.

There may be social security implications for the provider of the granny flat because the lump sum they receive may be assessed:

- Granny flat interests may assist the recipient with their Age Pension assessment, however, capital has been passed to the provider of the granny flat. Therefore, it is important to consider how much capital the recipient might need to last through their retirement.
- Consideration should be given to estate planning issues where assets are transferred to certain children. The retiree may wish to ensure that assets and compensation for the granny flat are fairly distributed between beneficiaries.
- Centrelink recommends that a legal document is drawn up. Where this is not done, Centrelink will need to be informed that a granny flat interest has been established.

**Case study**

In July 2015, Ursula's husband passed away. Soon after, she decided to establish a granny flat interest on her daughter's property. Ursula sold her own home for \$700,000 and paid the daughter \$100,000 for her home to be fit out to accommodate Ursula, in return for a life tenancy in the home. Although Ursula was in good health, her main reason for moving in with her daughter was for company. Ursula did not pay an amount on top of the construction costs, therefore the reasonableness test did not apply and the value of the granny flat was \$100,000. At the time, the EAA was \$149,000, which is more than \$100,000, so she is treated as a non-homeowner for Age Pension purposes.

In May 2021 Ursula, who is now 86, had a major fall and requires a level of care which her daughter is not able to provide. As the home can no longer accommodate her mobility needs, they decide a move to a nearby residential aged care facility will provide Ursula with more suitable accommodation and care, given her increased needs.

Ursula requires \$50 per week on top of any care fees to meet her other pharmaceutical and personal expenses. She has \$5,000 in personal assets and \$400,000 in the bank after paying a refundable accommodation deposit (RAD) of \$350,000. Ursula's current cash flow position is shown in Table 3.

**Table 3. Current scenario**

Cash flow	Per annum
Investment income*	\$4,800
Age Pension	\$23,114
Less personal expenses	(\$2,600)
Less basic daily fee	(\$19,239)
Less means-tested care fee	(\$10,052)
<b>Net cash flow</b>	<b>(\$3,977)</b>

\* Bank account and term deposit interest rates are 1.2% p.a.

The assessment of the granny flat interest upon moving into the aged care facility should be discussed with a Centrelink financial in-

formation service officer, who will be able to confirm homeowner status and the value of the granny flat interest, if any, that will be assessed.

As it has been more than five years since the granny flat interest was created, the deprivation rules will not apply for Ursula. In this case, the life interest has terminated upon Ursula entering care and therefore has no value for aged care or Age Pension purposes. Ursula is assessed as a non-homeowner.

Ursula and her daughter see a financial adviser to discuss her options. The adviser determines that Ursula's priority is the affordability of her aged care fees, however she would also like to increase her Age Pension entitlement, if possible.

To improve Ursula's cash flow position and address her concerns around drawing down on her capital, the financial adviser recommends an investment of \$350,000 in the Challenger CarePlus annu-

**Table 4. Proposed scenario**

Cash flow	Per annum
Investment income*	\$600
CarePlus income**	\$7,306
Age Pension	\$24,770
Less personal expenses	(\$2,600)
Less basic daily fee	(\$19,239)
Less means-tested care fee	(\$8,840)
<b>Net cash flow</b>	<b>\$1,997</b>

Source: Challenger

\* Bank account and term deposit interest rates are 1.2% p.a.

\*\* CarePlus rates as at 5 May 2021 for an 86-year-old female with no adviser service fees

ity product, as shown in Table 4.

In taking this recommendation, Ursula will achieve:

- a positive cash flow position that allows her to cover aged care fees, and provides an increase in cash flow of \$5,974 p.a.
- an increase in her Age Pension entitlement to the full amount of \$24,770 p.a. (an increase of \$1,656 p.a.), and
- a reduction in her means-tested care fee of \$1,212 p.a.

In addition to the cash flow benefits, Ursula will be able to ensure that 100% of the amount she invests in the CarePlus annuity is paid to her nominated beneficiaries or her estate when she passes away, providing her with certainty and control over her estate planning. **FS**

*The information contained in this update is current as at 5 May 2021 unless otherwise specified and is provided by Challenger Life Company Limited ABN 44 072 486 938, AFSL 234670 (Challenger), the issuer of Challenger annuities. The information in this update is general information only about our financial products. It is not intended to constitute financial product advice.*