

Social security special disability trusts

A SDT PROVIDES A TAX AND SOCIAL SECURITY EFFICIENT MEANS TO PROVIDE CARE AND ACCOMMODATION FOR A SEVERELY DISABLED RELATIVE.



INTRODUCTION

The social security system has historically been a barrier to persons making financial provision for a severely disabled relative, because a gift of assets for the benefit of the disabled relative could reduce the donor, the donor's spouse or the disabled relative's social security entitlements.

The Federal Government amended the *Social Security Act 1991* (SSA 1991)¹ to reduce those barriers to encourage immediate family members to establish a Special Disability Trust (SDT) for the care and accommodation of the disabled relative. SDT assets with an aggregate value of up to \$500,000 (indexed) (SDT asset threshold) will receive concessionary treatment for social security purposes.

This article discusses the changes to existing social security laws and selected income and capital gains tax consequences requiring consideration when establishing a SDT.

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HISTORICAL SOCIAL SECURITY BARRIERS

SSA 1991 means tests

A person's disability support pension and carer payment entitlements are subject to an asset means test and an income means test.² Carer payments are also subject to the receiver satisfying the special care receiver income test.³

The assets and income of a private trust or company are attributable to each of the persons who control the trust or company

or to each of the persons who were the source of the capital or corpus of the company or trust under the means tests.⁴

The income and assets thresholds that apply from 20 September 2006 are summarised in the table below:

Family situation	For full payment (per fortnight)*	For part payment (per fortnight)+#
Income test⁵		
Single	Up to \$128	Less than \$1,422.75
Couple (combined)	Up to \$228	Less than \$2,381.00
Asset test⁶		
Single – homeowner	Up to \$161,500	Less than \$334,250
Single – non-homeowner	Up to \$278,500	Less than \$451,250
Couple – homeowner	Up to \$229,000	Less than \$516,500
Single – non-homeowner	Up to \$346,000	Less than \$633,500
* Income over these amounts reduces the rate of pension payable by 40 cents in the dollar, and 20 cents in the dollar each (for couples);		
Assets over these amounts reduce pension by \$3 per fortnight for every \$1,000 above the limit.		
# Limits will increase if Rent Assistance is paid with the pension.		
+ Pharmaceutical Allowance included		

The asset means test does not include certain assets such as a right or interest in a principal home and proceeds from the sale of the principal home.⁷

Income for the income means test is gross income adjusted by specified SAA 1991 inclusions and exclusions⁸ and is often different to taxation income requiring care in calculating entitlements.

Both the income means test and assets means test calculate entitlements and the test that results in the lower entitlement (or no entitlement) will apply. Entitlements progressively reduce between the above thresholds with no entitlement payable after exceeding the part payment threshold.

Deprivation rules

Where a person disposes of assets for inadequate consideration or with the purpose to obtain a social security entitlement, the value of the disposed asset is included in that person's assets means tests and the person deemed to receive income at the statutory rate for the income means test for the following five years.⁹

The asset deprivation rules apply to any amount gifted in excess of \$10,000 in a single year or \$30,000 over a rolling five-year period. A disposal by one person of a couple will also affect that person's partner.

Provision for disabled relatives

Prior to 1 January 2002,¹⁰ it was possible to structure assets transferred to or acquired by a disability trust to avoid the means tests and the asset deprivation rules for the donor and for the disabled relative. However, from that date, the donor and the disabled relative's social security entitlements were subject to the deprivation rules and the revised means tests.¹¹

From 20 September 2006, the SDT rules constitute a means of assisting persons to provide for a severely disabled relative without reduction in entitlements.

SPECIAL DISABILITY TRUSTS

Overview

To qualify as a SDT, the trust must:

- have one principal beneficiary (although it can have a residuary beneficiary)¹² with a "severe disability"; and
- be established solely to provide for the care and accommodation needs of the principal beneficiary;¹³ and

- contain the clauses set out in the model trust deed in the establishing instrument;¹⁴ and
- have an independent trustee or more than one trustee;¹⁵ and
- comply with certain investment restrictions;¹⁶ and
- provide annual financial statements;¹⁷ and
- conduct independent audits when required.¹⁸

The social security advantages of a SDT include:

- transfer of assets by a social security recipient who is a qualified relative to the SDT up to the SDT assets threshold not being subject to the deprivation rules; and
- the value of asset not exceeding the SDT assets threshold not being attributed to the donor or the principal beneficiary under the asset means test;¹⁹ and
- the income from the assets not exceeding the SDT assets threshold not being attributed to the donor or the principal beneficiary under the income means test.

Where qualified donors make a number of transfers, the aggregated value of the transferred assets applies to the SDT asset threshold.²⁰ Subsequent transfers that exceed the SDT asset threshold are assessable as assets of the principal beneficiary for the means tests²¹ and the deprivation rules will apply.²²

Transitional measures apply in respect of trusts created before 20 September 2006.²³

Qualifying principal beneficiary

A principal beneficiary who has reached 16 years old qualifies if the person:²⁴

- has an impairment that would qualify that person for a disability support pension, or receive a service pension, or receive income support supplement; and
- has a disability that would qualify a carer for that person for a carer's allowance; or
- is living in an institution, hostel or group home in which care and funding is provided; and
- is not working and has no likelihood of working for a wage at or above the relevant minimum wage.

If the principal beneficiary is less than 16 years old, the person must be profoundly disabled within the meaning of s 197 SSA.²⁵

Statutory impairment tables detail the degree of physical, intellectual or psychiatric impairment based on medical, social and work function resulting in a continuing inability to work.²⁶ A profoundly disabled child has intellectual, psychiatric or behavioural disability manifesting itself as dangerous health risk behaviour, violent behaviour or sexually inappropriate behaviour that requires constant care or supervision.²⁷

It is beyond the scope of this article to discuss the degree of impairment. However, the degree of impairment to qualify is significant.

Qualifying trustees

An individual qualifies to be a trustee if the individual:²⁸

- is an Australian resident; and
- has not been convicted of an offence of dishonest conduct or an offence arising out of the SSA 1991, the Veterans' Entitlements Act 1986 (VEA 1986) or the *Social Security (Administration) Act 1999* (Cth); and
- has not been disqualified from managing a corporation.

If the trustee is a corporation, the above requirements apply to each director of the trustee.²⁹

Qualifying trust property

The assets of the trust must not include an asset transferred to the trust by the principal beneficiary or his or her partner³⁰ or include any compensation received by the principal beneficiary.³¹

The assets must not be used to pay an immediate family member or child of the principal beneficiary for care services or accommodation or be used to purchase or lease property from an immediate family member or a child of the principal beneficiary.³² Structuring donations so that the donor retains income or derives income directly or indirectly from the donated assets will be difficult.

In determining the assessable assets of the SDT, the value of any right or interest in the beneficiary's principal home is disregarded.³³

Qualifying asset transfer

If a social security recipient transfers an asset to a SDT (the value of which does not exceed the SDT asset threshold), the transfer is disregarded for the purposes of the deprivation rules.

A transfer qualifies if the donor:³⁴

- is an immediate family member of the principal beneficiary; and
- receives (or the donor's partner receives) a social security or service pension; and
- is of pension age; and
- does not receive consideration for the transfer; and
- transfers the asset unconditionally; and
- the aggregated value of the properties transferred does not exceed \$500,000.

Where neither the donor nor the donor's partner have reached pension age or are in receipt of a pension, the donor is deemed to have made the transfer at the time that the donor or the donor's partner reaches pension age.³⁵ Accordingly, donors that do not initially qualify may take advantage of the concessionary measures later when they do qualify.³⁶

SDT status cessation

A SDT ceases to qualify where the trust deed fails to comply with the statutory requirements³⁷ or at the date of the death of the principal beneficiary.³⁸

If an immediate family member or principal beneficiary (or the principal beneficiary's partner) transferred an asset to the trust within the five-year period preceding the cessation of the trust, the transfer is deemed for the purposes of the deprivation rules to be a disposal of an asset occurring at the time of the transfer.³⁹ The amount of the disposal is determined in accordance with a formula.

TAXATION TREATMENT OF SDT

Overview

The amendments do not alter the income tax treatment of the transfer of assets and the taxation of beneficiaries of the SDT.

A donor will usually transfer shares, units in trusts and real estate held on capital account to the SDT to provide income or accommodation for the principal

beneficiary. Issues arising from these assets are discussed below.

CGT on the transfer of assets

A capital gain may arise upon the occurrence of a CGT event in respect of a CGT asset, unless an exemption applies or rollover relief defers the capital gain. A capital gain arises where the proceeds from the CGT event exceed the adjusted acquisition costs of the CGT asset. Capital gains on assets acquired before 20 September 1985 are disregarded.

The CGT capital gain discount⁴⁰ or the CGT small business concessions⁴¹ (or both) may reduce the capital gain.

A net capital gain is included in the assessable income of the taxpayer.

The donor will need to consider and manage any CGT liability arising on the transfer of a CGT asset.

Revocable trust rules

Where a person creates a trust and income under that trust is payable to, accumulated for, or applicable for the benefit of that person's child who is under the age of 18 years, the Commissioner may assess the trustee to pay income tax and the beneficiary is not assessed to pay income tax.⁴²

Where the donor establishing the SDT is a parent of the minor principal beneficiary, the Commissioner may potentially apply the provision during the principal beneficiary's minority. The Commissioner should provide guidance in this respect by ruling or determination, particularly in light of the decision in *Hobbs v FCT*.⁴³ However, where an unrelated settlor established the SDT with a nominal settlement⁴⁴ and the parents subsequently donate property, this provision will not apply.⁴⁵ How the provision applies for a testamentary SDT where a parent is the testator is unclear. Again the Commissioner should provide guidance.

Taxation of the principal beneficiary

Generally, social security disability support pensions are exempt from income tax.⁴⁶ A principal beneficiary, who is over the age of 16 years, has a specified level of physical, intellectual or psychiatric impairment and who has a continuing inability to work is likely to receive a disability support pension.⁴⁷

Income from a SDT is taxable under the ordinary trust rules.⁴⁸ A beneficiary that is presently entitled to a share of the net income of the trust and is not under a legal disability is taxable on that income at individual tax rates.⁴⁹ However, where a beneficiary is under a legal disability, the trustee must withhold and remit tax on that income as if a separate individual at individual tax rates.⁵⁰ A beneficiary under a legal disability will not have to lodge a tax return, unless in receipt of other income.⁵¹ Where no beneficiary is presently entitled to the trust income, the trustee may be assessed at the maximum individual tax rate (currently 45 percent plus the Medicare levy),⁵² unless the Commissioner exercises his discretion and assesses the trustee.⁵³

The undefined term "legal disability" refers to a person that is unable to give an immediate valid discharge to the trustee in respect of a distribution such as a minor⁵⁴ or a person that is mentally incapable.⁵⁵

The principal beneficiary may be a minor or mentally incapable, so under a legal disability. However, other forms of physical disability and intellectual and psychiatric impairment may be insufficient to constitute a legal disability for income tax purposes. Income tax liability will require a case-by-case assessment.

A minor beneficiary that is a prescribed person is taxable at 45 percent plus the Medicare levy⁵⁶ on the beneficiary's share of the net trust income that is not, in relation to that beneficiary, excepted trust income.⁵⁷ A minor beneficiary is not a prescribed person if for or at the end of that income year:

- the minor beneficiary is entitled to a child disability allowance⁵⁸ or a disability support pension under the SAA 1991; or
- the Commissioner receives a medical certificate stating that the minor beneficiary is a disabled child or has a continuing inability to work within the meaning of the SAA 1991; or
- the Commissioner receives a medical certificate stating that the minor beneficiary is a person who, by reasons of a permanent disability, is unlikely to be able to engage in full-time occupation.

A principal beneficiary in receipt of a disability support pension will usually not be a prescribed person and will be taxed at individual adult tax rates. However, it is

unclear whether the exclusion applies to carer allowances (formerly child disability allowance). The taxation exclusions do not correlate with the SDT definitions and entitlements in SSA 1991 arising from various amendments to the SSA 1991. Accordingly, a SDT arising from living in a hostel may not satisfy the exemption and the principal beneficiary may be taxable at the penalty rate.

Where there is doubt about whether the minor principal beneficiary is a precluded person, a Will should establish the SDT, because any income arising from the trust property will likely be excepted trust income arising from property that devolved for the benefit of the beneficiary from the estate of a deceased person.⁵⁹ If excepted trust income, the income will not be taxable at the penalty rate.

Main residence exemption

A capital gain made on the disposal of an individual's dwelling or ownership interest in a dwelling used as a main residence throughout the entire ownership period is exempt from CGT. A pro rata exemption is provided in certain circumstances.⁶⁰ Where a trustee of a trust (other than a bare trust or a testamentary trust) owns the dwelling, the main residence exemption does not apply.⁶¹ Accordingly, CGT will be payable on any disposal by the SDT of a main residence used to accommodate the principal beneficiary.

However, the position is different for a testamentary trust. A trustee of a testamentary trust may disregard a capital gain on disposal of the dwelling where:⁶²

- the deceased acquired the ownership interest before 20 September 1985; or
- the deceased acquired the ownership interest on or after 20 September 1985 and the dwelling was the deceased's main residence just before death and was not used for producing assessable income; and
- the dwelling was from the deceased's death until disposal by the trustee the main residence of an individual who had a right to occupy the dwelling under the deceased's Will.

If a Will establishes the SDT and grants the principal beneficiary a right to occupy the dwelling, upon the death of the principal

beneficiary the trustee may dispose of the property and claim a full or part main residence exemption.

Accordingly, where the SDT will provide accommodation to the principal beneficiary, it is preferable to establish the SDT by Will.

CONCLUSION

Parents and other relatives have an opportunity to establish a SDT to care and provide accommodation for a severely disabled relative that offers significant social security concessions for the donor and the disabled relative. Parents with severely disabled children who are not entitled to social security benefits due to the value of their assets may be able to transfer sufficient assets to a SDT to satisfy the means tests and qualify for entitlements.

However, structuring the SDT correctly so that it qualifies and so there are no adverse income tax consequences will require careful consideration.

Ron Jorgensen
Director, Harwood Andrews Lawyers

Reference notes

- 1 *The Family, Community Services and Indigenous Affairs and Other Legislation (2006 Budget and Other Measures) Act 2006 (Cth) (FCSIAOLA 2006).*
- 2 *Parts. 3.12 and 3.10 SSA 1991; P Sutherland, Social Security and Family Assistance Law, 2nd Ed 2005, the Federation Press, at 453.*
- 3 www.centrelink.gov.au/internet/internet.nsf/payments/spec_care_at.htm.
- 4 *Divisions 2 and 3 of Part 3.18 of the SSA 1991.*
- 5 www.centrelink.gov.au/internet/internet.nsf/payments/chartc.htm.
- 6 www.centrelink.gov.au/internet/internet.nsf/payments/chartab.htm.
- 7 *Section 1118 SSA 1991.*
- 8 *DSS v Reed (1988) ASCC ¶192-098; Paula v DSS (1985) ASCC ¶192-042.*
- 9 *Section 1123 SSA 1991; P Sutherland, ibid, at 466.*
- 10 *Social Security and Veterans' Entitlements Legislation Amendment (Private Trusts and Private Companies - Integrity of Means Testing) Act 2000 (Cth).*
- 11 *Schedule 7, FCSIAOLA 2006 Explanatory Memorandum, at 28.*
- 12 *Section 1209M(1) FCSIAOLA 2006.*
- 13 *Section 1209N FCSIAOLA 2006.*
- 14 *Section 1209P FCSIAOLA 2006.*
- 15 *Section 1209Q FCSIAOLA 2006.*
- 16 *Section 1209R FCSIAOLA 2006.*
- 17 *Section 1209S FCSIAOLA 2006.*
- 18 *Section 1209T FCSIAOLA 2006.*
- 19 *Section 1209Y(5) FCSIAOLA 2006.*
- 20 *Section 1209ZA(2) FCSIAOLA 2006.*
- 21 *Section 1209Y(2) FCSIAOLA 2006.*
- 22 *Section 1209ZA(1) FCSIAOLA 2006.*
- 23 *Item 14 FCSIAOLA 2006.*
- 24 *Section 1209M(2) FCSIAOLA 2006.*
- 25 *Section 1209M(4) FCSIAOLA 2006.*
- 26 *Section 94 SSA 1991.*
- 27 *Section 197(2) SSA 1991.*
- 28 *Section 1209Q(1) FCSIAOLA 2006.*
- 29 *Section 1209Q(2) FCSIAOLA 2006.*
- 30 *Unless the transferred asset is a bequest or a superannuation death benefit and the transferor received the asset within three years of the transfer; Section 1209R(1) FCSIAOLA 2006.*
- 31 *Section 1209R(2) FCSIAOLA 2006.*
- 32 *Section 1209R FCSIAOLA 2006.*
- 33 *Section 1209Y(4) FCSIAOLA 2006.*
- 34 *Section 1209Z FCSIAOLA 2006.*
- 35 *Section 1209ZB(1) FCSIAOLA 2006.*
- 36 *Schedule 7 FCSIAOLA 2006 Explanatory Memorandum at 38.*
- 37 *Section 1209P FCSIAOLA 2006.*
- 38 *Section 1209ZD FCSIAOLA 2006.*
- 39 *Section 1209ZD(1) FCSIAOLA 2006.*
- 40 *Div. 115 Income Tax Assessment Act 1997 (Cth) (ITAA 1997).*
- 41 *Div. 152 ITAA 1997.*
- 42 *Section 102 Income Tax Assessment Act 1936 (Cth) (ITAA 1936).*
- 43 *Hobbs v FCT (1957) 98 CLR 151; 11 ATD 248; cf Truesdale v FCT 70 ATC 4056 at 4060.*
- 44 *Refer to the model special disability trust deed.*
- 45 *Truesdale v FCT (1971) 120 CLR 353; 70 ATC 4056.*
- 46 *Div. 52-A ITAA97.*
- 47 *Section 94(1) SSA 1991.*
- 48 *Part III, Div. 6A ITAA 1936.*
- 49 *Section 97 ITAA 1936.*
- 50 *Section 98 ITAA 1936; Xebec Pty Ltd (In Liq) v Enthe Pty Ltd 87 ATC 4570.*
- 51 *Section 100 ITAA 1936; Determination TD 92/159.*
- 52 *Section 99A ITAA 1936.*
- 53 *Section 99 ITAA 1936.*
- 54 *A person under 18 years old; Taylor v FCT (1970) 119 CLR 444; 70 ATC 4026; 1 ATR 582.*
- 55 *Ruling TR 2004/D25, para 67.*
- 56 *Schedule 11 Income Tax Rates Act 1986 (Cth).*
- 57 *Section 102AG ITAA 1936.*
- 58 *Now the Carer Allowance, but the child disability allowance continues to apply for applications before 1 July 1999.*
- 59 *Section 102AG(2)(d) ITAA 1936.*
- 60 *Section 118-110 ITAA 1997.*
- 61 *Determination TD 58.*
- 62 *Section 118-195 ITAA 1997.*

