



## Submission for Senate Community Affairs Committee Inquiry into Special Disability Trusts

by

Patrick Hughes

### Background

I have prepared this submission as the foster parent of an autistic boy for eighteen years. Our foster son is now 22 and as a former ward of the state he was fortunate enough to receive Government funding and is reasonably secure for the rest of his life.

As a result of my involvement in foster care, however, I became aware of the problems faced by people in a position similar to my own but raising their own children and the uncertainty they faced as those children reached adulthood.

I am also a lawyer and have some experience of parents trying to arrange for succession planning for the time when they are no longer around to assist their children personally.

### Barriers to Family Funded Support

Some three years ago I joined an Advocacy Group chaired by Barry McKinnon, the then Chairman of the Disability Services Commission, Western Australia. The group published a paper entitled Removing Barriers to Family Funded Support for People with Disabilities. A copy of that paper is annexed to this submission.

In that paper we set out a number of existing barriers at that time which were faced by parents wishing to set up the financial plan incorporating a private trust for their son or daughter with a disability. In particular, parents were faced with the following specific problems:-

- a. assets transferred to a trust attract stamp duty,
- b. in some cases the assets can attract Capital Gains Tax,
- c. real property in a private trust could be subject to Land Tax.
- d. for pension purposes the property was still considered as belonging to the parent for the relevant period under the Assets Test and
- e. income from an inter-vivos trust is taxed in the hands of the beneficiary, even if it is used to purchase support services.

Since that time changes in legislation have alleviated some of these barriers.

In particular, the Social Security Act was amended in 2006 to provide that as from 20 September 2006 parents have been able to establish a trust of up to \$500,000.00 (index linked) for the care needs of their son or daughter with a severe disability without being affected by the Social Security Means Test and Gifting Laws. Assets placed into this trust will also not impact on the disabled person's income support pension.

In addition, the State Government in Western Australia has extended the Land Tax exemptions and rates concessions to properties occupied by a disabled person but owned by another family member.

One particular and major draw back, however, remains in relation to Special Disability Trusts. Whilst the Social Security Act was amended in 2006 to provide the relevant exemptions for pensions purposes, the Income Tax Assessment Act was not amended to provide the necessary complementary changes to Income Tax and Capital Gains Tax legislation.

### Remaining Barriers to the Special Disability Trust

Accordingly, two major tax barriers still exist to the establishment of a Special Disability Trust:-

#### 1. Capital Gains Tax

Capital Gains Tax has a twofold implication to Special Disability Trusts:

- a. Assets (in particular real property) transferred into a trust can attract Capital Gains Tax at that time. Thus, for example, if a parent already owns a home which is used as a residence for the disabled son or daughter, and the parent wishes to transfer that home into the Special Disability Trust, the transfer is a Capital Gains Tax "event". Therefore the parents must include the difference between the purchase price of that property and the value of the property at the time of transfer, in the parents' income tax return for that year. This is clearly a disincentive for the transfer of that property and:
- b. If a property is owned by a Special Disability Trust and used as the residence for the person with the disability, the property itself will be subject to Capital Gains Tax if it is sold even for the purpose of a replacement residence for that same person. The Social Security Act accepts that the home is the home of the disabled person and is for the purposes of that Act treated in exactly the same way as the residence of any one else. The Income Tax Assessment Act however does not recognise the property as being a personal place of residence for Capital Gains Tax purposes.

It is relevant to note that in the Special Disability Trust booklet "*Getting Things Sorted*" the pro forma trust anticipates (in clause 2.3(b)) that the property in which the principal beneficiary lives (the residence) may be sold and "the proceeds" used to acquire a substituted residence. However lawyers must point out to their clients that "the proceeds" must be read as "the proceeds after setting aside sufficient funds to pay the Capital Gains Tax attracted by that sale to the Federal Government".

### **Recommended Change to the Income Tax Assessment Act for CGT Purposes**

A complementary change needs to be made to the Income Tax Assessment Act recognising what the Social Security Act already acknowledges – ie **a property owned by a Special Disability Trust and used as the residence for the person with the disability, should be exempt from Capital Gains Tax**

#### 2. Income Tax

Income Tax can be a considerable problem in relation to Special Disability Trusts. Again, as no complementary amendments have been made to the Income Tax Assessment Act, a Special Disability Trust is treated in same way as any other trust and any undistributed income is taxed to the trustee at the highest marginal rate. Unlike most other trusts, however, because the income from a Special Disability Trust can only be used for the accommodation and reasonable care needs (as a result of the disability) it is likely that in

many Special Disability Trusts the trustee will have no option but to retain some of the income in any year within the trust. This will then be taxed at those penalty rates.

As a result of this anomaly it is very difficult for lawyers to give advice to clients as to how to set up such a trust either during the clients' lifetimes or in their Wills. One way to alleviate the current problem (especially in Wills) is to set up two potential trusts one being the Special Disability Trust and another being an All Needs Protective Trust. This does however make the Will unnecessarily complicated and puts the executor in a very difficult position when determining the amount to put into each trust.

### **Recommended Changes to the Income Tax Assessment Act for Income Tax Purposes**

**Again a complementary change to the Social Security Act needs to be made to the Income Tax Assessment Act to give relief to undistributed income in a Special Disability Trust.**

Two possible options are:-

- a. to treat the trust itself as an "individual" for Income Tax purposes. In other words all the trust income in any particular year would be assessed to the trustee at the same incremental tax rates as an individual. This would include not only income used for the purposes of care and accommodation but also income that has to be accumulated. Or;
- b. cater for a very different kind of tax treatment in which, for example, income used for accommodation and care needs is exempt from tax altogether and any accumulated income is taxed at normal individuals rates.

These are only two possibilities and put forward for discussion purposes. **The main point however is that whatever changes are made any accumulated income should not be taxed at penalty rates as this is a very considerable disincentive for the trust to be created and a heavy burden on the person with the disability.**

It is accepted that there are other disincentives for these trusts and certainly the fact that only about 22 have been created since the legislation came into force speaks for itself. In particular I am aware that the eligibility to become a beneficiary is particularly restrictive and the reporting and audit requirements are quite onerous. This submission, however, is intended to highlight the income tax problems with these trusts and I hope that they will be considered carefully in the current review of the legislation.

  
Patrick Hughes

# Removing Barriers to Family Funded Support for People with Disabilities

## Background

For the first time in Australia's history a significant number of people with disabilities are now outliving their parents. As a consequence, parents are faced with the question, "What will happen to our sons and daughters when we die?"

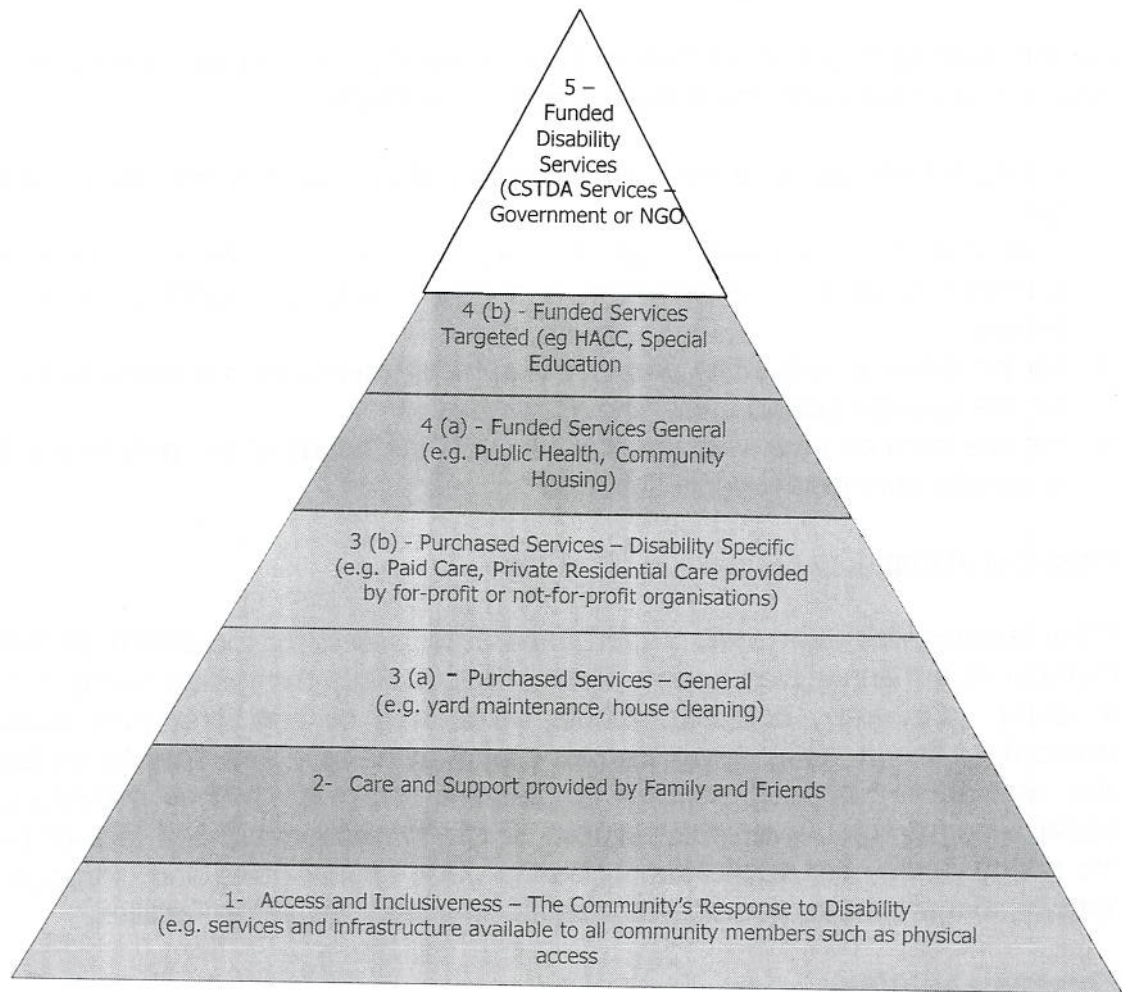
The increasing life expectancy of people with disabilities is contributing to growing demand for specialist disability services; it is also leading to families wishing to plan and secure a good life for their family member.

A good life for family members with disabilities means: enjoying friends and families; having a place to call home; having adequate resources to live with dignity above the poverty line; and becoming a contributing citizen.

Demand for specialist disability services to help fulfil such a vision has grown progressively in recent years despite significantly increased financial outlays by Australian and State/Territory Governments. As a result, the Commonwealth State/Territory Disability Agreement (CSTDA) contains a specific strategic policy priority focussed upon responding to and managing demand for services. The Agreement also acknowledges the pivotal role families and carers play in the lives of people with disabilities, and seeks to achieve collaboration and partnership to achieve satisfactory support outcomes. This is essential, as families currently provide 73 per cent of the care and support of people with disabilities (Australian Bureau of Statistics, *Survey of Disability, Ageing and Carers 2004*) and are the primary source of support for many family members until well into adulthood.

WA has some 4,800 primary carers aged 65-74 and a further 4,100 aged over 75 (ABS, *Survey of Disability, Ageing and Carers 2004*) with 3.6 per cent or 322 of these caring for a son or daughter.

It is quite clear that government funded disability services must complement and support the care provided by families, not replace it, and that for the foreseeable future funded services will fail to meet the demand for services. The support of people with disabilities is effectively conceptualised as a hierarchical response framework with persons accessing the next layer of support only when the lower strata is unable to satisfy their needs.



(Source: Disability Services Queensland)

- 5 Funded Disability Services
- 4 Whole-of-Government Response
- 3 Privately Purchased Response
- 2 Familial Response
- 1 Community Response

As the above diagram illustrates, the challenge for governments is to strengthen and facilitate the support response capability of levels 1, 2 and 3 while maintaining adequate growth in level 4 and 5 resourcing.

Recent consultations in WA identified a significant number of parents wishing to make provision for their son or daughter with a disability for the purpose of supplementing the support that State and Australian Governments may provide and/or to largely replace funded disability services. The need to make such provision is particularly expressed by older families uncertain of the capacity of governments to provide for their family member and wishing to secure the peace of mind that private provision may bring. However, existing State and Australian Government taxation and benefit provisions combine to create a number of disincentives for families.

## **Existing barriers and options for their removal**

Parents wishing to set up a financial plan incorporating a private trust for their son or daughter are faced with the following specific problems.

1. Assets transferred to a trust attract stamp duty and in some cases capital gains tax.
2. Real property in a private trust is subject to land tax. Although there are some exemptions, where the occupant is a person with a disability, these are quite limited.
3. For pensions' purpose the property is still considered as belonging to the parents for the relevant period under the assets test.
4. Income from an inter-vivos trust is taxed in the hands of the beneficiary even if it is used to purchase support services.

### Impact of stamp duty and capital gains tax

Many families look to provide property and other assets for the benefit of their family member in a manner that neither financially penalises the gifting family nor the gift recipient. Currently, however, assets transferred to any inter-vivos trust attract stamp duty and in some circumstances capital gains tax. The transferred assets are also assessable for aged pension entitlement under the gifting provisions of the Social Security Act. Given the purpose of the intended trust and lack of benefit to the gifting family, the application of stamp duty, capital gains and gifting provisions appears inappropriate, and acts as a significant disincentive for families.

### **Recommendation:**

**Trusts established for the benefit of a family member with a disability to be exempt from stamp duty, capital gains and gifting provisions.**

### Impact of land tax

There is some uncertainty as to the circumstances in which trust property occupied by a disabled beneficiary qualifies for exemption from land tax. In this respect, where a disabled beneficiary occupies trust property as his or her principal place of residence, the same exemption should apply as if that beneficiary owned the property in his or her own right.

### **Recommendation:**

**Where a disabled beneficiary occupies trust property as his or her principal place of residence, the same exemption be applied as if that beneficiary owned the property in his or her own right.**

### Income from trusts

Income derived from any inter-vivos trust deserves to be treated according to its use. That is, trust income paid personally to the beneficiary deserves to be treated as income and should (as is currently the case) be assessed by Centrelink in respect

of the level of any Disability Support Pension. However, it is not considered appropriate that trust income intended and used solely to purchase support services be considered taxable.

### **Recommendation**

**In the case of a person eligible for a Disability Support Pension, trust income intended and used solely to purchase support services to be considered not taxable.**

#### Proposal to defer payment of taxes and duties

It should be noted over 60 per cent of current disability service users in Australia have an intellectual disability and there is no reason to presume that the proportion is lower among those with unmet need for support. As a result, the majority of trusts that might be established should a more favourable environment be created, would be for persons lacking decision making competency and, often, testamentary capacity. The lack of capacity to be party to a contract has meant that some people with disabilities have been prevented from purchasing a home in their own name (and then qualifying for the first home owners grant) and the lack of testamentary capacity often leads to assets being in trust for lifetime use.

As the intention of the proposed trusts is solely to benefit the person with a disability during their lifetime (and in many cases assets upon the death of the person with a disability would be transferred to other family members), then payment of certain taxes or duties could be deferred until the trust was wound up.

### **Recommendation**

**Where the intention of a proposed trust is solely to benefit the person with a disability during their lifetime, then payment of certain taxes or duties be deferred until the trust was wound up.**

What is proposed is similar to the Disability Savings Plan designed by Planned Lifetime Advocacy Network of Canada. This tax-deferred savings vehicle has similar objectives to that proposed in this paper to assist families to provide support to their disabled family member. In addition, changes to the taxation and superannuation law of Canada may allow funds to be transferred from allocated pension funds to a trust for people with disabilities under specified circumstances. These provisions are discussed in the Report of the Technical Advisory Committee on Tax Measures for Persons with Disabilities – *Disability Tax Fairness* (p. 97) available at <http://www.disabilitytax.ca/main-e.html>

#### Factors for consideration in implementing exemptions

In circumstances where Australian and State Governments agreed to a form of trust that would be exempt from capital gains tax, stamp duty and gifting rules of Centrelink, the conditions of such trusts would need to take account of the competence and circumstances of the majority of beneficiaries.

Any agreement that specified which trust arrangements would qualify for the exemptions identified above would need to consider:

- Defining the target beneficiary population for which the options include eligibility for the Disability Support Pension (DSP) (even though only 37.4 per cent of DSP recipients receive disability support services or seek to do so) or having a disability as defined by the Western Australia State *Disability Services Act 1993* Section 3 or the Commonwealth State/Territory Disability Agreement, which on occasions would require a separate assessment.
- Maintaining and, if necessary, extending eligibility for land tax exemption and concessions granted under the *Rates and Charges (Rebates and Deferrals) Act 1992* where trust property is occupied by a beneficiary who is disabled and is his or her principal place of residence.
- Ensuring that the trust arrangements were not subject to varying interpretation of reviewing officers at any level of government and provided families with a stable, accountable and transparent vehicle for securing the future welfare of their family member with a disability. Trusts established for Disability Support Pensioners (or those eligible for the DSP) would be for the life of the individual and continue beyond the transfer to the aged pension at 65 years of age.

## Summary

In summary, families are realising more and more that governments will not necessarily look after their son or daughter with a disability when they are gone. Currently, a number of taxation and subsidy provisions at both a State and Australian Government level present significant barriers and disincentives to parents wishing to set-up a financial plan incorporating a private trust for their son or daughter with a disability.

There is a need for a coordinated effort across jurisdictions to remove such barriers and create a more supportive and encouraging environment for families to contribute to securing a good life for their family member with a disability. This, in turn, may reduce the reliance on formal specialist disability services and increase family involvement and community inclusion. People with disabilities often lack caring and reciprocal relationships which formal service systems and professional carers cannot provide. Disability service providers across Australia acknowledge the loneliness and social isolation of those they serve and recognise that the infrastructure, policies and procedures of the services they work within often pose barriers to the maintenance of unpaid relationships.

A partnership between families, service providers and government will help secure a better life for people with disabilities.

Barry MacKinnon  
CHAIRPERSON  
REMOVING BARRIERS TO FAMILY FUNDED SUPPORT FOR  
PEOPLE WITH DISABILITIES ADVOCACY GROUP