# Aged pension: deemed income from proceeds of sale of residence

**THOMAS and SECRETARY TO THE DFaCS (No. 13456)**

**Decided:** 17 November 1998 by W. McLean.

### Background

Mr and Mrs Thomas, both aged pensioners, entered a contract worth $552,000 for the construction of a new residence in South Yarra and subsequently sold their existing home for $800,000. Pending completion of their new home, Mr and Mrs Thomas invested the balance of the sale proceeds with the Commonwealth Bank and by purchasing Telstra shares. The DFaCS treated the balance of the sale moneys (approximately $525,000) as a financial asset the effect of which, applying the deemed income provisions, was that the Thomas' total income was such that their aged pensions were cancelled. In turn, this meant that they ceased to be eligible for concession cards. These decisions were affirmed by an ARO in January 1998 and by the SSAT in February 1998.

Mr and Mrs Thomas acknowledged that, in lieu of depositing the balance of the sale moneys in the Commonwealth Bank, they could prepay the vendor of their new home, or could deposit the moneys in their solicitors' trust account. However, they decided to not use either option as they needed the interest generated from the investment to offset the cost of renting the temporary accommodation required whilst their new home was completed.

### The issue

Mr and Mrs Thomas contended that it was unfair that the temporary investment arising between the sale of their family home and the completion of the construction of another, be regarded as a financial asset under the deemed income provisions of the income test for pension purposes.

### The law

The general meaning of 'income' is provided in s.1072 of the *Social Security Act 1991* (the Act):

> '1072. A reference in this Act to a person's ordinary income for a period is a reference to the person's gross ordinary income from all sources for the period calculated without any reduction, other than a reduction under Division 1A.
>
> Section 1077 of the Act provides that deemed income is to apply to financial assets held by members of a pensioner couple . . .'
>
> '1077.(1) This section applies to the members of a pensioner couple.
>
> 1077.(2) If one or both of the members of a couple have financial assets, the members of the couple are taken, for the purposes of this Act, to receive together ordinary income on those assets in accordance with this section.

However, the Act also provides that certain assets can be disregarded where the proceeds of the sale of the principal home are to be used to purchase a replacement residence. In this regard, s.1118 of the Act provides —

> 1118.(1) In calculating the value of a person's assets for the purposes of this Act, . . disregard the following:
>
> . . .
>
> 1118.(2) If:
>
> (a) a person sells the person's principal home; and
>
> (b) the person is likely, within 12 months, to apply the whole or a part of the proceeds of the sale in acquiring another residence that is to be the person's principal home;
>
> so much of the proceeds of the sale as the person is likely to apply in acquiring the other residence is to be disregarded during that period for the purposes of this Act.'

### Income from proceeds of sale

The AAT found that, although the Act allowed the proceeds of the sale of the family home to be disregarded from the calculation of the assets test for aged pension purposes:

> '. . . the whole of the income earned by the applicants from the proceeds of the sale is ordinary income. . . [T]he income from [the proceeds of the sale] is subject to the deeming provisions . . . while it continues to be held as a financial asset by the applicants'.

(Reasons, paras. 16-17)

### Formal decision

The AAT affirmed the decisions under review.

**[P.A.S.]**

# Conversion of investments: notification of change of investments

**DANIEL and SECRETARY TO THE DFaCS (No. 13497)**

**Decided:** 1 December 1998 by R.P. Handley.

### Background

Daniel was granted an invalid pension in January 1987. He advised the DFaCS that his assets included two AMP 'roll-over investments'. In May 1989 Daniel switched $50,000 from an AMP Investment Linked Deferred Annuity into an AMP Capital Secure Deferred Annuity. Daniel advised the DFaCS of this change in June 1989.

On 8 January 1992, Daniel turned 65 years of age and was transferred to age pension. His annuity matured and on 10 January 1992, Daniel invested $60,000 in a term deposit with the Commonwealth Bank earning interest at 8.75%. The DFaCS received written notification of the changes in Daniel's investment in October 1992. In December 1995, the DFaCS decided that Daniel was entitled to arrears for the period 5 November 1992 to 27 October 1994 as his pension had not been adjusted to coincide with the changes to his investments. The DFaCS decided not to pay arrears for the period January to November 1992. Daniel then sought to review the rate of pension payable from June 1989. The DFaCS decided he was not entitled to any arrears prior to November 1992.

### The issues

There were a number of issues before the AAT, namely:

- Were arrears of pension payable to Daniel for the period June 1989 to 5 November 1992?
- Was Daniel's AMP Capital Secure Deferred Annuity correctly assessed in terms of ongoing income from the date of purchase?
- Did Daniel's re-organisation of his AMP investments on 10 May 1989 constitute continuation of the same overall investment, conversion into an accruing return investment or the purchase of a new investment?

Did Daniel notify the DFaCS of the change in his assets within 14 days of 10 January 1992?

**Legislation**

For the period prior to 30 June 1991, the relevant legislation was the *Social Security Act 1947* (the 1947 Act).The *Social Security Act 1991* (the 1991 Act) took effect from 1 July 1991.

Relevant definitions from the 1947 Act include 'accruing return investment' and 'market-linked investment'. The definitions of accruing return investment (ARI) and market-linked investment (MLI) which appear in s.9(1) of the 1991 Act are similar.

Other relevant provisions relating to the conversion of investments and treatment of income in the 1947 Act are:

> '12H(1) Where an investment that was not an accruing return investment (in this subsection called the 'original investment') is converted into an accruing return investment, whether or not it was able to be so converted because of a provision of the agreement relating to the making of the original investment, then, for the purposes of this Division:
>
> (a) the accruing return investment shall be taken to have been made on the day the original investment was so converted; and
>
> (b) the original investment shall be taken to have been realised on that day.
>
> 12L(1) Where a person becomes entitled, whether before or after the commencement of this section, to receive an amount of income, being an amount of a capital nature but not being:
>
> (a) income from remunerative work undertaken by the person;
>
> (b) a return from an accruing return investment; or
>
> (c) a return from a market-linked investment made on or after 9 September 1988;
>
> the person shall, for the purposes of this Act, be taken to receive one fifty-second of that amount as income of the person each week in the period of 12 months commencing on the day on which the person becomes entitled to receive that amount.'

The effect of s.163 of the 1947 Act was that a person receiving a pension could be required to notify the DFaCS of any changes in his income or assets within 14 days.

Section 80(5) of the 1991 Act provides that if a favourable determination is made following a person having advised the DFaCS of a change in circumstances, that determination takes effect on the day on which the advice was received or the day on which the change occurred, whichever is later.

**Treatment of change in investments**

The first issue for the AAT was whether Daniel switching, on 10 May 1989, $50,000 from his AMP Investment-Linked Deferred Annuity Policy, a MLI, to the Capital Secure Deferred Annuity, a combination of both an ARI and a MLI, constituted a continuation of his existing investment, a conversion into an ARI or the purchase of a new investment.

Daniel submitted that when he transferred $50,000 of his investment from the AMP Investment-Linked Deferred Annuity into the AMP Capital Secure Deferred Annuity in May 1989, he was merely changing his investment mix. He did not withdraw the $50,000. He said the meaning of 'withdrawal' in this context was that money would be paid to him and he would handle its re-investment. None of this ever happened in his case. The $50,000 was merely transferred from one income producing source to another within the same investment. Because the Capital Secure Deferred Annuity was part of his original pre 9 September 1989 investment, income from this Deferred Annuity should not have been assessed in calculating his entitlement for pension. He was underpaid pension from June 1989.

Information from AMP to the DFaCS indicated that the value of units purchased under an Investment-Linked Deferred Annuity Plan 'is not guaranteed and will fluctuate with movements in the value of the underlying assets'. The AAT accepted the DFaCS's submission that such an investment meets the definition of a MLI in the 1947 Act.

A further letter from the AMP to the Specialist Policy Unit of the DFaCS in February 1989 described the Capital Secure Deferred Annuity as 'a new deferred annuity contract' and as a 'new product'. The investment account in which the Capital Secure Deferred Annuity funds were deposited comprised two components: a Guaranteed component and an Asset Value component in the proportion 80:20. The AAT agreed with the DFaCS's submission that the 80% Guaranteed component satisfies the definition of an ARI, which is defined as an investment 'the value of which from time to time is unlikely to decrease as a result of market changes', while the 20% Asset Value component satisfies the definition of a MLI. 'Based on the above information, the Tribunal does not consider that the switching of funds could be considered the continuation of the same investment': Reasons, para. 6.

The AAT then considered that if the switching of funds by Daniel in May 1989 constituted the purchase of a new investment, he could be said to have realised $50,000 from the Investment-Linked Deferred Annuity plan in order to purchase a new Deferred Annuity product. At that time, he became entitled to receive an amount of income in a capital form, that is, that proportion of the $50,000 attributable to income earned in the period 12 January 1987 to 9 May 1989, and s.12L(1) would come into operation.

The AAT also considered the alternative if the switch constituted a conversion of the investment. The AAT referred to s.12H which has the effect that where a person converts a MLI into an ARI, the MLI is taken to be realised and the ARI is taken to have been made, on the day of the conversion. If Daniel converted 80% of the $50,000 into an ARI (the Guaranteed component of the Capital Secure Deferred Annuity), pursuant to s.12H this amount was realised on 10 May 1989, and was therefore subject to s.12L(1). The 20% invested in the Asset Value component of the Capital Secure Deferred Annuity remained invested in a MLI so was not affected by s.12H.

The AAT found that 'whether the switch constituted a realisation of $50,000 or a conversion of $40,000, that transaction, as a result of s.12L(1), should have resulted in an assessment of the income component of that sum spread over the ensuing period of 52 weeks': Reasons, para. 9. Daniel's rate of pension was not assessed taking into account any such income component and thus he would have received an overpayment of pension in the 12 months from 10 May 1989.

In addition, the AAT noted, that where a person made an investment in a MLI on or after 9 September 1988, or in an ARI on or after 13 December 1987, an amount of income from those investments would be assessed on an ongoing annual basis (see ss.12D and 12C of the 1947 Act respectively). These provisions applied to Daniel's Capital Secure Deferred Annuity whether it was considered a new or a converted investment so that income from this investment should have been assessed on an annual basis.

The AAT noted that whether the investment was taken to be a new investment of $50,000, or a converted investment of $40,000, the income on which Daniel should have been assessed, was greater than the $5500 on which he was actually assessed. Consequently Daniel was overpaid in the period June 1989 to 8 January 1992.

The DFaCS acknowledged that at least part of the overpayment was principally due to administrative error and that recovery of any debt was now statute barred.

**Notification of maturing of annuity**

Daniel stated that he telephoned the DFaCS shortly after his 65th birthday