

Administrative Appeals Tribunal

Income test: is a dividend an exempt lump sum and are margin loans a charge or encumbrance?

DRAPER and SECRETARY TO THE DFACS
(No. 2003/706)

Decided: 25 July 2003 by R.P. Handley and P.J. Lindsay.

Background

The Department of Family and Community Services ('the Department') decided that for the purpose of assessing the rate of newstart allowance payable to Draper, the dividends he had received from his private company should be treated as income and loans made to him should not be offset against the value of his assets for the purpose of deeming income.

This decision was affirmed by the SSAT.

Evidence

Draper claimed newstart allowance in May 2001. He advised Centrelink that he was a shareholder and director of a private company and in the financial year ending 30 June 2001 he received a dividend of \$3992.67 from the company.

The company had been established as a vehicle for consultancy work provided by Draper. However, in the year 2000, Draper decided to wind up the company as he was not securing any contracts. In the course of winding up, the company paid a dividend from profits made in the year ended 30 June 2000; this amount was paid on 17 May 2001. The company ceased trading from the time it made the dividend payment. Draper's accountants stated that during its existence the company paid only one dividend. The company was ultimately deregistered on 1 October 2002.

Draper had also been loaned various sums of money. His mother loaned him an amount of \$15,000 and Draper took out margin loans to finance investment in shares and managed funds. The balances advised at September 2001 were: National Bank — \$16,179.43 and Westpac — \$18,122.28.

The issues

The two issues considered by the Tribunal were:

- whether the dividend paid to Draper in May 2001 should be treated as income; and
- whether certain of Draper's loans were charges or encumbrances over his financial assets.

Submissions

Draper argued that the dividend received from the company was a genuine one-off payment and should not be treated as income. He referred to the *Guide to Social Security Law* ('the Guide') prepared by the Department as follows:

4.7.2.10 Assessable income from private companies

Dividends on shares (including franking credits). Treatment: Hold them as their income for 12 months from the date of distribution. ...

Dividends NOT treated as income

Dividends from private companies should NOT be assessed as income if the private company:

- is wound up within the 12 months before the date of claim by the customer,
- has suffered a permanent decline in its source of income in the 12 months before the customer claims payment or after the date of claim, either from a:
 - reversal of business fortunes, or
 - disaster (see example)
- makes a genuine once-off payment, that will not be repeated, within the 12 months before the date of claim by the customer (see explanation).

Examples: Flood or fire.

Explanation: This occurs when the company does not have a history of dividends.

Draper's argument in relation to loans was that they were used to purchase investments and were secured over those investments. The shares and managed funds purchased from the borrowed funds were held as security for the margin lending facility and the terms of the loan included the ability for the lender to exercise various powers, including selling any of the secured property.

Draper argued that under s.1121(1) of the *Social Security Act 1991* ('the Act') the value of his loans should be reduced by the value of the charge or encumbrances on the assets.

Draper also argued that the loan from his mother should be offset against the value of his assets.

Conclusion

The AAT accepted that the dividend paid to Draper was the only dividend paid by the company. The Tribunal found the dividend was an income amount as defined in s.8 of the the Act.

The Tribunal then considered whether this amount was an exempt lump sum as defined in s.8(11) of the Act.

Section 8(11)

An amount received by a person is an exempt lump sum if:

(a) the amount is not a periodic amount (within the meaning of subsection 10(1A)); and

(b) the amount is not a leave payment within the meaning of points 1067G-H20, 1067L-D16 and 1068-G7AR; and

(c) the amount is not income from remunerative work undertaken by the person; and

(d) the amount is an amount, or class of amounts, determined by the Secretary to be an exempt lump sum.

Note: Some examples of the kinds of lump sums that the Secretary may determine to be exempt lump sums include a lottery win or other windfall, a legacy or bequest, or a gift — if it is a one-off gift.

The Tribunal referred to subparagraph (d) and concluded that the Guide was intended to assist the Secretary when determining whether an amount is an exempt lump sum. The Tribunal found that the dividend satisfied that condition referred to in 4.7.2.10 of the Guide. The Tribunal was also satisfied that it would be unfair to Draper to continue to assess the dividend as income given the state of the company. The Tribunal decided the amount of the dividend was an exempt lump sum.

Dealing first with the loan from Draper's mother, the Tribunal was not satisfied that there was any charge or encumbrance attached to particular assets. Therefore the loan should be treated as unsecured and the value of the loan could not be taken into account in determining the value of Draper's assets.

In regard to the margin loans, the Tribunal noted the Department's Guide, which stated:

4.4.1.30 Treatment of encumbrances on assets

For ASSETS TEST purposes, the value of a customer's asset is reduced by the value of a charge or encumbrance over that asset. This means that the assets test value is the customer's EQUITY in the asset.

Example: A common example of an encumbrance is a mortgage secured against an investment property.

For INCOME TEST purposes, the GROSS market value of a financial investment is used to calculate deemed income

Act reference: SSAct section 1072 General meaning of ordinary income

Policy reference: The Guide 4.6.6.30 Encumbrances & Loans Against Assets.

The Tribunal found that there was no legislative basis for the statement that the gross market value of a financial investment must be used to calculate deemed income. This was not consistent with s.1072. The Tribunal found that this section relates to gross ordinary income and not the gross value of assets.

The Tribunal found that the margin loans could therefore be offset against the value of assets under s.1121(1), for the purpose of calculation of deemed income from those assets.

Formal decision

The AAT remitted the matter to the Department with directions that:

- the rate of newstart allowance payable to Mr Draper should be determined by not treating as ordinary income the dividend of \$3992.67 he received from the company on 17 May 2001, which the Tribunal determined was an exempt lump sum;
- the secured margin loans used by Mr Draper to purchase shares and managed funds held at 5 September 2001 should be taken into account when valuing those assets in order to calculate deemed income pursuant to s.1076 of the Act.

[R.P.]

Age pension: whether attributable stakeholder; whether asset attribution less than 100%

**GEIDANS and SECRETARY TO
THE DFaCS
(No. 2003/773)**

Decided: 8 August 2003 by L. Savage Davis.

Background

Geidans established Geologics Pty Ltd ('the company') in the early 1970s and with his own funds, purchased the company's primary asset, an abandoned farm. Geidans cleared the land and renovated the house. His son Edgar, born in 1965, assisted him on the property from about the mid 1970s. Geidans received age pension from 1989 and in the early 1990s, moved to live in a shack on the property. He sold his Perth home in 1993, the proceeds being placed in the company's account. In 1995, he moved into a new house on the property. All farming activities had ceased on the property by the summer of 2002.

At the time the company was established, Geidans held an 'A' class Governing Director's share and 98 ordinary shares. He acquired a 'B' class share in 1987. His wife and four children held a share each, as well as his two sisters. In 1994, he transferred 98 shares to Edgar. In around May 2001, Geidans spoke to Edgar about 'bowing out'. Edgar and Geidans' daughter, Indra were prepared to take over and become co-directors. In October 2001, Geidans transferred his 'A' class share to Edgar, although supporting documents suggested it was transferred to Indra. Geidans disposed of his 'B' class share in early 2002.

In an email to Geidans dated 4 January 2002, Edgar commented 'if by keeping the company you'd be jeopardising your pension and that if the company was liquidated you'd receive your pension then the answer is clear! It must be dissolved. You should inform us if this is the case'.

Centrelink attributed 100% of the company's assets to Geidans, and as a consequence, his rate of age pension was reduced from January 2002.

The law

Section 1207N of the *Social Security Act 1991* ('the Act') requires a company

to be a 'designated private company'. The assets can be attributed to an individual, as an attributable stakeholder, if either the control or source tests set out in s.1207Q(2) and (3) respectively are satisfied. Section 1207X provides:

1207X.(1) For the purposes of this Part, if a company is a controlled private company in relation to an individual:

(a) the individual is an *attributable stakeholder* of the company unless the Secretary otherwise determines; and

(b) if the individual is an attributable stakeholder of the company-the individual's *asset attribution percentage* in relation to the company is:

(i) 100%; or

(ii) if the Secretary determines a lower percentage in relation to the individual and the company-that lower percentage; and

...

Section 1209E requires the Secretary to comply with the Attribution Principles when making a determination under s.1207X:

The issue

The AAT was required to decide if Geidans was an 'attributable stakeholder' and if so, whether 100% of the assets, or some other percentage, should be attributed to him.

Discussion

The AAT was satisfied the company was a 'designated private company' and that the 'A' class share was held by a family member who was an 'associate'. Pursuant to s.1207Q, Geidans satisfied the control test as the aggregate of direct voting interests held by his associates was 50% or more. Being satisfied the company was a 'controlled private company', Geidans was an attributable stakeholder unless deemed otherwise pursuant to s.1207X(1)(a).

The AAT turned its mind to the Attribution Principles and whether the effect of one or more circumstances provided a 'sufficient basis' to determine a person was not an attributable stakeholder. Principle 7(2)(c) required consideration of whether Geidans could '... reasonably be expected to exercise effective control'. Control was defined in s.1207A to include '... control as a result of, or by any means of, trusts, agreements, arrangements, understandings and practice, whether or not having legal or equitable force and whether or not based on legal or equitable rights'.

The AAT was satisfied that Geidans retained effective control. So confident was Geidans about the security in his home he handed over all his shares for minimal consideration. There was no