Administrative Appeals Tribunal

Value of assets: credit limit or amount drawn

NOCK and SECRETARY TO THE DFaCS (No. 2003/1063)

Decided: 20 October 2003 by G.A. Barton.

Background

Mr Nock claimed parenting payment partnered in October 2002. At the same time Mrs Nock claimed Austudy payments. These benefits had been previously cancelled in January 2002 because the value of their assets exceeded the relevant asset value limit. They were reapplying on the advice of Centrelink because their circumstances had changed. However, their claims were rejected because of the value of their assets. The assets value limit, at the time of the claim, for both payments, was $206,500. The relevant assets (and agreed values) were three residential properties, Rochdale Road ($380,000), Beecham Road ($417,000) and Graylands Road ($285,000).

Issues

Whether the value of assets could be reduced by the amount of loans from family members? Whether the value of assets could be reduced by the actual amount drawn down on the loan or the credit limit amount available?

Legislation

Section 500Q(1) of the *Social Security Act 1991* (the Act) provides that parenting payment is not payable to a person if the value of the person's assets exceeds the person's asset value limit. The assets value limit of a person who is a member of a couple is worked out using the table in s.500Q(3) of the Act.

Section 573 of the Act provides that an Austudy payment is not payable to a person if the person is not excluded from the application of the Austudy payment assets test; and the value of the person's assets is more than the person's assets value limit.

The general provisions relating to the value of a person's assets are in Division 1 of Part 3.12 of the Act.

Section 1121(1) of the Act provides:

> If there is a charge or encumbrance over a particular asset of the person, the value of the asset, for the purposes of calculating the value of the persons assets for the purpose of this Act, is to be reduced by the value of that charge or encumbrance.

What loans could be deducted?

When the Nocks made their claims they were indebted to two lending institutions. The first loan contract was secured by a mortgage over Beecham Road and had a credit limit of $340,000. At the time of the claims, the Tribunal found that the loan had been drawn down to an amount of $179,253.61. The second loan of $450,000 was secured by mortgages over Rochdale Road and Graylands Road.

The Nocks submitted that the assets were subject to further charges or encumbrances arising from three deeds acknowledging debts to members of their families. In December 2001, deeds were executed acknowledging a debt of $50,000 to Mrs Nock's mother and a debt of $20,000 to Mr Nock's mother. The terms of the deeds were the same. Each provided: '[A]nd to better secure the repayment of the principal sum the Borrower agrees that the Lender shall have a right to create a charge over the property known as No. 21 Beecham Road, Mt. Claremont in the said State'. These borrowings were used together with the bank loan to acquire Beecham Road.

In March 2002 a deed was executed acknowledging a debt of $450,000 to Mrs Nock's brothers. The deed agreed 'that the Lender shall have a right to create a charge over the property known as No. 143 Rochdale Road, Mt. Claremont in the said State'. However, the amount of $380,000 was paid for the property. Mrs Nock explained the difference between the market value and the acknowledged debt as a premium in token gratitude for the lenders' willingness to accommodate them.

The Tribunal found that no part of the principal amounts owed to family members had been repaid at the time the Nocks made their claims. The Tribunal also found that no charges had been registered over Beecham Road or Rochdale Road.

Family loans

The Department contended that the deeds acknowledging the family loans *per se* did not constitute charges or encumbrances for the purposes of s.1121(1) of the Act because the lenders had not registered charges against the properties. However, the Department also submitted that the value of the family loans could be deducted against the relevant properties if the Tribunal concluded that the loans were made for the purpose of acquiring the properties. This submission was based on departmental policy as set out in a document entitled *Guide to the Social Security Law* at 4.6.6.30 under the heading *Encumbrances and Loans against assets*. This statement of departmental policy is made specifically in relation to s.1121(1) of the Act. Under the sub-heading *Unsecured Loans* the document reads as follows:

> If a customer has an unsecured loan AND provides evidence that the loan was specifically obtained to purchase the asset, the outstanding amount of the loan IS deducted from the value of the asset.

The Nocks submitted that the right to create a charge was sufficient. They referred to the decisions in Samek and Secretary, Department of Social Security 16 ALD 295 and Radovanovic and Secretary, Department of Family and Community Services 61 ALD 530, that the outstanding value of unsecured loans constituted encumbrances for the purposes of s.1121(1) of the Act provided there was evidence that the loan had been obtained for the purpose of acquiring the asset in question.

The Tribunal found that the family loans were made for the purpose of enabling the applicants to acquire Beecham Road. The Tribunal also found that the family loan from Mrs Nock's brothers to the extent of $380,000 was made for the purpose of acquiring Rochdale Road. Because of this direct link between the family loans and the acquisition of the assets in question, the Tribunal found that the amounts of the loans should be offset against the value of the assets.

Equity access loan

The Nocks submitted that the value of Beecham Road be reduced by $340,000 (the credit limit amount) rather than $179,253 (the amount borrowed) in respect of the loan secured by the property. They argued that, for the purposes of s.1121(1) of the Act, the value of the charge or encumbrance is $340,000

regardless of the extent to which the facility was drawn down when they made their applications.

The Tribunal referred to the decision of Brennan J in *Sibbles v Highfern Pty Ltd* (1987) 164 CLR 214 at 229 cited in *Fawthrop and Repatriation Commission* (1993) 19 AAR 220. Based on the view that the asset is charged at a particular time only to the extent of an existing borrowing or debt, the Tribunal found that the value of the charge on Beecham Road in October 2002 was $179,253.

Consequently the Tribunal found that the value of Beecham Road for the purpose of the Act in relation to the Nocks claims was $417,000 less ($70,000 + $179,253), an amount of $167,647. The Tribunal found the relevant value for Graylands Road was $92,143. As the sum of the value of these assets was $259,890, it was an amount in excess of the current assets value limit for parenting payment partnered and Austudy, of $206,500.

Formal decision

The Tribunal affirmed the decision under review

[M.A.N.]

Loan to company: amended financial statements

WOOD and SECRETARY TO THE DFaCS
(No. 2002/1190)

Decided: 25 November 2003 by N. Isenberg.

Background

Wood and his wife sold their home and business and moved to Coffs Harbour where their son had a company called Coffs Classic Cabinets Pty Ltd ('the company') and was in the process of becoming a licensed builder. Wood was a shareholder and director of the company. Wood purchased two adjoining properties and the left-over funds were 'filtered into' the company. Wood lived in the house on one block and demolished the other and engaged the company to build three villas. Wood managed the company's funds and made progress payments as required, intermingling personal and company finances. The pattern of development continued over several years and entailed development of at least six properties. Although an arrangement existed for profits to be shared between Wood and the company, on at least two occasions, all settlement monies were paid into the company.

From 1994 and thereafter, the financial accounts recorded loans in varying sums by Wood to the company. The original accountant established 'goodwill' of $100,000 in 1994 to recognise funds invested in the company and the work of the family in setting it up. The goodwill was ultimately removed and in March 2001, a fresh set of accounts from 1995 to 2000, prepared by a different accountant, were presented to Centrelink. Centrelink did not accept the revised accounts and nor did the SSAT when it affirmed the decision of 21 July 1995 to reduce Wood's age pension.

Issues

The AAT was required to decide whether Wood's age pension was correctly reduced on the basis of deemed income from loans to the company. The AAT needed to resolve whether there was in fact a loan in existence and whether to accept the amended balance sheets from 1995 to 2000.

The law

Section 1077 of the *Social Security Act 1991* ('the Act') deems income on 'financial assets'. Section 9 defines 'financial assets' to include 'financial investments', which included loans. Section 1122 provides that if a person lends an amount after 27 October 1986, the unpaid balance of the loan is included in the value of a person's assets.

Submissions

Wood argued that the loan entry was erroneous. Wood suggested that the loan recorded 'progress payments' and that the company always made a loss which had been concealed by the original accountant. Wood argued that income had been overstated by $100,000 because of the erroneous goodwill entry.

The Department argued that the first set of accounts ought to be relied upon and inferred that the reconstruction of the books was done with a view to re-writing history in order to gain financial advantage.

Findings

The AAT was satisfied that the arrangement between Wood and the company had been very loose and that the company had been used extensively to fund personal expenditure. The AAT was satisfied that personal funds had been poured into the company as required and concluded:

> It seems to me that it is not unreasonable to assume that the loan amount recorded in the company's books was linked to the funds being contributed by the Woods to the company.

(Reasons, para. 38)

The AAT also held the view that the original accountant had understood the arrangements and accurately reflected Wood's contribution by way of a loan. The AAT observed that the loan shown in the 1997/98 financial statements no longer existed in the 1998/99 statements and that by removing them, Wood had deprived himself of an asset which remained assessable for five years thereafter under the deprivation rules.

The AAT contemplated the amended financial records:

> Having come to the view that there was a loan by the Woods to the company I regard it as unnecessary to consider the amended company records. Either there was a loan or there was not, irrespective of what the company's records may say from time to time; and I have decided that there was a loan.

(Reasons, para. 42)

Furthermore, the AAT stated:

> I do not accept the change of financial statements. There was no lodgement of these statements with the ATO or ASIC. I do not accept the contention that, because there was no tax advantage in doing so, it was unnecessary for the company to lodge the amended statements. My view is that it is likely they were produced as a matter of expediency.
>
> I also do not accept that the addition of goodwill to the company returns was linked to the increase of the loan in 1994/95. Neither do I accept that this addition of goodwill was an 'accounting error' which was then addressed in amended financial statements ...

(Reasons, paras 46, 47)

Formal decision

The AAT affirmed the decision under review.

[S.L.]