SUPERCENTRAL

Incentivising pensioners to downsize

October 2022

Significant changes to the social security means test treatment of sale proceeds of the principal home.

The amendments will also modify the application of the Income Test by treating the sale proceeds (if and to the extent the proceeds are intended to be applied in the acquisition of a replacement principal residence) as a separate pool of financial assets which will only be subject to the low threshold deeming rate.

The Government is continuing its policy to remove financial barriers which currently inhibit age pensioners (and service pensioners) from downsizing due to the application of the means tests to the sale proceeds of a pensioner's principal place of residence.

Currently, when a pensioner, say, Eleanor, sells her principal (and only) home, and does not immediately apply the sale proceeds in the purchase or building of a replacement principal home, the sale proceeds will be counted as an asset for the purposes of the Assets Test and, assuming the sale proceeds are credited to a bank account, will be treated as a financial asset and therefore subject to the deeming test. Consequently, the deemed income of the bank account to which the sale proceeds have been deposited, will be counted as income for the purposes of the Incomes Test.

Consequently, Eleanor, by downsizing and not immediately applying the sale proceeds in the acquisition of the replacement principal residence, may result in the consequence that she has reduced or eliminated her age (or service) pension entitlement. In short, by downsizer (and not immediately acquiring a replacement principal residence) Eleanor has converted an asset that is protected from the Means Tests to being an asset which is now subject to the Means Test.

Eleanor's predicament is partially moderated by the current treatment that the sale proceeds (if and to the extent the proceeds are intended to be applied in the acquisition of a replacement principal residence) will not be counted as an asset for the purposes of the Assets Test for 12 months (or, for a further period of 12 months at the discretion of the Secretary of the relevant Department). It is proposed that this current exemption period will be extended to a 24 month period (rather than the current 12 month period). This discretion conferred on the Secretary of the relevant Department to further extent this period by 12 months will remain.

The amendments will also modify the application of the Income Test by treating the sale proceeds (if and to the extent the proceeds are intended to be applied in the acquisition of a replacement principal residence) as a separate pool of financial assets which will only be subject to the low threshold deeming rate.

The impact of the proposed changes can be illustrated by referring to Eleanor's situation.

Example

Eleanor owns her principal residence. She is planning to move to more suitable and modern accommodation. She sells her current house and the net sale proceeds are $900,000. She intends to use $850,000 to apply in the purchase of a replacement residence. The remaining $50,000 is intended to be used as rainy-day monies. As Eleanor has not found a suitable replacement home, she invests the money into a bank account and rents for the time being. During this time, she locates a suitable replacement, users the entire $850,000 in the purchase of the replacement residence and moves in exactly 2 years and 8 months after the sale.

Under the current arrangements:

On the sale of her principal residence, Eleanor has sold an asset which was not counted as an asset for the Assets Test and acquired an asset, $900,000 which is both counted as an asset for that Test and also treated as a financial investment for the purposes of the Incomes Test.

However, the sale proceeds - to the extent they are intended to be used to acquire a replacement residence are not counted as an asset for 12 months following the sale. Consequently, $850,000 of the bank account is not counted as an asset for the Asset Test. However, the $50,000 rainy day money is counted as an asset. If it were not for this concession, Eleanor would have immediately had her pension terminated.

This position would change 12 months later when the bank account to the extent of $850,000 would now be counted as an asset for the Asset Means Test. This would reduce her pension to Nil which would be the case until she applied the $850,000 in acquiring a replacement residence.

Eleanor could seek to have Centrelink extent the non-counting of the sale proceeds for another 12 months, as Centrelink has the requisite power. However, she would have to establish a good reason and for reasons beyond her reasonable control.

In relation to the Income Test, the entire bank account deposit of $900,000 is a financial asset which is subject to deeming. At the current deeming rates (assuming it is entirely deemed at the higher rate of 2.25%) an amount of $779 per fortnight would be counted. If Eleanor was on a full pension before the sale had fully utilised her free income limit, her pension post sale (due to the deemed income) would be reduced by $389 per fortnight which is a material reduction.

Under the proposed arrangements:

The sale proceeds (to the extent that they are earmarked for the replacement home) would not be counted as an asset for the Asset Means Test for 2 years following the sale. Additionally, Eleanor could still apply to Centrelink for a further 12 month extension of this treatment of the asset (assuming there were good reasons to justify the extensions).

In relation to the Income Test, the portion of the financial asset earmarked for acquiring a replacement home (say $850,000 of the $900,000 of the sale proceeds) will constitute a separate pool of financial investments to which the deeming provisions will apply. This separate pool will be deemed at the "below threshold rate" of 0.25% on the entire value of pool (namely $850,000). The balance of the home proceeds ($50,000) will be included in the general pool of financial investments and the normal deeming rates will apply of 0.25% on the first $56,400 and 2.25% on the balance.

Under the proposed deeming arrangements, Eleanor will have $82 of deemed income per fortnight from the separate deeming pool for the sale proceeds and $43 of deemed income per fortnight (assuming the entire balance of the home proceeds at the higher deeming rate). This would reduce her age pension by $62.50 per fortnight.

Without this treatment of a separate investment pool to which the 0.25% deeming rate applied, Eleanor's age pension would have been reduced by $865 per fortnight.

Assessment of the Proposed Change

The example clearly shows the proposed beneficial treatment provided to the sale proceeds arising from the sale of principal home where there is a delay in acquiring a replacement home.

If the amending legislation is enacted before 31 December 2022, then the change is intended to apply from 1 January 2023. If the amending legislation is enacted after 31 December 2022, then the change will apply one month after enactment.

The proposed change is set out in *Social Services and Other Legislation Amendment (Incentivising Pensioners to Downsize) Bill, 2022, shown below*.

Social Services and Other Legislation Amendment (Incentivising Pensioners to Downsize) Bill 2022

For more information on any aspect covered in this article, please call SUPERCentral on 02 8296 6266 or email info@supercentral.com.au.