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The Tax Office and financial dependency: details matter

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In holistic tax and estate planning, one of the key issues in relation to superannuation entitlements is determining whether a person is financially dependent on another - and therefore entitled to be treated as a death benefit dependant and receive the payment tax free.

In a recent Private Binding Ruling 1052187560814, the Tax Office held that the following factual matrix was insufficient to establish financial dependency:

(a) adult child of deceased, living with former spouse of deceased;

(b) deceased had a binding child support agreement with the former spouse, which had expired when the beneficiary turned 18;

(c) after expiry of the child support agreement, the deceased continued to pay a monthly amount and costs such as extracurricular school activities and out of pocket medical expenses and intended to pay for the beneficiary's university fees;

(d) the beneficiary had low levels of taxable income.

The Tax Office confirm that in order to meet the Tax Act definition (see section 302-195(1)(d)) there must be more than the mere giving of money - rather, there must be a relationship where one party relies on the other for what is required for their ordinary living.

The Tax Office further confirmed that the definition of dependency was set out in the case of *Kauri Timber Co (Tasmania) Pty Ltd v. Reeman* (1973) 47 ALIR 184, where it was held that the key principle is that it is the actual fact of dependence or reliance on the earnings of another for support that is the test.

Therefore, as one example providing gifts does not create financially dependency (see *Edwards v Postsuper Pty Ltd* [2007] FCAFC 83).

Further context

Historically the Tax Office has released a number of private rulings in this area.

For example, the Tax Office in Private Ruling Authorisation Number 64085 provides some insight to the Tax Office view of the level of financial support required.

In deciding that a sibling was not financially dependent on their deceased sibling the Tax Office confirmed as follows:

1. a 'financial dependant' is considered to be a person to whom another person contributes all or a major amount of necessary financial support. If the level of financial support is insignificant or minor, then the person cannot be regarded as a dependant.

2. if the person who is alleged to be a 'dependant' relies on another as the source wholly or in part of their existence, then dependence is established.

3. thus if the facts show that the beneficiary is a person to whom the deceased contributed all or a major amount of necessary financial support and the beneficiary 'depended or relied on' the earnings of the deceased for day-to-day sustenance then the person will be a financial dependant.

4. in other words, the test to be applied under the definition of 'dependant' is: if the financial support received by a person were withdrawn would the person concerned be able to survive on a day-to-day basis.

5. in contrast then, if the financial support provided merely supplements the person's income and represents 'quality of life' payments, then it would not be considered a substantial support.

6. relatively minor financial support should be regarded as part of normal domestic and/or familial arrangements and not a dependency relationship, particularly given the Tax Act does not acknowledge partial dependency.

In contrast, Tax Office Private Ruling Authorisation Number 1051525438016 is another useful example. There, the parents of an adult child living at home who did make some financial contributions to the household, were held not to in an independency relationship. Therefore, in turn, the parents could not be held to be financial dependants of the child.

Similarly, in PBR Authorisation Number 1051795225241, the Tax Office confirmed that although a parent provided an adult child, living at home and who had no assets regular and continuous financial support (e.g. daily cost of living expenses such as food and rent) this did not create dependency. Rather, the financial support provided merely supplemented the income of the adult child and was not required by them to maintain their basic living standards.

Other key case

While the Tax Office appears to accept that each situation will turn on the factual matrix, arguably the leading case in this area remains *Malek (as Trustee for the Estate of Antoine Malek) v Federal Commissioner of Taxation* (1999) 42 ATR.

In this case, the relevant fund member was, at the time of his death, living with his widowed mother in a unit owned by her. The son contributed to paying most expenses, paid for repairs and alterations to the unit and a holiday for his mother.

Following the member’s death, the Tax Office treated the mother’s receipt of the death benefit payment (that flowed to her via the son’s will) as taxable as she was not a dependant.
In reversing the Tax Office’s decision it was confirmed:

'… the relevant financial support (to create financial dependency) is that required to maintain the person's normal standard of living and the question of fact to be answered is whether the alleged dependant was reliant on the regular continuous contribution of the other person to maintain that standard.'

Here, it was clear that the requisite level of dependency existed and therefore the mother was entitled to receive the death benefit payment tax free.

Conclusion

Ultimately it seems clear that, as set out in *Griffiths v Westernhagen* [2008] NSWSC 851, for a relationship of dependency to be established, there must be more than the mere giving of money.

Rather there must be a relationship where one party relies on the other for what is required for their ordinary living.

In making the assessment, the entirety of the relationship and all financial affairs, particularly of the recipient, must be considered.