

Tax update

MAY 2022

No reduction in the private health insurance rebate at 1 April 2022

Every year on 1 April, the amount of the private health insurance (PHI) rebate generally decreases.

The Australian Government PHI rebate is indexed annually on 1 April by a rebate adjustment factor (RAF) representing the difference between the consumer price index and the industry weighted average increase in premiums.

The 2022 RAF has been calculated as 1, which meant no changes to the PHI rebate on 1 April 2022.

With inflation at levels Australians have been unaccustomed to over the last 20 years, that is at least one small piece of good news.

Disclosure of business tax debts

The ATO is currently writing to taxpayers that may be eligible to have their tax debts disclosed to credit reporting bureaus (CRBs).

The ATO can potentially report outstanding tax debts to CRBs where the following criteria are satisfied:

- The taxpayer has an Australian business number and is not an excluded entity
- The taxpayer has one or more tax debts and at least \$100,000 is overdue by more than 90 days
- The taxpayer is not engaging with the ATO to manage their tax debt, and
- The taxpayer has no active complaint with the Inspector-General of Taxation about the ATO's intent to report its tax debt information.

Excluded entities are deductible gift recipients, complying superannuation funds, registered charities and government entities.

The ATO's purpose is to raise awareness of actions the ATO can now take under the Disclosure of Business Tax Debts measure.

The letter will be sent to all taxpayers with business tax debts that currently meet the criteria for disclosure. It gives business taxpayers information on how to effectively engage with the ATO to manage their tax debt.

Taxpayers can avoid disclosure to a CRB by making payment in full or negotiating a payment plan.

If an eligible taxpayer takes no steps to actively manage their debt, they will remain eligible for disclosure. Before the ATO takes any final action to disclose a tax debt, it will issue the taxpayer with a formal 'intent to disclose' notice.

If a taxpayer receives an intent notice, asking them to 'act now or your tax debt will be reported to CRBs', the taxpayer or their tax agent must contact the ATO within 28 days to avoid the debt being reported.

It is crucial for taxpayers to engage with the ATO early before their debts become unmanageable.

If the ATO reports a taxpayer with an outstanding debt to a CRB, that can negatively impact on the client's credit rating. That may affect their ability to borrow from banks and other financial institutions.

High Court rejects attempt to disclaim interest in trust distribution

The High Court has rejected a taxpayer's attempt to disclaim an interest in trust income that arose because a default beneficiary clause was triggered.

Taxpayer Natalie Carter was one of five default beneficiaries of the Whitby Trust, a discretionary trust.

For the 2014 income year, the trustee had failed to appoint or accumulate any of the trust's income.

The trust deed contained a default beneficiary clause, nominating Ms Carter and four other beneficiaries as the default beneficiaries, if the trustee had failed to allocate trust income for the benefit of beneficiaries by 30 June of a particular year.

The ATO issued each of the five default beneficiaries with an assessment for one-fifth of the Whitby Trust's income for the 2014 income year on October 2015.

That was done on the basis they were "presently entitled" to that income within the meaning of S.97(1) of the *Income Tax Assessment Act 1936*.

The five made an initial unsuccessful attempt to disclaim their entitlement to default distributions in November 2015. A further attempt to disclaim their interest in trust income for the 2014 income year was made in September 2016 in what was referred to as the "third disclaimers".

The Administrative Appeals Tribunal found the third disclaimers were ineffective, whereas the Full Federal Court found in the taxpayers' favour that they were effective.

Careful analysis

The High Court was then asked to consider the legal status of the third disclaimers. Its unanimous decision was that the third disclaimers were ineffective.

The court carefully analysed the words of S.97(1). In particular, the phrase "is presently entitled to a share of the income of the trust estate", which is expressed in the present tense.

The court found the expression "is directed to the position existing immediately before the end of the income year for the stated purpose of identifying the beneficiaries who are to be assessed with the income of the trust – namely, those beneficiaries of the trust who, as well as having an interest in the income of the trust, which is vested both in interest and in possession, have a present legal right to demand and receive payment of the income".

The High Court decided the question of a trust beneficiary's "present entitlement" must be tested and examined "at the close of the taxation year", not some reasonable period of time after the end of the taxation year.

Accordingly, the five beneficiaries had been appropriately assessed by the ATO under S.97(1), given their status as default beneficiaries under the trust deed.

For the sake of completeness, the High Court also rejected the taxpayers' argument that a beneficiary of a discretionary trust, with reference to events that may occur in a "reasonable period" after the end of an income year, can trigger an event that would disentitle the beneficiary to a distribution.

Significant decision

The decision is significant, because it backs the proposition that disclaimers of trust income cannot be effective if they occur after the end of the income year that gave rise to a present entitlement.

It will be interesting to see, in any subsequent decision impact statement, how the ATO intends to apply the decision in Ms Carter's case.

As we head to the end of another income year, the case is a timely reminder to ensure that, for discretionary trusts, steps are taken before the end of the income year to effectively distribute trust income.

That avoids the operation of default beneficiary clauses, or a situation where no beneficiary is presently entitled to trust income and the trustee is assessed at the highest marginal rate.

Please note: Many comments in this publication are general in nature and anyone intending to apply the information to practical circumstances should seek professional advice to independently verify their interpretation and the information's applicability to their particular circumstances.