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THE ATO'S APPROACH TO TAX DEBTS

Statistics from December 2023 showed that the ATO's collectable debt from taxpayers amounted to approximately $50 billion. A sizeable increase from the $7 billion in June 2022. Notably, small businesses accounted for approximately two-thirds of the total $50 billion debt.

Given the significant amount of debt that has accrued over the past few years, it is worth reviewing the ATO's approach and what tools are available to the ATO in collecting debts.

The ATO's Approach

The ATO's approach to tax debt can be summarised as follows:

1. **Prevention**: In the form of the ATO sending reminders and employing engagement programs to stop debt accumulating.

2. **Early intervention**: i.e. the ATO offers self-service payment plans as a tool to allow taxpayers to actively manage their debts.

3. **Firmer action**: Whereby the ATO sends statements of accounts, awareness letters and other forms of communication to encourage and prompt action by the taxpayer (for example, the dreaded red headed letter).

4. **Stronger action**: Finally, in cases of non-engagement by taxpayers, the ATO may resort to stronger legal measures, such as director penalty notices (DPNs), garnishee notices and legal action.

General Interest Charges 'GIC'

GIC is the primary deterrent to taxpayers in accumulating debt with the ATO. GIC accrues each day the debt remains unpaid and is automatically added to debt on a taxpayer's ATO accounts. The annual GIC rate for the December 2024 quarter is 11.38%.

Importantly, draft legislation has been introduced to deny tax deductions for general interest (and shortfall interest) charges from 1 July 2025. The draft legislation had a consultation period which ended on 16 October 2024. If enacted, the denial of deductions would effectively operate as an additional 15% to 45% increase in GIC depending on the entity of the taxpayer.

Requests of remissions for GIC are available to tax agents and taxpayers through the tax agent portal and via ATO phone services. However, in our experience, the ATO has taken a much stricter line in allowing the remission of GIC.

The ATO's Means of Debt Collection

Other means available to the ATO to collect outstanding tax debts include:

- Offsetting Credits & Refunds: If a taxpayer has outstanding tax debts and is due a refund from a lodgement, the ATO can offset the refund against the debts.
- Engagement with external debt collection agencies: In the circumstances where a taxpayer has an overdue debt and does not respond to the ATO's request to pay, the ATO may refer the taxpayer to an external debt collection agency.
- Issuing of garnishee notices: The ATO may issue a garnishee notice to a person or business that holds money for the taxpayer (i.e. employers, banks, debtors etc). Effectively the garnishee notice requires these entities to pay money directly to the ATO as a repayment of tax debt rather than to the taxpayer.
- Issuing of director penalty notices 'DPN's': Where the taxpayer is a company, the ATO may issue a director penalty notice to one or all Directors. The DPN pierces the corporate veil and makes the director personally liable for any outstanding debts. DPN's are primarily issued where the debts arise from PAYGW, GST & Superannuation.

Further Legal action

Where the above means of debt collection fail, the ATO can resort to legal action including:

- Claims or summons being issued to the relevant courts in the taxpayer's state or territory.
- Bankruptcy notices can be issued demanding payment of debt or entrance into a payment with the ATO. Failure to comply with the bankruptcy notice may result in the ATO issuing a creditor petition to officially declare the taxpayer as bankrupt. A bankruptcy trustee will then take possession and liquidate a taxpayer's assets to repay the outstanding debts.
- For companies, statutory demands can be issued to demand payment of debts or entrance into a payment plan with the ATO. Failure to comply with the demand may result insolvency, liquidation and wind-up actions against taken the company.

Conclusion

As discussed, there are a number of means available to the ATO to collect debts owed by taxpayers. These range from simple text message reminders of tax debts to severe legal actions of bankruptcy and/or liquidation. Outstanding tax debts are an issue that needs to be actively managed by taxpayers and their agents. The issue is also due to become more significant with the proposed denial of deductions for GIC from 1 July 2025.

We recommend that you engage with the ATO as early as possible to ensure that the tax debt is managed as cooperatively as possible with the ATO.

If you would like to discuss the above matters further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

TIMING COUNTS WHEN DEPRECIATING ASSETS ARE LOST OR DESTROYED

Start the clock.

That is not what someone is generally thinking when they have an asset stolen, lost or destroyed. When it comes to the assets that are subject to the Division 40 capital allowance regime, i.e. a depreciable asset, timing is quite important.

Where a depreciable item, say, plant and equipment, is lost, destroyed in a fire or in any other manner, or has been stolen, the owner may receive an insurance payout in relation to that asset. Where the insurance payout is greater than its written down value, there would be an amount of assessable income included in the owner's tax return.

Losing a portion of the insurance payout to tax may seem like an inequitable tax outcome where those insurance proceeds are used to purchase a replacement asset. To alleviate this outcome, the asset owner can choose to utilise the Involuntary Disposals provision.

"Involuntary disposals" cover the loss of assets described above as well as assets that have been compulsory acquired in certain circumstances.

Where a replacement asset has been acquired, asset owners can choose to exclude the assessable income from the involuntary disposal, and instead reduce the cost base of the replacement asset by that amount. The effect of this choice is that assessable income is reduced in the current year, and there would be lower depreciation deductions over the life of the replacement asset.

So why did we start the clock?

The ability to choose to exclude the assessable income only exists if the replacement asset is held **by the end of the income year after** the original asset was lost or destroyed. The asset then needs to be installed ready for use wholly for business purposes.

The requirement to have a replacement asset ready for use by the end of the following income year may not be a concern for off the shelf assets or those that do not require customisation. But what of large assets that may take significant amounts of time to construct, customise, import or install?

If the original asset was lost or destroyed on 29 June of one year, will the replacement asset be ready by 30 June of the following year?

In this case the involuntary disposals provision may still be available, however a request must be made to the Commissioner of Taxation to allow for a longer period of time to begin to hold the replacement asset.

The Commissioner is more likely to allow for a longer time period where the asset is so large that it would take longer than 12 months to construct or be delivered and installed, or where there are delays in receiving the insurance proceeds. Delays that are caused by the asset owner will weigh against the owner.

So, when and asset is lost, consider when its replacement is likely to be ready. If the Commissioner is going to be required to rule on the involuntary disposals provisions, then consider the timing of making the request as it may take many months for the Commissioner to finalise his decision.

If you would like to discuss the above matters further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

RECEIVING FOREIGN GIFTS AND INHERITANCES – BEWARE SECTION 99B

The ATO recently finalised its Tax Determination and accompanying Practical Compliance Guideline (PCG) dealing with the Australian tax consequences for an Australian beneficiary of a Foreign Resident Trust.

Of interest to many Australians with family members overseas is the ATO's proposed compliance approach outlined in PCG 2024/3.

The ATO are aware of an increase in the flow of foreign money and property to Australian residents because of either family gifts or inheritances.

Section 99B is an obscure provision within the Tax Act that seeks to tax the "receipt of trust income not previously subject to tax".

In recent years the ATO have sought to clarify what they believe section 99B applies to and in the PCG outline the following:

> *9. Section 99B may apply where a resident beneficiary receives an amount of trust property from a non-resident trust estate, including:*
>
> - *distributions paid by the trustee to a beneficiary;*
> - *assets transferred by the trustee to a beneficiary;*
> - *use of trust property by a beneficiary;*
> - *loans from the trustee to a beneficiary;*
> - ***amounts received from a deceased estate***

The PCG then goes on to provide 27 examples of scenarios that may occur involving foreign trusts and outlines what the ATO's compliance approach would be. 7 of those examples relate to deceased estates.

The ATO has stated that an arrangement will be considered Low Risk where the trustee/executor distributes an amount or the benefit of trust property from a non-resident deceased estate to a resident beneficiary and **both** of the following criteria are satisfied:

- The trust property, including cash or proceeds from the sale of trust assets, is distributed to the resident beneficiary within 24 months of the date of death; and

- The total value of trust property received, whether in multiple payments or in one lump sum payment, by the resident beneficiary does not exceed A$2 million at the time the amount is paid or applied to the resident beneficiary.

The ATO further state that the compliance approach outlined in the PCG is confined to a non-resident deceased estate and does not extend to any testamentary trust established under the will of the deceased.

Should the ATO undertake a review of the foreign distributions they will expect to be provided sufficient documentation to be able to determine whether any part of that distribution might represent an assessable distribution under section 99B.

In order to be considered Low Risk, in addition to the earlier criteria, beneficiaries also need to be able to hold or provide the following documents.

- a document confirming the date of the deceased's death;
- the will of the deceased, letter of wishes or correspondence from executors or their legal advisers stating the terms of the will;
- documentation confirming that the assets were owned or held by the deceased at the time of death; and
- documentation setting out the distribution to the Australian-resident beneficiary and the assets of the deceased used to fund this distribution.

Where the inheritance does not meet the Low Risk criteria, resident beneficiaries will likely be faced with an ATO review that seeks to include the full amount of the inheritance in their assessable income. The PCG provides other examples where the ATO states that if a beneficiary is not able to provide sufficient records to establish that the distribution is not assessable, the ATO will administer section 99B on the basis that the full distribution is taxable.

If you or your clients are beneficiaries of a foreign deceased estate, it is vitally important that you are able to obtain the records required by the ATO to support the nature and source of the payment.

If you would like to discuss the above matters further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.