THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

MEDICARE LEVY AMENDMENT BILL (NO. 2) 1996

EXPLANATORY MEMORANDUM

(Circulated by authority of the
Treasurer, the Hon Peter Costello, MP)

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General outline and financial impact

Medicare levy low income exemption thresholds

Raises the Medicare levy low income exemption thresholds for individuals, married couples and sole parents. Persons with a taxable income (or family income) below the low income thresholds are not required to pay the levy. The Bill also raises the upper thresholds for shade-out of the exemption.

Date of effect: 1 July 1996.

Proposal announced: 1996-97 Budget, 20 August 1996.

Financial impact: The estimated cost of raising the low income thresholds will be $2 million in 1996-97; $30 million in 1997-98; and $15 million in 1998-99 and 1999-2000.

Compliance cost impact: There are no additional compliance costs for taxpayers generally. Additional up front compliance costs will be incurred by employers who need to adjust their payroll systems to take into account the new rates for PAYE purposes.

Medicare levy surcharge

Imposes an additional 1 per cent Medicare levy on single people with taxable incomes greater than $50,000 and families with combined taxable incomes greater than $100,000 who do not have private patient hospital cover.

Date of effect: 1 July 1997.

Proposal announced: Announced as part of the 1996-97 Budget.

Financial impact: Estimated additional revenue of $60 million in 1998-99 and $75 million in 1999-00.

Compliance cost impact: Taxpayers who do not have private patient hospital insurance will need to understand the new taxation rules in order for them to calculate their liability for the surcharge. Those who do have insurance will need to keep a record of their coverage and to provide information in tax returns.

The surcharge is to be payable on assessment along with other tax liabilities. The cost of paying this debt can be minimised by electing to use the electronic fund transfers facility in tax returns or, for salary or wage earners, by choosing for extra tax instalments to be deducted throughout the year.

Where extra instalments are involved the employers will incur compliance costs through having to keep extra records, make calculations and modify payroll systems.

Health funds will have to deal with increased enquiries but these should result in increased business. They may also incur costs associated with the provision of information to the Commissioner of Taxation to enable the checking of information provided in tax returns.

Chapter 1

Medicare levy low income exemption thresholds

Overview

1.1 *Schedule 1* of the Bill will amend the *Medicare Levy Act 1986* (the Act) to increase the Medicare levy low income exemption thresholds ('low income thresholds') for individuals, married couples and sole parents. It will also increase the upper exemption shade-out thresholds as a result of the increased low income thresholds and the change of Medicare levy rate from 1 July 1996.

Summary of the amendments

Purpose of the amendments

1.2 The measure will amend:

- sections 7 and 8 of the Act to raise the low income thresholds for individuals, married couples and sole parents;
- subsection 7(2) of the Act to raise the exemption shade-out threshold for individuals; and
- subsection 7(4) of the Act to increase from $450 to $454 for the 1996-97 year of income only, the upper exemption shade-out threshold for trustees of certain trust estates liable to pay the Medicare levy.

Date of effect

1.3 The amendment to the low income thresholds will apply from 1 July 1996. The amendment to the exemption shade-out threshold for certain trustees will have effect for the 1996-97 year of income.

Background to the legislation

Low income thresholds

1.4 The Act makes provision for individuals, certain trustees, married couples and sole parents entitled to a sole parent rebate, and who have low taxable incomes (or family incomes), to be exempt from the levy. Except for trustees, the existing exemption thresholds are to be increased by a factor based on forecast CPI. The exemptions are shaded-out for a limited range above the low income thresholds.

Shading out of the exemption

1.5 The *Medicare Levy Amendment Act 1996* amended section 6 of the Act to increase the rate of levy from 1.5 per cent to 1.7 per cent for the 1996-97 year of income, reverting to 1.5 per cent in subsequent years of income. As a result of the rate change, the threshold at which the exemption shades-out for individuals has to be increased. The shade-out threshold is amended again upon the rate reverting to 1.5 per cent.

1.6 No amendment is made here to the family exemption shade-out threshold. This because that threshold is formula based and the relevant component was amended when the Act was amended to change the rate of levy.

1.7 The rate increase also necessitates an amendment to subsection 7(4). An amendment is required to raise the upper exemption shade-out threshold for trustees paying Medicare levy on the net income of a trust estate assessed under section 99.

Explanation of the amendments

Medicare levy low income exemption thresholds

1.8 The low income thresholds for individuals, married couples and certain sole parents will be increased for 1996-97 and subsequent financial years.

1.9 Section 7 of the Act exempts individuals with taxable incomes at or below the low income threshold from any liability for the Medicare levy. It also applies the levy at a reduced rate for individual taxpayers with taxable incomes within a certain range over which the exemption is shaded-out.

1.10 The level of the individual low income threshold is to be increased from $12,870 to $13,127. ***[Item 1 of Part 1]***

1.11 A reduced levy will be payable if an individual's taxable income exceeds $13,127 but does not exceed $14,346. ***[Item 2 of Part 1]***

1.12 Section 8 of the Act exempts from the Medicare levy a person whose family income is below the family low income threshold and who satisfies either of the following:

- the person is married (includes a de facto relationship) on the last day of the year of income; or
- the person is entitled to a sole parent rebate or a rebate for a housekeeper in his or her assessment in respect of the relevant year of income.

1.13 Family income is the taxable income of the person or, if the person was married on the last day of the year, the taxable income of the person and person's spouse.

1.14 The level of the 'family income threshold' in subsection 8(5) of the Act is to be increased from $21,718 to $22,152 ***[item 4 of Part 1]***. The threshold will continue to be increased by a further $2,100 for each dependent child or student. (The child or student must be one in respect of whom the taxpayer or spouse would have been entitled to a dependant rebate in that year had those rebates been continued.)

1.15 Subsection 8(2) reduces the rate of levy payable by a married couple, or a sole parent, where they are not entitled to exemption because the family income exceeds the family low income threshold by a small or moderate amount. In such circumstances, the amount of levy otherwise payable is reduced in accordance with the formula specified in the subsection. The effect of the subsection is to limit the levy payable by these taxpayers to 20 per cent of the amount of family income which exceeds the family low income threshold. The formula provides for the shade-out of the family low income threshold over the family income range $22,153 to $24,209 (family with no dependent children).

1.16 Subsection 8(6) of the Act places a restriction on increasing the 'family income threshold' on account of certain dependants in respect of a year of income. The restriction applies only where the taxpayer was not a married person on the last day of the year of income. In these circumstances the 'family income threshold' is not increased on account of a dependant unless a family allowance was payable to the taxpayer in respect of the dependant. The reference in the subsection to the amount of $21,718 referred to in the definition of 'family income threshold' is to be increased to $22,152. ***[Item 5 of Part 1]***

Exemption shade-out thresholds

1.17 The exemption shade-out threshold for individuals contained in subsection 7(2) of the Act is increased from $13,913 to $14,346 for the 1996-97 year of income only. ***[Item 2 of Part 1]***

1.18 The increased exemption shade-out threshold of $14,346 will then reduce to $14,191 from 1 July 1997 when the Medicare levy rate reduces from 1.7 per cent to 1.5 per cent. ***[Item 7 of Part 2]***

1.19 ***Item 3 of Part 1*** increases, for 1996-97 year of income only, the upper exemption shade-out threshold amount for the payment of the Medicare levy by a trustee of a trust estate assessed under section 99 from $450 to $454. This results from the increased rate of levy of 1.7 per cent payable for that year.

1.20 ***Item 8 of Part 2*** changes that increased threshold amount back to $450 from 1 July 1997 when the levy rate reverts to 1.5 per cent.

1.21 The increased low income exemption thresholds and exemption shading-out ranges for 1996-97 will be as shown in the following table:

1996-97 MEDICARE LEVY LOW INCOME EXEMPTION THRESHOLDS AND EXEMPTION SHADING-OUT RANGES

Category of taxpayer	No levy payable if taxable income (family income) does not exceed (previous figures)	Reduced levy if taxable income (family income) is within the range (inclusive)	Ordinary rate of levy payable where taxable income (family income) exceeds (previous figures)
Individual taxpayer	$13,127 ($12,870)	$13,128 - $14,346	$14,346 ($13,913)
Married taxpayer* with the following children and/or students	(family income)	(family income)	(family income)
0	$22,152 ($21,718)	$22,153 - $24,209	$24,209 ($23,478)
1	$24,252 ($23,818)	$24,253 - $26,504	$26,504 ($25,749)
2	$26,352 ($25,918)	$26,353 - $28,800	$28,800 ($28,019)
3	$28,452 ($28,018)	$28,453 - $31,095	$31,095 ($30,289)
4	$30,552 ($30,118)	$30,553 - $33,390	$33,390 ($32,560)
5	$32,652 ($32,218)	$32,653 - $35,685	$35,685 ($34,830)
6	$34,752** ($34,318)**	$34,753** - $37,980***	$37,980*** ($37,100)***

* or taxpayer entitled to a sole parent, child/housekeeper or housekeeper rebate.

** add $2,100 for each extra child.

*** add $2,295 for each extra child (previously $2,270).

1.22 The amendments made by items 1, 4 and 5 of Part 1 apply for the financial year commencing on 1 July 1996 and all later years. ***[Subitem 6(1) of Part 1]***

1.23 The amendments made by items 2 and 3 of Part 1 apply for the 1996-97 financial year only. ***[Subitem 6(2) of Part 1]***

1.24 The amendments made by items 7 and 8 of Part 2 apply for the financial year commencing on 1 July 1997 and all later years. ***[Item 9 of Part 2]***

Chapter

2 Medicare levy surcharge

Overview

2.1 The Bill will amend the *Medicare Levy Act 1986* (the Act) to impose an increased amount of Medicare levy (referred to here as 'surcharge') on people with high incomes who do not take out private patient hospital cover. Related amendments to the *Income Tax Assessment Act 1936* (the Assessment Act) are contained in the Taxation Laws Amendment (Private Health Insurance Incentives) Bill 1996 (the PHI Bill). The related amendments make it clear who is to be liable for the surcharge.

Summary of the amendments

Purpose of the amendments

2.2 The amendments will:

- impose a surcharge of 1 per cent on individuals with taxable incomes greater than $50,000 or families with combined taxable incomes greater than $100,000 who do not have private patient hospital insurance coverage for themselves and all family members for any part of a year of income; and

- ensure that present Medicare levy exemptions for prescribed persons do not apply to the surcharge where any member of a family is not a prescribed person and is not covered by private patient hospital insurance.

Date of effect

2.3 The amendments will apply from 1 July 1997 in respect of the 1997-98 and subsequent years of income.

Background to the legislation

2.4 The Government announced in the 1996-97 Budget that a 1 per cent Medicare levy surcharge is to be imposed on single people and families with taxable incomes above stated thresholds that do not have private hospital cover through private health insurance. The new surcharge is part of a package of measures designed to encourage people to retain or take up a private health insurance option. Where a person is liable, the new surcharge is an addition to the amount payable under the current Medicare levy arrangements.

Medicare levy

2.5 When the Medicare levy was first introduced in 1984 the rate payable was 1 per cent of taxable income. That rate has been increased on several occasions. Most recently, the levy was increased from 1.4 per cent to 1.5 per cent from 1 July 1995 (although it has been temporarily increased to 1.7 per cent for the 1996-97 income year to fund gun control measures).

2.6 Subject to a few exceptions, Medicare levy is payable by all taxpayers who benefit under Australia's health system or who have a dependant who so benefits. Trustees of trust estates are also liable to pay the levy. The exceptions extend to those on low incomes and those who are otherwise provided with health benefits, such as members of the Defence Force and certain pension recipients. Non-residents are also excluded as they are not generally entitled to free benefits under the health system. The categories of people specifically excluded (other than low income earners) are referred to in the law as prescribed persons.

Summary of the essential features of the surcharge

What is the Medicare levy surcharge?

2.7 The Medicare levy surcharge is an additional amount of Medicare levy imposed where a person on a high income does not meet a certain requirement of hospital insurance coverage. The additional amount is 1 per cent of the taxable income of the relevant person. Where it applies it does so in full to each dollar of taxable income. It will generally be payable when income tax for a year is assessed and is payable. However, provision is to be made for PAYE taxpayers to provide for their liability for the additional amount through the tax instalment deduction system.

Who will be liable for the Medicare levy surcharge?

2.8 A liability for the surcharge arises where a person or any of his/her dependants does not have the required private patient hospital cover and the person's taxable income, or the sum of the person's taxable income and the person's spouse's taxable income, exceeds a certain amount. Where the person is an individual, the amount is $50,000. Where the person is regarded as a member of a family, the amount is $100,000. These amounts are not indexed.

2.9 A trustee of a trust estate who is assessed under section 98 of the Assessment Act (that is a trustee who pays tax on behalf of a beneficiary who is under a legal disability) is liable for the surcharge if the beneficiary would have been liable. Persons who are prescribed persons for normal rate Medicare levy purposes are also liable, subject to the income tests, where any one of their dependants is not a prescribed person and does not have the required private patient hospital cover. A prescribed person who has one or more dependants who are not also prescribed persons is not considered to be a prescribed person for surcharge purposes.

What is the required private patient hospital cover?

2.10 The required private patient hospital cover in respect of a person is cover under a health insurance policy that provides benefits in relation to fees and charges for hospital treatment. Cover merely for treatment provided by a medical professional in a hospital (ancillary cover) does not avoid the surcharge. Where a person has dependants, the cover must be held for the person and **all** his/her dependants. It is not necessary that the person has liability for policy premiums or actually pays them himself/herself.

Who are dependants for cover purposes?

2.11 Any person who is a spouse of the person, a child of the person under 16 years of age, or a student child of the person under 25 years of age and to whose maintenance the person contributes is a dependant for purposes of the surcharge. No income limits are associated with this test. All dependants must be covered under a private patient hospital policy, or be a prescribed person, for a person to avoid the surcharge.

Explanation of the amendments

2.12 The amendments implementing the surcharge are contained in Schedule 2 of the Bill and apply for the 1997-98 year of income and all later years of income ***[clause 2, and item 6 of Schedule 2].*** Six new sections operate to impose liability to the surcharge and the amount of that liability. Three new sections apply to individual taxpayers. They are **new sections 8B** (applies to a person without dependants), **8C** (applies to a person with dependants) and **8D** (applies to married persons). The other three sections apply to beneficiaries of trust estates in similar situations. These new sections are **new sections 8E** (applies to a beneficiary without dependants), **8F** (applies to a beneficiary with dependants) and **8G** (applies to a married beneficiary).

Single person without dependants ***[Item 4 of Schedule 2]***

2.13 **New section 8B** applies to impose the surcharge on certain single persons without dependants. The persons are those to whom all the tests set out in **new subsection 8B(1)** apply for the whole or a part of a year of income. The tests are that the person:

- is not a married person (**new paragraph 8B(1)(a)**); and
- does not have any dependants (**new paragraph 8B(1)(b)**); and
- does not have private patient hospital cover (**new paragraph 8B(1)(c)**); and
- is not a prescribed person (**new paragraph 8B(1)(d)**).

2.14 If **new section 8B** applies for the whole of the year of income - that is, all the tests as set out in **new subsection 8B(1)** apply to the person for the whole of the year of income - and the person's taxable income exceeds $50,000, a surcharge at 1 per cent of the person's taxable income is payable in addition to the amount of Medicare levy otherwise payable (**new paragraph 8B(2)(a)**). Where **new section 8B** applies to the person for a part only of a year of income, pro rata arrangements operate to calculate a person's liability to the surcharge for that part of the year (depending on the circumstances, other new sections may impose the surcharge for other parts of a year of income). **New paragraph 8B(2)(b)** provides the following formula to determine liability for part only of a year of income:

$$(1\% \text{ of the person's taxable income}) \times \frac{\text{Number of those days}}{\text{Number of days in year of income}}$$

2.15 **New paragraph 8B(2)(b)** will apply in any situation where a person meets the tests set out in **new subsection 8B(1)** for less than the whole of a year of income. Examples are where a person marries or separates during a year of income or purchases private patient hospital cover during a year. Where a person marries, **new section 8D** would be relevant from the date of marriage. A single person will be liable to pay the surcharge for the period until he or she takes out private patient hospital cover, provided, of course, that his or her taxable income for the year exceeds $50,000.

2.16 **New paragraph 8B(1)(d)** refers to the person not being a prescribed person. A prescribed person is not liable for the surcharge (see paragraph 2.6 and 2.9 above). A person may be a prescribed person for part only of a year of income and therefore the person will be liable to the surcharge for the period that the person was not a prescribed person and met the other tests for liability.

Example 1:

Gavin is a single person. He has no dependants. He is not a prescribed person. In the 1997-98 income year he has a taxable income of $52,000. He does not have any private health insurance. Under **new section 8B** he is liable for the additional 1% Medicare levy surcharge as his income is over the $50,000 threshold. The amount of his liability will be $520.

Example 2:

Gavin decides that he does not want to pay the Medicare levy surcharge again. On 1 January 1999 he takes out private patient hospital cover. In the 1998-99 income year he has a taxable income of $75,000. He has no dependants and is not a prescribed person. He is liable for the Medicare levy surcharge only for the period 1 July 1998 to 31 December 1998 - the amount is $378 [(1% x $75,000) x 184/365].

Persons with dependants ***[Item 4 of Schedule 2]***

2.17 **New section 8C** applies to impose the surcharge on certain persons who have dependants and who are not married during the whole or a part of a year of income. Married includes a de facto relationship - subsection 251R(2) of the Assessment Act. The persons are those to whom all the tests set out in **new subsection 8C(1)** apply for the whole or a part of a year of income. Most of the tests are similar to those that apply for new section 8B purposes. The tests are that the person:

- is not a married person (**new paragraph 8C(1)(a)**); and
- has one or more dependants (dependant is defined in subsection 251R(3) of the Assessment Act) (**new paragraph 8C(1)(b)**); and
- does not have private patient hospital cover for himself/herself or at least one of his/her dependants (other than a dependant who is a prescribed person or would be but for subsection 251U(2)) (**new paragraph 8C(1)(c)**); and
- is not, or is taken under **new section 251VA** of the Assessment Act ***[item 4 of Schedule 1, PHI Bill]*** not to be, a prescribed person (**new paragraph 8C(1)(d)**).

2.18 **New section 8C** applies only where all the tests set out above apply to the person for the whole or a part of a year of income. Consequently, liability to the surcharge is avoided by the person taking out the required hospital cover for himself/herself and **all** his/her dependants. In this situation, the person would not satisfy the test in **new paragraph 8C(1)(c)** and the section would not apply to him/her.

2.19 **New section 251VA** ***[item 4 of Schedule 1, PHI Bill]*** operates to deem a prescribed person with dependants, who are themselves not prescribed persons, not to be a prescribed person for the purposes of the surcharge and therefore potentially liable for the surcharge (**new paragraph 8C(1)(d)**). This is in contrast with subsection 251U(3) of the Assessment Act where a person who is a prescribed person and who has a dependant who is not a prescribed person is taken to be a prescribed person during one-half only of the period they have such a dependant. The person is then liable for the normal rate Medicare levy for the other half of the period.

2.20 **New subsection 8C(2)** provides that a person to whom **new section 251VA** ***[item 4 of Schedule 1, PHI Bill]*** applies for a period (that is, a prescribed person who is taken not to be a prescribed person for the purposes of the surcharge) is never the less taken to be covered during the whole of the period by the required private patient hospital cover. This is because a prescribed person receives full free medical treatment. These persons would not benefit from taking out hospital insurance and are therefore taken to have the required hospital cover. The overall effect of this subsection and **new paragraph 8C(1)(c)** is that a person who is a prescribed person in his/her own right may be liable for the surcharge only where one of his/her dependants does not have the required hospital cover and is not a prescribed person. In this way a prescribed person faces the same incentives to take out private patient hospital cover in respect of dependants as does a non-prescribed person.

2.21 If **new section 8C** applies for the whole of a year of income - that is, all the tests as set out in **new subsection 8C(1)** apply to the person for the whole of the year of income - and the person's taxable income exceeds $100,000, a surcharge of 1 per cent of the person's taxable income is payable in addition to the amount of Medicare levy otherwise payable (**new paragraph 8C(3)(a)**). Where **new section 8C** applies for a part only of a year of income, **new paragraph 8C(3)(b)** provides pro rata arrangements.

2.22 Pro rata arrangements operate when a person's circumstances change during a year of income and this potentially affects his/her liability to the surcharge. For instance, a person may purchase private patient hospital cover during a year of income, be a prescribed person for part only of a year of income or have an uninsured dependant for part only of the year of income. In these cases **new paragraph 8C(3)(b)** provides the following formula to determine liability for part only of a year of income:

$$(1\% \text{ of the person's taxable income}) \times \frac{\text{Number of those days}}{\text{Number of days in year of income}}$$

It should be noted that if **new section 8C** applies for part only of a year of income, **new sections 8B** or **8D** may apply to the person for other parts of the year of income.

2.23 A dependant is defined in subsection 251R(3) of the Assessment Act for normal Medicare levy purposes to be a spouse of the person or a child of the person (provided the child is under 16 years of age or a student under 25 years of age). A number of qualifications apply to that definition. For surcharge purposes a dependant is as defined in subsection 251R(3) but without the qualifications (see also **new section 251V**, ***[item 4 of Schedule 1, PHI Bill]*** in this regard).

Example 1:

> Maree was divorced in 1996. She has sole daily care and control of her children. Maree and her children do not have private patient hospital cover. Maree is not a prescribed person. In the 1997-98 income year she has a taxable income of $110,000. Maree is liable for surcharge of $1,100 (1% of $110,000).

Example 2:

> Mark and Diane are separated and have shared custody of their daughter Melanie. Melanie is a dependant, as defined for surcharge purposes, of both Mark and Diane. Diane has taken out private patient hospital cover for herself and Melanie. Diane is not liable for the surcharge because all members of her family are covered. Mark does not have private patient hospital cover. All the members of Mark's family are not covered, that is Melanie is covered but Mark is not covered. Therefore, Mark will be liable for the surcharge where his taxable income exceeds $100,000.

Married person *[Item 4 of Schedule 2]*

2.24 **New section 8D** applies to impose the surcharge on certain persons who are married during the whole or a part of a year of income. Married includes a de facto relationship - subsection 251R(2) of the Assessment Act. The persons are those to whom all the tests set out in **new subsection 8D(1)** apply for the whole or a part of a year of income. The tests are that the person:

- is a married person (**new paragraph 8D(1)(a)**); and
- does not have private patient hospital cover for himself/herself or at least one of his/her dependants (includes spouse) (**new paragraph 8D(1)(b)**). The reference to the person's dependants does not include a dependant who is a prescribed person or would have been a prescribed person but for the operation of subsection 251U(2) of the Assessment Act (under subsection 251U(2) a prescribed person with dependants is taken not to be a prescribed person unless all their dependants are also prescribed persons); and
- is not, or is taken under **new section 251VA** not to be, a prescribed person ***[item 4 of Schedule 1, PHI Bill]*** (**new paragraph 8D(1)(c)**).

2.25 The effect of **new paragraph 8D(1)(b)** is to make a person liable for the surcharge where that person or at least one of the person's dependants does not have private patient hospital cover and is not a prescribed person. To avoid liability to the surcharge **all** members of a family are to have cover. For example, a person may have coverage but his/her spouse does not have coverage. In this case the effect is that **new section 8D** will apply and the person will be liable to the surcharge, provided the sum of his or her taxable income and the taxable income of his or her spouse is above the relevant threshold level.

2.26 **New subsection 8D(2)** provides that a person to whom **new section 251VA** ***[item 4 of Schedule 1, PHI Bill]*** applies (that is, a prescribed person who is taken not to be a prescribed person for the purposes of the surcharge) is never the less taken to be covered during the whole of the period by the required private patient hospital cover. This is because such a prescribed person receives full free medical treatment. These persons would not benefit from taking out hospital insurance and are therefore taken to have the required hospital cover. The overall effect of the subsection and **new paragraph 8D(1)(c)** is that a person who is ordinarily a prescribed person will be liable for the surcharge only where one of his/her dependants does not have the required hospital cover and is not a prescribed person. In this way a prescribed person faces the same incentives to take out private patient hospital cover in respect of dependants as does a non-prescribed person.

2.27 If **new section 8D** applies for the whole of the year of income - that is, all the tests as set out in **new subsection 8D(1)** apply to the person for the whole of the year - and the combined taxable incomes of the person and the person's spouse exceeds $100,000 (**new paragraph 8D(3)(b)**) and the person's income exceeds $13,127 (**new paragraph 8D(3)(c)**), a surcharge of 1 per cent of the person's taxable income is payable in addition to the amount of Medicare levy otherwise payable. Income of a dependent child is not included as part of the person's combined taxable income.

2.28 The effect of **new paragraph 8D(3)(c)** is to exempt a person from liability to the surcharge in cases where, although the combined taxable incomes of a person and the person's spouse exceeds $100,000, the person's taxable income does not exceed $13,127. The person's spouse would still be liable for the surcharge since the spouse's taxable income must exceed $86,873 for the couple to have exceeded the $100,000 combined income threshold. The $13,127 corresponds with the Medicare levy single low income exemption threshold which operates to exempt low income earners from normal rate Medicare levy. The exemption has been adopted for ease of administration and to reduce compliance costs for those affected. Unlike the Medicare levy, there is no shading-out of the exemption above this threshold for surcharge purposes.

2.29 **New subsection 8D(5)** provides a definition of 'taxable income' in relation to a spouse of a person. Taxable income, in this regard, is the spouse's taxable income, within the ordinary meaning of the Assessment Act, and includes any share in the net income of a trust estate to which the beneficiary is presently entitled and in respect of which the trustee of the trust estate is liable to be assessed under section 98 of the Assessment Act. Ordinarily, such a share of net income is assessable income only where the spouse has other income - see paragraph 100(1)(b) of the Assessment Act. The effect of the subsection is that a person whose spouse has no taxable income but who is presently entitled to a share in the net income of a trust estate will not avoid liability to the surcharge where combined taxable income's (including the share of net income) exceed $100,000.

2.30 Where **new section 8D** applies for a part only of a year of income, pro rata arrangements operate to pro rata the full year surcharge. The section provides for situations such as where a person is married, has private patient hospital cover, or is a prescribed person for a part only of a year of income.

2.31 Where the tests in **new subsection 8D(1)** apply to a person for only some of the days of the income year and, if the person is married for the whole of the income year, the combined taxable incomes of the person and the person's spouse exceeds $100,000 and the person's taxable income exceeds $13,127 (**new paragraph 8D(4)(a)**) or, if the person is married for a part of the year of income only, the person's taxable income exceeds $100,000 (**new paragraph 8D(4)(b)**), a formula operates to calculate the person's liability to the surcharge. The formula is contained in **new subsection 8D(4)** and is the same formula used in **new sections 8B** and **8C** to determine a person's liability to the surcharge for a part only of a year of income. The formula is:

$$(1\% \text{ of the person's taxable income}) \times \frac{\text{Number of those days}}{\text{Number of days in year of income}}$$

2.32 A married person who separates during a year of income can meet the tests of **new subsection 8D(1)** only for the period the person was married (for the period the person is separated, and therefore considered an individual, **new subsections 8B(1)** or **8C(1)** may apply if all the tests as set out in either of those subsections apply). Where the tests are met for that period, the person will be liable for the surcharge for the period if the person's taxable income exceeds $100,000 (**paragraph 8D(4)(b)**). It should be noted that in these cases the threshold level is not the combined taxable incomes of the person and the person's spouse for that part of the year but the person's taxable income only. This is to avoid imposing the surcharge on a person in situations such as where the person's combined taxable income for a year exceeds the threshold but some of the spouse's income for that year was derived during a period when the person was not married.

2.33 A dependant is defined in subsection 251R(3) of the Assessment Act to be a spouse of the person or a child of the person (provided the child is under 16 years of age or a student under 25 years of age). A number of qualifications apply to that definition. For surcharge purposes a dependant is as defined in subsection 251R(3) but without the qualifications.(see also **new section 251V**, ***[item 4 of Schedule 1, PHI Bill]*** in this regard)

Example 1:

Aurelio and Filomena marry on 1 January 1998. They were not in a de facto relationship before then and do not have dependants. They conduct a business in partnership and both have a taxable income of $70,000 for the 1997-98 year of income.

Aurelio does not have private patient hospital cover. As his taxable income is over the $50,000 threshold, **new section 8B** applies for the part of the year in which he is single. His liability for the surcharge for that part of the year is $352.87 [(1% x $70,000) x 184/365].

New section 8D applies for the part of the year in which Aurelio is married. However, he is not liable for the surcharge because his income is below the married person's threshold of $100,000. Filomena's income is not included in determining whether Aurelio's income is over the threshold as Aurelio and Filomena were married part way through the year. Filomena's income will be included in determining whether Aurelio is liable for the surcharge in all later years in which they are married.

Filomena has individual private patient hospital cover for the full year. She is not liable under **new section 8B** during the period she was not married. **New section 8D** applies for the period she is married because Aurelio does not have the required cover. However, she does not pay the surcharge in 1997-98 as her income is under $100,000.

Example 2:

Mick and Glenys have been living together since 1992. They are in a de facto relationship. They have two children, Kellie and Megan. Glenys is covered by private patient hospital cover but Mick and their children are not. None of them are prescribed persons. Mick's income for the 1997-98 income year is $50,000. Glenys's income for the 1997-98 income year is $65,000. They are both liable under **new section 8D** for the surcharge because:

- their dependants do not have private patient hospital cover;
- they are married persons;
- their combined income is over the $100,000 threshold; and

none of the family are prescribed persons.

Certain trustees ***[Item 4 of Schedule 2]***

2.34 Existing Medicare provisions provide that the trustee of a trust estate that is assessed under section 98 of the Assessment Act (where a beneficiary is presently entitled to income but under a legal disability) is liable to pay levy of the same amount that the beneficiary would have paid if the beneficiary's share of income were the taxable income of an individual (section 10 of the Act). This same concept has been adopted for surcharge purposes. Existing provisions also impose Medicare levy on trustees who are assessed under section 99 or 99A of the Assessment Act (because no beneficiary is presently entitled). However, that concept could not be adopted with the surcharge as there is no beneficiary against whom to apply the various tests set out in the new sections imposing the surcharge on single and married taxpayers.

2.35 **New sections 8E, 8F and 8G** exist to impose the surcharge on trustees of section 98 trusts where a resident beneficiary, whether single or married, does not have private patient hospital cover for himself/herself and **all** his/her dependants. Imposition is subject to the same income thresholds mentioned earlier.

2.36 **New section 8E** relates to new section 8B, and imposes liability on the trustee for the surcharge where the following tests are met (**new subsection 8E(1)**):

- the beneficiary is a person to whom **new section 8B** applies, that is, the tests as set in **new subsection 8B(1)** apply (**new paragraph 8E(1)(a)**); and
- the trustee is liable to be assessed under section 98 of the Assessment Act in respect of the share of the net income of the trust estate to which the beneficiary is presently entitled (the share of the net income of the trust estate is to be known as the 'beneficiary's trust income') (**new paragraph 8E(1)(b)**).

2.37 Where it is established that the beneficiary is a beneficiary to whom **new subsection 8E(1)** applies for the whole of the year of income and the beneficiary's trust income exceeds $50,000, a surcharge of 1 per cent of the beneficiary's trust income is payable in addition to the amount of Medicare levy otherwise payable by the trustee of the trust estate (**new paragraph 8E(2)(a)**).

2.38 **New paragraph 8E(2)(b)** imposes the surcharge on a pro rata basis where **new section 8B** applies for only some of the days of the year of income (see paragraph 2.14). The following formula is contained in **new paragraph 8E(2)(b)** and is in similar terms to the formulae used in the other new sections that provide for the pro rata of liability:

$$(1\% \text{ of the beneficiary's trust income}) \times \frac{\text{Number of those days}}{\text{Number of days in year of income}}$$

2.39 Examples of situations which may provide for a beneficiary to come within **new section 8B** for only some of the days of the year of income are the same as mentioned in paragraph 2.15.

2.40 **New section 8F** relates to **new section 8C,** and imposes liability on the trustee for the surcharge where the following tests are met (**new subsection 8F(1)**):

- the beneficiary is a person to whom **new section 8C** applies (a single person with dependants), that is, the tests as set out in **new subsection 8C(1)** apply (**new paragraph 8F(1)(a)**); and
- the trustee of the trust estate is liable to be assessed under section 98 of the Assessment Act in respect of a share of the net income of the trust estate to which the beneficiary is presently entitled ('the beneficiary's trust income') (**new paragraph 8F(1)(b)**).

2.41 Where **new section 8F** applies to the beneficiary for the whole of the year of income and the beneficiary's trust income exceeds $100,000, a surcharge of 1 per cent of the beneficiary's trust income is payable in addition to the amount of Medicare levy otherwise payable by the trustee of the trust estate (**new paragraph 8F(2)(a)**).

2.42 As with **new section 8E,** a formula is provided in **new paragraph 8F(2)(b)** to impose liability to the surcharge in cases where the section applies to the trustee for only some of the days of the income year.

2.43 **New section 8G** relates to **new section 8D,** and imposes liability on the trustee for the surcharge where the following tests are met (**new subsection 8G(1)**):

- the beneficiary is a person to whom **new section 8D** applies (a married person), that is, the tests as set in **new subsection 8D(1)** apply **(new paragraph 8G(1)(a)**; and
- the trustee is liable to be assessed under section 98 of the Assessment Act in respect of the share of the net income of the trust estate to which the beneficiary is presently entitled (the share of the net income is to be known as the 'beneficiary's trust income') (**new paragraph 8G(1)(b)**).

2.44 If **new subsection 8G(1)** applies for the whole of the year of income and the sum of the beneficiary's trust income and the taxable income of the beneficiary's spouse exceeds $100,000 and the beneficiary's trust income exceeds $13,127, a surcharge of 1 per cent of the beneficiary's trust income is payable in addition to the amount of Medicare levy otherwise payable by the trustee of the trust estate (**new subsection 8G(2)**).

2.45 Where **new subsection 8G(1)** applies for only some of the year of income, pro rata arrangements operate to pro rata the full year surcharge. It provides for situations such as where a beneficiary is married, has private patient hospital cover, or is a prescribed person for part only of a year of income (**new subsection 8G(3)**).

2.46 In a case where **new section 8G** applies to a beneficiary for only some of the days of the year of income and the beneficiary is married for the whole of the year of income, and the sum of the beneficiary's trust income and the taxable income of the beneficiary's spouse exceeds \$100,000 (**new subparagraph 8G(3)(a)(i)**) and the beneficiary's trust income exceeds \$13,127 (**new subparagraph 8G(3)(a)(ii)**), a formula operates to calculate the person's liability to the surcharge. The same formula operates in cases where a beneficiary is a married person for only some of the days of the income year and the beneficiary's trust income exceeds \$100,000 (**new paragraph 8G(3)(b)**).

2.47 The formula provided in **new subsection 8G(3)** is the same formula provided in **new sections 8E** and **8F**.

2.48 **New subsection 8G(4)** provides a definition of 'taxable income' in relation to a spouse of a beneficiary. Taxable income, in this regard, is the spouse's taxable income, within the ordinary meaning of the Assessment Act, and includes any share in the net income of a trust estate to which the beneficiary is presently entitled and in respect of which the trustee of the trust estate is liable to be assessed under section 98 of the Assessment Act. Ordinarily, such a share of net income is assessable income only where the spouse has other income - see paragraph 100(1)(b) of the Assessment Act. The effect of the subsection is that a person whose spouse has no taxable income but who is presently entitled to a share in the net income of a trust estate will not avoid liability to the surcharge where combined taxable income's (including the share of net income) exceed \$100,000.

Other provisions

Deemed married *[Items 1 and 2 of Schedule 2]*

2.49 Existing Medicare levy provisions provide that a person whose spouse dies during a year of income is taken to be married on the last day of the year of income (paragraph 3(3)(b) of the Act). This enables the person to be eligible for the family low income exemption threshold, which operates on married status at year end. The concept has been extended to the surcharge. This is achieved by the insertion of **new subsection 3(3A)**. For the purposes of **new sections 8B, 8C** and **8D,** where a person's spouse dies during a year of income, the person is taken to be married from the date of death until 30 June of the particular year of income. Without this provision a person could become immediately liable for the surcharge merely because of the death of his/her spouse - the income threshold applicable would otherwise drop from $100,000 to $50,000 for the period following the spouse's death. ***[Item 2 of Schedule 2]***

2.50 ***Item 1 of Schedule 2*** amends subsection 3(3) to make that subsection subject to **new subsection 3(3A)**. This is necessary because current Medicare provisions use the last day of the income year for marriage status whereas the surcharge provisions use the status of a person during any given period.

Definition of private patient hospital cover *[Item 3 of Schedule 2]*

2.51 To avoid liability to the surcharge a person is required to have private patient hospital cover. A person is taken to have private patient hospital cover if the insurance policy providing cover is an 'applicable benefits arrangement', within the meaning of section 5A of the *National Health Act 1953* (NHA), to which paragraph 5A(1)(a) applies (**new subsection 3(5)**).

2.52 Under paragraph 5A(1)(a) of the NHA, an arrangement is an 'applicable benefits arrangement' if the contributor is covered for liability to pay fees and charges in respect of some or all hospital treatment provided by a hospital or a day hospital facility with which the organisation has a hospital purchaser-provider agreement. Ancillary cover does not constitute private patient hospital cover.

2.53 A person who has basic hospital cover will avoid the imposition of the surcharge (unless a dependant is not covered). The requirement is for a person at least to have cover that pays the hospital fees and charges in respect of a stay in hospital.

2.54 A person covered by private patient hospital cover remains covered even if some other person actually pays the premiums. This means that where an employer pays premiums the employee is still regarded as covered by private patient hospital cover.

2.55 A person is also covered by private patient hospital cover if the insurance policy is issued by a person to whom subsection 67(3) of the NHA applies (**new paragraph 3(6)(a)**) and, were the organisation a registered organisation, the policy would be an 'applicable benefits arrangement', within the meaning of section 5A, to which paragraph 5A(1)(a) of that Act would apply (**new paragraph 3(6)(b)**).

2.56 This new subsection applies to companies that did not register as a health benefits organisation when the new requirements under the NHA for registered health funds commenced in 1994. A company operates under subsection 67(3) of the NHA when it carried out health insurance business prior to the commencement of the new requirements and it continues to discharge liabilities under policies issued before that commencement. A person who has an insurance policy with such a company which covers them for the cost of hospital fees and charges that, if the company had registered under the new requirements, would come under paragraph 5A(1)(a) of the NHA, is taken to have the required private patient hospital cover for surcharge purposes.

Prescribed person for part of a year *[Item 5 of Schedule 2]*

2.57 ***Item 5 of Schedule 2*** amends subsection 9(1) of the Act to insert a reference to the surcharge provisions, namely **new sections 8B**, **8C**, **8D**, **8E**, **8F**, and **8G.** Subsection 9(1) provides that a person who was a prescribed person for part of a year of income is liable for the Medicare levy only for that period that he/she was not a prescribed person. The surcharge provisions contain their own provisions to cover these situations. Therefore the new sections have been excluded from the operation of section 9.