EXPLANATORY STATEMENT

Social Security (Penalty Interest) Determination 2001

Summary

This determination is made under subsections 1229B(2) and 1229C(1) of the ***Social Security Act 1991*** (the Act), which were inserted by Schedule 1 to the ***Family and Community Services and Veterans' Affairs Legislation Amendment (Debt Recovery) Act 2001*** (the Debt Recovery Act).

The purpose of this determination is, firstly, to set the penalty interest rate. The determination also provides guidelines for the exercise of the Secretary's discretion, under section 1229AA of the Act, to determine that interest is not payable in circumstances where a person might otherwise be liable to pay interest on the outstanding amount of a debt.

Background

In general terms, the Debt Recovery Act provides for a person to be liable to pay interest on the outstanding amount of a debt in two situations. The first situation arises where the person fails to enter into an arrangement to repay the debt in the time required by section 1229A. The second situation is where the person has entered into an arrangement but fails to make a payment in accordance with that arrangement. The effect of section 1229AA is that the Secretary may determine that interest is not payable, or is not payable in respect of a particular period.

Subsection 1229AA(1A) states that the Secretary may make such a determination where the Secretary is satisfied the person has a reasonable excuse for failing to enter an arrangement or, having entered an arrangement, has a reasonable excuse for failing to make a payment in accordance with that arrangement.

Subsection 1229AA(3) provides that the determination that interest is not payable may be expressed to be subject to the person complying with one or more specified conditions. The effect of subsection 1229AA(6) is that, if the determination is made subject to the person complying with a condition and the person contravenes the condition, the determination ceases to have effect from the day on which the contravention occurred.

Explanation of the provisions

<u>Part 1 - Preliminary</u>

Section 1 – Name of Determination

Section 1 provides that the name of the Determination is the *Social Security (Penalty Interest) Determination 2001*.

Section 2 – Commencement

Section 2 provides that the Determination commences on gazettal.

Section 3 – Social Security (Penalty Interest Charge Guidelines) Determination No. 1 - revocation

The Debt Recovery Act repealed certain provisions of the Act that previously provided for a penalty interest scheme. The <u>Social Security (Penalty Interest Charge Guidelines) Determination No. 1</u> as published in *Gazette* No. S227 on 27 June 1994 contained guidelines for the operation of that penalty interest scheme. Section 3 of this Determination revokes that earlier determination.

Section 4 - Definitions

Section 4 contains 2 definitions for the purposes of this Determination. It provides that, unless the contrary intention appears, the term **Act** means the *Social Security Act 1991* and the term **determination** means a determination under section 1229AA of the Act. Section 1229AA is concerned with the power of the Secretary to determine that interest is **<u>not</u>** payable.

<u>Part 2 – Penalty interest rate</u>

Section 5 – Penalty interest rate

Subsection 1229B(1) provides that the penalty interest rate is either 20% or such lower rate as determined by the Minister under subsection 1229B(2) of the Act.

This section provides that the penalty interest rate is 3% per year. This determination is consistent with statements made by the then Minister for Family and Community Services during the debate in the Senate in respect of the Debt Recovery Act that the interest rate would be the equivalent of the <u>below threshold rate</u> as determined by the Minister under section 1082 of the Act. At present, the below threshold rate is determined to be 3%.

Part 3 – Penalty interest guidelines

Section 6 – Purpose of Part 3

Section 6 describes the purpose of Part 3. Subsection 1229C(1) of the Act provides that the Minister must determine guidelines for the operation of the provisions of the Act dealing with penalty interest. Subsection 6(1) of this Determination provides that, for the purposes of subsection 1229C(1), Part 3 sets out those guidelines.

Subsection 6(2) provides that, in deciding whether to make a determination that interest is not payable, or is not payable in respect of a particular period, the Secretary must comply with these guidelines.

Section 7 – Arrangement entered into after final payment day

The broad effect of subsection 1229A(2) of the Act is that a person becomes liable to pay interest on the outstanding amount of a debt if the person has not entered into an arrangement to pay the debt by the later of two dates. That date is referred to as the **final payment day** and is defined in subsection 1229(4) of the Act. Subsection 7(1) of the Determination provides that section 7 applies in relation to a person who is liable to pay interest on the outstanding amount of a debt under subsection 1229A(2).

A potential loophole existed in the operation of the previous penalty interest scheme. In general terms, the previous provisions provided that, where a person was liable to pay interest because the person had not entered into an agreement to pay the debt, the person was not required to pay interest if the person subsequently entered into an agreement to pay the debt. The provisions did not require the person to be making payments in accordance with that agreement. Accordingly, there was the potential for a debtor to avoid having to pay interest despite failing to make payments in respect of a debt where the debtor continued to enter into agreements to repay that debt. Subsections 7(2) and (3) of this Determination operate to remove that potential loophole.

Subsection 7(2) provides that the Secretary should make a determination that interest is not payable by a person if, after the final payment day, the person has entered into an arrangement to pay the debt and the person is making payments in accordance with the arrangement.

The effect of subsection 7(3) is to provide for the contents of a determination made under subsection (2). It provides, firstly, that the Secretary is to determine that interest is not payable on and after the day when the first payment made in accordance with the arrangement is received by, or on behalf of, Centrelink. Secondly, paragraph 7(3)(b) requires the determination to specify, as a condition of the determination, that the person must continue to make payments in accordance with the arrangement. In broad terms, subsection 1229AA(6) of the Act provides that, if a determination is expressed to be subject to a person complying with a condition and the person contravenes that condition, the determination ceases to have effect from and including the day on which the person contravened the condition. Accordingly, the effect of paragraph 7(3)(b) is that, if a person fails to make a payment in accordance with the arrangement, the debtor is again liable to pay interest from the date that the person fails to make the payment.

Subsection 7(4) provides that the term **final payment day** has the meaning given by subsection 1229A(4) of the Act.

Section 8 – Payments resumed under existing arrangement or new arrangement entered into after failure day

The broad effect of subsection 1229A(3) of the Act is that a person becomes liable to pay interest on the outstanding amount of a debt if the person has entered into an arrangement to pay the debt and fails to make a particular payment in accordance with that arrangement. If the failure occurs on or before the final payment day, interest is incurred from the first day after that day. If the failure occurs after the final payment day, interest is incurred from the day after the day in respect of which the last payment was made. Subsection 8(1) of the Determination provides that section 8 applies in relation to a person who is liable to pay interest on the outstanding amount of a debt under subsection 1229A(3).

Subsection 8(2) provides that the Secretary should make a determination that interest is not payable by a person if either of two scenarios arise – firstly, if, after the **failure day** (defined at subsection 8(5) of the Determination), the person has resumed making payments in accordance with the existing arrangement or, secondly, if the person has entered into a new arrangement and is making payments in accordance with that arrangement.

Subsection 8(3) provides for the contents of a determination made in the first scenario referred to above. Paragraph 8(3)(a) provides for the date from which interest will not be payable under the determination while paragraph (b) requires the determination to specify, as a condition of the determination, that the person must continue to make payments in accordance with the existing arrangement.

According to subparagraph 8(3)(a)(i), if the person resumes payments after the day on which the person became liable to pay interest, the determination is to provide that interest is not payable on and after the day when the first payment made in accordance with the existing arrangement is received by, or on behalf of, Centrelink.

Subparagraph 8(3)(a)(ii) introduces the concept of the **liability day** (which is defined in subsection (5) of the Determination as meaning the day mentioned in paragraph 1229A(3)(d) or (e) of the Act from which a person is liable to pay interest). According to subparagraph 8(3)(a)(ii), if the first payment is received by Centrelink before the day on which the person becomes liable to pay interest (ie before the liability day), the determination is to provide that interest is not payable on and after the liability day.

Subparagraph 8(3)(a)(ii) is necessary to prevent an undesirable potential application of subsection 1229A(3) of the Act. Under paragraph 1229A(3)(d) a debtor who fails to make a payment (ie in accordance with an existing arrangement to repay a debt) on or before the final payment day is liable to pay interest from the first day after the final payment day. By definition, the final payment day cannot occur before a debt becomes due and payable.

Without subsection 8(3)(a)(ii) a debtor who:

- before the final payment day, had entered into an arrangement to pay a debt; and
- before the final payment day, failed to make a payment in accordance with that arrangement; and
- on or before the final payment day, resumed making payments under the arrangement;

would be potentially liable to pay interest from the day after the final payment day. As this outcome is not intended as it would be inequitable, subparagraph 8(3)(a)(ii) expressly removes the potential for subsection 1229A(3) to be applied with that effect.

Paragraph 8(3)(b) requires the determination to specify, as a condition of the determination, that the person must continue to make payments in accordance with the arrangement. The rationale for this approach is discussed above in reference to subsection 7(3).

Subsection 8(4) provides for the contents of a determination made in the circumstances referred to in paragraph 8(2)(b). Paragraph 8(4)(a) provides for the date from which interest will not be payable under the determination while paragraph (b) requires the determination to specify, as a condition of the determination, that the person must continue to make payments in accordance with the existing arrangement.

According to subparagraph 8(4)(a)(i), if the person makes the first payment under the new arrangement after the day on which the person became liable to pay interest, the determination is to provide that interest is not payable on and after the day when the payment is received by, or on behalf of, Centrelink. According to subparagraph 8(4)(a)(ii), if Centrelink receives the first payment before the day on which the person becomes liable to pay interest (ie before the liability day), the determination is to provide that interest is not payable on and after the liability day. The rationale behind this approach is similar to the rationale, discussed above, for subparagraph 8(3)(a)(ii).

Paragraph 8(4)(b) requires the determination to specify, as a condition of the determination, that the person must continue to make payments in accordance with the arrangement. The rationale for this approach is discussed above in reference to subsection 7(3).

Subsection 8(5) defines the terms **failure day** and **liability day**. In effect, the failure day is the day a person fails to make a payment under an arrangement entered into to pay a debt while the liability day is the day mentioned in paragraph 1229A(3)(d) or (e) of the Act from which a person is liable to pay interest.

Section 9 – Garnishee notice issued in respect of debt

Subsection 9(1) provides that section 9 applies in relation to a person who is liable to pay interest on a debt under subsection 1229A(2) or (3) of the Act.

Subsection 9(2) provides that the Secretary should determine that interest is not payable by a person in respect of a particular period if a notice has been given to another person under subsection 1233(1) which requires the other person to pay to the Commonwealth an amount under paragraph 1233(1)(f) or (g). In general terms, where a person owes or holds money on behalf of a debtor, section 1233 allows the Secretary to give the person a notice requiring him or her to pay to the Commonwealth a specified amount (or a specified percentage) out of each payment that the person becomes liable to pay to the debtor from time to time.

The purpose of subsection 9(3) is to clarify what is the period referred to in subsection 9(2) where interest will not be payable. In effect, the period is the period during which the person is liable to make payments to the debtor.

Section 10 – No capacity to pay debt

Subsection 10(1) provides that section 10 applies in relation to a person who is liable to pay interest on a debt under subsection 1229A(2) or (3) of the Act.

In part, the combined effect of subsections 1236(1) and (1A) is that the Secretary may decide to write off a debt if the debtor has no capacity to repay the debt. Significantly, the decision does not prevent subsequent recovery of the debt when the person does have the capacity to repay the debt.

The effect of subsection 10(2) is that the Secretary should determine that interest is not payable during the period that a decision under section 1236 is in force. The rationale behind this approach is that it is considered inappropriate for a person to be liable to pay interest in respect of the outstanding amount of a debt where the Secretary has decided that the person in fact lacks the capacity to repay the debt.