



Taxation Ruling

Income tax: withholding on payments to foreign residents for works and related activities

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Ruling	4
Date of effect	32
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	33
Appendix 2:	
Detailed contents list	87

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling considers what constitutes a 'payment under a contract entered into after 30 June 2004 (including payments to subcontractors) for works or related activities' for the purpose of regulation 44C of Taxation Administration Regulations 1976 (TAR 1976). In this Ruling a reference to regulations is a reference to regulations in the TAR 1976.

2. Sections 12-315 and 12-317 of Subdivision 12-FB – 'Payments to foreign residents etc' of Part 2-5 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) impose an obligation on payers to withhold an amount from certain types of payments made to foreign entities or received for foreign entities (called 'payees' in this Ruling). This Ruling provides guidance as to when an obligation to withhold an amount arises under sections 12-315 and 12-317.

3. This Ruling is only concerned with payments to which sections 12-315 and 12-317 of Schedule 1 to the TAA apply. In this Ruling and its Appendices, legislative references are references to Schedule 1 of the TAA unless otherwise indicated.

Ruling

4. For the purpose of paragraph 12-315(1)(b) a prescribed payment pursuant to regulation 44C is a payment made under a contract entered into after 30 June 2004 for works or related activities (including payments to subcontractors).

What are 'works' and 'related activities' for the purposes of regulation 44C?

5. 'Works' takes on its ordinary meaning as understood in the construction, infrastructure and resource sectors and specifically includes the construction, installation and upgrading of buildings, plant and fixtures (see the definition of 'works' in subregulation 44C(3)). That subregulation provides examples of what are considered works for the purposes of the regulation. The word 'plant' as used in the definition of 'works' in subregulation 44C(3) includes both fixed and moveable plant.

6. 'Related activities' includes any activities associated with the works including activities associated with the construction, installation and upgrading of buildings, plant and fixtures whether or not provided by the same contractor who performs the contract for works (see the definition of 'related activities' in subregulation 44C(3)). That subregulation provides examples of what are considered related activities for the purposes of the regulation.

7. The works and related activities covered by regulation 44C are restricted to those performed in Australia (including the coastal sea of Australia)¹, and as extended by section 6AA of the *Income Tax Assessment Act 1936* (ITAA 1936). In the case of related activities, this will be so regardless of whether or not the works to which the activities are related are performed in Australia. Accordingly, for the purposes of this Ruling, where the words 'works' or 'related activities' are used they should be read as only covering those activities performed in Australia.

8. Included amongst the examples of what are related activities is 'supply of plant and equipment'. This does not include supply in the sense of an acquisition of plant and equipment by the payer from the payee. Rather it includes the use of plant and equipment in undertaking the works or related activities (for example, the use of the payee's bulldozer in undertaking earthworks). The use of things (such as equipment and consumables) by the payee in carrying out the works or related activities is part of those works or activities.

9. It follows that works or related activities do not include the acquisition by the payer of goods (like plant or equipment) that are not the product of works or related activities performed in Australia.

¹ See section 15B of the *Acts Interpretation Act 1901*.

What payments are covered by regulation 44C?

10. A payment must be one for works or related activities covered by regulation 44C in order for the payment to be a prescribed payment for the purposes of paragraph 12-315(1)(b). If the payment is for something else, such as activities performed outside Australia, it is not such a prescribed payment and will not be considered to be for works or related activities. A payment can be for works or related activities even though the final product of those works or activities is an asset (for example, a completed building, fixture or item of plant).

11. Sometimes a single undissected payment under a contract may be made in respect of both works or related activities and something else. In these cases, it will be necessary to determine the extent to which the payment is for works or related activities. That portion which can reasonably be related to the works or related activities is for those works or activities and therefore a prescribed payment for the purposes of paragraph 12-315(1)(b). Any payment apportioned to works or related activities must be reasonable having regard to all relevant matters, including the value of the things provided under the works arrangement.

12. Pursuant to subregulation 44C(2), an amount of 5% is to be withheld from each payment made for works or related activities.

13. There is no requirement for a payment to be assessable income of the payee before it is subject to an FRW obligation. Rather, it is a question of whether or not the payment is for works or related activities covered by regulation 44C.

Variations and exemptions

14. To meet the special circumstances of a case or class of cases, the Commissioner may vary the amount required to be withheld, including to nil, in accordance with section 15-15. Examples of the circumstances where this may occur include where the Commissioner forms the view that a foreign entity is not required to pay tax in Australia through the operation of a tax treaty or where the tax on the expected profits is less than the amount of withholding.

15. The Commissioner may also grant a foreign entity an exemption for the purposes of paragraphs 12-315(1)(d) and 12-317(1)(d) where the foreign entity has established a history of compliance with its obligations under Australian taxation laws and in the Commissioner's opinion the entity will continue to comply with those obligations.

Examples

16. The following are examples of some of the payments that fall within the scope of the FRW legislation in so far as it applies to payments for works or related activities.

Example 1 – acquisition of major equipment with foreign involvement

17. MillCo, a resident company, contracts with an Indian firm to supply a brake press for their metal fabrication business. The contract is for one inclusive amount of \$500,000. The brake press is shipped in 3 modules which are assembled on site. The Indian firm provides technical specialists who travel to Australia to supervise and assist with the installation and commissioning of the equipment.

18. The portion of the consideration under the contract that can be related to the installation and commissioning of the equipment is a payment for works or related activities and subject to FRW of 5%. Although the contract is for the supply of an installed and commissioned asset, the works component of the payment is subject to FRW. To the extent the payment reasonably relates merely to the purchase of the three modules it is not subject to FRW. Each of the modules is not the product of works or related activities covered by regulation 44C because they are goods that are manufactured overseas.

19. Absent a variation or exemption granted by the Commissioner, FRW is payable on the works component even if the works component proves to be exempt from Australian income tax under Article 7 of the Double Taxation Agreement between India and Australia (for example, because the installation and commissioning lasts for less than six months²). In such a case, the FRW will subsequently be refunded to the Indian firm.³

Example 2 – chimney construction

20. Chimeree Ltd, a foreign resident chimney construction firm, is contracted by Bricked Ltd to demolish an industrial chimney and construct a new one at Bricked's premises in Australia. Chimeree is required to do all the necessary things to carry out the contracted work, including supplying materials. The contract also provides for the acquisition by Bricked from Chimeree of pollution control plant, which is manufactured overseas.

21. The demolition and construction of the chimney is works or related activities within the meaning of subregulation 44C(3). Therefore all payments by Bricked that relate to those works or activities are subject to FRW of 5%. These would include those payments that relate to the equipment, personnel and consumables used by Chimeree in undertaking the works. However, the payment that relates to the acquisition of the pollution control plant by Bricked is not a payment for works or related activities covered by regulation 44C.

² See Taxation Ruling TR 2002/5.

³ Assuming that firm has no other Australian tax commitments.

Example 3 – pipeline installation

22. Drillco, an Australian resident, is developing an off shore oil and gas reserve. It has installed a platform and is connecting the wellhead to onshore receivable facilities. Drillco contracts a foreign resident, SeaSub, to monitor and assist Pipesco (an Australian resident) who is laying the pipeline on the sea bed. Under the arrangement SeaSub provides the use of remote operated submarines, diving equipment and related services. SeaSub provides the use of the equipment under one contract for \$5 million and personnel under another contract for \$7.9 million.

23. The pipeline construction is works as defined and assistance with and monitoring of that construction is a related activity. Consequently all payments made under both contracts, for \$5 million and \$7.9 million, are prescribed payments within regulation 44C and therefore subject to FRW of 5%.

Example 4 – smelter construction

24. MineCo, an Australian resident, has decided to undertake down stream processing of its ore. It contracts with an Australian project manager SmelCo to construct a smelter. The contract requires separate payments for goods, equipment, construction and commissioning. SmelCo enters into a contract to purchase a furnace from a German supplier – a purchase of goods. SmelCo then imports and installs the furnace.

25. The smelter construction is works as defined in regulation 44C. However, the payment by MineCo is to an Australian resident and therefore no withholding obligation arises under section 12-315.

26. Note – the payment by SmelCo to the foreign resident for the mere supply of the furnace in the way described above is not for works. It is a made under a contract between the two entities for the purchase of goods and is therefore not a prescribed payment. SmelCo, an Australian resident, undertakes the installation of the furnace.

Example 5 – road design

27. RoadCo Ltd is constructing a new highway to the resort NoWhere for \$250 million. RoadCo engages RevHead Ltd, an Australian firm, to supply the engineering design and supervision work for \$12 million. RevHead subcontracts a German firm SpeedierCo to design the bridging works for the highway for \$3 million. Employees of SpeedierCo come to Australia and inspect the site and return to Germany. The employees return at regular intervals for short periods to Australia to confirm testing of soils and other design parameters. However all the plans and drawings are produced in Germany and then transmitted to RevHead.

28. The activities performed in Australia by SpeedierCo on the bridging design work are related activities. However, only the portion of the payment to SpeedierCo that relates to those activities performed in Australia is subject to FRW of 5%.

29. SpeedierCo requests a variation to nil on the basis that there are no business profits or other activity which would give rise to taxation in Australia. RevHead offers to lodge a request for variation to a Nil withholding amount on SpeedierCo's behalf. On the basis of the particular circumstances of SpeedierCo, the Commissioner agrees and issues a notice varying the amount required to be withheld by RevHead from payments made to SpeedierCo to Nil.

Example 6 – exploration activities

30. JumpOnCo (JOC) is an Australian gold explorer which holds Australian exploration licences. JOC contracts with a foreign resident, Sensor, to conduct flights to collect and analyse electronic data recorded over the exploration areas. There is no FRW obligation in respect of payments to Sensor as Sensor's activities are not associated with the construction, installation or upgrading of buildings, plant or fixtures or any other works.

31. Following the collection of data, JOC decides to undertake further appraisal of the exploration area by drilling for core samples of the earth. It contracts with another foreign resident, SamplerCo, to drill for core samples. There is no FRW obligation in respect of payments to SamplerCo as SamplerCo's activities are also not associated with the construction, installation or upgrading of buildings, plant or fixtures or any other works.

Date of effect

32. Subject to one exception, this Ruling applies to payments made or received on or after 1 July 2004 under a contract entered into after 30 June 2004.⁴ The exception is where an FRW obligation arises for payments made under the views set out in this Ruling where no such obligation would have arisen under the views expressed in the draft of this Ruling which issued on 15 March 2006 (TR 2006/D3). For these payments, the obligation to withhold only applies from the date of issue of this Ruling. However, the final Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the final Ruling.

Commissioner of Taxation

18 October 2006

⁴ Note that regulation 44C applies to payments made or received on or after 1 July 2004 under a contract entered into after 30 June 2004 (see item 4 of the Taxation Administration Amendment Regulations 2004 (No. 1) and subregulation 44C(1)).

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Policy context

33. The FRW regime is a compliance mechanism which broadly aims to ensure that the withheld moneys approximate the tax liability of the payee. In the event that an entity fails to lodge a tax return, the proper collection of the income tax revenue is facilitated to the extent of the withholding. The payee's obligation to lodge a tax return for the year of income is not negated by the Pay As You Go (PAYG) withholding provisions. Further, the annual reporting of the regulated payments will facilitate the collection of complete and up to date information on foreign resident taxpayers which will enable the Tax Office to better support this group in meeting their tax obligations.

Legislative background

34. Part 2-5 sets out the PAYG withholding provisions. The PAYG withholding provisions are a way for amounts to be collected in respect of particular kinds of payments or transactions. The PAYG provisions impose an obligation to withhold, but do not impose or determine liability to income tax. Amounts withheld are remitted to the Commissioner, by the payer, to meet the payee's tax obligations. The payee is entitled to a credit under Subdivision 18-A of Part 2-5 for the withheld amounts. These amounts are then applied (credited) against the payee's tax liability under Division 3 of Part IIB of the TAA and any excess is then refunded in accordance with Division 3A of Part IIB of the TAA.

35. The PAYG provisions create the obligation on an entity to withhold from certain payments made by the entity by reference to the payment. The provisions also define the scope of the withholding arrangements including the remitting and reporting obligations of the payer.

36. The withholding obligation is separate from the liability to taxation and relies on an objective test of whether a payment meets the tests described in Part 2-5. A summary of all the withholding payments is found in section 10-5. The FRW provisions are listed in the table in subsection 10-5(1) at items 22B and 22C and are found in Subdivision 12-FB.

37. Section 12-5 provides a mechanism to prevent any duplication of withholding obligations if more than one withholding provision applies to a payment.

38. A variation to the amount required to be withheld is provided for under section 15-15. The Commissioner may vary the amount required to be withheld including to nil in a particular case or class of cases to meet the special circumstances of taxpayers. These special circumstances will include where it is agreed, after consideration of the facts provided to the Commissioner, that there are no taxing rights over the payment.

Obligation to withhold under FRW rules

39. The obligation to withhold an amount from a payment is imposed by sections 12-315 and 12-317. In accordance with section 12-315:⁵

- (1) An entity (the **payer**) that *carries on an *enterprise must withhold an amount from a payment it makes to another entity, or to other entities jointly, in the course or furtherance of the enterprise if:
 - (a) the entity receiving the payment, or any of the entities receiving the payment, is an entity covered by subsection (2); and
 - (b) the payment is of a kind set out in the regulations; and
 - (c) the payment is not:
 - (i) a *dividend of a company; or
 - (ii) interest (within the meaning of Division 11A of Part III of the *Income Tax Assessment Act 1936*); or
 - (iii) a *royalty; or
 - (iv) a departing Australia superannuation payment (within the meaning of Subdivision AA of Division 2 of Part III of the *Income Tax Assessment Act 1936*); or
 - (v) a payment worked out wholly or partly by reference to the value or quantity of *natural resources produced or recovered in Australia; or
 - (vi) a *mining payment; and
 - (d) the entity receiving the payment is not covered by an exemption in force under subsection 12-319(1), or at least one of the entities receiving the payment is not covered by an exemption in force under that subsection.

⁵ Note: Asterisks are used to identify defined terms (see section 950-100 *Income Tax Assessment Act 1997* – incorporated by section 3AA of the TAA).

- (2) An entity is covered by this subsection if any of the following conditions is satisfied:
 - (a) the entity is a foreign resident;
 - (b) the payer believes, or has reasonable grounds to believe, that the entity is a foreign resident;
 - (c) the payer has no reasonable grounds to believe that the entity is an Australian resident, and either:
 - (i) the entity has an address outside Australia (according to any record that is in the payer's possession, or is kept or maintained on the payer's behalf, about the transaction to which the payment relates); or
 - (ii) the payer is authorised to make the payment at a place outside Australia (whether to the entity or to anyone else);
 - (d) the entity has a connection outside Australia of a kind set out in the regulations.
- (3) Before the Governor-General makes a regulation for the purposes of paragraph (1)(b), the Minister must be satisfied that each payment set out in the regulation is a payment of a kind that could reasonably be related to assessable income of foreign residents.

40. Broadly, an entity carrying on an enterprise whether a resident or a foreign resident must withhold on a payment when it is made to a foreign resident and the payment is of a kind set out in the regulations. Withholding is not required under the foreign resident withholding provisions on payments which are defined above as dividends, interest, royalties, departing superannuation payments, payments calculated on the value or quantity of natural resources or for mining payments. These types of payments are subject to withholding under other provisions. An entity receiving the payment may also be covered by an exemption from withholding given by the Commissioner (see section 12-319).

PAYG – Administration

41. The PAYG withholding provisions also provide the administrative framework for the FRW provisions. For example, a payer is required to issue a payment summary to payees and report amounts withheld on their activity statement, pursuant to sections 16-155 and 16-150 respectively. Further a withholding entity must apply to register with the Commissioner when the entity is first required to withhold an amount from a payment pursuant to section 16-140 and provide an annual payment report to the Commissioner – section 16-153. (Further guidance on withholding obligations can be obtained from various PAYG and FRW publications on ato.gov.au).

PAYG – Penalties

42. A payer is liable to a penalty which is equal to the amount not withheld (see sections 16-25 and 16-30). The general interest charge (GIC) also applies. Penalties and the offence provisions also apply for failing to comply with the various administrative requirements for PAYG amounts, some of which are described in the above paragraph. (Practice Statement PS LA 2003/11 explains the Commissioner's views in this area of the law.)

Foreign resident

43. 'Foreign resident' is defined in section 995-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) as follows:

foreign resident means a person who is not a resident of Australia for the purposes of the *Income Tax Assessment Act 1936*.

44. This definition applies to Schedule 1 by virtue of subsection 3AA(2) of the TAA.

45. The question of who is a resident of Australia is dealt with extensively in other tax rulings such as TR 98/17, IT 2615, IT 2650, and IT 2681. Where the entity receiving the payment is known by the payer to be a foreign resident the payer must withhold an amount from certain payments. The payer must also withhold on certain payments if:

- the payer believes or has reasonable grounds to believe that the entity is a foreign resident;
- the payer has no reasonable grounds to believe that the entity is an Australian resident and the entity has an address outside Australia according to any record in the payer's possession or the transaction or the payment is authorised to be made to a place outside Australia; or
- the entity has a prescribed connection outside Australia.

46. The practical effect of these provisions is that if there are no reasonable grounds to believe that the recipient is an Australian resident, and the amount is to be paid outside Australia, or the recipient has a foreign address, withholding will be required – see paragraph 5.18 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 4) 2003.

47. The legislation is drafted on the basis that payers, unlike taxpayers or the Commissioner, will not necessarily have information relevant to the determination of a payee's residency status. The payer acting only from information and knowledge within its possession, should be able to determine whether the payment is of the kind that is prescribed. Inherent in this approach is the possibility that either the person might not be a foreign resident, or might not be liable to income tax.

48. The question of what factors would give rise to a belief that an entity was a foreign resident are objective. If the payer believes that the payee is a foreign resident, then an obligation to withhold arises. Associated with this test is a purposive and positive test of whether the payer has facts which would reasonably give rise to a belief that the payer was a foreign resident. This second limb of the test negates the argument that a lack of complete certainty about the residency status of a payee relieves the payer from a withholding obligation.

49. Guidance on evidence which would go to establishing that a payer has reasonable grounds to form an opinion that a person is a foreign resident will depend on the facts of the case. Relevant factors could be place of formation of the entity, representations and warranties given by the payee, the origin of correspondence, location of contract signing, industry knowledge, reports, public commentary, accounts, professional advice and other matters peculiar to the arrangement.

Regulation 44C

50. The regulation imposing withholding on payments for works or related activities reads as follows:

44C Construction and related activities

(1) For paragraph 12-315(1)(b) of Schedule 1 to the Act, payment under a contract entered into after 30 June 2004 (including payments to subcontractors) for works or related activities is prescribed.

(2) For subsection 15-10(2) of Schedule 1 to the Act, the amount to be withheld from a payment mentioned in subregulation (1) is 5% of each payment under a contract.

(3) In this regulation:

related activities includes activities associated with the construction, installation and upgrading of buildings, plant and fixtures.

Examples

Administration, assembly, de-commissioning plant, design, commissioning and operation of facilities, costing, engineering, erection, fabrication, hook-up, installation, project management, site management, supervision and provision of personnel, supply of plant and equipment, warranty repairs.

works includes the construction, installation and upgrading of buildings, plant and fixtures.

Examples

Dam, electricity links, mine site development, natural gas field development, natural resource infrastructure, oilfield development, pipeline, power generation infrastructure, railway or road, residential building, resort development, retail or commercial development, upgrading airport, upgrading telecommunications equipment, water treatment plant.

What are 'works'?

51. 'Works' are defined in subregulation 44C(3) to include the construction, installation, and upgrading of buildings, plant and fixtures. The word 'including' indicates that this is not an exhaustive list of activities which constitute works for the purposes of regulation 44C. As outlined in the Explanatory Statement to the Taxation Administration Amendment Regulations 2004 (No. 1) we must also look to the ordinary meaning of the word as understood in the construction, infrastructure and resource sectors along with ordinary retail and commercial developments. In accordance with the Explanatory Statement this is:

broadly the activity of creating or altering a physical asset such as a building or structure, changing the form of the earth such as earthworks, or a combination of these activities.

The Butterworth's Australian Legal Dictionary⁶ defines 'works' as:

the construction, alteration, repair, refurbishment, or fitting out of buildings, other structures, and equipment designed to be used in the provision of services.

52. Implicit in the definition is the notion that a payment for 'works' involves, in whole or in part, the performance or exercise of skill and labour and the use of things by the payee in carrying out the works or related activities (like plant, equipment and consumables).

53. The inclusion of the words 'installation and upgrading' in the definition points to activities in addition to the construction of primary structures. For example, substantial installation, assembly or commissioning of plant or machinery to make it useable will be works – or may be related to wider works activity. Clearly work on existing structures is also included.

54. The examples provided under the definition of 'works' further exemplify the breadth of activity. Whilst focussed on larger infrastructure and natural resource projects, all construction projects whether, for example, an office building, a resort construction, amusement park, shopping centre or a residential house would answer the description of works potentially subject to FRW.

⁶ Butterworths Australian Legal Dictionary, 1997, Butterworths, at page 1,276.

Platforms and other moveable plant

55. Similarly regulation 44C extends to works in relation to moveable property or plant. The use in the definition of works of the word 'plant' in addition to 'buildings' and 'fixtures' indicates that plant was not intended to be limited to fixed plant. So, for example, the construction, installation or upgrading of oil platforms, offshore storage facilities, rigs and other substantial equipment, whether moveable or fixed, will answer the description of 'works' as fixtures or plant involving installation and other construction activity.⁷

What are 'related activities'?

56. From the definition and the examples provided in regulation 44C, related activities will include all activities associated with works, in effect which enable or are necessary to the works undertaken. If works are being undertaken by an entity, any activities undertaken by the entity that are in any way related to those works will be included within the meaning of related activities.

57. The examples in regulation 44C of related activities include 'supply of plant and equipment' related to works. This example refers to the use of plant and equipment in undertaking works (Example 3 in the Ruling section illustrates this point). The context of the examples of related activities indicates that the things set out as examples are intended to cover things done or used in the context of carrying out works, rather than the simple acquisition by the payer of plant and equipment.

Repairs and maintenance

58. Repairs and maintenance do not normally answer the description of works and nor will they be related activities unless referable to the works, for example warranty repairs. However, analogous with the distinction between repairs and improvements, there will be a point where the scale and nature of the activity will amount to 'works' being installation, upgrading or rebuilding.

⁷ The Administrative Appeals Tribunal in considering whether a drill ship was an oil rig as defined in paragraph 35 of the *Fringe Benefits Tax Assessment Act 1986*, said: 'It is therefore unnecessary to consider whether, in any event, the MODU in question is within the description of "or other petroleum or gas installation" in s 30(2)(b). However, the Tribunal finds as fact that because the MODU was anchored to the site for a period of about six months, it was installed there. An installation does not imply permanence; it can be temporary. *The Macquarie Dictionary* defines installation as "1. something installed. 2. a system of machinery or apparatus placed in position for use", and install as "1. to place in position for service or use,...". The MODU, in relative terms, was temporary during its use in situ – it would always leave that site when its contract was completed. But that does not deny it the quality of being an "installation".' *Case 54/95 95 ATC 447*.

Exploration in the resources industry

59. The various activities which take place in the course of exploration for resources (such as minerals) will need to be tested against the definitions and ordinary meaning attaching to 'works' and 'related activities' (that is, are the activities of themselves works or associated with works?). Prospecting activities such as drilling and seismic work would not of themselves form 'related activities'. Example 6 in the Ruling section illustrates this point.

Works or related activities in Australia

60. Whilst it is possible for the Parliament to require withholding on payments for things done outside of Australia, in the absence of specific words or necessary implication, or extrinsic materials advancing that outcome in the regulations, the Commissioner considers that regulation 44C will only apply to works or related activities performed in Australia (including the coastal sea of Australia), and as extended by section 6AA of the ITAA 1936.

61. Subsection 12-315(3) indicates that the payments prescribed in the regulations are intended to be those that can reasonably be related to the assessable income of foreign residents⁸. This supports the conclusion that payments for works or related activities performed outside Australia by foreign residents were not intended to be within the scope of the regulation, since it is unlikely that such payments would be Australian assessable income.

62. Section 6AA of the ITAA 1936 applies for the purposes of the FRW provisions in Schedule 1 of the TAA by virtue of the definition of 'this Act' in subsection 6(1) of the ITAA 1936. For this reason section 6AA would apply for the purposes of regulations made under the FRW provisions. Furthermore, given that the FRW provisions exist to enhance the collection of income tax, the Commissioner considers that the context of regulation 44C requires the application of that extended definition of Australia in the interpretation of works or related activities covered by the regulation.

Payments for works or related activities are covered

63. The use of the language 'payment...for works or related activities' in subregulation 44C(1) indicates that the test so created is one of nexus. Therefore a payment will be covered when it is made for the provision of works or related activities.

⁸ Which is not to say that payments are only covered by the regulations if they are assessable income (see paragraphs 69 to 73 of this Ruling).

64. The formulation of the words 'payment... *for* works or related activities' might be thought to imply that a single undissected payment for more than one thing would, in applying regulation 44C, need to be characterised either as one for works or related activities or as one for something else. However, whilst the regulation does not talk about payments 'to the extent' that they are for works or related activities, the Commissioner considers that in the context of regulation 44C the word 'for' relates the payment to the works or related activities to the extent to which the payment is directed to providing the consideration for them. This means that a single payment for both works or related activities and something else can be apportioned between those two things.

65. The context of regulation 44C requires that approach because it is essentially concerned with arrangements that produce a result (construction of buildings, plant or fixtures) by means that include, but are not necessarily limited to, works or related activities performed in Australia.

66. The grammar of regulation 44C links the 'works or related activities' to the 'payment' which is to be subject to an FRW obligation. The other words in subregulation 44C(1) describing the prescribed activities 'under a contract entered into after 30 June 2004' are preliminary in nature and simply describe payments which will be excluded from withholding by reference to the timing of the contract. That is, payments to foreign residents, even though made for works or related activities after the commencement of the regulation, will not be subject to withholding if the contract was entered into before 1 July 2004. This analysis is consistent with the way other regulations prescribe payments subject to FRW (see regulations 44A and 44B).

Meaning of 'payment'

67. The word 'payment' means the total or gross (GST inclusive) amount paid for works or related activities. GST is calculated on the price of a supply (see section 9-75 of *A New Tax System (Goods and Services Tax) Act 1999*). The price is the consideration (without any discount for the amount of GST). The payment for works or related activities forms the consideration and is the amount on which withholding is made.

68. Payment occurs and is made irrespective of whether it is paid by conventional means for example, cash, cheque, transfer, setting off an account of the payee or, as provided in section 14-5, the provision of a non cash benefit. The payment is made pursuant to section 11-5 when the amount is first applied or dealt with in any way on the payee's behalf. There is no *de minimis* test.

Payments covered are not limited to those that are assessable income

69. A possible view is that, by virtue of subsection 12-315(3), a payment is only covered by FRW if it is assessable income of the payee. The Commissioner does not accept that view.

70. Subsection 12-315(3) provides a threshold test for the making of regulations prescribing payments to be subject to FRW. Paragraph 5.27 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 4) 2003 said:

Regulations made under these provisions prescribing payments to which withholding applies can only be made where the Minister is satisfied the payment could reasonably be related to assessable income of foreign residents. This requirement relates to the nature of the payment itself, not the characterisation of the payment in the hands of a particular recipient.

71. It is clear that subsection 12-315(3) need not require the payments prescribed to be assessable income; there only need be a reasonable possibility that the payments could relate to assessable income of foreign residents as a class. Payments to foreign residents for works or related activities performed in Australia could relate to the assessable income of foreign residents.

72. This is the case even if the foreign resident considers that it may be deriving exempt income because of the operation of a tax treaty. As such payments could reasonably relate to assessable income, they are subject to FRW if they are for works or related activities. This is made clear in paragraph 5.49 of the Explanatory Memorandum to the *Taxation Laws Amendment Bill (No. 4) 2003*, which states that the variation system (discussed at paragraph 78 of this Ruling onwards) should be used in such circumstances if the payer and payee wish to be relieved of their FRW obligations.

73. Structuring the FRW obligation to withhold in this way ensures that a withholder is not required to be aware of the particular circumstances of a payee that are relevant to whether a particular payment would be assessable income to that payee. The legislation simply asks whether there is a payment to a foreign resident, and then whether it is a prescribed payment. The payments covered by regulation 44C are intended to approximate, but not necessarily align completely with, payments that would be included in a foreign resident's assessable income.

Intermediaries and agents

74. Broadly a person who receives a prescribed payment on behalf of a foreign resident as outlined in subsection 12-315(2), or where such a foreign resident is or becomes entitled to receive or have the payment dealt with on their behalf, the Australian agent or intermediary must withhold from that payment on receipt of the moneys or at the point entitlement to the moneys arises in accordance with section 12-317. This provision ensures an obligation to withhold arises in agency arrangements or where there is an Australian intermediary for one or more foreign residents.

75. Where the original payer or a previous intermediary has already withheld an amount the subsequent withholding obligation is reduced by the amounts already withheld from the payment pursuant to regulation 44D.

Withholding rate

76. Pursuant to subsection 15-10(2), the rate of withholding is determined in accordance with subregulation 44C(2). The rate of withholding is set at 5% of each prescribed payment made. However, provision exists for the Commissioner to either vary the rate of withholding, including to nil, in accordance with section 15-15 or to provide an exemption from the FRW obligations pursuant to section 12-319.

77. The rate of withholding on the gross payment takes into account expenses and profit margins typical of industry involved in construction and related activities and consequently is designed to broadly equate with the corporate rate of tax payable on the net taxable income derived from construction and related activities. Inherent in the rate is allowance for the expenses of performing the contract.

Variations

78. The variation mechanism is provided in the legislation to adjust the withholding amounts for payments to reflect underlying tax outcomes. The Commissioner can vary the amount required to be withheld including to a nil amount to meet the special circumstances of a particular case or class of cases. A variation must be a written notice given by the Commissioner to the entity or published in the Gazette if it applies for a class of entities in accordance with subsection 15-15(3).

79. Law Administration Practice Statement PS LA 2006/10 sets out the Commissioner's practice and procedure for FRW variations. Paragraphs 31 to 45 of that Practice Statement set out the requirements for processing a FRW variation application.

80. Where a variation is sought the Commissioner, in accordance with the policy objective of the measure, seeks to ensure that the total withholding amount for the income year approximates the payee entity's likely final income tax liability for the year of income. Consequently, this will ensure that any amounts which are collected from the foreign resident to meet their Australian income tax obligations are kept to a minimum whilst recognising on assessment the treatment of income and deductions may be different to that claimed on the variation. It should be noted that a request for a variation can seek an increase, or a decrease, in the withholding rate.

81. A common reason for seeking a variation will be that because of the operation of a tax treaty that Australia has with another country there are no, or altered, taxing rights over the particular transaction or payment. The Commissioner must form a view on the proper interpretation of the treaty in the circumstances of the entity's case.

82. Variations can also be sought in circumstances where the amount of tax payable on the income arising from the gross payment to the foreign resident is less, or more, than the withholding amount given by the statutory rate of 5%.

Exemptions

83. The Commissioner may grant a foreign resident an exemption from FRW pursuant to section 12-319, which relieves the payer of the obligation to withhold in accordance with paragraphs 12-315(1)(d) and 12-317(1)(d). The exemption is only granted if the Commissioner is satisfied that the entity:

- has an established history of compliance with its obligations under taxation laws ('taxation laws' mean all the acts and regulations which the Commissioner administers, see section 995-1 of the *Income Tax Assessment Act 1997*⁹); and
- is likely to continue to comply with those obligations in the future.

84. The exemption is limited to the time period specified in accordance with subsection 12-319(2).

85. The Commissioner may have regard to any matters when deciding whether to grant an exemption but is specifically authorised in subsection 12-319(3) to have regard to:

- whether the entity was subject to the PAYG instalment system in the year for which exemption is sought and the previous two income years;
- the amount of any outstanding tax related liabilities currently due and payable; and
- the extent to which the entity and its associates have complied with their tax obligations in the year of income in which the exemption is proposed and the previous two income years.

86. In a practical sense the exemption is designed for those foreign entities which have an ongoing permanent presence in Australia and are compliant with their tax obligations. The Commissioner will only be able to form a view on the tax compliance of a new foreign resident if the foreign resident is in Australia long enough to satisfy all of their tax obligations. The Commissioner would expect to see all tax obligations satisfactorily discharged as a minimum to concluding that there was an established history of compliance.

⁹ This definition applies here by virtue of section 3AA of the TAA.

Appendix 2 – Detailed contents list

87. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Ruling	4
What are 'works' and 'related activities' for the purposes of regulation 44C?	5
What payments are covered by regulation 44C?	10
Variations and exemptions	14
Examples	16
<i>Example 1 – acquisition of major equipment with foreign involvement</i>	17
<i>Example 2 – chimney construction</i>	20
<i>Example 3 – pipeline installation</i>	22
<i>Example 4 – smelter construction</i>	24
<i>Example 5 – road design</i>	27
<i>Example 6 – exploration activities</i>	30
Date of effect	32
Appendix 1 – Explanation	33
Policy context	33
Legislative background	34
Obligation to withhold under FRW rules	39
PAYG – Administration	41
PAYG – Penalties	42
Foreign resident	43
Regulation 44C	50
What are 'works'?	51
<i>Platforms and other moveable plant</i>	55
What are 'related activities'?	56
Repairs and maintenance	58
Exploration in the resources industry	59
Works or related activities in Australia	60
Payments for works or related activities are covered	63
Meaning of 'payment'	67

TR 2006/12

Payments covered are not limited to those that are assessable income	69
Intermediaries and agents	74
Withholding rate	76
Variations	78
Exemptions	83
Appendix 2 – Detailed contents list	87

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Previous draft:

TR 2006/D3

Related Rulings/Determinations:

TR 98/17; TR 2002/5; IT 2615;
IT 2650; IT 2681

Subject references:

- buildings, plant and fixtures
- construction
- contractor
- foreign resident
- foreign Resident Withholding
- FRW
- installation
- PAYG
- payment under a contract
- related activities
- subcontractors
- supplies
- withholding
- works
- works and related activities

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