TR 2003/D7 - Income tax: Pay As You Go (PAYG) Withholding - Payments made by trustees under the Bankruptcy Act 1966 to former employees

This cover sheet is provided for information only. It does not form part of *TR 2003/D7 - Income tax: Pay As You Go (PAYG) Withholding - Payments made by trustees under the Bankruptcy Act 1966 to former employees*

This document has been finalised by TR 2003/15.

Generated on: 28 November 2026, 05:21:54 AM

Draft Taxation Ruling
Income tax: Pay As You Go (PAYG) Withholding – Payments made by trustees under the Bankruptcy Act 1966 to former employees

Contents	Para
What this Ruling is about	**1**
Date of effect	**9**
Ruling	**10**
Explanation	**15**
Alternative view	**35**
Examples	**40**
Your comments	**42**
Detailed contents list	**43**

Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the ***Taxation Administration Act 1953****. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office.*

What this Ruling is about

1. This Ruling provides guidance as to whether an amount is required to be withheld, under sections 12-35, 12-85 and 12-90 of Part 2-5 (the PAYG provisions) in Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953), from a payment made to a former employee of the debtor by a trustee under the *Bankruptcy Act 1966* (Bankruptcy Act). Section 12-35 deals with payments of salary, wages, commission, bonuses or allowances paid to employees, section 12-85 deals with eligible termination payments, and section 12-90 deals with payments for unused leave. These sections place an obligation on the paying entity to withhold an amount from payments made to an individual.

2. In this Ruling, the phrase 'trustee under the Bankruptcy Act' means the trustee who holds the property or money of the debtor, or the proceeds of the debtor's property, on trust for distribution amongst the creditors.

3. Under the Bankruptcy Act, property of the bankrupt or insolvent debtor may vest in the trustee. This can occur:

- when the debtor becomes bankrupt (paragraph 58(1)(a) of the Bankruptcy Act);
- when a trustee is appointed by the creditors (section 132 of the Bankruptcy Act);
- on execution of a deed of assignment (subsection 229(1) of the Bankruptcy Act);

- under the terms of a deed of arrangement under Part X of the Bankruptcy Act; or
- under a composition under Part X of the Bankruptcy Act.

4. Where the property or money of the debtor or the proceeds of the debtor's property do not vest in the trustee, but the trustee exercises its powers in the name of the debtor (for example, under subsection 190(4) of the Bankruptcy Act a controlling trustee exercises its powers in the name of the debtor), it is the debtor which is the entity that would have any withholding obligations in respect of payments made to employees or former employees. The trustee in making payments on behalf of, or in the name of the debtor, should ensure that the debtor's PAYG withholding obligations are complied with. This Ruling does not consider the debtor's obligations in these circumstances.

5. Former employees of a bankrupt individual may prove a debt to a trustee under the Bankruptcy Act for outstanding entitlements owing to them by the bankrupt individual. The Bankruptcy Act contains provisions for the trustee to make priority payments, including priority payments to former employees of the bankrupt, in respect of amounts (up to a statutory limit) due for services rendered to the bankrupt,[1] and for amounts due for leave in respect of a period before the date of the bankruptcy.[2]

6. These statutory priorities, with certain modifications, also apply to payments made by the trustee of a deed of assignment or a deed of arrangement under Part X of the Bankruptcy Act.

7. A trustee under the Bankruptcy Act can also make non-priority payments in respect of outstanding employee entitlements. For example, where part of the outstanding salary or wages exceeds the statutory limit for a priority payment to an employee, the excess amount will rank equally with other non-priority debts. A trustee of a composition under Part X of the Bankruptcy Act does not make priority payments, but may nonetheless make a non-priority payment in respect of outstanding employee entitlements.

8. This Ruling outlines the Commissioner's view on the application of the decision in *Deputy Commissioner of Taxation v. Applied Design Development Pty Ltd (In Liq)*[3] to the PAYG withholding obligations of trustees under the Bankruptcy Act on priority and non-priority payments made to former employees of the debtor.

---

[1] Paragraph 109(1)(e) of the Bankruptcy Act.
[2] Paragraph 109(1)(g) of the Bankruptcy Act.
[3] 2002 ATC 4193; (2002) 49 ATR 196.

Date of effect

9. It is proposed that when the final Ruling is issued, it will apply to relevant payments made on or after the commencement of the PAYG withholding system on 1 July 2000. 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 (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Ruling

Payments to employees – section 12-35

10. Section 12-35 in Schedule 1 to the TAA 1953 only applies to payments made to individuals in their capacity as an employee. For section 12-35 to apply, the individual does not have to be an employee of the entity making the payment, nor does the employment relationship necessarily have to exist at the time of payment. The essential element is the character of the payment and not the identity or capacity of the entity making the payment.

11. Where a trustee under the Bankruptcy Act (the payer) makes a payment to an individual in respect of a provable debt for salary, wages, commissions, bonuses or allowances, the trustee has a PAYG withholding obligation. Such a payment, although paid under the statutory provisions of the Bankruptcy Act, retains its character as salary or wages for PAYG withholding purposes. This is because the consideration for the payment was the services the former employee rendered to the employer prior to the bankruptcy occurring.[4] A trustee is required to withhold an amount from such a payment in accordance with section 12-35 of Schedule 1 to the TAA 1953 and to pay the withheld amounts to the Commissioner under section 16-70 in Schedule 1 to the TAA 1953.

Payments for unused annual leave and long service leave – section 12-90 and eligible termination payments – section 12-85

12. Where a trustee under the Bankruptcy Act makes other payments in respect of provable debts for unpaid entitlements of former employees, these payments also retain their underlying character.

---

[4] *Deputy Commissioner of Taxation v. Applied Design and Development Pty Ltd (In Liq)* 2002 ATC 4193 at 4198; (2002) 49 ATR 196 at 202.

13. Accordingly, the trustee has an obligation under section 12-90 in Schedule 1 to the TAA 1953 to withhold an amount from payments it makes in respect of debts for unused annual leave and unused long service leave entitlements in consequence of retirement or termination of employment where the amount of the payment is assessable to the former employee under section 26AC or 26AD of the *Income Tax Assessment Act 1936* (ITAA 1936).

14. Similarly, the trustee under the Bankruptcy Act is required to withhold an amount, in accordance with section 12-85 in Schedule 1 to the TAA 1953, from a payment it makes to a former employee of the debtor in respect of a provable debt for an eligible termination payment.[5]

Explanation

Payments to employees - section 12-35

15. For an entity to be required to withhold an amount under section 12-35 in Schedule 1 to the TAA 1953, there must be:

- a payment made by the 'entity';
- the payment must be made to an individual as an employee (*whether of the payer or another entity*); and
- the payment must be a payment of salary, wages, commission, bonus or allowance.

Payment to be made by an entity

16. For the purposes of the PAYG provisions, the definition of entity takes its meaning from section 995-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).[6] Under that provision, an entity is defined by section 960-100 of the ITAA 1997 to mean an individual, body corporate, body politic, partnership, any other unincorporated association or body of persons, a trust and a superannuation fund. The trustee of a trust or superannuation fund is also taken to be an entity.

17. Where the property or money of the debtor, or the proceeds of the debtor's property, vests in the trustee under the Bankruptcy Act, the trustee is an 'entity' for the purposes of the section 12-35 in Schedule 1 to the TAA 1953.

---

[5] The term 'eligible termination payment' is defined in subsection 27A(1) of the ITAA 1936.

[6] Section 3AA(2) of the TAA 1953 provides that an expression has the same meaning in Schedule 1 as in the ITAA 1997.

Payment to an individual as an employee

18. Section 12-35 in Schedule 1 to the TAA 1953 only applies to payments made to individuals in their capacity as an employee. For section 12-35 to apply, the individual does not have to be an employee of the entity making the payment, nor does the employment relationship necessarily have to exist at the time of payment.[7] The essential element is the character of the payment and not the identity or capacity of the entity making the payment.[8]

19. Where the PAYG provisions refer to 'employees', the reference is to employees at common law. Taxation Ruling TR 2000/14 Income Tax: Pay As You Go – withholding from payments to employees, discusses the meaning of 'employee' for the purposes of section 12-35 in Schedule 1 to the TAA 1953. In the context of this ruling, an individual must have been an employee of the bankrupt individual for the provisions of section 12-35.

Payment of salary, wages, commission, bonuses or allowances.

20. As salary, wages, commission, bonuses or allowances are not defined terms in PAYG provisions they take their ordinary meaning. At common law, salary or wages denotes money payable to an individual for work or services.[9]

21. When a trustee makes a payment under the provisions of the Bankruptcy Act to a former employee who has a provable debt for unpaid salary, wages, commission, bonuses or allowances, it is necessary to establish whether the payment retains its character as a payment of salary, wages, commission, bonuses or allowances.

Payment retains its character

22. In *Deputy Commissioner of Taxation v. Applied Design Development Pty Ltd (In Liq)*[10] it was held that a priority payment, made under paragraph 556(1)(e) of the *Corporations Act 2001* (Corporations Act) to an employee who had proved a debt for wages, retained its character as salary or wages for the purposes of section

---

[7] *Deputy Commissioner of Taxation v. Applied Design and Development Pty Ltd (In Liq)* 2002 ATC 4193 at 4199; 2002 49 ATR 196 at 204.

[8] *Deputy Commissioner of Taxation v. Applied Design and Development Pty Ltd (In Liq)* 2002 ATC 4193 at 4199; (2002) 49 ATR 196 at 203.

[9] *Commissioner of Pay-roll Tax (Vic) v. Reserve Bank of Australia* 86 ATC 4373 at 4379; (1987) 17 ATR 678 at 685.
Terry Shields Pty Ltd v. Commissioner of Pay-roll Tax (NSW) 89 ATC 4674 at 4677; (1989) 20 ATR 901 at 904.
Deputy Commissioner of Taxation v. Applied Design Development Pty Ltd (In Liq) 2002 ATC 4193 at 4195; (2002) 49 ATR 196 at 198-199.

[10] 2002 ATC 4193; (2002) 49 ATR 196.

12-35 in Schedule 1 to the TAA 1953. It was found that the consideration for the payment was the services rendered by the former employee to the company before its liquidation. The nature of the payment remained unaltered by the liquidation process. It was also found that the payment was made to the taxpayer in his capacity as an employee as required by section 12-35 notwithstanding that he was also a creditor of the respondent.

23. Mansfield J looked to the fact that the consideration for the payment was services rendered by the individual to the company in liquidation as the factor that would lead to its characterisation. His Honour said:

> Nothing turns in the present case on the fact the payment was made to [the former employee] by way of a dividend pursuant to his statutory right to receive it. The consideration for the payment was the services [the former employee] rendered to the company prior to its liquidation. But for that consideration, the proof of debt lodged by [the former employee] would not have been admitted to rank as a liability... It is that consideration that leads to the characterisation of the payment as a payment in the nature of salary and wages. The nature of that consideration is not only unaltered by the winding up process under the Corporations Law, but expressly acknowledged as the criterion under which [the former employee's] entitlement to the priority payment under s556(1)(e) arose. The priority accorded to [the former employee's] debt was because his debt constituted wages…payable by the respondent in respect of services rendered by him as an employee to the respondent.[11]

24. In making a priority payment under paragraph 556(1)(e) of the Corporations Act in relation to a debt for wages, the liquidator applies the property of the company in discharging the company's liability. However, in the case of a bankrupt, the bankrupt's property vests in the trustee for distribution among the creditors of the bankrupt. While there is that difference, a parallel can be drawn with the decision in *Deputy Commissioner of Taxation v. Applied Design Development Pty Ltd (In Liq)* in the circumstances where a trustee makes a priority payment under paragraph 109(1)(e) of the Bankruptcy Act to a former employee who has a provable debt for salary or wages:

- the consideration for the payment is the services rendered by the former employee to the debtor;
- the nature of this consideration is not altered by the process under the Bankruptcy Act even though the former employee's personal contractual right to enforce his or her debt is in effect compromised when the employer enters into bankruptcy (section 60

[11] 2002 ATC 4193 at 4198; (2002) 49 ATR 196 at 202.

Bankruptcy Act) and is replaced by a statutory right to participate in the estate of the bankrupt;

- the proof of debt lodged by the former employee is admitted to rank as a liability (section 82 Bankruptcy Act) because of that consideration; and
- the nature of that consideration is expressly acknowledged as the criterion under which the former employee's entitlement to a priority payment under paragraph 109(1)(e) of the Bankruptcy Act arises - that is, because the debt constitutes wages due to the former employee in respect of services rendered as an employee to the debtor.

25. A payment made under paragraph 109(1)(e) of the Bankruptcy Act by a trustee in bankruptcy to a former employee of the bankrupt retains its character as a payment of salary, wages, commission, bonuses or allowances paid to an individual as an employee for the purposes of section 12-35 in Schedule 1 to the TAA 1953.

26. Where a part of the salary or wages outstanding at the date of bankruptcy exceeds the amount payable to a former employee as a priority payment (as specified in Regulation 6.02 of the Bankruptcy Regulations), the excess amount ranks equally with other non-priority debts. There are also other circumstances covered by the Bankruptcy Act whereby former employees of the debtor are paid a non-priority dividend under sections 140 and 145 of the Bankruptcy Act. For example, a trustee of a deed of composition does not make a priority payment under paragraph 109(1)(e) of the Bankruptcy Act to employees, but may nonetheless make a non-priority payment to a former employee in respect of outstanding salary or wages. It follows that where a trustee makes a non-priority payment to a former employee for outstanding salary or wages, that payment would also survive the process under the Bankruptcy Act to retain its character as a payment of salary, wages, commission, etc for the purposes of section 12-35 in Schedule 1 to the TAA 1953.

Payments for unused annual leave and long service leave – section 12-90, and eligible termination payments – section 12-85

27. The Commissioner considers that the reasoning in *Deputy Commissioner of Taxation v. Applied Design Development Pty Ltd (In Liq)* in finding that the character of salary and wages survive the insolvency process is broad enough to apply equally to other payments representing unpaid entitlements of employees.

Unused leave – section 12-90

28. Section 12-90 in Schedule 1 to the TAA 1953 states:

> An entity must withhold an amount from a payment it makes to an individual if the payment is included in the individual's assessable income under:
>
> (a) section 26AC (payment for unused annual leave); or
>
> (b) section 26AD (payment for unused long service leave);
>
> of the Income Tax Assessment Act 1936.

29. The wording of this provision can be differentiated from section 12-35 in Schedule 1 to the TAA 1953 in that it does not rely on an individual receiving the payment 'as an employee'. Rather it relies on the nature of the payment in the hand of the recipient as assessable income under sections 26AC or 26AD of the ITAA 1936.

30. Section 26AC of the ITAA 1936 includes in an individual's assessable income amounts received in consequence of the retirement or termination of employment of that individual from any office or employment in respect of unused annual leave. Section 26AD of the ITAA 1936 includes in an individual's assessable income amounts received in consequence of the retirement or termination of employment of that individual from any office or employment in respect of unused long service leave. Where an amount is assessable income to an individual under these provisions, section 12-90 in Schedule 1 to the TAA 1953 requires a payer to withhold a PAYG amount.

31. To the extent a payment by the trustee to a former employee is in respect of a provable debt for unused annual or long service leave entitlements in consequence of the retirement or termination of employment, the payment retains that underlying character. The amount is assessable income to the former employee under section 26AC or 26AD of the ITAA 1936. Accordingly, a trustee under the Bankruptcy Act is required to withhold an amount from such payments in accordance with section 12-90 in Schedule 1 to the TAA 1953.

Eligible termination payments – section 12-85

32. Section 12-85 in Schedule 1 to the TAA 1953 requires an entity to withhold an amount from an eligible termination payment it makes to an individual. Eligible termination payments are certain payments made in consequence of the termination of any employment and are defined in subsection 27A(1) of the ITAA 1936.

33. Where a former employee's entitlement to a termination payment arises as a consequence of the termination of employment, there is a sufficient causal connection with the termination of employment, even though the amount is paid by a trustee under the statutory provisions of the Bankruptcy Act. The payment retains its character as being in consequence of the termination of employment.

34. Accordingly, a trustee under the Bankruptcy Act is required to withhold an amount, under section 12-85 in Schedule 1 to the TAA 1953, from payments it makes to any former employee in respect of a provable debt for an eligible termination payment.

Alternative view

35. An alternative view is that trustees under the Bankruptcy Act are not required to withhold amounts from payments to former employees of the debtor. Under this view, a payment by a trustee under the Bankruptcy Act is claimed to be a dividend to meet a debt owed to a creditor, and is not a payment made by an employer to an employee of salary or wages or of other unpaid entitlements of the former employee. This view relies on the decision in *Re Johnson and anor; Ex parte Law*[12] (*Re Johnson*).

36. This case determined that a trustee under a deed of arrangement under the Bankruptcy Act was not required to make deductions under the former Pay As You Earn (PAYE) provisions of the ITAA 1936 from payments made to persons proving for wages owing by the debtor prior to the deed of arrangement. The former PAYE provisions required employers to make tax instalment deductions from salary or wages paid to employees. Under section 221A of ITAA 1936 'employer' was defined to mean a person who pays or is liable to pay any salary or wages; and 'employee' was defined to mean a person who receives, or is entitled to receive, salary or wages.

37. The emphasis in *Re Johnson* was on the lack of an employer/employee relationship between the trustee and the creditor receiving the payment. However, more recently there have been a number of cases that have held that at common law and under subsection 221A (1) of ITAA 1936, 'salary or wages' may be payable

[12] (1946) 14 ABC 43; 8 ATD 201; 3 AITR 458.

to an employee by a person who, at common law, is not the employer of the employee.[13]

38. This later interpretation under the case law is now reflected in the current PAYG Withholding provisions that apply to payments made after 30 June 2000. The current PAYG system requires withholding under section 12-35 in Schedule 1 to TAA 1953 from payments of salary or wages made to an individual as an employee (*whether of the payer or another entity*).

39. The emphasis is on the character of the payment, and it is quite clear that the payer does not need to be the common law employer of the employee. Therefore, it is not considered that the decision in *Re Johnson* can be relied upon as support for a contention that withholding is not required where the trustee is not the common law employer.

Examples

40. On 15 March 2002, John entered into official bankruptcy. At the date of bankruptcy, John owed Sam, an employee, outstanding wages in the sum of $1,500. In consequence of the termination of his employment, Sam also had an entitlement to a payment for unused annual leave of 2 weeks. On 1 April 2002, Sam lodged with the official trustee in bankruptcy a proof of debt for the wages outstanding in the sum of $1,500 and unused annual leave in the sum of $1,000. On 15 April the proof of debt was admitted by the trustee in bankruptcy. On 10 May 2002, the trustee in bankruptcy declared a dividend in the amount of $2,500 payable to Sam. The payment is to be made pursuant to paragraphs 109(1)(e) and 109(1)(g) of the Bankruptcy Act.

41. The trustee in bankruptcy is required to withhold a PAYG amount under section 12-35 and 12-90 of Schedule 1 to the TAA 1953 from the payment made to Sam, and to pay the withheld amounts to the Commissioner (section 16-70 of Schedule 1 to the TAA 1953).

[13] *Re S&N (Nominees) Pty Ltd and the Companies Act 1981 (Cth)* (1984) 15 ATR 475, 84 ATC 4253; *Dean and McLean v. Federal Commissioner of Taxation* (1997) 37 ATR 52, 97 ATC 4762; *Murdoch v. Commissioner of Pay-Roll Tax (Vic)* (1980) 143 CLR 629; *McDonald v. Deputy Commissioner of Taxation* (1997) 37 ATR 521, 97 ATC 5114.

Your comments

42. We invite you to comment on this draft Taxation Ruling. Please forward your comments to the contact officer by the due date.

Due date: **17 September 2003**

Contact officer: **Felicity Herbert**

E-mail address: **felicity.herbert@ato.gov.au**

Telephone: **07 321 35348**

Facsimile: **07 321 35835**

Address: **Australian Taxation Office**
Small Business PAYG
140 Creek Street
Brisbane 4000 QLD

Detailed contents list

43. Below is a detailed contents list for this draft Taxation Ruling:

Paragraph

What this Ruling is about **1**

Date of effect **9**

Ruling **10**

Payments to employees - section 12-35 10

Payments for unused annual leave and long service leave – section 12-90 and eligible termination payments – section 12-85 12

Explanation **15**

Payments to employees - section 12-35 15

Payment to be made by an entity 16

Payment to an individual as an employee 18

Payment of salary, wages, commission, bonuses or allowances 20

Payment retains its character 22

Payments for unused annual leave and long service leave – section 12-90, and eligible termination payments – section 12-85 27

Unused leave – section 12-90 28

Eligible termination payments – section 12-85 32

Alternative view **35**
Examples **40**
Your comments **42**
Detailed contents list **43**

Commissioner of Taxation
6 August 2003

Previous draft:
Not previously released as a draft

Related Rulings/Determinations:
TR 92/20; TR 2000/14

Subject references:
- PAYG withholding
- PAYG withholding payments to employees
- PAYG withholding under retirement payments, eligible termination payments & annuities category

Legislative references:
- Bankruptcy Act 1966
- Bankruptcy Act 1966 58(1)(a)
- Bankruptcy Act 1966 60
- Bankruptcy Act 1966 82
- Bankruptcy Act 1966 109(1)(e)
- Bankruptcy Act 1966 109(1)(g)
- Bankruptcy Act 1966 132
- Bankruptcy Act 1966 140
- Bankruptcy Act 1966 145
- Bankruptcy Act 1966 190(4)
- Bankruptcy Act 1966 229(1)
- Bankruptcy Act 1966 Part X
- Bankruptcy Regulation 6.02
- Corporations Act 2001 556(1)(e)
- ITAA 1936 26AC
- ITAA 1936 26AD
- ITAA 1936 27A(1)
- ITAA 1936 221A
- ITAA 1997 1
- ITAA 1997 960-100
- ITAA 1997 995-1
- TAA 1953 sch 1 12-35
- TAA 1953 sch 1 12-85
- TAA 1953 sch 1 12-90
- TAA 1953 sch 1 16-70
- TAA 1953 Pt IVAAA
- TAA 1953 3AA(2)

Case references:
- Commissioner of Pay-roll Tax (Vic) v. Reserve Bank of Australia 86 ATC 4373; (1986) 17 ATR 678
- Dean and McLean v. Federal Commissioner of Taxation (1997) 37 ATR 52, 97 ATC 4762
- Deputy Commissioner of Taxation v. Applied Design Development Pty Ltd (In Liq) 2002 ATC 4193; (2002) 49 ATR 196
- Re Johnson and anor; Ex parte Law (1946) 14 ABC 43; 8 ATD 201; 3 AITR 458
- Re S&N (Nominees) Pty Ltd and the Companies Act 1981 (Cth) (1984) 15 ATR 475, 84 ATC 4253
- Terry Shields Pty Ltd v. Commissioner of Pay-roll Tax (NSW) (1989) 17 NSWLR 493; 89 ATC 4674; (1989) 20 ATR 901
- McDonald v. Deputy Commissioner of Taxation (1997) 37 ATR 521, 97 ATC 5114
- Murdoch v. Commissioner of Pay-Roll Tax (Vic) (1980) 143 CLR 629

ATO references
NO: 2003/06005
ISSN: 1039-0731