

TR 97/D13 - Income tax: PPS deduction variation certificates

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This document has been finalised by TR 98/20.



Draft Taxation Ruling

Income tax: PPS deduction variation certificates

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What this Ruling is about

Class of person/arrangement

1. The legislation relating to the Prescribed Payments System ('PPS') is in Division 3A of Part VI of the *Income Tax Assessment Act 1936* ('ITAA'). This Ruling applies to any person who either makes or receives a payment which is subject to the PPS provisions in that Division. Provisions discussed in this Ruling are in Division 3A unless otherwise indicated.

2. This Ruling explains:

- the process for making applications for a deduction variation certificate ('variation certificate');
- how the Commissioner applies the tests in that Division in deciding whether to issue a variation certificate;
- the circumstances in which the Commissioner may revoke a variation certificate; and
- the objection and appeal rights available to a payee who is dissatisfied with a decision of the Commissioner to either grant or not grant a variation certificate.

Background

3. PPS operates to collect tax by deduction from 'prescribed payments'. A payer is required to deduct and pay to the Commissioner a percentage of a prescribed payment made to a payee.

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4. Ordinarily, the payer deducts tax from a prescribed payment at the rate of 20% (the 'ordinary percentage'). If a variation certificate number is stated on a payee declaration form and the payer reasonably believes that the certificate is in force, subsection 221YHD(3) requires the payer to deduct tax from the payment at the rate specified.

5. A payee may apply to the Commissioner under subsection 221YHP(1) for a variation certificate which allows tax to be deducted at a rate lower than the ordinary percentage. The Commissioner is required under subsection 221YHT(1) to give written notice to the payee of his decision on any such application.

6. Subsection 221YHS(1) provides that the Commissioner may revoke a variation certificate at any time. A person who is dissatisfied with a decision to either not issue or revoke a variation certificate may lodge an objection against the decision.

Date of effect

7. This Ruling applies to decisions involving the issue, failure to issue or revocation of a variation certificate, made by the Commissioner on or after the date of issue of the Ruling. However, the Ruling does not apply to payees under PPS to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraph 21 of Taxation Ruling TR 92/20).

Ruling

8. An application for a variation certificate must be made in a form approved by the Commissioner and must specify the percentage of deduction sought. The percentage must be below the ordinary percentage which is presently 20%. The percentage will be rounded to the nearest whole number.

9. The applicant must establish to the satisfaction of the Commissioner that the percentage is reasonable. In deciding whether the percentage applied for is reasonable, the Commissioner can consider only assessable income from prescribed payments and allowable deductions relevant to that income, on a 'whole year of income basis'. Income and allowable deductions relating to sources other than prescribed payments are not relevant. In respect of losses carried forward, only those referable to PPS apply to the calculation of a reasonable percentage.

10. A percentage rate in respect of partnerships and trusts is to be calculated by reference to the tax payable by the partners or beneficiaries if their respective income consisted only of the net PPS profit or loss. In the calculation, the tax free threshold will be applied to each partner or beneficiary.

11. A variation certificate remains in force until it is revoked or is superseded by a later certificate. For this reason, the estimate must, to the extent possible, be a 'reasonable estimate' of the percentage of tax payable in future years from PPS. It must not be based solely on the PPS income and expenses in one particular year without consideration of the anticipated situation for at least the next two income years.

12. Once it is established that the proposed rate of deduction is a reasonable estimate, the Commissioner examines the applicant's compliance record. A compliance record is acceptable where, during the twelve months immediately prior to the lodgment of the application, the applicant has satisfactorily complied with all Acts administered by the Commissioner. What is satisfactory depends on the facts in each case. Paragraphs 36 to 41 give further guidance on what is 'satisfactory'.

13. Where the percentage requested and the compliance history are both satisfactory, a variation certificate is issued to the applicant. The certificate is effective immediately upon issue.

14. Where the percentage requested is not acceptable (subject to satisfactory compliance), the Commissioner may advise of a percentage that will be accepted. If the Commissioner does so, and the applicant is satisfied with the percentage, the applicant does not need to make a further request.

15. Where the percentage as notified in the certificate becomes inappropriate, the certificate holder should apply, within a reasonable time, for a replacement variation certificate at a percentage which is a reasonable estimate of the percentage of tax payable from PPS. Where the Commissioner's investigations show that the percentage has become inappropriate, the certificate is revoked.

Explanations

How an application is made

16. Subsection 221YHP(1) of the ITAA provides that a person may make application for a variation certificate. The legislation defines a 'person' to include a company and a government body (subsection 221YHA(1)). A 'company' is further defined to include all bodies or associations corporate or unincorporate, but does not include

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partnerships. The definition of 'person' also includes a natural person (whether as a sole trader or a partner in a partnership), and a trustee (whether incorporated or otherwise).

17. When making an application, a person must:

- specify the percentage of deduction sought; the percentage must be less than the ordinary percentage (currently 20%); and
- provide sufficient details of expected income and deductions from prescribed activities for the Commissioner to assess whether the rate sought is appropriate.

18. Subsection 221YHP(1) states that the application must be in 'a form approved by the Commissioner for the purpose'. Pre-printed application forms are available from any branch of the Australian Taxation Office.

19. The onus is on the applicant to provide all information relevant to forming an opinion, even where that information may not be favourable to their case. The Commissioner may investigate any matters relevant to the application, whether advised by the applicant or not, and may seek extra information if necessary from any source. However, the Commissioner does not, on behalf of an applicant, search for reasons to justify the varied percentage applied for.

Percentage rate

20. The purpose of a variation certificate is to reduce the amount of tax deductions required to be made from prescribed payments so that the percentage of tax deducted approximates the percentage of tax payable by the payee solely from prescribed activities for a full income year.

21. The calculation of the percentage of tax payable may result in a whole number and fraction. In such a case, the percentage is rounded to the nearest whole number. For example, a percentage of 10.50% is rounded up to 11%, while a percentage of 10.25% is rounded down to 10%. Although there is no legislative requirement to do so, the percentage is rounded to the nearest whole number for the sake of simplicity. As the current ordinary percentage is 20%, the percentage may be any whole number in the range of nil to 19%.

Reasonable percentage

22. Paragraph 221YHP(2)(a) provides that the Commissioner shall not issue a variation certificate unless he is satisfied that the

percentage requested is a reasonable estimate of the percentage that would represent the percentage of tax payable on prescribed payment income on a whole year of income basis. A 'year of income' means either a financial year or a substituted accounting period for which tax is levied.

Whole year of income basis

23. In making reference to a whole year of income basis, the ITAA requires an estimate of the tax payable to be on the basis of an applicant operating for a full year. In many cases, a person will make an application after the start of the relevant financial year or substituted accounting period. In these cases, the percentage must reflect the estimated taxable income that an applicant is expected to earn if operating for a whole year of income.

24. This may cause a seemingly incorrect percentage for the first year to which the certificate relates. However, given the ongoing nature of a variation certificate, the Commissioner also decides the percentage for future years.

Indefinite duration of certificate

25. As the variation certificate remains in force until it is revoked or superseded, it is necessary that the estimate be a reasonable estimate of tax payable over an indefinite period. Accordingly, the estimate should not be based solely on a single year's results without consideration of the anticipated situation for at least the next two income years.

26. It is recognised that future trends may be difficult to predict. However, the estimate must consider future trends to the extent possible. Applicants should provide any evidence which is available to justify the percentage sought.

27. There may be cases where the estimate reflects the percentage of tax payable for the next two years, but the situation after that time is expected to be markedly different. In such cases, the appropriate percentage for the variation certificate would ordinarily be the percentage which reflects the situation for the next two years. If the deduction percentage becomes inappropriate in the future because of changed circumstances, the payee should apply then for a new variation certificate.

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'Reasonable estimate'

28. The words 'reasonable estimate' refer to forming an opinion on the calculation of the nominated percentage. In forming that opinion, the Commissioner examines all circumstances relevant to the PPS income of the applicant and the tax payable on that income, after taking into account relevant allowable deductions.

29. Only assessable income from prescribed payments is relevant in determining the estimate. This means that income from other sources, such as salary or wages, investment or non-PPS activity, is not an element of the calculation.

30. The percentage requested must represent the percentage of tax payable on the applicant's taxable income on a whole of income year basis, from their PPS activity alone. In calculating the taxable income, the Commissioner only considers allowable deductions related to the assessable income from prescribed payments. Expenses that relate to assessable income from sources other than prescribed payments, are not relevant in working out the estimate.

31. Only losses carried forward that have arisen from PPS activities are to be taken into account as part of the estimate. As with allowable deductions, carried forward losses from other sources are not relevant.

32. Where the losses are expected to be recouped within the next financial year, it is inappropriate to include the effect of those losses as the certificate is valid for an indefinite period.

Nil rate of deduction

33. A nil rate of deduction (0%) is reasonable only in exceptional cases. Such cases would only arise where there is a high level of expectation that there would not, in the foreseeable future, be any tax payable on prescribed payments.

34. Examples of cases where a nil deduction might be appropriate are where the applicant:

- is a company paying no income tax as its profits are paid as salary or wages to its employees or directors;
- has PPS losses to be carried forward which are not expected to be recouped against PPS profits in the next two years at least;
- is a partner in a partnership which has occasional PPS involvement such that no tax would be payable by the partners on the PPS income (i.e., if such income is below the tax free threshold of partners who are individuals);

- is an individual who has occasional PPS involvement such that no tax would be payable on the PPS income as it would be below the tax free threshold; or
- because of the high level of PPS expenses, can, on an indefinite basis justify that no tax would be payable on the PPS income.

35. A nil rate of deduction is not appropriate solely on the grounds that the trustee distributed all of the PPS income to its beneficiaries. In that case, the beneficiaries who receive distributions are entitled to a share of the PPS credits and it is the taxable position of the beneficiaries which is relevant in determining the tax payable.

Determination of 'satisfactory compliance'

36. Before the Commissioner can grant a variation certificate, the compliance history of the applicant with respect to Acts administered by the Commissioner (paragraph 221 YHP(2)(b)) must be satisfactory. The level of compliance is looked at to decide whether the collection of tax will be at risk if a variation certificate issues.

37. In looking at an applicant's history, the examination:

- (a) is limited to the compliance history of the **applicant** only;
- (b) is limited to the 12 month period immediately preceding the making of the application; and
- (c) is of the applicant's compliance record in respect of obligations under Acts administered by the Commissioner.

38. The Commissioner examines the applicant's compliance history for the 12 month period immediately before the lodgment of the application. In cases where, in the 12 month period before the application is made, the applicant is:

- a company incorporated in that period;
- a trustee of a trust settled in that period; or
- a partner in a partnership formed within that period;

the Commissioner examines the applicant's compliance during the time that the company, trust or partnership has been in existence.

39. It is the compliance of the **applicant** that is important. In the case of companies, this examination does not extend to either shareholders or directors. Where partners carry on business in partnership, the compliance of the partners is considered. Where the applicant is a trust, it is the trustee's affairs in respect of the trust that are considered. The Commissioner does not have regard to the compliance records of the beneficiaries of a trust.

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40. The Commissioner decides each case on its merits in the determination of satisfactory compliance as required by subparagraph 221YHP(2)(b). *Case W104* 89 ATC 832; *AAT Case 5395* (1989) 20 ATR 4054 dealt with a similar provision (subparagraph 221YHQ(2)(a)(iii)). The decision in that case indicates that 'satisfactory' in this context does not mean that the applicant's record must be perfect, but that the record is reasonable in the circumstances.

41. The indicators which may be taken into account by the Commissioner in deciding the issue include:

- (a) whether any income tax, sales tax or fringe benefits tax returns are outstanding and not the subject of an agreed arrangement;
- (b) whether any remittance of deductions required in respect of the PAYE, PPS or Reportable Payments System or remittance of sales tax is outstanding, and not the subject of an agreed arrangement;
- (c) whether returns or remittances of the type referred to in paragraphs (a) and (b) have been lodged in the past within agreed time frames;
- (d) whether ancillary items such as reconciliation statements and required forms have been lodged within agreed time frames;
- (e) whether there are any unpaid taxes owing to the Commissioner;
- (f) the frequency of any non-compliance;
- (g) the applicant's ability to control the cause of any non-compliance;
- (h) the applicant's efforts in reducing the effects of any non-compliance; and
- (i) the applicant's attempts to remedy the cause of any non-compliance.

Effect of decision

42. Where the Commissioner decides that the application is both reasonable in its percentage and that the applicant has a satisfactory compliance record, a variation certificate issues. Upon issue, the certificate includes a number as its variation certificate number.

43. The certificate comes into force immediately it is issued and remains in force at all times thereafter unless revoked or superseded

by another certificate. The process of revoking certificates is discussed in the section on 'Revocation' commencing at paragraph 46.

44. To enable payers to deduct the varied percentage of tax, the details of the variation certificate number and variation percentage should be included on all current and future PPS Payee Declarations lodged by the certificate holder.

45. In cases where the application for variation is refused, a notice issues advising of that decision. Paragraphs 59 to 64 explain the objection and appeal rights available to a person whose application has been refused.

Revocation

46. Once issued, a variation certificate operates indefinitely. However, such certificates may be revoked at any time by the Commissioner (subsection 221YHS(1)). This would typically occur where a certificate holder:

- fails to comply with the taxation laws;
- changes business structure;
- has a variation percentage which is inappropriate;
- ceases business; or
- is subsequently found to have made a false declaration or statement in respect of the application.

47. Paragraphs 59 to 64 outline the objection and appeal rights of a person whose variation certificate has been revoked.

Unsatisfactory compliance

48. Where the holder of a variation certificate has failed to maintain a satisfactory compliance record, the Commissioner ordinarily notifies the taxpayer and requests that the matters be rectified. If the matters are not rectified within the stipulated period or the Commissioner does not receive a reply to the request within the required time for reply, the variation certificate may be revoked without further notice.

49. Where it is not possible for the compliance issues to be rectified, the Commissioner may request further information concerning the circumstances of the non-compliance. In blatant cases of poor compliance, the Commissioner may revoke the certificate without seeking any further information.

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Change of business structure

50. The Commissioner may also revoke a certificate where the holder changes the structure of their business operations. A change of structure includes forming a new partnership, a sole trader becoming a company or creating a trust for the purposes of operating the business. In such cases, an application needs to be made by the new entity or person carrying on the business.

Inappropriate percentage

51. A revocation may also occur where the variation certificate percentage no longer reflects the current situation. This occurs most commonly where the certificate holder's percentage of tax payable on PPS income has altered markedly from the time when the existing certificate issued. Cases may also arise where carried forward losses previously used in calculating the percentage have been fully offset.

52. The certificate holder should re-apply for a variation certificate nominating a percentage which is a reasonable estimate based on the circumstances existing at the time.

Cessation of business

53. Where a holder of a certificate ceases business, the certificate is no longer necessary and should be forwarded to the ATO for revocation. An exception occurs when the holder suspends business operations for a temporary period and intends to recommence operations. In that case, the holder of the certificate has to satisfy the Commissioner of the need for the certificate to remain in force.

54. Where a variation certificate has been issued, and the business of the certificate holder is now being conducted through a different entity or structure, the certificate cannot be used by the new entity. An application for a variation certificate, if required, should be lodged by the new entity or person carrying on the business.

False declaration or statement

55. Where it is subsequently discovered that a false statement or declaration has been made in order to obtain a certificate, it is ordinarily revoked unless it can be shown that the statement would have been inconsequential to the original decision.

Effect of decision to revoke

56. Where the Commissioner decides to revoke a certificate, a written notice issues to the holder of that certificate. The holder must return the certificate to the Commissioner within 14 days after receipt of such a notice. Where a certificate holder fails to return a revoked certificate, the penalty upon conviction for such an offence is \$500.

57. The person who held a revoked variation certificate should notify payers that the certificate has been revoked where:

- the holder has previously notified the payer, in a payee declaration form, of a variation certificate number;
- the certificate was in force when the declaration was given; and
- the certificate was revoked after the declaration was given but before a prescribed payment is made.

58. Where all of these circumstances are present and the person whose certificate has been revoked does not notify the payer before a payment is made, that person is guilty of an offence. The maximum fine upon conviction for such an offence is \$2,000.

Objection and appeal rights

59. Where the Commissioner decides not to issue a variation certificate or decides to revoke a variation certificate, a person dissatisfied with that decision may object against the decision.

Objection rights

60. An objection must be lodged, in writing, within 60 days of notification of the decision. Where the objection is valid, the Commissioner must determine whether to allow or disallow the objection.

61. An objection is valid where it is lodged, in writing, within the 60 day period and sets out in detail the reasons why the original decision is considered to be incorrect. A mere statement that the decision is wrong is not sufficient.

62. In some instances, the Commissioner may not determine the objection within 60 days of receipt. In such cases the person who lodged the objection may, by written notice, require that a decision be made within a further 60 day period. If the Commissioner does not make a determination within the additional 60 days, the objection may be taken to have been disallowed.

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63. Where a person does not lodge their objection within the required 60 days, they may request an extension of time to lodge the objection. The person seeking the extension of time has to provide reasons in writing why the objection is outside the 60 day period and why the extension should be granted.

Appeal rights

64. Where the Commissioner disallows an objection, either in whole or in part, the person may either apply to the Administrative Appeals Tribunal ('AAT') for review of the decision or lodge an appeal with the Federal Court against the decision. The application for review or appeal must be lodged directly with the AAT or the Federal Court as appropriate. There are costs to applicants in lodging either an application for review or an appeal. These costs differ depending upon the venue chosen.

Examples

Example 1

65. Sally has been operating her own business as an architect for six months. During that time, her gross business income from all sources was \$50,000 with allowable deductions of \$10,000 therefrom. She is not eligible for any other rebates of tax.

66. Most of her work has involved the preparation of plans for various architects. Accordingly, payments from the architects for such work are subject to PPS. Sally has decided to apply for a variation certificate. Her income during the six month period from PPS activities was \$15,000 and she incurred deductions of \$5,000 in earning that income.

67. In considering Sally's application, the Commissioner has determined that Sally has complied with all her taxation obligations. Sally has provided evidence to the Commissioner that the previous six months are reflective of the income situation for the next three years. The Commissioner has granted her a variation certificate allowing a 15% rate of deduction which was calculated as follows:

PPS income (annualised for a whole year)	\$30,000
Allowable deductions from PPS income (annualised for a whole year)	\$10,000
Net PPS income	\$20,000

Estimated tax payable on net PPS income	\$2920
Percentage of tax payable (2,920/30,000)	9.73%
Variation percentage (rounded upwards)	10%

Example 2

68. David is a carpenter who operates his own business with two employees. He applies for a variation certificate from the Commissioner nominating a percentage of 5%. This percentage takes into account losses which will be recouped in the following year and will halve his net PPS income.

69. Beyond the next twelve months, David's PPS activities require an average deduction rate of 10% to equate with the percentage of tax payable. The Commissioner decided that as the losses would only affect one year, the appropriate rate for the percentage was 10%. The Commissioner advised David in writing of the decision outlining the reasons based upon the facts and evidence available.

70. In this example, David does not need to make a new application as the Commissioner in deciding his original request found that the rate of 10% was appropriate and issued the certificate. If he is not satisfied with the percentage, David has the option of objecting to the decision made.

71. One year after receiving the variation certificate, the Commissioner decides to review David's case as he has not paid tax instalment deductions, as required by the PAYE system, for the previous two months. Upon notification of an intention to revoke his certificate, David pays the tax instalments and penalty. As he has otherwise maintained a perfect compliance record and rectified the non-compliance, the Commissioner does not withdraw the certificate. The deduction variation percentage of 10% is still correct for the operation of his business on a long term basis.

Example 3

72. Pierre operates a motor vehicle repair shop in partnership with his cousin Monique. They have been in business for eight years specialising in air conditioning service. They have an established referral trade from other motor vehicle repairers who cannot undertake air conditioning work. This is their only form of PPS income. The partnership has an existing variation certificate allowing a 5% rate of deduction.

73. The Commissioner requests further information on the expected income from other motor vehicle repairers. Pierre and Monique

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advise that they do not expect any change in the referral work despite the expected increase across the industry. The Commissioner will not withdraw the certificate unless he becomes aware of any further information which is relevant. Industry trends are not sufficient cause to revoke the certificate.

Previous Rulings

74. This Ruling replaces Taxation Ruling IT 2448 (which will be withdrawn on finalisation of this Ruling).

Your comments

75. If you wish to comment on this Draft Ruling, please send your comments by: 19 September 1997

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Commissioner of Taxation

6 August 1997

ISSN	1039 - 0731	FOI index detail <i>reference number</i>
ATO references		
NO	97/6856-4	
BO	varrul6.doc	<i>subject references</i>
Not previously released to the public in draft form		- prescribed payments system - PPS payee deduction variations - PPS variation issues - PPS variation revocation - PPS deduction variation certificate
Price	\$1.50	
		<i>legislative references</i>
		- ITAA Pt VI Div 3A

- ITAA 221YHA(1)
- ITAA 221YHD(3)
- ITAA 221YHP(1)
- ITAA 221YHP(2)(a)
- ITAA 221YHP(2)(b)
- ITAA 221YHQ(2)(a)(iii)
- ITAA 221YHS(1)
- ITAA 221YHT(1)

case references

- Case W104 89 ATC 832; AAT
Case 5395 (1989) 20 ATR 4054