

IT 2056 - Prescribed payments system : interpretation and operation

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TAXATION RULING NO. IT 2056

PRESCRIBED PAYMENTS SYSTEM : INTERPRETATION AND
OPERATION

F.O.I. EMBARGO: May be released

REF H.O. REF: 12 L79/16 P10 DATE OF EFFECT: Immediate

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO: SUBJECT REFS: LEGISLAT. REFS:

I 1115067	PRESCRIBED PAYMENT SYSTEM PRESCRIBED PERSON	221 YHA 221 YHC 221 YHD REG. 54ZEB
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PREAMBLE The purpose of this ruling is to clarify a number of major issues which have been raised in relation to the interpretation and operation of the provisions of Division 3A of Part VI of the Income Tax Assessment Act 1936 and of Division 3A of Part VI of the Income Tax Regulations which together implement the Prescribed Payments System.

RULING "Prescribed payment"

2. By virtue of sub-regulation 54ZEB(1), a payment will only be a prescribed payment where the following tests are satisfied -

- (a) the payment is a payment within the meaning of Division 3A of Part VI of the Act (i.e., not payments of salary or wages or of exempt income, e.g., payments to a local council for road construction carried out by it);
- (b) the payment must be made, or be liable to be made under a contract which, in whole or in part, involves the performance of work (e.g., supply and fix or labour and material contracts but not contracts wholly for supply of goods or materials). Separate contracts for goods and services are acceptable, but not separate invoices and/or payments under a single goods and services contract;
- (c) the work must consist of an activity to which sub-regulation 54ZEB(2) or (3) applies; and
- (d) the work must be carried out for a person who is a prescribed person as defined in sub-regulation 54ZEB(4).

"Payment"

3. The term "payment" means the total payment under a contract irrespective of whether it is paid by conventional means e.g., by cash, cheque, postal note, telegraphic transfer, etc., or by transfer of funds to a payee's bank account, or, e.g., by setting off in an account of the payee with the payer or in kind. Any allowances such as for accommodation, meals, fuel, etc. that are actually paid by any of these means would also constitute a payment, but the provision of accommodation or meals would not constitute a payment and are not subject to deduction of tax under the system.

"Payment ... liable to be made"

4. The words "liable to be made", which appear in the definition of "payment" in sub-section 221YHA(1) and in sub-regulation 54ZEB(1) have an anti-avoidance purpose, and do not give rise to an obligation to deduct tax earlier than the time at which payment is actually to be made. Essentially, these words are intended to identify the person who has a primary liability to ensure that a deduction is made from a payment for activities specified in sub-regulations 54ZEB(2) or (3). For example, where a shopkeeper or householder contracts with a builder for a building project the cost of which exceeds \$10,000, and arranges for a bank or other financial institution to actually make the payments to the builder, it is the shopkeeper or householder, and not the bank or other financial institution, who is liable to deduct tax or report payments made. In such cases, however, it would be necessary for the person concerned to make appropriate arrangements with the bank or other financial institution that would allow that person to meet his obligations under the law.

"Prescribed persons"

5. In most cases the question of whether or not a person is a prescribed person should not present any difficulty, e.g., where the person carries on a business that consists of carrying out any of the activities specified in sub-regulation 54ZEB(2) or (3), either wholly or principally, or in part for other people. Details were contained in the notes on the regulations which were made available at the end of July.

"Agency test"

6. Some clarification is however necessary in relation to the agency test which, as indicated in the abovementioned notes, is essentially an anti-avoidance measure. In that context, it will guard against circumvention of the legislation by arrangements under which, instead of the person who is to perform a specified activity being directly engaged by a person who is, on other tests, a prescribed person, he is engaged and paid under a contract with an intermediary who separately contracts with, and is paid by, the prescribed person for the provision of those services. The test does, however, also operate in a general way in some common situations, e.g., as indicated in Schedule A to the Prescribed Payments System

Information Booklet, a courier or freight agency which does not carry on a road transport business as such, but which carries on a business of arranging such services by persons under contract to the agency for that purpose. In such cases, the intermediary is the prescribed person for whom the activity is carried out. As indicated in the abovementioned notes on the regulations, however, an agency would not be a prescribed person if it engaged, for commission, in, e.g., recruiting personnel or locating road transport operators who contract directly with, and are paid by, the person for whom the services are performed.

7. The "agency" test does not, however, generally apply so as to bring within the scope of the system payments made in connection with arrangements such as, those made by car manufacturers (in relation to warranty work), insurance companies (in relation to repairs, etc., of their clients' vehicles or property) or estate or property agents (in relation to repairs, etc., to most property under their management as an agent). In such cases, the view is taken that these firms do no more, in most situations, than authorise the particular work which is, in fact, carried out for the vehicle or property owner. Where, however, an insurance company or an estate or property agent authorises work in connection with a construction project over \$10,000, payments made in connection with that project would be prescribed payments and subject to deduction, or reporting if the owner is a householder, by the owner who would have to make appropriate arrangements to meet that obligation - see earlier re payments by banks, etc.

8. There will be exceptions to this general view, e.g., where a car manufacturer or an insurance company operates its own facilities for repairing motor vehicles belonging to others, or where an estate or property agent contracts with a property owner for the commercial management of a property (including building maintenance and cleaning), and sub-contracts some of the work involved to others. In such cases, of course, the businesses concerned would be carrying on business that consists in part of carrying out specified activities for others, or of furnishing or arranging the particular service.

9. Consistent with the general intra-industry scope of the system, payments made under "design and construct" contracts, by contractors who are, in effect, builders, for the provision of architectural, engineering and surveying services to them, will not be prescribed payments. In these cases, payments received by the contractor from the client, and payments made by them to persons engaged in performing construction activities (not including, in either case, payments for architectural, engineering, surveying or other professional services) are prescribed payments.

10. Moreover, as contemplated under the heading of "other" professional building and construction services in Schedule A to the Prescribed Payments System Information Booklet, if a project or construction manager, whose activities do not involve the actual construction of a building but merely the provision of professional services and the monitoring of work to ensure

compliance, authorise progress and other payments by the client etc., payments by the client for those activities would not be prescribed payments.

Structure

11. In determining, for the purposes of the prescribed payments system, what is a structure, the key criteria are as follows:

- (a) it is a characteristic of a structure that it is generally built up of its component parts at the place which it is intended to occupy. In the case of pre-fabricated buildings where components are manufactured off-site, it would only be payments under a contract involving assembly and installation or erection on-site that would be prescribed payments;
- (b) a structure is generally intended to remain permanently on a permanent foundation. Permanent does not, however, mean everlasting. An item may be a structure if it is intended to remain in the one position for an indefinitely continuing period. A movable drilling rig used for exploration would not be regarded as of a permanent nature; and
- (c) a structure is normally an item that rises above the ground (e.g., underground pipelines or tanks, or mines or wells would not be regarded as structures).

12. On this basis, buildings are clearly structures. Other examples of structures include, fences walls, bridges and dams (other than earth dams).

13. Buildings may be broadly described as structures designed for use as a habitation or for other purposes of occupation, or for storage of goods, components or plant. Examples of buildings would include residential or dwelling houses or flats, offices, factories, warehouses, schools, halls, hospitals, theatres, churches, garages, sheds and grandstands. In that context, the term structure also includes an integral part of a structure that is a building even though the particular item might take on the nature of, and be regarded for income tax depreciation purposes as, an item of plant, e.g., a cool room in a warehouse. The term would, of course, also include any other structure which forms a recognisable part of, and is constructed primarily for use in connection with, the principal building, e.g. employees amenities, tennis courts, swimming pools, etc.

14. Subject to these general rules, however, it has been decided that, as a matter of practical administration, any item which, although in the nature of a structure, is treated for income tax depreciation purposes as an item of plant (other than

fences and other structural improvements that are so treated by virtue of the extended definition of plant in sub-section 54(2) of the Income Tax Assessment Act 1936), will generally not be regarded as a structure.

15. It should, however, be noted that, although items of plant will not generally be regarded as structures, payments for the installation of many such items where they are to form an integral part of a structure will, by virtue of sub-regulation 54ZEB(2), be prescribed payments (e.g., payments for the installation of refrigeration equipment in the cool room referred to in the earlier example). On this basis, payments under contracts for the maintenance of such items of plant will not be prescribed payments.

Road transport - payments from outside the industry

16. An exception to the general intra-industry basis in the road transport industry applies where a person who is not himself engaged in that industry engages another person to transport goods, etc. and that transport is carried out on a "regular daily basis" involving the "exclusive use" of a vehicle or vehicles provided by that other person. In practice, this test will only apply in relation to persons who are engaged under contractual arrangements that involve the transportation of goods virtually on an all day, day in, day out basis for an indefinitely continuing period. Examples of industries making use of these types of arrangements were given in Schedule A to the Prescribed Payments System Information Booklet.

17. Payments under arrangements involving the intermittent or irregular use of a person's truck or trucks will not be prescribed payments. Examples of these types of arrangements are:

- (a) a regular contract with a payer for one or two days a week;
- (b) regular daily contracts with more than one payer for whom services are performed each week;
- (c) an arrangement under which, although the operator may be required to report for work each day, he does not, in fact, obtain work each day;
- (d) under contracts - whether for a specified period of not - to transport goods as and when required; or
- (e) where the activity is performed for only part of a day on a regular and exclusive basis, e.g., a general carrier under a contract for the delivery of milk or newspapers for, say, 3 hours every day.

18. Where a payer reasonably concludes that he has exclusive use of the payee's truck on a regular daily basis and

that conclusion is based on the fact that the truck is made available for that purpose, the payer should, unless the payee establishes the situation to be otherwise, deduct tax from payments made under a contract involving road transport activities.

Deduction forms - computer production by payers

19. Under section 221YHC a payee is required to complete Part A of a deduction form and furnish this form to the payer before the first payment is made in any month. However, a number of approaches have been received from payers seeking to use computer processes to complete both Part A and Part B details. To accommodate these requests within the requirements of the existing legislation, the following arrangements are to apply:

- (a) The payee is to provide the payer with a deduction form, with the declaration in Part A completed, at or before the time the first prescribed payment is made in any month, but not earlier than 7 days prior to the commencement of the month in which the prescribed payment is made.
- (b) The payer may then produce by computer a deduction form using the Part A details already provided by the payee; the payer is to retain the deduction form provided by the payee in safe storage and cancel Part B of that form.
- (c) In producing the deduction form by computer the words "Declaration Held" are to be printed in the space provided for the payee's signature. The payee's signature is not required on this form. However, if a payer wishes to obtain a payee's signature on this form, this could be done in lieu of the "Declaration Held" requirement.
- (d) In completing the monthly reconciliation form, the payer must include a statement - "In respect of those deduction forms bearing the words 'Declaration Held', the payee particulars shown in Part A of the respective forms are the same as those shown in the declarations lodged for the month by the payees".
- (e) Procedures related to other requirements in regard to deduction of tax, remittance of tax deducted and monthly reconciliations remain unchanged.

20. Payers who want to take advantage of these arrangements should approach their local Deputy Commissioner of Taxation. Arrangements for the supply of deduction forms in continuous stationery format and a print spacing specification should also be made with that Deputy Commissioner.

18 August 1983