

TR 98/20 - Income tax: PPS deduction variation certificates



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This document has changed over time. This is a consolidated version of the ruling which was published on *2 December 1998*



Taxation Ruling

Income tax: PPS deduction variation certificates

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Preamble

*This document is not a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953** and is not legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

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 Division 3A 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 not issue or revoke 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.

4. Ordinarily, the payer deducts tax from a prescribed payment at the rate of 20% (the 'ordinary percentage'). If a variation certificate number and a variation percentage are 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 variation percentage rate stated on the payee declaration form.

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 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 is 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 as if their respective income consisted only of the net PPS profit or loss. In the calculation, the tax free threshold is applied to each partner or beneficiary, if applicable.

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.

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 is acceptable. 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 that 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.¹ A 'company' is further defined to include all bodies or associations corporate or unincorporate, but does not include 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. This information should be provided by way of a detailed profit and loss statement in respect of prescribed activities of the business.

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. If the information provided by the applicant is unsatisfactory or inadequate, the Commissioner may request that further information be provided from the applicant or from any other source. In addition, the Commissioner may investigate any matters relevant to the application, whether advised by the applicant or not. 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 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

¹ subsection 221YHA(1)

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 from all the information available, 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' or an 'income year' 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 makes 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. The minimum requirement is the estimate be based on consideration of the anticipated situation for the balance of the income year in which the application is made and the following income year.

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 that is available to justify the percentage sought.

27. There may be cases where the estimated rate reflects the percentage of tax payable for the next year, 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 that reflects the situation for the next year. If the deduction percentage becomes inappropriate in the future because of changed circumstances, the payee should apply then for a new variation certificate.

'Reasonable estimate'

28. The words 'reasonable estimate' refer to forming an opinion on the calculation of the nominated percentage. In forming the 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 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 year of income 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 income 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 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 that are not expected to be fully recouped against PPS profits in the next year;
- is a partner in a partnership that has occasional PPS involvement such that no tax would be payable by the partners on the PPS income (e.g., 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 distributes 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 that is relevant in determining the tax payable on the prescribed payments.

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 Commissioner² 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 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;

² per paragraph 221YHP(2)(b). This refers to the Commissioner of Taxation so, for example, Child Support compliance cannot be considered as the relevant Acts are administered by the Child Support Registrar

- 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 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 in respect of the partnership 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.

40. The Commissioner decides each case on its merits in the determination of satisfactory compliance as required by subparagraph 221YHP(2)(b). *Case W104; AAT Case 5395*³ dealt with a similar provision (subparagraph 221YHQ(2)(a)(iii)). The decision in the case indicates that 'satisfactory' in this context does not mean the applicant's record must be perfect, but the record is reasonable in the circumstances.

41. The indicators that 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;

³ 89 ATC 832; (1989) 20 ATR 4054

- (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;
- (i) the applicant's attempts to remedy the cause of any non-compliance; and
- (j) whether the applicant has been convicted in regard to an offence against the taxation laws.

Effect of decision

42. Where the Commissioner decides the application is both reasonable in its percentage and 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.⁴ 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

⁴ subsection 221YHS(1)

- 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 the matters be rectified. If the matters are not rectified within the period stipulated in the notice 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 or if there is a serious risk that tax will be avoided, the Commissioner may revoke the certificate without seeking any further information.

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 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 that 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 a false statement or declaration has been made in order to obtain a certificate, it is ordinarily revoked unless it can be shown 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 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 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.

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 two years. The Commissioner has granted her a variation certificate allowing a 10% rate of deduction based on the following information:

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 variation percentage of 5%.

69. The calculation incorrectly takes into account the effect of losses from an investment property. Disregarding the losses from the investment property, the Commissioner determines the appropriate variation percentage is 10%. The Commissioner advises David in writing of the decision outlining the reasons based upon the facts and evidence available and issues him with a variation certificate specifying the variation percentage as 10%.

70. If he is not satisfied with the percentage specified in the variation certificate, 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. As the Commissioner becomes aware of an increase in referral work in the industry, he requests further information from the partners about their expected income and expenses from PPS activities. Pierre and Monique provide the information that indicates the variation percentage is still appropriate to their circumstances. As the Commissioner is satisfied with the information, the certificate is not revoked.

Example 4

74. Build Pty Ltd applies for a variation certificate. In considering the application, the Commissioner discovers the following compliance history:

- the income tax return for the last year was due 6 months ago and has not yet been lodged;
- the FBT return for the last year has not been lodged;
- PAYE remittances have not been forwarded for the past 3 months;
- the PPS reconciliation statement has not been lodged for the last year; and

- an amount of \$15,000 is owing to the Commissioner and no arrangement for payment has been made.

75. The Commissioner advises the company its compliance is not satisfactory and the application is declined. Upon receipt of the advice, the company rectifies all outstanding matters and pays any applicable penalty. During the succeeding 12 month period, the company's compliance is satisfactory. It then makes a fresh application for a variation. As the rate and compliance now are satisfactory, the variation certificate is issued.

Example 5

76. Service Pty Ltd applies for a variation certificate nominating a percentage of 5%. The company recently compiled its business plan with cash flow projections. The projected income and expense statements in respect of PPS activities for the balance of the financial year and for the next financial year were submitted as follows:

	balance of financial year	next financial year
Income		
Total PPS Income	255,300	306,400
Expenses		
Accountancy fees	4,000	5,000
Bank fees and charges	550	550
Contractor costs	25,000	35,000
Corporate fees	1,000	1,000
Depreciation	8,050	7,550
Insurance	7,800	8,500
Interest	15,400	14,400
Lease payments	12,000	12,000
Materials	102,120	122,560
Motor vehicle expenses	14,000	15,000
Repairs and maintenance	4,300	5,200
Salaries and wages	25,000	28,000
Telephone	4,200	4,800
Total Expenses	223,420	259,560
Operating Profit (Loss)	31,880	46,840

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Tax payable on net PPS income	11,477	16,862
Percentage of tax payable on income	4.5%	5.5%

77. The percentages of tax payable for the balance of the current financial year and for the next financial year are not markedly different from each other. In this case, the Commissioner agrees the variation percentage should be 5%. The company will need to review the percentage and, if it does not reflect the rate of tax payable on PPS income, it should submit an application for a variation certificate at a different rate.

78. Note that examples used are an illustration only. The figures used are not definitive of the level of deductions a taxpayer may claim.

Example 6

79. Steven is a sole trader who operates as a surveyor. He has held a variation certificate for the past 2 years with a variation percentage of nil. The Commissioner undertakes a review of Steven's variation certificate. His compliance history is satisfactory; however, the percentage of tax payable on his PPS income indicates the appropriate variation percentage is 14%. The Commissioner notifies Steven that, on information held, the variation rate appears to be inappropriate and requests information concerning the present and projected future level of PPS income and expenses.

80. Steven takes no action to respond to the request within the required period. As Steven fails to respond and there is a strong indication the rate is inappropriate, the certificate is revoked and Steven is notified accordingly.

Previous Rulings

81. This Ruling replaces Taxation Ruling IT 2448, which has been withdrawn.

Detailed contents list

82. Below is a detailed list of the contents of this Ruling:

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- prescribed payments system
- PPS deduction variation certificate
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legislative references

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

case references

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