

PS LA 2003/6 - Administrative arrangements for the calculation of Alienated Personal Services Payments withholding amounts

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ATO Practice Statement Law Administration

PS LA 2003/6

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This Practice Statement is issued under the authority of the Commissioner and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by ATO officers unless doing so creates unintended consequences. Where this occurs ATO officers must follow their Business Line's escalation process.

SUBJECT: Administrative arrangements for the calculation of Alienated Personal Services Payments withholding amounts

PURPOSE: This Practice Statement sets out the circumstances in which the Commissioner of Taxation will allow a taxpayer to use administrative options for calculating withholding amounts under Division 13 in Schedule 1 to the *Taxation Administration Act 1953*.

STATEMENT

1. For the 2001–2002 and 2002–2003 income years the Commissioner implemented transitional administrative arrangements to allow a personal services entity to use an alternative option to achieve practical compliance with their obligations under Division 13 in Schedule 1 to the *Taxation Administration Act 1953* ('TAA'). For the purposes of this practice statement, unless stated otherwise, all division and section references are to Schedule 1 to the TAA.
2. The administrative arrangements were developed to address concerns raised by tax practitioners around the cost of compliance with the method statement in subsection 13-5(2) (used to work out the amount of an entity's Division 13 obligation).
3. As a long-term solution to enable taxpayers to meet their obligations under Division 13 the Commissioner has developed administrative arrangements that will apply for payments made from 1 July 2003.
4. Under the administrative arrangements, a personal services entity can satisfy their Division 13 obligations by withholding or paying amounts under Part 2-5 (either withholding under Division 12 or paying under Division 13) that are calculated by applying the applicable withholding rate to a *minimum personal services income payout measure*.
5. The applicable withholding rate is the rate listed in the relevant PAYG Withholding Tax Tables published by the Tax Office. If the Commissioner has granted the individual service provider a variation to the rate of withholding the personal services entity should use the varied rate advised by the Commissioner.

6. The *minimum personal services income payout measure* will be an amount that is either equal to or greater than:
- 70% of the gross personal services income (exclusive of GST) received by the personal services entity during the current PAYG payment period; or
 - a *net personal services income percentage* applied to the gross personal services income (exclusive of GST) received by the personal services entity during the current PAYG payment period.
7. The *net personal services income percentage* is worked out by dividing the individual's gross personal services income (exclusive of GST) for the previous income year less the amount worked out under the method statement in section 86-20 of the *Income Tax Assessment Act 1997* (the 'ITAA 1997') for the previous income year, by the personal services entity's gross personal services income (exclusive of GST) for the previous income year. This amount is multiplied by 100 to give a percentage figure. This percentage is then applied to the gross personal services income (exclusive of GST) for each PAYG payment period in the current year:

$$\frac{\text{Individual's gross personal services income (excl. GST) for the previous income year} - \text{Amount worked out under the method statement in section 86-20 of the ITAA 1997 for the previous income year}}{\text{Personal services entity's gross personal services income (excl. GST) for the previous income year}} \times \frac{100}{1} = \text{net personal services income percentage}$$

8. The administrative options will be achieved using the Commissioner's discretion to remit failure to withhold penalty under section 16-45.
9. Where a personal services entity that has an obligation to pay an amount to the Commissioner under Division 13:
- withholds or pays amounts under Part 2-5 (either withholding under Division 12 or paying under Division 13) that are calculated by applying the applicable withholding rate to the *minimum personal services income payout measure* as outlined in paragraphs 6 and 7 above; but
 - does not withhold or pay amounts to the Commissioner during the financial year that are exactly equal to that required by the method statement in subsection 13-5(2); and
 - there is a shortfall in amounts that should have been paid to the Commissioner under Division 13 (once the attributed personal services income for the year has been worked out);
- the Commissioner will remit to nil, any failure to withhold penalty on that shortfall that arises under section 16-30.
10. After the end of the income year, the personal services entity is required to attribute the remaining personal services income (after allowing for certain deductions) to the individual service provider under Part 2-42 of the ITAA 1997.

11. Where the personal services entity does not meet the conditions for remission of failure to withhold penalty under this Practice Statement, any remission of failure to withhold penalty will be considered under the Commissioner's general guidelines on remission of failure to withhold penalty.

EXPLANATION

Background

12. The object of Division 13 is to ensure the efficient collection of income tax (and other liabilities) on any personal services income included in an individual's assessable income under the Alienation of Personal Services Income Measures (Part 2-42 of the ITAA 1997).
13. Under section 13-5, a personal services entity must pay an amount of tax to the Commissioner if it receives an *alienated personal services payment* that relates to an individual's personal services income; and if it receives the payment during a *PAYG payment period* for which it is a *personal services payment remitter*.¹
14. In working out the amount to pay to the Commissioner under Division 13, the personal services entity follows a method statement in subsection 13-5(2).
15. Step 2(a) of the method statement in subsection 13-5(2) requires the personal services entity to identify amounts that are included in the individual's assessable income under section 86-15 of the ITAA 1997 and that relate to alienated personal services payments the entity received during the PAYG payment period.
16. The amounts that are included in the individual's assessable income under section 86-15 of the ITAA 1997 are reduced by certain deductions calculated under section 86-20 of the ITAA 1997. These amounts are worked out after the end of an income year.
17. The personal services entity therefore cannot quantify the amount to be included at Step 2(a) of the method statement in subsection 13-5(2) during the income year as these amounts are not determined until after the end of the income year. As a result, the personal services entity will not be able to accurately determine the correct amount to pay to the Commissioner under Division 13.
18. Where there is a shortfall in the amounts that should have been paid under Division 13 and the amounts actually paid under that Division, a failure to withhold penalty is imposed under section 16-30 in relation to the shortfall amount. The failure to withhold penalty is equal to the shortfall amount.

The Transitional Administrative Arrangements

19. To overcome this technical difficulty in complying with Division 13, the transitional administrative arrangements were developed to cover payments made during the 2001–2002 and 2002–2003 income years.

¹ Taxation Ruling TR 2001/8 and Fact Sheets provide further guidance on when an entity has an obligation to pay amount under Division 13.

20. The transitional arrangements utilised the Commissioner's discretionary power under section 15-15 to vary the rate of withholding for Division 13 amounts to nil. The class of cases is described in the variation as:

Any alienated personal services payment that is received by a personal services entity and that relates to one or more individuals' personal services income where salary or wages are paid to the individual or individuals within 14 days after the end of the relevant Pay As You Go payment period either equally or greater than:

1. 70% of the gross personal services income (exclusive of GST) received by the personal services entity during the current PAYG payment period; or
 2. A *net personal services income percentage* applied to the gross personal services income (exclusive of GST) received by the personal services entity during the current PAYG payment period. The net personal services income percentage is calculated by dividing the personal services entity's gross personal services income (exclusive of GST) less allowable deductions (excluding salary or wages paid in accordance with subsection 86-15(4) of the ITAA 1997) for the previous income year by the personal services entity's gross personal services income (exclusive of GST) for the previous income year and multiplying this amount by 100.
21. This meant that the amount to pay under Division 13 in respect of any shortfall (which would only become apparent when the calculations for the purposes of section 86-15 of the ITAA 1997 were performed) was nil.
22. Partnerships were not covered by this variation as they could not pay amounts out as salary or wages to partners. In the case of partnerships, the same outcome was achieved by utilising the Commissioner's discretion to remit failure to withhold penalty to nil where:
- the amounts the partnership paid to the Commissioner under Division 13 were calculated by reference to either 70% of the gross personal services income or the net personal services income percentage (as stated in the variation) applied to the gross personal services income received by partnership during the PAYG payments period; and
 - there was a shortfall between the amounts the partnership paid under Division 13 and the amounts the partnership should have paid under Division 13 had the partnership been in a position to determine the personal services income amounts to be included in the individual's assessable income under section 86-15 of the ITAA 1997.

Administrative Arrangements (from 1 July 2003)

23. Under the administrative arrangements, the Commissioner will fully remit failure to withhold penalty relating to a shortfall in Division 13 amounts (see paragraph 24) where a personal services entity that has an obligation to pay amounts under Division 13 withholds or pays amounts under Part 2-5 (either withholding under Division 12 or paying under Division 13) that are worked out by applying the relevant withholding rate to an amount that is either equal to or greater than:
- (a) 70% of the gross personal services income (exclusive of GST) received by the personal services entity during the current PAYG payment period; or

- (b) the *net personal services income percentage* (see paragraph 16) applied to the gross personal services income (exclusive of GST) received by the personal services entity during the current PAYG payment period.
24. When a personal services entity uses one of the administrative options the amounts withheld or paid to the Commissioner during the financial year will not exactly equal that required by the method statement in subsection 13-5(2). There may be a shortfall in the amounts the entity is required to pay under Division 13. This shortfall will only become apparent when the calculations for the purposes of section 86-15 of the ITAA 1997 are performed after the end of the income year.
25. Companies or trusts who use the administrative options can either:
- pay amounts out as salary or wages to the individual service provider and withhold under Division 12; or
 - choose not to pay amounts out as salary or wages and instead attribute amounts to the individual service provider and pay amounts to the Commissioner under Division 13.

Previously companies and trusts were only covered by the transitional administrative arrangements where they paid amounts out as salary or wages and withheld correctly under Division 12 (rather than choosing to pay equivalent amounts under Division 13).

26. Partnerships who use the administrative options will continue to pay amounts to the Commissioner under Division 13 as they cannot pay amounts out as ‘salary or wages’ to partners.
27. The failure to withhold penalty remission guidelines outlined in this Practice Statement will not apply where the personal services entity has not met the conditions of remission outlined in paragraph 23. For example, where a personal services entity either:
- does not withhold amounts under Division 12 or pay amounts to the Commissioner under Division 13;
 - does withhold amounts under Division 12 or pays amounts to the Commissioner under Division 13 but those amounts are calculated on salary or wages or attributed income that is less than:
 - 70 % of the gross personal services income (exclusive of GST) received by the personal services entity during the current PAYG payment period; or
 - the net personal services income percentage applied to gross personal services income received by the personal services entity during the current PAYG payment period; or
 - does make payments of salary or wages or attributes amounts to the individual service provider but does not withhold at the applicable withholding rate;

remission of failure to withhold penalty will depend upon the Commissioner's general remission guidelines for failure to withhold penalty.

Examples

28. For the following examples, assume that the personal services entities are subject to the Alienation of Personal Services Income Measures under Part 2-42 of the ITAA 1997 and have withholding obligations under Division 13.
29. The withholding amounts calculated in the following examples were based on the PAYG Withholding Tax Tables (Quarterly) that were current at the time of publication. When working out the amount to withhold payers should refer to the most recent tax tables published by the Commissioner as the tax tables may change from year to year to reflect changes in income tax rates.
30. The following example illustrates a company using the *net personal services income percentage* option to calculate salary to pay to an individual service provider. Personal services entities that are trusts would also be treated similarly. The example concludes with an analysis of potential penalty and the application of the Practice Statement to the shortfall in amounts that should have been paid under Division 13.

Example 1

InfotechBiz Pty Ltd provides Peter's services as an IT consultant. InfotechBiz has only one worker (Peter) and is registered as a small withholder. InfotechBiz chooses to pay amounts out as salary to Peter within 14 days of the end of the quarter calculated using the *net personal services income percentage*.

During the Current Income Year

The *net personal services income percentage* will be the same for each quarter in the income year as it is worked out using amounts from the previous income year. For the previous income year, InfotechBiz Pty Ltd:

- received total payments of \$100,000 (GST exclusive) for Peter's services;
- received other income of \$2,000;
- incurred expenses (other than promptly paid salary or wages and entity maintenance expenses) of \$30,000 to generate the income for Peter's services; and
- incurred entity maintenance expenses of \$5,000.

The calculation of the *net personal services income percentage* is worked out as follows:

$$\frac{\text{Individual's gross personal services income (excl. GST) for the previous income year}}{\text{Personal services entity's gross personal services income (excl. GST) for the previous income year}} - \frac{\text{Amount worked out under the method statement in section 86-20 of the ITAA 1997 for the previous income year}}{\text{Personal services income (excl. GST) for the previous income year}} \times \frac{100}{1} = \text{net personal services income percentage}$$

Peter's gross personal services income (excluding GST) for the previous income year was \$100,000. As InfotechBiz had no other service providers, its gross personal services income (excluding GST) for the previous income year was also \$100,000.

The amount worked out under the method statement in section 86-20 of the ITAA 1997 is: \$33,000.
This was worked out as follows:

<i>Method Statement</i>		<i>Calculation</i>
Step 1	Work out, for the income year, the amount of any deductions (other than *entity maintenance deductions or deductions for amounts of salary or wages paid to you) to which the *personal services entity is entitled that are deductions relating to your *personal services income.	\$30,000
Step 2	Work out, for the income year, the amount of any *entity maintenance deductions to which the *personal services entity is entitled.	\$5,000
Step 3	Work out the *personal services entity's assessable income for that income year, disregarding any income it receives that is your *personal services income or the personal services income of anyone else.	\$2,000
Step 4	Subtract the amount under step 3 from the amount under step 2. <i>Note 1: Step 4 ensures that, before entity maintenance deductions can contribute to the reduction, they are first exhausted against any income of the entity that is not personal services income.</i> <i>Note 2: If the personal services entity received another individual's personal services income, see section 86-25.</i>	\$3,000
Step 5	If the amount under step 4 is greater than zero, the amount of the reduction under subsection (1) is the sum of the amounts under steps 1 and 4.	\$33,000
Step 6	If the amount under step 4 is not greater than zero, the amount of the reduction under subsection (1) is the amount under step 1.	N/A

The *net personal services income percentage* is:

$$\frac{\$100,000 - \$33,000}{\$100,000} \times \frac{100}{1} = 67\%$$

To work out the amount of salary to pay to Peter, the *net personal services income percentage* is multiplied by the gross personal services income (exclusive of GST) of InfotechBiz for the current PAYG payment period. During quarter 1, InfotechBiz received gross personal services income (exclusive of GST) of \$28,000.

67% x \$28,000 = \$18,760. InfotechBiz pays out \$18,760 as salary to Peter within 14 days of the end of quarter 1.

InfotechBiz works out the amount to withhold from the payment by referring to the *PAYG Withholding Tax Tables (Quarterly)* and withholds \$5,811 from the payment of \$18,760. InfotechBiz has not made any other withholding payments during that quarter so the amount of \$18,760 is reported at W1, and the amount of \$5,811 is reported at W2 on InfotechBiz's quarterly BAS. InfotechBiz then sends the BAS together with \$5,811 to the Tax Office. (Assume InfotechBiz has no other activity statement obligations).

Assume the gross personal services income (exclusive of GST) received by InfotechBiz is the same for each quarter (ie., \$28,000). By the end of the income year, InfotechBiz has withheld the following amounts during the year from payments of salary to Peter:

<i>Quarter</i>	<i>Promptly paid salary</i>	<i>Amount withheld under Division 12</i>
1	\$28,000 x 67% = \$18,760	\$5,811
2	\$28,000 x 67% = \$18,760	\$5,811
3	\$28,000 x 67% = \$18,760	\$5,811
4	\$28,000 x 67% = \$18,760	\$5,811
TOTAL	\$75,040	\$23,244

All amounts are correctly reported on the BAS and withheld amounts have been paid to the Tax Office.

After the end of the income year

By 14 July following the end of the income year, InfotechBiz prepares the payment summary for Peter. InfotechBiz also prepares an annual report and submits that to the Tax Office.

To complete their income tax returns, Peter and InfotechBiz need to work out the amount of personal services income that is attributed to Peter under Part 2-42 of the ITAA 1997.

Assume that during the income year InfotechBiz:

- received \$112,000 (excluding GST) as a payment for Peter's services;
- received investment income of \$4,000;
- incurred other expenses of \$32,000 to generate the income for Peter's services; and
- incurred entity maintenance expenses of \$6,000.

The amount attributed to Peter at the end of the income year is Peter's personal services income less certain deductions (worked out under sections 86-15 and 86-20 ITAA 1997).

The amount of Peter's personal services income is \$112,000. This amount is reduced by amounts promptly paid to Peter as salary (\$75,040). Peter's personal services income under section 86-15 (before the application of section 86-20 ITAA 1997) will therefore be \$36,960.

This amount is then reduced by the amount worked out in accordance with the method statement in section 86-20(2) ITAA 1997: \$34,000

<i>Method Statement</i>		<i>Calculation</i>
Step 1	Work out, for the income year, the amount of any deductions (other than *entity maintenance deductions or deductions for amounts of salary or wages paid to you) to which the *personal services entity is entitled that are deductions relating to your *personal services income.	\$32,000
Step 2	Work out, for the income year, the amount of any *entity maintenance deductions to which the *personal services entity is entitled.	\$6,000
Step 3	Work out the *personal services entity's assessable income for that income year, disregarding any income it receives that is your *personal services income or the personal services income of anyone else.	\$4,000
Step 4	Subtract the amount under step 3 from the amount under step 2. <i>Note 1: Step 4 ensures that, before entity maintenance deductions can contribute to the reduction, they are first exhausted against any income of the entity that is not personal services income.</i> <i>Note 2: If the personal services entity received another individual's</i>	\$2,000

	<i>personal services income, see section 86-25.</i>	
Step 5	If the amount under step 4 is greater than zero, the amount of the reduction under subsection (1) is the sum of the amounts under steps 1 and 4.	\$34,000
Step 6	If the amount under step 4 is not greater than zero, the amount of the reduction under subsection (1) is the amount under step 1.	N/A

The amount therefore attributable to Peter under section 86-15 ITAA 1997 is \$2,960 (that is, \$36,960 less \$34,000).

In completing his income tax return Peter includes the amounts of \$2,960 (attributed personal services income) and \$75,040 (salary) in his assessable income.

Analysis

After the end of the income year we are in a position to accurately review the amounts that *should* have been paid under Division 13 had InfotechBiz been in a position to know the amount to include at Step 2(a) in the method statement in paragraph 13-5(2)(a). This potentially exposes InfotechBiz to a penalty for failure to withhold if there is a shortfall in the amounts that *should* have been paid under Division 13.

The amounts which should have been paid under Division 13 in quarter 1 if InfotechBiz had been using the method statement in paragraph 13-5(2)(a) is worked out as:

<i>Method Statement</i>		<i>Calculation</i>
Step 1	Identify the payments that the *personal services entity makes to the individual during the period mentioned in paragraph (1)(b) that are *withholding payments covered by section 12-35.	\$18,760
Step 2	Identify the amounts that: (a) are included in the individual's assessable income under section 86-15 of the <i>Income Tax Assessment Act 1997</i> ; and (b) relate to *alienated personal services payments the entity receives during that period	\$740 (\$2,960 x [28,000/112,000])
Step 3	Work out the sum of all the amounts that Division 12 would require the entity to withhold in respect of that period if both of these were taken into account: (a) the payments identified in step 1; and (b) the amounts identified in step 2, as if they were payments of salary covered by section 12-35.	\$6,169 (Amount to withhold on quarterly basis from \$19,500)
Step 4	Sum of all the amount withheld under section 12-35 from the payments identified in Step 1.	\$5,811
Step 5	Subtract the sum under step 4 from the sum under step 3.	\$358

In addition to the amounts withheld under Division 12 throughout the year, InfotechBiz should have also paid \$358 per quarter under Division 13. There is therefore a shortfall in the amounts that InfotechBiz was required to pay under Division 13 and therefore a failure to withhold penalty of \$358² applies to InfotechBiz for quarter 1. Similarly, a failure to withhold penalty of \$358 will also apply for quarters 2, 3 and 4.

However, because InfotechBiz:

- paid Peter salary within 14 days after the end of the PAYG payment period that were equal to the *net personal services income percentage* applied to the gross personal services income received by InfotechBiz during the quarter ; and

² The failure to withhold penalty for Division 13 is equal to the shortfall in amounts the entity should have paid under Division 13. See paragraph 18.

- withheld from that salary at the applicable withholding rate;

any failure to withhold penalty relating to the shortfall of amounts required to be paid under Division 13, is remitted to nil.

31. The following example illustrates the application of the administrative options for partnerships. As partnerships cannot pay amounts out as salary or wages to partners they can only pay amounts under Division 13 rather than Division 12. In this example the partnership has chosen to work out Division 13 amounts based on the flat rate of 70% of the gross personal services income of the partnership during the PAYG payment period.

Example 2

Carrie and Jamie are partners in a partnership trading as 'Chic Deco'. Chic Deco provides Carrie's services as an interior designer. Chic Deco does not have any employees, but has registered as a small withholder. Jamie provides some assistance in the administration of the partnership. Chic Deco chooses to work out its Division 13 obligations using 70% of the partnership's gross personal services income (exclusive of GST) per quarter.

During quarter 1, Chic Deco received gross personal services income (exclusive of GST) of \$28,000.

Chic Deco attributes \$19,600 (70% of \$28,000) to Carrie.

Chic Deco then works out the amount to pay to the Commissioner under Division 13 relating to this amount by referring to the *PAYG Withholding Tax Tables (Quarterly)*. The amount Chic Deco is required to pay to the Commissioner is \$6,218. Chic Deco has not made any other withholding payments during that quarter so the amount of \$19,600 is reported at W1, and the amount of \$6,218 is report at W2 on Chic Deco' quarterly BAS. Chic Deco then sends the BAS together with \$6,218 to the Tax Office. (Assume Chic Deco has not other activity statement obligations).

Assume for each quarter, the gross personal services income (exclusive of GST) received by Chic Deco is the same as for quarter 1 (ie, \$28,000). By the end of the income year, Chic Deco has paid the following amounts to the Tax Office in respect of Division 13 during the year.

<i>Quarter</i>	<i>Attributed Income</i>	<i>Amount paid under Division 13</i>
1	\$28,000 x 70% = \$19,600	\$6,218
2	\$28,000 x 70% = \$19,600	\$6,218
3	\$28,000 x 70% = \$19,600	\$6,218
4	\$28,000 x 70% = \$19,600	\$6,218
TOTAL	\$78,400	\$24,872

All amounts are correctly reported on the BAS and Division 13 amounts have been paid to the Tax Office.

After the end of the income year

By 14 July following the end of the income year, Chic Deco prepares a payment summary for Carrie. Chic Deco also prepares an annual report and submits that to the Tax Office.

To complete their income tax returns, Carrie and Chic Deco need to work out the amount of personal services income that is attributed to Carrie under Part 2-42 of the ITAA 1997.

Assume that during the year Chic Deco:

- received \$112,000 (excluding GST) as payment for Carrie's services;
- received investment income of \$4,000;

- incurred other expenses of \$32,000 to generate the income from Carrie’s services; and
- incurred entity maintenance expenses of \$6,000.

The amount attributed to Carrie at the end of the income year is Carrie’s personal service income less certain deductions (worked out under sections 86-15 and 86-20 ITAA 1997).

The amount of Carrie’s personal services income under section 86-15 ITAA 1997 (before the application of section 86-20 ITAA 1997) is \$112,000.

This amount is then reduced by the amount worked out in accordance with the method statement in section 86-20(2) ITAA 1997: \$34,000 (calculations are the same as in Example 1 above).

The amount therefore attributable to Carrie under section 86-15 ITAA 1997 is \$78,000 (that is, \$112,000 less \$34,000).

In completing her income tax return Carrie includes the amount of \$78,000 (attributed personal services income) in her assessable income.

Analysis

After the end of the income year we are in a position to accurately review the amounts that *should* have been paid under Division 13 had Chic Deco been in a position to know the amount to include at Step 2(a) in the method statement in paragraph 13-5(2)(a). This potentially exposes Chic Deco to a penalty for failure to withhold if there is a shortfall in the amounts that *should* have been paid under Division 13.

The amounts which should have been paid under Division 13 in quarter 1 if Chic Deco had been using the method statement in paragraph 13-5(2)(a) is worked out as:

<i>Method Statement</i>		<i>Calculation</i>
Step 1	Identify the payments that the *personal services entity makes to the individual during the period mentioned in paragraph (1)(b) that are *withholding payments covered by section 12-35.	\$0
Step 2	Identify the amounts that: (a) are included in the individual’s assessable income under section 86-15 of the <i>Income Tax Assessment Act 1997</i> ; and (b) relate to *alienated personal services payments the entity receives during that period	\$19,500 (\$78,000 x [28,000/112,000])
Step 3	Work out the sum of all the amounts that Division 12 would require the entity to withhold in respect of that period if both of these were taken into account: (a) the payments identified in step 1; and (b) the amounts identified in step 2, as if they were payments of salary covered by section 12-35.	\$6,169 (Amount to withhold on quarterly basis from \$19,500)
Step 4	Sum of all the amount withheld under section 12-35 from the payments identified in Step 1.	\$0
Step 5	Subtract the sum under step 4 from the sum under step 3.	\$6,169

Had Chic Deco been in a position to accurately calculate Step 2(a) of the method statement in section 13-5(2)(a), Chic Deco would have only been required to pay \$6,169 under Division 13. However Chic Deco paid \$6,218 under Division 13 for quarter 1. In this case there is a small ‘over-withholding’ of \$49 per quarter. In this example there is no shortfall under Division 13 for quarter 1 and therefore no failure to withhold penalty.

32. The following example illustrates the situation where the Commissioner will consider remission of failure to withhold penalty under the general remission policy, rather than these specific guidelines because the company pays a set amount of

salary each quarter that is not calculated by reference to the gross personal services income received by the company.

Example 3

Peppe Pty Ltd provides Jack’s services as an engineer. Peppe was aware that it had Division 13 obligations in respect of the personal services provided by Jack. Peppe is registered as a small withholder.

In quarter 1, Peppe receives \$60,000 in gross personal services income (excluding GST). Peppe pays \$20,000 as salary to Jack. Peppe works out the amount to withhold by referring to the *PAYG Withholding Tax Tables (Quarterly)* and withholds \$6,412 from the payment of \$20,000. Peppe has not made any other withholding payments during that quarter so the amount of \$20,000 is reported at W1 and the amount of \$6,412 is reported at W2 on Peppe’s BAS. Peppe then sends the BAS together with \$6,412 to the Tax Office. (Assume Peppe has no other Activity Statement obligations).

Assume the gross personal services income (exclusive of GST) received by Peppe is the same for each quarter (ie., \$60,000). By the end of the income year, Peppe has withheld the following amounts from salary paid to Jack:

<i>Quarter</i>	<i>Promptly paid salary</i>	<i>Amount withheld under Division 12</i>
1	\$20,000	\$6,412
2	\$20,000	\$6,412
3	\$20,000	\$6,412
4	\$20,000	\$6,412
TOTAL	\$80,000	\$25,648

All amounts are correctly reported on the BAS and withheld amounts have been paid to the Tax Office.

After the end of the income year

By 14 July following the end of the income year, Peppe prepares the payment summary for Jack. Peppe also prepares an annual report and submits that to the Tax Office.

To complete their income tax returns, Jack and Peppe need to work out the amount of personal services income that is attributed to Peppe under Part 2-42 of the ITAA 1997.

Assume that during the income year Peppe:

- received \$240,000 (excluding GST) as a payment for Jack’s services;
- received investment income of \$5,000;
- incurred other expenses of \$65,000 to generate the income for Jack’s services; and
- incurred entity maintenance expenses of \$5,000.

The amount attributed to Jack at the end of the income year is Jack’s personal service income less certain deductions (worked out under section 86-15 and 86-20 ITAA 1997).

The amount of Jack’s personal services income is \$240,000. This amount is reduced by amounts promptly paid to Jack as salary or wages (\$80,000). Jack’s personal services income under section 86-15 will therefore be \$160,000.

This amount is then reduced by the amount worked out in accordance with the method statement in section 86-20(2) ITAA 1997: \$65,000

<i>Method Statement</i>	<i>Calculation</i>
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Step 1	Work out, for the income year, the amount of any deductions (other than *entity maintenance deductions or deductions for amounts of salary or wages paid to you) to which the *personal services entity is entitled that are deductions relating to your *personal services income.	\$65,000
Step 2	Work out, for the income year, the amount of any *entity maintenance deductions to which the *personal services entity is entitled.	\$5,000
Step 3	Work out the *personal services entity's assessable income for that income year, disregarding any income it receives that is your *personal services income or the personal services income of anyone else.	\$5,000
Step 4	Subtract the amount under step 3 from the amount under step 2. <i>Note 1: Step 4 ensures that, before entity maintenance deductions can contribute to the reduction, they are first exhausted against any income of the entity that is not personal services income.</i> <i>Note 2: If the personal services entity received another individual's personal services income, see section 86-25.</i>	\$0
Step 5	If the amount under step 4 is greater than zero, the amount of the reduction under subsection (1) is the sum of the amounts under steps 1 and 4.	N/A
Step 6	If the amount under step 4 is not greater than zero, the amount of the reduction under subsection (1) is the amount under step 1.	\$65,000

The amount therefore attributable to Jack under section 86-15 ITAA 1997 is \$95,000 (that is, \$160,000 less \$65,000).

In completing his income tax return Jack includes the amounts of \$95,000 (attributed personal services income) and \$80,000 (salary or wages) in his assessable income.

Analysis

After the end of the income year we are in a position to accurately review the amounts that *should* have been paid under Division 13 had Peppe been in a position to know the amount to include at Step 2(a) in the method statement in paragraph 13-5(2)(a). This potentially exposes Peppe to a penalty for failure to withhold if there is a shortfall in the amounts that *should* have been paid under Division 13.

The amounts which should have been paid under Division 13 in quarter 1 if Peppe had been using the method statement in paragraph 13-5(2)(a) is worked out as:

<i>Method Statement</i>		<i>Calculation</i>
Step 1	Identify the payments that the *personal services entity makes to the individual during the period mentioned in paragraph (1)(b) that are *withholding payments covered by section 12-35.	\$20,000
Step 2	Identify the amounts that: (a) are included in the individual's assessable income under section 86-15 of the <i>Income Tax Assessment Act 1997</i> ; and (b) relate to *alienated personal services payments the entity receives during that period	\$23,750 (\$95,000 x [60,000/240,000])
Step 3	Work out the sum of all the amounts that Division 12 would require the entity to withhold in respect of that period if both of these were taken into account: (a) the payments identified in step 1; and (b) the amounts identified in step 2, as if they were payments of salary covered by section 12-35.	\$17,931 (Amount to withhold on quarterly basis from \$43,750)
Step 4	Sum of all the amount withheld under section 12-35 from the payments identified in Step 1.	\$6,412
Step 5	Subtract the sum under step 4 from the sum under step 3.	\$11,519

In addition to the amounts withheld under Division 12 for quarter 1, Peppe should have also paid \$11,519 under Division 13. There is therefore a shortfall in the amounts that Peppe was required to pay under Division 13 and therefore a failure to withhold penalty of \$11,519³ applies to Peppe for quarter 1. Similarly a penalty of \$11,519 will apply to Peppe for quarters 2, 3 and 4.

Even though Peppe did not make a conscious choice to adopt the administrative options, if the amounts that Peppe withheld during each quarter of the year are equal to or greater than the amounts that would have been withheld if the relevant withholding rate had been applied to:

- 70% of the gross personal services income (exclusive of GST) received by Peppe during the quarter; or
- the *net personal services income percentage* applied to the gross personal services income (exclusive of GT) received by Peppe during the quarter;

the Commissioner will remit the failure to withhold penalty to nil. Otherwise, the Commissioner will apply the general guidelines on remission of failure to withhold penalty for Division 13.

The amount actually withheld during quarter 1 was \$6,412.

Under the *70% of the gross personal services income* option 70% of \$60,000 (Peppe's gross personal services income for quarter 1) is \$42,000. The amount to withhold from \$42,000 according to the *PAYG Withholding Tax Tables (Quarterly)* is \$17,082.

Under the *net personal services income percentage* option, the calculation relies on the previous years figures. Assume for the previous income year Peppe:

- received total payments of \$200,000 (GST exclusive) for Jack's services;
- received other income of \$4,000;
- incurred expenses (other than promptly paid salary or wages and entity maintenance expenses) of \$60,000 to generate the income for the Jack's services; and
- incurred entity maintenance expenses of \$5,000.

The calculation of the *net personal services income percentage* is worked out as follows:

$$\frac{\text{Individual's gross personal services income (excl. GST) for the previous income year}}{\text{Personal services entity's gross personal services income (excl. GST) for the previous income year}} \times \frac{100}{1} = \text{net personal services income percentage}$$

Jack's gross personal services income (excluding GST) for the previous income year was \$200,000. As Peppe had no other service providers, its gross personal services income (excluding GST) for the previous income year was also \$200,000.

The amount worked out under the method statement in section 86-20 of the ITAA 1997 is: \$61,000. This was worked out as follows:

<i>Method Statement</i>		<i>Calculation</i>
Step 1	Work out, for the income year, the amount of any deductions (other than *entity maintenance deductions or deductions for amounts of salary or wages paid to you) to which the *personal services entity is entitled that are deductions relating to your	\$60,000

³ The failure to withhold penalty for Division 13 is equal to the shortfall in amounts the entity should have paid under Division 13. See paragraph 18.

	*personal services income.	
Step 2	Work out, for the income year, the amount of any *entity maintenance deductions to which the *personal services entity is entitled.	\$5,000
Step 3	Work out the *personal services entity's assessable income for that income year, disregarding any income it receives that is your *personal services income or the personal services income of anyone else.	\$4,000
Step 4	Subtract the amount under step 3 from the amount under step 2. <i>Note 1: Step 4 ensures that, before entity maintenance deductions can contribute to the reduction, they are first exhausted against any income of the entity that is not personal services income.</i> <i>Note 2: If the personal services entity received another individual's personal services income, see section 86-25.</i>	\$1,000
Step 5	If the amount under step 4 is greater than zero, the amount of the reduction under subsection (1) is the sum of the amounts under steps 1 and 4.	\$61,000
Step 6	If the amount under step 4 is not greater than zero, the amount of the reduction under subsection (1) is the amount under step 1.	N/A

The net personal services income percentage is:

$$\frac{\$200,000 - \$61,000}{\$200,000} \times \frac{100}{1} = 69.5\%$$

69.5% of \$60,000 (Peppe's gross personal services income for quarter 1) is \$41,700. The amount to withhold from \$41,700 according to the *PAYG Withholding Tax Tables (Quarterly)* is \$16,936.

The amount that Peppe actually withheld in quarter 1 (ie., \$6,412) is neither equal to or greater the amount that would have been withheld using one of the administrative options (ie., \$17,082 or \$16,936). Therefore the Commissioner will not remit the failure to withhold penalty of \$11,519 for quarter 1 to nil under the guidelines in this Practice Statement. The Commissioner will consider remission of the failure to withhold penalty in accordance with the general failure to withhold remission guidelines for Division 13. (The Commissioner will consider remission of failure to withhold penalties for quarters 2, 3 and 4 similarly.)

subject references: PAYG withholding; alienation of personal services income; failure to withhold

legislative references: Division 12, Division 13 and Division 16 in Schedule 1 to the *Taxation Administration Act 1953*

related public rulings: Taxation Ruling TR 2001/8

file references: 2003/007197

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