PAYG WITHHOLDING RATES IN DISTRIBUTIONS TO EMPLOYEES

by Kim Arnold | Feb 25, 2014

A member has raised a concern with ARITA that there may be an inconsistency in the ATO guidance on PAYG withholding rates that apply to distributions to employees by insolvency practitioners.

The guidance that appeared to be in conflict appeared in the following two documents:

- Notice of Variation - Legislative Instrument (dated 13 May 2005); and
- Pay as you go withholding for external administrators (NAT 10913)

Specifically the issue was around ETPs and whether the tax free threshold applied and the relevant withholding rate. ARITA has consulted with the ATO and has been advised of the following:

Do ETP's retain their character and tax treatment when they are paid as a dividend by an administrator?

In the view of the ATO, employment termination payments (ETPs) retain their character in a similar manner to the treatment of salary and wages outlined in the Applied Design case (Deputy Commissioner of Taxation v. Applied Design Development Pty Ltd (in Liq.) [2002] ATC 4193; (2002) 49 ATR 196). This is supported by paragraphs 35 and 36 of taxation ruling TR 2003/15 'Income tax: Pay As You Go (PAYG) Withholding - Payments made by trustees under the Bankruptcy Act 1966 to former employees' for personal insolvency administrations. Essentially:

1. Where a former employee's entitlement to a termination payment arises as a consequence of the termination of employment, there is a sufficient causal connection with the termination of employment, even though the amount is paid by a insolvency practitioner under the statutory provisions of the Bankruptcy Act/Corporations Act. The payment retains its character as being in consequence of the termination of employment.
2. Accordingly, an insolvency practitioner is required to withhold an amount, under section 12-85 in Schedule 1 to the TAA 1953, from payments it makes to any former employee in respect of a provable debt for an eligible termination payment.

The ATO is also of the view the variation only requires withholding from the taxable component of a genuine redundancy payment. This is because the tax-free amount of a genuine redundancy payment is clearly not an ETP under subsection 82-135(e) of the Income Tax Assessment Act 1997. Implicit in the withholding variation is that a withholding obligation exists. The effect of the variation, as explained in the explanatory statement, is to alter the rate of withholding. The effect of the variation is NOT to impose a withholding obligation on payments where the withholding legislation did not previously provide for one.

Other

The class variation ought to have priority over usual rates of withholding if the conditions of the class variation are met. This may cause some anomalies, for example, where the payee receiving an ETP has reached preservation age (normally these employees would only be taxed at 16.5% but may be taxed at a flat 31.5% in an insolvency). It should be noted the variation was made in order to ease the administrative burden of the external administrators. The flat rate was introduced because of the difficulties the external administrators had in accessing relevant information and documentation. The withholding arrangements were made at the request of, and with the agreement of, the external administrators after considerable consultation.

In conclusion

The result is that because of the variation, all entitlements which accrued prior to appointment are subject to withholding at 31.5%, with the exception of the tax free component of a genuine redundancy payment, which is not subject to withholding at all.

These rates also apply to payments made on behalf of the Department of Employment under the GEERS or FEG arrangements.

If the flat rate of taxation results in an employee paying more tax that they otherwise should, employees will be entitled to refunds on the lodging of their income tax returns in the ordinary course.

Should any members have any queries regarding PAYG withholding rates, please contact Kim Arnold.