


IT 2125 - Prescribed payments system - credit for deductions of tax from prescribed payments made to a partnership, or the trustee of a trust estate

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TAXATION RULING NO.IT 2125

PRESCRIBED PAYMENTS SYSTEM -
CREDIT FOR DEDUCTIONS OF TAX FROM PRESCRIBED PAYMENTS
MADE TO A PARTNERSHIP, OR THE TRUSTEE OF A TRUST ESTATE

F.O.I. EMBARGO: May be released

REF H.O. REF: L79/16 P16 DATE OF EFFECT: Immediate

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

F.O.I. INDEX DETAIL

REFERENCE NO: SUBJECT REFS: LEGISLAT. REFS:

I 1122259 PRESCRIBED PAYMENTS SYSTEM :
ALLOWANCE OF CREDIT TO 221YHF
PARTNERS, BENEFICIARIES AND 221YHG
TRUSTEES OF TRUST ESTATES

PREAMBLE The question has been raised as to the way in which the prescribed payments system (PPS) credit provisions (sections 221YHF and 221YHG of Division 3A of Part VI of the Income Tax Assessment Act 1936) operate in a situation where the Commissioner receives a deduction form or deduction forms in relation to deductions made in a year of income from prescribed payments to a partnership or to a trustee of a trust estate.

2 In particular, there has been some confusion as to the operation of the law where -

- . a partner in the partnership or a beneficiary of the trust estate is not subject to tax, e.g., the income of the person does not exceed the tax-free threshold represented by the zero rate step in the personal income tax scale or the person is exempt from tax;
- . a "salary" is paid to a partner under the terms of a partnership agreement; or
- . a trust estate has no net income for the year of income or sustains a loss.

3 The purpose of this ruling is to provide general guidelines in relation to the operation of sections 221YHF and 221YHG in allocating and allowing PPS credit.

RULING Partnerships

4 Sub-section 221YHF(2) sets out the entitlement of partners in a partnership to the credit for PPS deductions made in a year of income from prescribed payments to the partnership. Each partner is entitled to a credit for a part of the tax deducted, determined in the proportion that the partner shares in the net income of the partnership from PPS activities in the

year of income or in the net loss from PPS activities. This rule also applies where a partnership deriving PPS income also returns income from another source; the PPS credit is allocated in the same proportion as each partner shares in the net PPS income (or PPS loss) component of the total net income (or loss) of the partnership.

5 The credit allocated to a partner in accordance with sub-section 221YHF(2) is then applied in accordance with the terms of section 221YHG, even though the partner will have no tax liability on his or her distribution, e.g., because the person's taxable income will not exceed the tax-free threshold represented by the zero rate step in the personal income tax scale or because the person is exempt from tax. In this latter regard, however, the special arrangements discussed in paragraphs 18-21 may be applied in some circumstances where a partner/beneficiary (or trustee) has no tax to pay in relation to a particular year of income.

6 In practice, the allocation of PPS credit to a partner in the same proportion that he or she shares in the net income/loss of the partnership will be accepted on the assumption that he or she also shares in the net PPS income/loss in that proportion. In the case where the distribution of the credit is in accordance with the sharing of the net PPS income/loss, but this differs from the basis of sharing in the net income/loss, the partnership return should include an explanation of the basis of distribution of the credit.

7 Consideration has been given to the question of the allocation of PPS credit where partners draw a "salary" and the amount of the drawings is taken into account in determining each partners' share in the net income or net loss of the partnership. Some guidelines are set out below. In applying the principles outlined, it should be borne in mind that the basic rule of the law requires PPS credit to be allocated between partners on the same basis as they share in the net PPS income/loss of the partnership. It is always open to partners to distribute particular income in accordance with the terms of the partnership agreement and, where this has been done and PPS credit distributed accordingly, full details should be disclosed in the return in support of the basis of allocating the credit.

8 Where a partnership profit remains after charging salaries, there is a clear indication of the partners' intentions regarding the manner in which they have agreed to share the net income of the partnership as defined in section 90 of the Assessment Act. Therefore, any PPS credit will be available to partners in the same proportion as they share in the overall net income of the partnership. The following example shows the manner in which the individual credit entitlements of partners will be calculated in these cases (it is assumed that the partners share profits equally after payment of the salary). In fact, the distribution of credit accords with the distribution of income as it should be returned in column (5) of item 1 on the Form P.

| | |
|--|------|
| | \$ |
| Partnership net income for section 90 purposes | 2000 |
| Salary - Partner A | 1000 |
| Partnership profit after charging salary | 1000 |

Distribution as between partners -

| | | |
|---|---|------|
| Partner A - salary \$1000 plus \$500 (50% of profit of \$1000 after salary) | = | 1500 |
|---|---|------|

| | | |
|--|---|-----|
| Partner B - (50% of profit of \$1000 after salary) | = | 500 |
|--|---|-----|

PPS credit entitlement -

| |
|---|
| Partner A \$1500 or 3/4 of available credit \$2000 |
|---|

| |
|---|
| Partner B \$ 500 or 1/4 of available credit \$2000 |
|---|

9 The charging of partners' salaries may result in either the conversion of what would otherwise be the net income of the partnership to a loss, or an increase in the partnership loss. The following examples indicate the manner in which the individual credit entitlements of partners is to be calculated in these cases :

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