PAYG instalments and PAYG instalment variations

What are PAYG instalments?

PAYG instalments are regular prepayments of Australian tax during the income year.

They are not an extra tax.

Rather, they are amounts paid in advance towards your expected end-of-year Australian tax liability.

When your income tax return is lodged, the PAYG instalments you have paid are credited against your final tax liability.

If your PAYG instalments are more than your final tax liability the excess is generally refunded or credited to your ATO account. If your PAYG instalments are less than your final tax liability, you pay the balance to the ATO when your tax return is assessed.

PAYG instalments most commonly apply where you receive income that has not had enough tax withheld during the year. Examples include:

- sole trader or business income;
- rental income;
- bank interest;
- dividends;
- trust distributions;
- foreign investment income; and
- other investment income.

PAYG instalments are different from PAYG withholding. PAYG withholding is tax withheld from salary, wages, pensions or other payments by the payer before you receive the income. PAYG instalments are payments you make directly to the ATO towards tax on income where tax has not already been withheld, or has not been withheld at a sufficient level.

Why has the ATO entered me into the PAYG instalment system?

The ATO can automatically enter you into the PAYG instalment system after your income tax return is lodged.

For most Australian-resident individuals this usually happens where **all** of the following apply based on your latest tax return and notice of assessment:

- you reported instalment income of $4,000 or more;
- your tax payable on your latest notice of assessment was $1,000 or more; and
- the ATO estimates that the tax on your business and/or investment income is $500 or more.

Your instalment income is all the ordinary income you earned from your business and investment activities.

The ATO has a list of instalment income on their website.

The PAYG instalment rules can also apply to individuals who do not carry on a business. For example, you may be entered into the PAYG instalment system because you have interest, dividend, rental, or foreign pension income.

Do I need to register or lodge a form to enter PAYG instalments?

Usually, no.

If you meet the ATO's entry criteria the ATO will generally enter you into the PAYG instalment system automatically after your tax return is assessed.

The ATO will notify you, usually through your myGov inbox, ATO online services, your registered tax agent, or by post.

You can also voluntarily enter the PAYG instalment system if you expect to earn business or investment income and want to reduce the risk of a large tax bill after lodging your next tax return. This may be useful where, for example, you have started receiving rental income, business income, significant interest income, or significant dividends.

How do PAYG instalments work in practice?

The ATO will issue an instalment notice or activity statement to you.

This may be an Instalment Activity Statement or, where relevant, a Business Activity Statement.

The ATO will tell you:

- how often you need to pay;
- the instalment amount or instalment rate; and
- the due date for payment.

Most individual taxpayers who are in the PAYG instalment system pay quarterly. Quarterly PAYG instalments are generally due after the end of each quarter. The usual due dates are:

- 28 October for the July to September quarter;
- 28 February for the October to December quarter;
- 28 April for the January to March quarter; and
- 28 July for the April to June quarter.

Some taxpayers may be eligible to pay one annual instalment instead.

Annual PAYG instalments are generally due on 21 October.

You should follow the payment instructions on the ATO notice or activity statement. In some cases, if you accept the ATO-calculated instalment amount and are not varying it, you may only need to pay the amount shown. In other cases, particularly where an instalment rate is used, details may need to be reported on the activity statement.

How does the ATO calculate the instalment?

The ATO usually calculates PAYG instalments with reference to your most recently assessed income tax return.

There are two common calculation methods.

1. The first is the instalment amount method. Under this method, the ATO calculates a fixed instalment amount. This is usually the simplest method because the ATO tells you how much to pay.

2. The second is the instalment rate method. Under this method, the ATO gives you a percentage rate. You apply that rate to your business and/or investment income for the relevant period. This method can be useful where your income varies during the year, but it requires more active calculation and reporting.

Can I be removed from the PAYG instalment system?

You may not need to continue paying PAYG instalments if your circumstances have changed.

The ATO will automatically remove you from the PAYG instalment system if you:

- are eligible to claim the senior and pensioners tax offset in your tax return;
- report business and investment income of less than $4,000 (for residents, or $1 for non-residents) in your tax return;
- have a tax debt of less than $1,000 (after adjustments for PAYG instalments and voluntary payments) in your tax assessment;
- have a calculated PAYG instalment rate of 0.0%;
- have an estimated (notional) tax liability of less than $500;
- are under 18 and your tax return shows Division 6AA income less than the lowest marginal threshold; or
- lodge a final tax return or non-lodgment advice, or your tax agent lodges a 'further return not necessary'.

The ATO will also remove a taxpayer from PAYG instalments if they are notified the taxpayer is deceased.

If you want to exit earlier you or your registered tax agent can request this through ATO online services.

If the ATO does not remove you immediately it may still be possible to vary your instalments down, including to nil, where this reflects your expected tax position for the year.

Care should be taken before varying instalments. If your varied instalments are less than 85% of your total tax payable you may have to pay a general interest charge on the difference, in addition to paying the shortfall.

Depending on the circumstances there may also be penalties.

What is a PAYG instalment variation?

A PAYG instalment variation is a request to change the instalment amount or instalment rate that the ATO has calculated.

You may wish to vary your PAYG instalments if the ATO-calculated amount does not reflect your expected tax position for the current income year.

For example, a variation may be appropriate where:

- your business income has reduced;
- your rental income has reduced;
- your interest or dividend income has reduced;
- you have sold an investment that previously produced income;
- you have ceased business;
- you have higher deductions than the prior year;
- your prior year income included a one-off amount; or
- your current year tax liability is expected to be materially lower than the ATO estimate.

You can also vary upwards if your income has increased and you want to reduce the risk of a larger tax bill after lodging your tax return.

Who can apply for a PAYG instalment variation?

You can apply for a PAYG instalment variation if you are in the PAYG instalment system and you consider that the ATO-calculated instalment amount or rate is too high or too low.

A registered tax agent can also apply for the variation on your behalf.

A variation should be based on a reasonable estimate of your expected business and/or investment income, deductions and tax payable for the income year. It should not be used simply to defer tax where the ATO-calculated instalment is broadly reasonable.

How do I apply for a variation?

PAYG instalments can generally be varied through the relevant ATO activity statement or instalment notice.

For individuals, this is commonly done through:

- myGov linked to ATO online services;
- ATO online services for business, where relevant;
- the paper instalment notice or activity statement; or
- your registered tax agent.

The variation must generally be lodged on or before the due date for the relevant instalment.

If you vary an instalment amount the varied amount will generally apply to the remaining instalments for that income year unless you vary again later. If your circumstances change again during the year, a further variation may be possible.

What information is needed to support a variation?

Before varying PAYG instalments, it is sensible and prudent to estimate your tax position for the current year.

Relevant information may include:

- expected business income for the year;
- expected business deductions for the year;
- expected rental income and rental expenses;
- expected interest and dividend income;
- expected trust distributions;
- changes in employment income;
- expected deductions;
- carried-forward losses, if relevant;
- details of one-off income in the prior year; and
- any other changes that may affect your Australian tax liability.

You should keep records supporting the variation. These may be needed if the ATO later asks why the instalment was varied.

bdh Tax can assist with a PAYG instalment variation when we are instructed to assist with your Australian individual tax return.

If you are not yet a client of bdh Tax please complete the enquiry form at www.bdhtax.com to arrange a free initial conversation about your situation, after which we can send a no obligation fee quote to you.

Practical examples of PAYG instalment variations

Example 1 – rental property sold

You were entered into PAYG instalments because your last tax return included significant rental income. During the current year, you sold the rental property and no longer expect to receive rental income.

In this situation it may be appropriate to request removal from the PAYG instalment system or vary future instalments down, potentially to nil, depending on your expected income and tax position for the tax year.

Example 2 – interest income reduced

You received a large amount of bank interest in the previous year because you temporarily held funds in a high-interest savings account.

You have since used those funds to purchase a home and expect much lower interest income this year.

In this case, the ATO-calculated PAYG instalments may be too high because they are based on last year's income. A PAYG instalment variation may be appropriate.

Example 3 – business income lower than expected

You operate as a sole trader and your business income is significantly lower this year than last year. Your ATO instalments are based on the higher prior year income.

In this case, you may be able to vary the instalments down to better match your expected current year tax liability.

Example 4 – business income higher than expected

Your business or investment income has increased materially compared with the prior year, meaning the ATO-calculated instalments may be too low.

In this case, you may choose to vary upwards or make voluntary payments to reduce the expected tax bill when your tax return is lodged.