How to calculate pay as you go (PAYG) instalment amount and rate

The Australian Taxation Office uses information from the most recent tax return to work out the PAYG instalment amount, which is adjusted to reflect any likely growth in the taxpayer's income. The adjustment is based on changes in Australia's gross domestic product (GDP).

The GDP adjustment factor is updated at the start of each income year using data from the Australian Bureau of Statistics. The adjustment is based on GDP changes over the previous two calendar years.

The reason for such adjustment is because if the instalment amount was solely based on the previous tax situation, it might not cover the actual tax liability, which means that one may have to pay extra tax when lodging a tax return.

The GDP adjustment factor is 0% for 2020/21 and 0% for 2021/22. The 0% rate applies for instalment quarters that commence on or after 1 July 2020.

The GDP adjustment factor:

- applies to PAYG instalments for the 2021–22 income year for taxpayers whose quarter starts on or after 1 July 2021
- is used to calculate PAYG instalments if the taxpayer pays quarterly (or twice yearly) using the instalment amount
- does not affect the taxpayer if they work out their own instalments (using the rate method) or pay annually.

The ATO calculates a taxpayer's instalment rate (to two decimal places) using the following formula:

$$\frac{\text{Estimated (notional tax)}}{\text{Instlament income}} \text{ x } 100$$

If the calculated rate is more than the highest income tax rate for the entity type, it will automatically reduce it to a more reasonable rate (below).

The instalment rate may be high before adjustment if:

- income includes receipt from an employee share scheme
- there is a tertiary education debt in the last tax return
- income is reported at the wrong label in the last tax return
- the return is amended to include excess superannuation contributions.

Reasonable instalment rates by entity type

Entity type	Reasonable rate
Individuals (including sole traders)	55%
Trusts	55%
Superannuation funds and SMSF	45%
Corporate tax entities	30%

If the taxpayer is an individual (including a sole trader), they will automatically enter the PAYG instalments system if they have all of the following:

- instalment income (gross business and investment income excluding any capital gains) from the latest tax return of $4,000 or more

- tax payable on the latest notice of assessment of $1,000 or more, and
- estimated (notional) tax of $500 or more.

A company will automatically enter the PAYG instalments system if any of the following apply:

- it has instalment income from its latest tax return of $2 million or more
- it has estimated (notional) tax of $500 or more, or
- it is the head company of a consolidated group.

PAYG notional tax

A taxpayer's "notional tax" for the base year (the latest income year for which an assessment has been made) is calculated as follows:

adjusted tax on adjusted taxable income - *adjusted tax on adjusted withholding income*

Where a taxpayer's adjusted tax on adjusted withholding income is greater than the adjusted tax on adjusted taxable income for the base year, the notional tax is nil.

Adjusted taxable income

A taxpayer's "adjusted taxable income" for the base year is the taxpayer's total assessable income for the base year, reduced by:

- any net capital gains included in assessable income
- all deductions allowed for the base year, except tax losses
- if the taxpayer is a company or it is a head company that had tax losses transferred to it, the lesser of:
  ~ any tax loss to the extent that it can be carried forward to the next income year, and
  ~ the deduction for tax losses claimed in the base year, and
- if the taxpayer is neither a company nor a head company that had tax losses transferred to it, any tax loss to the extent that it can be carried forward to the next income year.

Adjusted withholding income

A taxpayer's "adjusted withholding income" for the base year is the amount of assessable income from which PAYG withholding has been, or should have been, made for the base year (except for amounts that have been subject to PAYG withholding because the taxpayer did not quote a TFN or an ABN), reduced by the deductions allowed for the base year to the extent that they reasonably relate to those amounts.

There is no legislative guidance as to what deductions reasonably relate to the amounts from which PAYG withholding has been, or should have been, made. There is also no mention of how such deductions are to be allocated where they do not fully relate to PAYG withholding income.

Adjusted tax

Calculation of the adjusted tax on either the adjusted taxable income or the adjusted withholding income is a four-step process.

Step 1: Calculate the income tax payable on the adjusted taxable income or the adjusted withholding income (as relevant). The following tax offsets are disregarded:

- private health insurance offset
- tax offset arising from franking deficit tax liabilities

- low income tax offset and low and middle tax offset
- offset for superannuation contributions made on behalf of the taxpayer's spouse
- offset for Medicare levy surcharge (lump sum payments in arrears)
- the corporate loss- carry back tax offset

Step 2: Calculate the Medicare levy payable on the adjusted taxable income or the adjusted withholding income (as the case may be), disregarding the Medicare levy surcharge.

Step 3: Calculate the amount of any tertiary education assessment debt that would have been repayable for the base year on the assumption that the taxpayer's taxable income was equal to the adjusted taxable income or the adjusted withholding income (as the case may be).

Step 4: Add up the amounts determined for steps 1, 2 and 3.

➢ **Example 1: Corporate taxpayer**

ABC Ltd derived the following assessable income during the base year:

Gross sales	$120,000
Interest	$10,000
Royalties	$25,000

It incurred the following deductions during the base year:

Cost of sales	$50,000
Tax agent's fees	$2,000

ABC Ltd did not quote its TFN in relation to the interest income and, consequently, tax was withheld. On the assumption that ABC is a base rate entity and the tax rate of 25% applies for the year for which the instalment rate is calculated, ABC Ltd's instalment rate is calculated as follows:

ABC Ltd’s adjusted taxable income	=	assessable income of base year	-	Net capital gains of base year	-	allowable deductions (except tax losses) of base year	-	Tax losses carried forward from base year
	=	$155,000 - $0 - $52,000 - $0						
	=	$103,000						

ABC Ltd’s adjusted withholding income	=	nil, since amounts subject to PAYG withholding due to the non-quotation of either the taxpayer’s TFN or ABN do not count

Adjusted tax on adjusted taxable income

Step 1:	=	Income tax payable on $103,000
	=	25% x $103,000
	=	$25,750
Step 2:		Not applicable

Step 3		Not applicable
Step 4		Add Steps 1 to 3
	=	$25,750 + $0 + $0 - $0
	=	$25,750

ABC Ltd's notional tax is therefore $25,750.

ABC Ltd's base assessment instalment income equals so much of its assessable income for the base year that is instalment income. This would be $155,000 ($120,000 + $10,000 + $25,000).

ABC Ltd's instalment rate	=	$\frac{\text{ABC Ltd's notional tax x 100}}{\text{ABC Ltd's base assessment instalment income}}$
	=	$\frac{\$25,750}{\$155,000}$ x 100
	=	16.61% (rounded to two decimal places)

- **Example 2: Individual taxpayer**

Mary derived the following assessable income during the year ended 30 June 2021 (the base year):

Salary	$30,000
Net capital gain	$12,000
Interest	$8,000
Dividends (fully franked)	$2,000
Dividend gross-up amount ($2,000 x 30/70)	$857

She incurred the following deductions during the base year:

Work-related expenses	$800
Interest and dividend deductions	$200

Mary did not quote her TFN in relation to the interest income and, consequently, $3,720 tax was withheld. Further, on her assessment for the year ended 30 June 2016, Mary does not have a tertiary education assessment debt. Using the personal tax rates for the year ending 30 June 2022, Mary's instalment rate is calculated as follows:

Mary's adjusted taxable income	=	assessable income of base year	-	Net capital gains of base year	-	allowable deductions (except tax losses) of base year	-	Tax losses carried forward from base year
	=	$52,857 - $12,000 - $1,000 - $0						
	=	$39,857						

Mary's adjusted withholding income = $30,000 - $800 = $29,200

The interest subject to PAYG withholding due to the fact that Mary did not quote her TFN does not count as adjusted withholding income.

Adjusted tax on adjusted taxable income

Step 1:	=	Income tax payable on $39,857
	=	Tax on $39,857 using 2021/22 rates - franking credit of S857
		$4,114.83 - $857
	=	$3,257.83
Step 2:	=	Medicare levy on $39,857
	=	$39,857 x 2%
	=	$797.14
Step 3:		Not applicable
Step 4:		Add steps 1to 3
	=	$3,257.83 + $797.14 + $0 - $0
	=	$4,054.97

Adjusted tax on adjusted withholding income

Step 1:	=	Income tax payable on $29,200
	=	Tax on $29,200 using 2021/22 rates
	=	$2,090
Step 2:	=	Medicare levy on $29,200
	=	$29,200 x 2%
	=	$584
Step 3:		Not applicable
Step 4:		Add steps 1 to 3
	=	$2,090 + $584 + $0 - $0
	=	$2,674

Mary's notional tax is therefore $1,380.97 ($4,054.97 - $2,674.00).

Mary's base assessment instalment income equals so much of her assessable income for the base year that is instalment income. This would be $10,000 ($8,000 + $2,000). The dividend gross-up amount is not instalment income as it is statutory income.

$$\text{Mary}'\text{sinstalment rate} = \frac{\text{Mary}'\text{snotional tax x 100}}{\text{Mary}'\text{s base assessment instalment income}'\text{s}}$$

$$= \frac{1{,}380.97 \text{ x } 100}{\$10{,}000}$$

= 13.81% (rounded to two decimal places)

This article is a guide, and it does not have details that suit every taxpayer. The reader may consult a qualified tax professional since each individual has different situations where calculation may vary.