



Australian Government  

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Inspector-General of Taxation

# Review into Aspects of the Pay As You Go Instalments System

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January 2018





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## EXECUTIVE SUMMARY

The review into aspects of the Pay As You Go (PAYG) instalments system is the first Inspector-General of Taxation (IGT) review to be undertaken in direct response to insights drawn from the IGT's complaint handling service. It also had stakeholder support during consultation on the IGT 2017 work program and attracted submissions from individual taxpayers, tax practitioners and their representative bodies.

A key focus of this review was individual taxpayers' awareness and understanding of the PAYG instalments system. Individual taxpayers were unclear as to why they had been entered into the system, its requirements and exemptions, its interaction with the annual income tax system and the support tools available to them. Accordingly, the IGT has recommended a number of improvements to the ATO's taxpayer communication and guidance materials as well as internal staff education and support.

The major underlying source of stakeholders' concerns arose from confusion caused by the interaction between the ATO's accounting systems. Symptoms raised by stakeholders included the non-receipt of ATO communications and consequential issuing of multiple Activity Statements for past periods as well as unnecessary debt collection action whilst the ATO manually 'washed up' duplicated liabilities. Accordingly, the IGT has recommended that, as a longer term goal, the ATO consider using a single integrated accounting system for administering the income tax and PAYG instalments regimes. In the interim, a number of recommendations have been made that are aimed at improving the current processes.

Stakeholders had also raised concerns regarding specific elements of the PAYG instalments system. These elements were the ATO's entry criteria for individuals, administration of penalties and interest as well as the inclusion of statutory income in calculating the instalment rate. In response, the IGT has recommended periodic review of the entry criteria as well as additional system functionality to allow tax and BAS agents to voluntarily enter their clients into, or exit them from, the system through their practice management software.

The IGT has also made recommendations to enhance the ATO's PAYG instalments risk treatment strategy including the education of individuals regarding underestimation of instalment amounts, appropriate consideration of penalty imposition and public reporting of ATO enforcement statistics.

Overall, the IGT has made seven recommendations which are made up of 22 parts. The ATO has agreed in full with six recommendations and has partly agreed with the other (or agreement with 21 out of 22 parts). The one part on which agreement was not reached relates to the provision of a general information brochure to new entrants into the system when issuing the ATO welcome letter. However, the ATO has committed to considering alternatives.

The implementation of the agreed recommendations should result in significant improvements for individual PAYG instalment taxpayers, their representatives and the ATO. The IGT wishes to take this opportunity to thank all who contributed to the success of this review.





## LIST OF RECOMMENDATIONS

### RECOMMENDATION 2.1

*The IGT recommends that with respect to the PAYG instalments system, the ATO:*

- a) improve its 'welcome letter' to provide taxpayer specific information, including:*
  - the circumstances that triggered entry into the system;*
  - a payment schedule of default instalment amounts;*
  - an explanation of how to make variation elections;*
  - how the ATO processes an exit from the system; and*
  - where to find additional information;*
- b) where instalment amounts or reporting frequency have been varied, provide confirmation to taxpayers together with an updated payment schedule;*
- c) accompany the welcome letter with a brochure containing more general information;*
- d) provide a comprehensive PAYG instalments guide on the ATO website;*
- e) update its Notice of Assessment to set out any outstanding instalments; and*
- f) improve ATO staff education and support by, for example, aligning scripting for those handling telephone enquires with the comprehensive PAYG instalments guide and provide access to the PAYG instalments eligibility form and associated training.*

### RECOMMENDATION 3.1

*The IGT recommends the ATO:*

- a) consider using a single accounting method for administering the income tax regime including the PAYG instalments system as a long term goal; and*
- b) alert taxpayers and/or their tax or BAS agents to their unpaid PAYG instalment amounts through pre-filling and inform them that such amounts must be paid irrespective of any refund or debt arising from their income tax assessment.*

## RECOMMENDATION 3.2

*The IGT recommends the ATO:*

- a) modify its call centre scripting, for dealing with taxpayers' request to update their addresses, to require its staff to check if a taxpayer has an existing ICA and ask all necessary questions to determine if the address on it needs to be updated;*
- b) where taxpayers have unpaid or unreported PAYG instalments, take prompt action to confirm the taxpayer's address by alternative means such as telephone; and*
- c) engage with the Department of Human Services and software developers to:*
  - i. consider, as a long term goal, providing functionality that allows taxpayers to set address preferences for where they wish to receive different types of correspondence and more detailed notification of any correspondence that has been received in their myGov inbox; and*
  - ii. ensure that, on linking of myGov accounts to the ATO, the existing address for correspondence is not overridden where the taxpayer uses a BAS or tax agent.*

## RECOMMENDATION 3.3

*The IGT recommends the ATO:*

- a) as soon as practicable after it has detected that a taxpayer's address is outdated, take prompt action to update the address, for example, by attempting to contact that taxpayer by alternatives means, such as telephone; and*
- b) develop procedures and policies for determining the appropriate deferred lodgment and payment dates when issuing multiple PAYG instalment Activity Statements and train its relevant staff accordingly.*

## **RECOMMENDATION 3.4**

*The IGT recommends the ATO:*

- a) for taxpayers who have lodged an income tax return but not lodged corresponding BASs by the due date, automatically suppress any obligations to report and pay PAYG instalments for that income tax period;*
- b) for taxpayers who would otherwise require a manual finalisation of the PAYG instalments label, issue targeted communications encouraging them to delay lodgment of their income tax return until 21 July; and*
- c) where a manual finalisation of the PAYG instalments becomes necessary, any related debt recovery action should be delayed pending the completion of this task.*

## **RECOMMENDATION 4.1**

*The IGT recommends that the ATO improve its monitoring of the entry and exit criteria of the PAYG instalments system by:*

- a) periodically reviewing, at least every three years, the threshold entry criteria;*
- b) better informing those no longer meeting the entry criteria that they may choose to voluntarily remain in the system; and*
- c) seeking to provide additional functionality, in its new Practitioner Lodgment Service, to allow BAS and tax agents to voluntarily enter or exit their clients into or out of the system.*

## **RECOMMENDATION 4.2**

*The IGT recommends the ATO:*

- a) educate and warn taxpayers of the risk of underestimation of PAYG instalment amounts particularly where repeated and/or excessive underestimations occur;*
- b) enforce penalties in appropriate circumstances where such taxpayers have repeatedly not adhered to warnings; and*
- c) publish statistics on its enforcement activities including the number and quantum of penalties imposed.*



# CHAPTER 1 — BACKGROUND

## CONDUCT OF THE REVIEW

1.1 The Inspector-General of Taxation's (IGT) review into aspects of the Pay As You Go (PAYG) instalments system was conducted largely in response to insights drawn from the complaint handling service which the IGT has been providing to the community since May 2015. There was also stakeholder support for this review to be undertaken during the consultation on the IGT 2017 work program.

1.2 It is the first time that the IGT has been able to analyse sufficient complaint investigation data to determine that a particular review was required. This is a significant development as it allows the IGT to take prompt action into targeted areas of real concern. The IGT had previously foreshadowed that, whilst consultation to develop the work program would continue, there would be increased reliance on themes emerging from the complaint handling service.

1.3 This review is targeted at the PAYG instalments system as it pertains to individual taxpayers. The terms of reference and submission guidelines were released on 29 March 2017<sup>1</sup> and submissions were received from individual taxpayers, tax practitioners and their representative bodies.

1.4 Concerns raised in complaints and submissions broadly relate to:

- taxpayer awareness and understanding of the PAYG instalments system;
- the ATO's processes to administer the PAYG instalments system; and
- elements of the PAYG instalments framework, namely: the entry criteria, instalment calculations as well as penalties and interest for incorrectly estimating income and instalment rates.

1.5 The IGT review team has worked progressively with the ATO to distil potential areas for examination, independently considered ATO systems, processes and procedures and analysed relevant ATO statistics to develop recommendations for improvement.

## THE PAYG ARRANGEMENTS SCHEME

1.6 The PAYG arrangements scheme, of which the PAYG instalments system is a part, aims to assist taxpayers meet their anticipated tax liabilities by making progressive payments to minimise large end-of-year tax bills whilst providing the Government with revenue during the financial year.<sup>2</sup> The scheme requires periodic reporting and pre-payment of income taxes during the financial year.<sup>3</sup>

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1 Terms of reference are reproduced in Appendix 1 of this report.

2 Explanatory Memorandum, House of Representatives, A New Tax System (Taxation Laws Amendment) Bill (No. 1) 1999, p 1.

3 *Taxation Administration Act 1953* sch 1 s 6-1.

1.7 The PAYG arrangements scheme was implemented on 1 July 2000 to provide a single set of common machinery rules and replace 11 pre-existing reporting systems<sup>4</sup> which were considered to have created duplicate obligations or were inefficient and outdated.<sup>5</sup>

1.8 The PAYG arrangements scheme provides both a withholding system and an instalments system. The withholding system requires a person who makes a payment to a taxpayer for work,<sup>6</sup> such as salary or wages,<sup>7</sup> to withhold an amount from the payment and remit it to the Commissioner of Taxation (the Commissioner). The withheld amount is then applied by the Commissioner towards the annual income tax liability of the taxpayer.<sup>8</sup>

1.9 Taxpayers who earn business or investment income, such as interest and dividends, which is not subject to withholding at source,<sup>9</sup> are required to periodically pay instalments towards their annual income tax liability if they are so notified by the Commissioner.<sup>10</sup> Upon entry into the PAYG instalments system, the ATO provides taxpayers with an Activity Statement setting out the taxpayer's instalment amount which is based on their previous year's income tax liability. Generally, instalment amounts are required to be paid on a quarterly basis directly to the Commissioner.<sup>11</sup>

1.10 The number and type of entities as well as the quantum of instalments paid from the 2013–14 to 2015–16 financial years, inclusive, are set out in Table 1.1.

**Table 1.1: Number of entities and quantum of PAYG instalments from 1 July 2013 to 30 June 2016, by entity type and financial year**

Entity type	2013–14 Entities (no.)	2013–14 PAYG (\$m)	2014–15 Entities (no.)	2014–15 PAYG (\$m)	2015–16 Entities (no.)	2015–16 PAYG (\$m)
Individuals	1,553,532	18,661	1,490,896	20,209	1,447,035	21,186
Companies	365,250	61,825	368,117	55,720	376,246	53,341
Trusts	7,590	129	7,327	98	5,831	106
Super funds	232,128	7,520	220,499	7,920	222,154	9,080
<b>TOTAL</b>	<b>2,158,500</b>	<b>88,135</b>	<b>2,086,839</b>	<b>83,947</b>	<b>2,051,266</b>	<b>83,713</b>

Source: ATO.

4 For example, pay as you earn (PAYE), prescribed pre-payments system (PPS), provisional tax and the company superannuation fund systems: Explanatory Memorandum, House of Representatives, A New Tax System (Tax Laws Amendment) Bill (No. 1) 1999, p 1.

5 The Treasury, *Submission to the Joint Committee of Public Accounts and Audit, Report 410 Tax Administration*, para [7.1].

6 Explanatory Memorandum, House of Representatives, A New Tax System (Tax Laws Amendment) Bill (No. 1) 1999, p 8.

7 The types of payments for work from which amounts must be withheld are summarised in Div 10 of Sch 1 to the *Tax Administration Act 1953*.

8 *Taxation Administration Act 1953* sch 1 s 6-5(2).

9 *Taxation Administration Act 1953* sch 1 s 45-120.

10 *Taxation Administration Act 1953* sch 1 s 45-15.

11 *Taxation Administration Act 1953* sch 1 s 45-1.

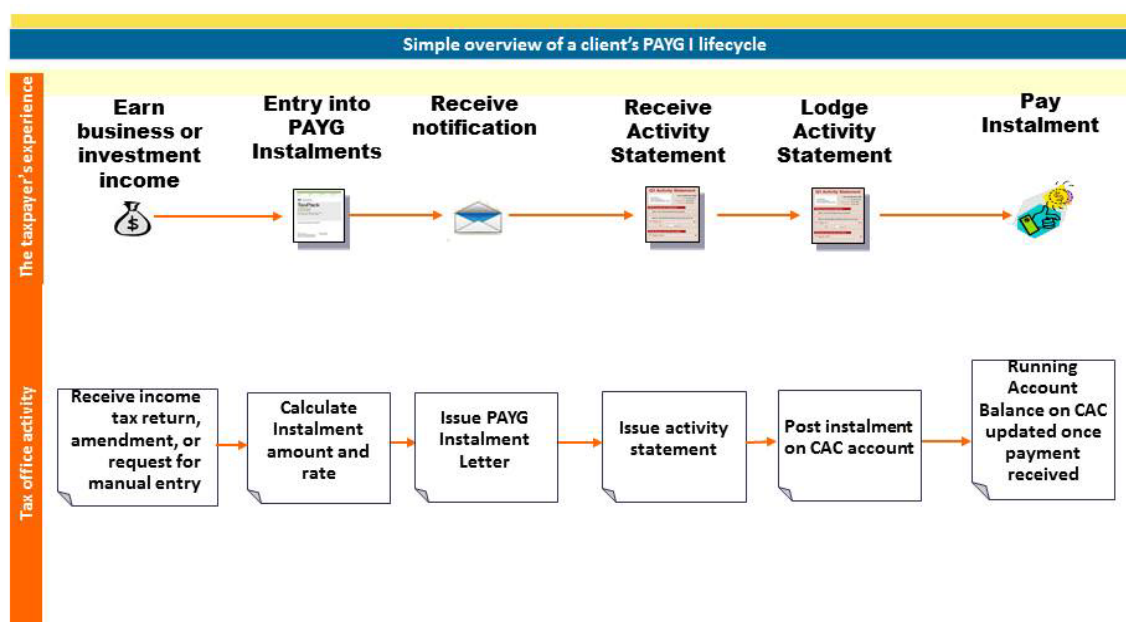
1.11 Table 1.1 above shows that individuals have the greatest representation by number in the PAYG instalments system, consistently comprising over 70 per cent of all taxpayers over the 2013–14 to 2015–16 financial years. Their contribution to the total revenue has increased from 20 percent in 2013–14 to 25 per cent in 2015–16.

1.12 Importantly, other entities, such as companies, are significant contributors to revenue collections for Government as Table 1.1 demonstrates. However, the focus of this review is individual taxpayers, in line with the concerns raised with the IGT in complaints and submissions.

## THE PAYG INSTALMENTS SYSTEM

1.13 There are six main stages in a taxpayer's interactions with the PAYG instalments system which are set out in the figure below.

**Figure 1.1: Six stages of the PAYG instalments lifecycle**



Note: for the purpose of this report, "CAC" will be referred to as "ICA", which will be explained in greater detail further in this chapter.  
Source: ATO.

## Business or investment income

1.14 Broadly, business or investment income is earned without amounts of tax being withheld at source. Examples of such income include income earned as a sole trader (sale of goods or service fees), bank interest, dividends or rental income.<sup>12</sup> In contrast, employment income is an example where the employer withholds tax at source.

<sup>12</sup> Australian Taxation Office (ATO), 'Investment Income' (4 May 2017) < [www.ato.gov.au](http://www.ato.gov.au)>.

## Entry into the PAYG instalments system

1.15 The legislative framework for the PAYG instalments system is set out in Division 45 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953). The legislation requires any person, who is provided with an instalment rate by written notice from the Commissioner, be entered into the PAYG instalments system and periodically pay instalments towards their annual income tax liability.

1.16 The criteria for receiving an instalment rate notice are determined by the ATO. Subject to a number of exemptions, for individual taxpayers, the criteria is whether the amount of gross business or investment income reported in their latest tax return equals or exceeds a certain threshold. For Australian tax residents that threshold is \$4,000 whilst for non-residents, it is \$1.<sup>13</sup> The exemptions apply where:

- the tax payable on the latest notice of assessment (NOA) is less than \$1,000;
- the notional tax<sup>14</sup> is less than \$500; or
- there is an entitlement to the seniors and pensioners tax offset.<sup>15</sup>

1.17 The ATO's systems will automatically<sup>16</sup> determine whether an individual taxpayer meets the PAYG instalments entry criteria. However, an individual may also voluntarily enter the PAYG instalments system by contacting the ATO via telephone or via the online myGov platform if they believe they will be earning business or investment income.<sup>17</sup> Upon a taxpayer voluntarily entering into the PAYG instalments system, they may choose the quantum of their instalments.<sup>18</sup>

## Notification of entry to taxpayers

1.18 The ATO notifies individual taxpayers of their entry into the PAYG instalments system by way of a 'welcome letter'.

1.19 The ATO's 'welcome letter' is posted to a taxpayer's nominated postal address registered on the ATO's Income Tax Account (ITA) system. This address may either be the individual's address or that of their tax agent.

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13 ATO, 'Who needs to pay PAYG instalments' (3 July 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

14 Notional tax is an estimate of the tax payable on business and/or investment income (excluding net capital gains) in the latest year for which income tax had been assessed: *Taxation Administration Act 1953* sch 1 s 45-325.

15 Above n 13.

16 ATO, 'PAYG instalments – end to end process' (Internal ATO Document, 3 July 2017).

17 *Taxation Administration Act 1953* sch 1 s 45-15; ATO, 'How to start paying instalments' (22 June 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

18 Above n 16.



## Activity Statements

1.20 Following notification to an individual taxpayer of their entry into the PAYG instalments system, the ATO issues an Activity Statement before the first instalment is due. The Activity Statement is sent to either the individual's nominated postal address registered on the ATO's Integrated Client Account (ICA) system, the individual's online myGov account or to the individual's tax or Business Activity Statement (BAS) agent via the agent's respective Portals<sup>19</sup> or practice management software.<sup>20</sup> Where the Activity Statements are sent depends upon a range of circumstances which will be examined in Chapter 3.

1.21 Individual taxpayers, who have additional tax reporting obligations, such as for Goods and Services Tax (GST), are required to report their PAYG instalments on a BAS. For the purpose of this report, reference will be made to Activity Statements inclusive of those who are required to report by lodging a BAS, unless otherwise specifically mentioned.

1.22 The Activity Statement sets out the PAYG instalment amount or rate to be paid. By default, individual taxpayers are required to pay the instalment amount set out in their Activity Statement. This amount is based on their most recently assessed income tax return which is adjusted by the likely growth in Australia's Gross Domestic Product (GDP) (GDP adjusted method).<sup>21</sup> For the 2017-18 financial year, the GDP growth factor is 4 per cent.<sup>22</sup>

1.23 As a default position, individual taxpayers are required to report and pay instalments on a quarterly basis.<sup>23</sup> The standard quarterly due dates for reporting<sup>24</sup> and payment<sup>25</sup> are set out in Table 1.2.

**Table 1.2: Due dates for quarterly PAYG instalments**

PAYG instalment quarter	Period	Activity Statement due date	BAS due date
1	1 July to 30 September	21 October	28 October
2	1 October to 31 December	21 February	28 February
3	1 January to 31 March	21 April	28 April
4	1 April to 30 June	21 July	28 July

Source: ATO.

1.24 Table 1.2 shows that PAYG instalments are generally due for payment 21 or 28 days after the relevant quarter has ended, except for the second quarter which has an additional month leeway.

19 ATO, 'Tax Agent Portal' (30 June 2017) <www.ato.gov.au>.

20 ATO, 'Electronic lodgment service – tax agents' (6 Dec 2016) <www.ato.gov.au>.

21 *Taxation Administration Act 1953* sch 1 ss 6-5(3), 45-112 and 45-405; Explanatory Memorandum, House of Representatives, A New Tax System (Tax Laws Amendment) Bill (No. 1) 1999, p 51.

22 ATO, 'GDP adjusted PAYG and GST instalment amounts' (28 June 2017) <www.ato.gov.au>.

23 *Taxation Administration Act 1953* sch 1 subdivision 45-D; ATO, 'PAYG instalments – end to end process' (Internal ATO Document, 3 July 2017).

24 *Taxation Administration Act 1953* sch 1 s 15-150(a).

25 *Taxation Administration Act 1953* sch 1 s 16-75(4).

1.25 Individual taxpayers may make certain elections concerning the instalments they need to pay and how often they do so via lodgment of their Activity Statement. These elections are described in the section below.

## Lodging Activity Statements

1.26 The Activity Statement may issue in one of 19 different forms which depend upon the combination of the taxpayer's obligations, such as GST, and the elections they make (see Appendix 2 for a sample Activity Statement). For example, individual taxpayers may vary their instalment calculation method or their instalment reporting/payment frequency when lodging their Activity Statement.

1.27 If taxpayers adopt the default GDP adjusted method, they can vary the amount every quarter by substituting their estimated benchmark tax<sup>26</sup> in place of the amount determined by the Commissioner.<sup>27</sup>

1.28 Alternatively, taxpayers may elect not to use the GDP adjusted method at the start of a financial year and determine their PAYG instalments on the basis of their income earned in the current quarter multiplied by an instalment rate set by the Commissioner (instalment rate method). Again, taxpayers can vary the instalment rate calculated by the Commissioner every quarter,<sup>28</sup> for example, where there is significant change in investment activities such as ceasing business or investment activities.<sup>29</sup>

1.29 However, if the taxpayer reduces the instalment amounts by one of the above methods but the total of the instalment amounts are found to have been understated by 15 per cent or more on or after the end of the financial year, the taxpayer may be subject to a penalty equivalent to the General Interest Charge (GIC) on the shortfall (the 15 per cent Rule).<sup>30</sup>

1.30 The due date for varying instalments aligns with the dates the Activity Statements are required to be lodged, as explained in Table 1.2. The ATO has some flexibility to vary quarterly PAYG instalment amounts where requests are received after the statutory due date but before the next Activity Statement has been generated.<sup>31</sup>

1.31 Taxpayers may also elect to report and pay instalments on an annual basis instead of quarterly. To be eligible to report and pay instalments annually, legislation requires that individual taxpayers' notional tax, as determined by the ATO, is less than \$8,000 and that they are not required to be registered for GST.<sup>32</sup>

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26 'Benchmark tax' is an estimate of tax that will be payable for the income year, reduced by any tax attributable to any capital gains that may be included in assessable income and any credits for amounts deducted from withholding income: *Tax Administration Act 1953* sch 1 s 45-415.

27 *Taxation Administration Act 1953* sch 1 ss 45-412 and 45-415.

28 *Taxation Administration Act 1953* sch 1 s 45-205.

29 *Taxation Administration Act 1953* sch 1 s 45-110; ATO, 'Option 2 - instalment rate' (28 Jul 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

30 *Taxation Administration Act 1953* sch 1 ss 45-230, 45-360, 45-232 and 45-365.

31 Above n 16.

32 *Tax Administration Act 1953* sch 1 s 45-140.

1.32 The election to report and pay instalments annually for new entrants into the PAYG instalments system must be made before the due date of their first Activity Statement. Taxpayers already in the PAYG instalments system must make the election before the due date of the first instalment quarter being 28 October each year.<sup>33</sup>

1.33 The due date for reporting annual instalments is 21 October each year except for self-preparers who lodge their income tax return by 31 October.<sup>34</sup> Additionally, annual payers may also be subject to GIC on any shortfall amounts as with quarterly payers.<sup>35</sup>

## Processing instalment payments

1.34 The ATO operates two accounting systems, the ITA and the ICA systems, to record taxpayers' PAYG instalment liabilities, payments and credits. The ITA system records all transactions in relation to annual income tax assessments, such as income tax liabilities, amendments and refund payments as well as the crediting of PAYG instalment liabilities in those assessments. The ICA system, on the other hand, records transactions for obligations, such as PAYG instalments, PAYG withholding and GST, which do not relate to annual income tax assessment.

1.35 Accordingly, once a taxpayer enters the PAYG instalments system, PAYG instalments liabilities and payments are recorded on the taxpayer's ICA.<sup>36</sup> For example, amounts due on an Activity Statement are recorded as liabilities on the taxpayer's ICA and payments made towards those due amounts are recorded as credits on that account.

1.36 Upon lodgment of an income tax return, a credit equal to the total amount of the PAYG instalment liabilities that accrued during the financial year is posted to the individual's ITA. As mandated by legislation, such crediting occurs regardless of whether the PAYG instalment liabilities were actually paid<sup>37</sup> and any unpaid instalments remain as liabilities on the individual's ICA. Further analysis of this accounting process is presented in Chapter 3.

## EXITING THE PAYG INSTALMENTS SYSTEM

1.37 The Commissioner automatically withdraws the instalment rate notice or exits individual taxpayers from the PAYG instalments system if, for example, the taxpayer no longer meets the entry criteria mentioned earlier in this chapter.<sup>38</sup>

1.38 Taxpayers may also make a request to exit the PAYG instalments system if their circumstances change, for example, if they have ceased earning business or investment income.<sup>39</sup>

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33 *Tax Administration Act 1953* sch 1 ss 45-125 and 45-140.

34 ATO, 'Annual instalments' (12 July 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

35 *Tax Administration Act 1953* sch 1 s 45-235.

36 Above n 16.

37 *Taxation Administration Act 1953* s 45-30.

38 Above n 16.

1.39 Where the ATO processes a request for removal from the system, the taxpayer is still required to report and pay any outstanding Activity Statements which have already been issued.

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39 For example, individual taxpayers with a myGov account linked to the ATO may request cessation of PAYG obligations online.

## **CHAPTER 2 — TAXPAYER AWARENESS OF PAYG INSTALMENT OBLIGATIONS**

2.1 This chapter explores concerns raised regarding taxpayers' level of awareness of PAYG instalment obligations, including the ATO's key correspondence and advice to affected individual taxpayers. It also considers training and support provided to ATO staff who, for example, assist taxpayers with their enquiries about the PAYG instalments system.

### **STAKEHOLDER CONCERNS**

2.2 The IGT's complaint investigations and stakeholders' submissions to the review have highlighted a number of aspects of the PAYG instalments system of which individual taxpayers are commonly unaware and that the relevant ATO correspondence do not address.

2.3 First, taxpayers are not provided specific reasoning for being entered into the PAYG instalments system and the resulting taxpayer obligations are not adequately explained. Therefore, some taxpayers may disregard the correspondence, believing they have complied with their annual tax obligations and no further action is required. Such taxpayers are then surprised when the ATO takes action to recover the resulting tax debt which may also include an interest component and penalties.

2.4 Secondly, taxpayers are not sufficiently made aware of the tools on the ATO website, which can assist them to vary the amount of their PAYG instalments. Some taxpayers are apprehensive about making such variations due to the complexity of the instalment amount calculations and potential to incur interest and penalties for underestimating the amount needed to cover their final income tax liability. Accordingly, stakeholders believe that this leads some taxpayers to pay more than is needed and unnecessarily impacts their cash flows.

2.5 Thirdly, the eligibility requirements for taxpayers to report and pay instalments annually are not adequately explained. They are also not made aware of the impact of seeking to vary instalment amounts after the due date. As a result, stakeholders have commented that some taxpayers have formed an impression that the ATO is not processing their requests, which unnecessarily affects their cash flow, or increases their compliance burden in trying to correct what they believe to be an error.

2.6 Fourthly, it is unclear to taxpayers the date on which they will be removed from the system following an exit request (the 'effective date'), for example, where their circumstances have changed during the financial year. In particular, it is not clear that all PAYG instalment obligations, which arose prior to the effective date of the exit request, must still be met. In these cases, stakeholders have commented that some taxpayers perceive that the ATO is not processing their exit requests, particularly as they receive no acknowledgement or confirmation from the ATO. In some situations, stakeholders have also observed that the ATO has advised taxpayers to await the lodgment of their next annual income tax return to be removed from the PAYG instalments system which is said to be an ineffective solution and results in unnecessary debts and recovery action.

2.7 Lastly, the ATO includes notional credits on an individual taxpayer's NOA for PAYG instalment amounts, regardless of whether they have been paid. Stakeholders have said that this leads some taxpayers to believe that they have fulfilled their income tax and PAYG instalment obligations upon making any final payments specified on the NOA or receipt of refunds. It is not clear to these taxpayers that unpaid PAYG instalments are recoverable debts and they are surprised when debt collection action is later taken by the ATO.

2.8 Given the range of aspects of the PAYG instalments system of which taxpayers are unaware, stakeholders believe that the ATO should improve its guidance material. It should also be noted that tax practitioners have also commented that they expend considerable amounts of unbillable time and resources in explaining the ATO's PAYG instalments correspondence to their clients.

2.9 Stakeholders have singled out the ATO's welcome letter, issued to taxpayers upon their entry into the PAYG instalments system, as key to improving taxpayers' knowledge in this area. The letter is an opportunity for the ATO to more clearly explain the system, its main features and taxpayers' obligations. Additionally, stakeholders believe that the ATO should provide more detailed information by way of an easy to read guide to accompany the welcome letter.

2.10 Furthermore, stakeholders have observed that ATO staff dealing with telephone enquires often lack basic knowledge of the PAYG instalments system. They believe that such ATO staff should be provided additional training and support to effectively deal with these enquires.

## RELEVANT MATERIALS

2.11 The ATO had commissioned research in 2011 to better understand the compliance experience of individual and small business taxpayers as well as tax professionals in dealing with the PAYG instalments system.

2.12 The research found entry into the system was confusing for many, especially individuals, as it is a significant increase in reporting and payment obligations from their usual income tax preparation and lodgment experience.<sup>40</sup> It was also observed that once taxpayers had mastered the basics of the PAYG instalments system, they continued to use an approach which was pragmatic and economical. However it was clear that there was still a significant knowledge gap—the report refers to this as 'not knowing what they don't know'.<sup>41</sup>

2.13 Individual taxpayers were found to have the lowest levels of awareness of key aspects of the system, including the different options for calculating instalment amounts, the ability to vary instalment amounts if their circumstances changed during the year and the ability to exit the system should their business or investment activities cease.<sup>42</sup>

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40 Colmar Brunton, 'ATO PAYG instalments Exploratory Research' (2011) pp 6-7 [unpublished research].

41 Ibid p 4.

42 Ibid p 7.

2.14 The research also found that, for both individuals and businesses, the ATO website was the primary information channel. The next source of information for individuals was generally the ATO's call centre, whereas businesses contacted their tax representatives.<sup>43</sup> Both individual and business taxpayers asked similar questions of the ATO and their tax representatives, including:

- general information about the PAYG instalments system;
- how much they need to pay;
- how to vary instalments;
- the frequency of payment required; and
- the reasons they have been entered into the system.<sup>44</sup>

2.15 A number of areas for improvement were identified, including that the ATO:

- review its suite of correspondence provided to taxpayers upon their entry into the PAYG instalments system and address the information gap in the materials to improve taxpayers' understanding of the system, including the development of a simplistic overview brochure to foster initial system wide understanding; and
- build awareness of the system through existing touch points including better communicating the options to calculate instalment amounts and their associated risks and benefits, the ability to vary instalment amounts should taxpayers' circumstances change and the ability for taxpayers to exit the system should their business or investment activity cease as well as the system's integrity measures.

2.16 During this review, ATO management implemented its 2017-18 *PAYG instalments communication plan*. The communication plan details how the ATO aims to help taxpayers understand and meet their PAYG instalments obligations and improve the taxpayer experience with the system such as through review of its correspondence, updating online content and scripting for ATO call centre staff.<sup>45</sup>

## **ATO welcome letter and brochure**

2.17 The ATO's PAYG instalments welcome letter was last amended 3 years ago. It is provided to taxpayers upon their entry into the PAYG instalments system. A template of this letter is reproduced in Appendix 3.

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<sup>43</sup> Ibid p 5.

<sup>44</sup> Ibid p 69.

<sup>45</sup> Above n 16.



2.18 The ATO's welcome letter explains broadly the requirement for taxpayers to pay instalments and the crediting of those instalments toward their annual income tax liability. It sets out the options for taxpayers to pay the instalment amounts calculated by the ATO or to calculate their own instalments, how to vary instalments if their income changes and how to elect to report and pay annually. It also explains that taxpayers may visit the ATO's website or contact the ATO if they have any further questions.<sup>46</sup>

2.19 During this review, ATO management endorsed a brochure, *Top tips for PAYG instalments*, to assist individual taxpayers to better understand the PAYG instalments system. The brochure provides an overview of taxpayer obligations under the PAYG instalments system as well as informing taxpayers that a calculator is available on its website to help them work out how much to pay, that they may vary instalments amounts and where they may obtain further information.<sup>47</sup> The ATO has advised that the brochure is currently only provided to taxpayers at public events attended by ATO representatives.

## ATO website

2.20 The ATO's website explains that the PAYG instalments system is a system for making regular payments towards expected annual income tax liabilities and only applies if taxpayers earn business or investment income over a certain amount. The website also informs taxpayers that the ATO will notify them if they need to start paying instalments and will send them an Activity Statement before instalments are due. Additionally, taxpayers are informed that where they have a myGov account linked to the ATO, they are able to view, lodge, pay, vary and manage all their PAYG instalment obligations online. Other relevant information on the ATO website are provided under the following headings:

- Who needs to pay PAYG instalments;
- How to start paying instalments;
- Your PAYG instalments correspondence;
- Calculating the amount you pay;
- How to vary the amount you pay;
- How often you lodge and pay;
- Your activity statement or instalment notice;
- Getting your PAYG instalments right; and
- Contact us about PAYG instalments.<sup>48</sup>

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<sup>46</sup> ATO, 'Welcome to the PAYG instalment system' (2014 PAYG instalments welcome letter first sent to new entrants over 2014-2017 period).

<sup>47</sup> ATO, 'Top tips for PAYG instalments' (brochure, 2017).

<sup>48</sup> ATO, 'PAYG instalments' (12 July 2017) < [www.ato.gov.au](http://www.ato.gov.au) >.



## Notice of assessment

2.21 The NOA provides an itemised account of the income tax liability following the lodgment of a tax return.<sup>49</sup> Any PAYG instalments raised during the year are credited towards the taxpayer's income tax assessment, even if the instalments were not paid.<sup>50</sup> However, the NOA does not specify which of these instalments have been paid.

## ATO staff training and support

2.22 The ATO directs telephone calls from individual taxpayers with PAYG instalment enquiries to ATO staff members who have obtained the required training.<sup>51</sup>

2.23 The ATO provides a one day training program to its staff on the PAYG instalments system in two modules, namely a primary training module<sup>52</sup> and a secondary training module.<sup>53</sup> Both training modules were updated during this review.

2.24 At the conclusion of the primary training module, ATO staff are expected to:

- be familiar with the principles and administration of the PAYG instalments system;
- understand the relationship between PAYG instalments and income tax;
- describe the calculations that are relevant to PAYG instalments;
- explain the reporting options and the eligibility requirements for specific taxpayers;
- explain variations;
- identify 'wash up' cases;<sup>54</sup> and
- understand the PAYG instalment procedures.

2.25 ATO staff may be required to complete a written assessment at the completion of the primary training module. Whilst there is no 'pass' or 'fail' mark, the assessment is designed to highlight areas where further understanding is required by ATO staff.<sup>55</sup>

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49 ATO, 'Your notice of assessment' (29 June 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

50 *Taxation Administration Act 1953* s 45-30.

51 ATO, 'Skill sets escalation directory', SMART scripting (Internal ATO document, undated).

52 ATO, 'Training module, PAYG instalments principles' (Internal ATO document, March 2016).

53 ATO, 'Training module, PAYG instalment labels' (Internal ATO document, June 2017).

54 A wash up case occurs where a taxpayer lodges their annual income return before all applicable Activity Statements have been processed by the ATO. Wash up cases will be discussed in greater detail in Chapter 4.

55 ATO, 'Training module, PAYG instalments principles workbook' (Internal ATO document, 23 June 2017) p 2.

2.26 Upon completing the secondary training module, ATO staff are expected to be able to explain how to:

- make Activity Statement elections;
- report PAYG instalments in Activity Statements; and
- vary instalments.

2.27 ATO staff are assessed on the secondary training module using skills verification questions.<sup>56</sup> Whilst there is no pass or fail mark, the questions are designed to help staff identify areas in which they need to revisit.<sup>57</sup>

2.28 ATO staff are also provided with scripting to help guide them in answering telephone enquiries about the PAYG instalments system. In particular, the scripting provides ATO staff with an overview of the system and general guidance on the following topics:

- entry and exit;
- reporting and calculations;
- PAYG letters; and
- incorrect PAYG instalment amounts on the NOA.<sup>58</sup>

## IGT OBSERVATIONS

2.29 Taxpayers' awareness of their tax obligations and the complexity of the administrative rules directly affect their ability and willingness to comply. For example, recent research has revealed that individuals who were fully dedicated to compliance could still fail through lack of awareness of rules, mistakes or unforced errors when navigating the tax system.<sup>59</sup>

2.30 The ATO has acknowledged that improving individual taxpayers' understanding of the PAYG instalments system would improve compliance, reduce costs of responding to taxpayer queries and address taxpayer errors as well as deliver an improved taxpayer experience. The issue for the ATO is identifying the best approach which the IGT believes may be achieved through the following:

- improvements to the welcome letter;
- a brief brochure;
- a comprehensive web-based guide;
- improvements to the NOA; and
- enhancing the training and support for ATO staff.

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<sup>56</sup> ATO, 'Training module, PAYG instalment labels workbook' (Internal ATO document, 28 June 2017) p 2.

<sup>57</sup> ATO, 'Program specific evaluation – B03, Facilitator Guide' (Internal ATO document, 19 June 2017).

<sup>58</sup> ATO, 'More information – PAYG instalments (B-3 I-4)', SMART Scripting (Internal ATO document).

<sup>59</sup> Jo'Anne Langham and Neil Paulsen, 'Invisible taxation: fantasy or just good service design?' (2017) 32 *Australian Taxation Forum*.

2.31 There is a balance between providing enough information in the welcome letter so that taxpayers are able to understand how to comply with their PAYG instalments obligations and providing too much information resulting in ‘information overload’ such that key areas of the letter are ignored.

2.32 Financial institutions experience the same challenges of ensuring their clients understand their obligations when they register for a financial product. They address this issue by providing their clients with the key information in a letter accompanied with a paper copy of the financial product guides. The IGT is of the view that the ATO should adopt a similar approach by providing sufficient information in the welcome letter to alert the taxpayer to the specific actions they need to take to comply with their obligations and more general information in an accompanying brochure. The brochure, as well as the welcome letter, would refer to a more comprehensive guide which would be available on the ATO website.

2.33 The IGT also believes that improvements can be made to the NOA and ATO staff training and support.

### **ATO welcome letter**

2.34 As stated earlier, the ATO’s commissioned research has identified that entry into the system is confusing, particularly for individual taxpayers who become subjected to an increased compliance burden and have the lowest level of knowledge about the system. The report asserts that this may lead to inadvertent failure to comply or making overpayments.<sup>60</sup>

2.35 Accordingly, the initial welcome letter provides an important ‘touch point’ for providing key information needed by taxpayers at that stage in the process. This letter was also identified by the ATO in the process of reviewing its current PAYG instalments correspondence as a means to raise taxpayers’ awareness of their instalment obligations.<sup>61</sup>

2.36 Currently, the welcome letter provides taxpayers with general information on the criteria for entry but those general criteria are not applied to their particular circumstances. As a result, they do not understand why they have entered the system and are required to prepay tax towards the current financial year. Although the taxpayer’s notional tax is specified in the welcome letter, other elements of the ATO’s entry criteria are not specified, for example, the taxpayer’s business and investment income, tax payable and eligibility to the seniors and pensioners tax offset. These terms also require an explanation for most taxpayers.

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<sup>60</sup> Above n 40, p 10.

<sup>61</sup> ATO, ‘Pay as you go instalments communication plan 2017-2018’ (Internal ATO document, June 2017); ATO, ‘You have entered PAYG instalments’ (draft 2017 PAYG instalments welcome letter).

2.37 The welcome letter is automatically generated and to include information, such as the taxpayer's business or investment income, system changes would be required. The IGT believes that these system changes are warranted so that the necessary information could be included in the welcome letter to explain why the taxpayer has been entered into the system. Figure 2.1 depicts how this may be achieved in tabular form in the welcome letter.

**Figure 2.1 Example of simplified explanation for taxpayer entry into the PAYG instalments system**

Criteria for entry into the PAYG instalments system	Your information
If gross business and/or investment income is \$4,000 or more in the taxpayer's latest tax return;	Your business and/or investment income in your latest tax return was <b>\$8,573</b>
Tax payable on the taxpayer's latest notice of assessment is more than \$1,000;	Tax payable on your latest notice of assessment was <b>\$1,859</b>
The taxpayer's notional tax is more than \$500; or	Your notional tax is <b>\$958</b>
The taxpayer is not entitled to the seniors and pensioners tax offset.	You are <b>NOT</b> entitled to the seniors and pensioners tax offset.

Source: IGT.

2.38 In the IGT's view, the welcome letter should also explain how the quantum of the instalment was determined and refer the taxpayer to the tools available on the ATO website, such as the PAYG instalments calculator, which allows them to verify the quantum. It is also critical that taxpayers are expressly made aware of the due date for each instalment. Figure 2.2, below, shows how this may be achieved in tabular form in the welcome letter.

**Figure 2.2 Due dates and amounts for PAYG instalments**

If your circumstances have not changed and you do not contact us, you must pay the following amounts by the due dates:

First quarter	Second quarter	Third quarter	Fourth quarter
\$2,000	\$2,000	\$2,000	\$2,000
21 October 2017	21 February 2018	21 April 2018	21 July 2018

Note: interest accrues on instalments that remain unpaid after the due date.

Source: IGT.

2.39 Although the current welcome letter indicates that instalment amounts may be varied, it does not clearly stipulate that such variation must be lodged by a certain date, nor does it explain the consequences of not lodging such variations on time. The IGT believes that the due date must be clearly stated and taxpayers warned that they have to strictly adhere to it or risk having to pay the amount determined by the ATO. Similarly, the welcome letter should explain how the taxpayer can request an exit from the system and that any amounts that were outstanding prior to the making of the exit request should be paid in full.

2.40 Where taxpayers elect to vary their instalment amount or their reporting frequency, the IGT considers that the ATO should provide taxpayers with confirmation of the variation and provide them with an updated table, similar to figure 2.2, detailing their new PAYG instalment amounts and the due dates for payment.

## PAYG instalments brochure

2.41 As stated earlier, the IGT is of the view that the ATO should provide information specific to the taxpayer in the welcome letter and more general information about the PAYG instalments system in an accompanying brochure. The brochure could also be made available online along with a more detailed guide discussed below. The brochure may be particularly useful to new businesses considering voluntary entry into the system and wanting a quick overview.

2.42 Furthermore, the IGT considers the brochure is an appropriate channel to address a range of taxpayer misunderstandings identified in submissions to the review, IGT complaint cases as well as the ATO's own complaint cases. In this respect, the brochure should provide:

- an explanation of the key information contained in the 'welcome letter';
- the address to which the ATO will send Activity Statements and PAYG instalments correspondence;
- the website address for tools available to assist taxpayers, for example the PAYG instalments calculator, and where more comprehensive information can be found;
- instructions and information on how to vary instalments and reporting obligations, including the relevant eligibility criteria, due dates and the consequences of missing those dates; and
- information concerning application of notional credits in NOAs for PAYG instalment liabilities, processing of exit requests and application of penalties.

2.43 To further assist taxpayer understanding, the ATO may also consider the use of visual diagrams as noted in the ATO-commissioned research.<sup>62</sup>

## Online comprehensive PAYG instalments guide

2.44 Whilst the welcome letter and the brochure may deal with a taxpayer's immediate needs and provide context, some taxpayers may require further information at various stages of the process. As too much information in these two documents may lead to confusion and non-compliance, taxpayers can also be referred to a more comprehensive guide on the ATO website. The brochure could be the summary section of the comprehensive guide to eliminate any duplication.

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62 Above n 40, p 7.

## Notice of assessment and PAYG instalments credits

2.45 As stated earlier, the ATO's NOA does not specifically identify any instalment amounts which have not been paid. This leads taxpayers to be unaware of any associated outstanding debts particularly given their lack of knowledge about the PAYG instalments system and its interaction with annual income tax assessments.

2.46 Accordingly, the IGT is of the view that the ATO should update the NOA to alert individual taxpayers to any instalment debts that remain outstanding. Alternatively, as some stakeholders have suggested, a single piece of correspondence could be issued to taxpayers with their NOA, clearly identifying any unpaid PAYG instalment liabilities that remain due and payable.

## ATO staff training and support

2.47 The IGT has observed that taxpayers may contact the ATO to understand why they have been entered into the system, particularly where they consider that their circumstances have not changed from the prior year. A specific explanation of how their circumstances have changed may not be easily conveyed in ATO correspondence, a brochure or the online comprehensive guide. It may be best achieved through direct contact with the ATO. For example, ATO staff can access the relevant systems, such as the PAYG instalments 'eligibility form',<sup>63</sup> which provides the information needed to explain the changed circumstances.

2.48 The IGT has observed, however, that not all ATO call centre staff that respond to PAYG instalments enquiries have access to the eligibility form and associated training. Therefore, the ATO should provide relevant staff with access to the eligibility form as well as updating the procedures and training on how to use the form.

2.49 Furthermore, the online comprehensive guide should be aligned with call centre scripting for ATO staff. This will allow ATO staff to guide taxpayers when responding to enquiries by helping them navigate a document visible to both parties.

### RECOMMENDATION 2.1

*The IGT recommends that with respect to the PAYG instalments system, the ATO:*

- a) improve its 'welcome letter' to provide taxpayer specific information, including:*
  - the circumstances that triggered entry into the system;*
  - a payment schedule of default instalment amounts;*
  - an explanation of how to make variation elections;*
  - how the ATO processes an exit from the system; and*
  - where to find additional information;*

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<sup>63</sup> The PAYG instalment eligibility form is an ATO created systems-form which sets out the data used to determine a taxpayer's entry into the PAYG instalments system and their resulting obligations including rates, amount calculations, lodgement cycles and correspondence details.

**RECOMMENDATION 2.1 (CONTINUED)**

- b) where instalment amounts or reporting frequency have been varied, provide confirmation to taxpayers together with an updated payment schedule;*
- c) accompany the welcome letter with a brochure containing more general information;*
- d) provide a comprehensive PAYG instalments guide on the ATO website;*
- e) update its Notice of Assessment to set out any outstanding instalments; and*
- f) improve ATO staff education and support by, for example, aligning scripting for those handling telephone enquires with the comprehensive PAYG instalments guide and provide access to the PAYG instalments eligibility form and associated training.*

**ATO RESPONSE****(a) Agree**

The ATO agrees to improve its PAYG instalments welcome letter, but the extent of any changes will be subject to user testing and system capability.

**(b) Agree**

Currently ATO Online provides an electronic confirmation when taxpayers elect to change their reporting frequency or vary their rate or amount using this channel. We will explore other ways to provide confirmation to the taxpayer.

Taxpayers generally vary their rate or amount on their activity statement, with the activity statement being the source of truth. Remaining activity statements in the income year will reflect their varied amount or rate.

**(c) Disagree**

The ATO disagrees with a brochure accompanying the letter due to the digital based approach that the ATO is taking as well as the cost involved in producing a brochure. We will consider alternative options, such as improvements to the website in response to recommendation 2.1(d).

**(d) Agree****(e) Agree**

Updating the Notice of Assessment is part of the ATO's transformation agenda. Any updates to the Notice of Assessment to better specify liabilities will depend on funding, systems capability and the prioritisation process.

**(f) Agree**





## CHAPTER 3 — ATO ACCOUNTING SYSTEMS

3.1 Through the investigations of complaints and submissions to this review, the IGT has identified a number of issues involving ATO accounting systems including the following:

- the crediting of unpaid PAYG instalments in a taxpayer's income tax assessment;
- ATO correspondence not being received;
- multiple Activity Statements being issued for past periods; and
- the delay in processing 'wash ups' of duplicated instalment liabilities.

3.2 This chapter explores the above issues and their underlying causes to identify potential solutions.

### CREDITING OF UNPAID PAYG INSTALMENT LIABILITIES

#### Stakeholder concerns

3.3 As stated in Chapter 2, the crediting of unpaid PAYG instalments in income tax assessments, leads some taxpayers to believe that they have fulfilled both their income tax and PAYG instalment obligations upon making the required payments as indicated on the NOA. As a result, such taxpayers are surprised when the ATO commences debt collection action at a later date to recover the unpaid instalment amounts.

#### Relevant materials

3.4 As mentioned previously, the ATO uses two different types of accounts for each taxpayer to administer the PAYG instalments system, namely, the ICA and the ITA. Each account has different accounting rules, for example, in the ICA, GIC is calculated on the 'running balance' whereas GIC is calculated on individual postings in the ITA. One of the reasons for the different accounting rules is to simplify the administration of the different tax liabilities. The ITA is used to administer income tax liabilities whilst, other tax liabilities such as GST and PAYG instalments are maintained on the ICA.

3.5 Upon lodgment of an income tax return, legislation mandates that a credit equal to the total amount of PAYG instalment liabilities that were accrued during the financial year be posted on the individual's ITA.<sup>64</sup> This crediting process occurs regardless of whether the PAYG instalments were actually paid. Any unpaid PAYG instalment amounts remain as a recoverable debt on the ICA. Such an approach avoids problems with trying to attribute payments made on the ICA to the different tax liabilities as well as identifying which liabilities remain unpaid and accruing GIC against which recovery action may be taken.

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64 Taxation Administration Act 1953 sch 1 s 45-30.

3.6 Following an income tax assessment, an NOA is issued to the taxpayer. It identifies any credit that was given for PAYG instalment liabilities, however, it does not specify which instalments have been paid.

3.7 In some cases, the ATO may provide a statement of account along with the NOA when the account balance is different to the outcome of a taxpayer's assessment.<sup>65</sup> A statement of account can be used to reconcile outstanding debts.<sup>66</sup> However, it should be noted that such statements are limited to the account to which they relate, for example, unpaid PAYG instalment amounts are identified on an ICA's statement of account but not an ITA's statement of account.

## IGT observations

3.8 In investigating complaints, the IGT has observed that many taxpayers were of the view that the ATO had incorrectly commenced debt recovery action against them for unpaid PAYG instalments as their latest NOA provided an overall net balance for income tax liabilities with no unpaid amounts identified. After the relevant accounting processes were explained to these taxpayers, they believed the ATO was at fault for not offsetting the unpaid instalment amounts against the credit that was given on their NOA or alerting them to the fact that unpaid PAYG instalments were needed to be paid in addition to any amounts identified on the NOA.

3.9 Generally, BAS and tax agents are aware of the above issues and they seek to address their client's confusion. However, they believe that this creates some tension in their relationship with their clients and they cannot recover the cost associated with resolving the confusion. Furthermore, as demonstrated in complaints to the IGT, many affected taxpayers do not use tax agents.

3.10 In the IGT's view, as long as two different sets of accounting rules are used to raise, credit and reconcile PAYG instalments and income tax liabilities, many taxpayers will continue to be confused resulting in unnecessary compliance and administrative costs. The use of a single accounting methodology is the ideal solution but it would be a long term goal as it would require significant changes to ATO systems and private sector practice management software.

3.11 As an interim solution, the ATO could apply, or offset,<sup>67</sup> unpaid PAYG instalments to the total amount of income tax determined once the lodged tax return has been processed. This is easily achievable for those taxpayers who do not have any other tax liabilities on their ICA. Accordingly, such taxpayers could be informed of their net balance positions by their unpaid PAYG instalments amounts appearing on their NOA as recommended in Chapter 2.

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65 ATO, 'Your notice of assessment' (29 June 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

66 ATO, 'Purpose of the statement' (16 January 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

67 ATO, *Offsetting of refunds and other credits against taxation and other debts*, PS LA 2011/21, 26 November 2015, p 3: indicates an ATO preference and a legislative requirement to offset such amounts.

3.12 In addition to providing a net balance position as described above, the ATO could alert taxpayers and/or tax or BAS agents that there are unpaid PAYG instalment liabilities via the prefill service. For example, for taxpayers who use the myTax service, the ATO could prompt the taxpayer to the existence of unpaid PAYG instalments before they lodge their income tax return. Such a prompt could be made by accounting for unpaid instalments on the myTax 'estimate' page and providing a pop-up screen which requires the taxpayer to acknowledge that these amounts will need to be paid in addition to any refund or debit resulting from their income tax assessment.

### RECOMMENDATION 3.1

*The IGT recommends the ATO:*

- a) consider using a single accounting method for administering the income tax regime including the PAYG instalments system as a long term goal; and*
- b) alert taxpayers and/or their tax or BAS agents to their unpaid PAYG instalment amounts through pre-filling and inform them that such amounts must be paid irrespective of any refund or debt arising from their income tax assessment.*

## ATO RESPONSE

### (a) Agree

The implementation of a single accounting method will be subject to corporate funding and current priorities.

### (b) Agree

The critical driver of a wash-up is activity statements that have not been lodged when the Income Tax Return is processed. Whether or not the instalment itself has been paid does not impact the requirement to process a wash-up manually to correct the clients account. Therefore to address this issue we have developed a prefill report (also available via ATO's online services for Agents), which advises clients of the amount of PAYG instalments raised and any that have not yet been lodged, that is, that would trigger a need for a wash-up. The ATO is exploring ways to broaden this for all clients with PAYG instalment obligations.

## ENTRY AND PAYMENT CORRESPONDENCE

### Stakeholder concerns

3.13 Stakeholders have expressed concern that some taxpayers do not receive any ATO correspondence advising them of their entry into the PAYG instalments system. The first notification these taxpayers receive is by way of a debt notice from debt collection agencies or where their bank account is garnished by the ATO, sometimes many years after the instalments liability was raised. In some cases, taxpayers initially thought that the ATO must have made a mistake as no mention of such debts had been made when dealing with other tax matters with the ATO. Furthermore, having raised the issue, ATO staff have been unable to explain the origin of the debt.

3.14 The IGT's investigation of complaints uncovered that the main cause of taxpayers not receiving PAYG instalment correspondence is that the ATO had used an incorrect or outdated address for them or their nominated representatives. The address used for these purposes is sourced from the taxpayer's ICA. Activity Statements and debt-related correspondence are sent to the same address.

3.15 In the above complaints investigations, correspondence was sent to outdated addresses where the ATO:

- had changed the taxpayer's address on their ITA but not their ICA;
- had not refreshed the taxpayer's address details on their ICA when they re-enter the PAYG instalments system; and
- was unable to update the taxpayer's address in the ICA as their accounts were inactive at the time.

3.16 Another cause of taxpayers not receiving ATO correspondence is because they had opened an account on myGov and linked that account to the ATO. As a result, PAYG instalments correspondence is sent electronically to that account. This issue is broader than the PAYG instalments system and it has been explored by the IGT in the past.<sup>68</sup> In these cases, a taxpayer may set up a myGov account and link it to the ATO but may never use it again, at least for tax purposes, forget they have such an account and/or not inform their tax or BAS agent. In the meantime, they or their tax or BAS agents no longer receive correspondence via their previously nominated channels. It has also become a source of tension between tax or BAS agents and their clients who may perceive that the agent has received the correspondence but has been negligent in taking action or informing them.

3.17 The last major reason for taxpayers not receiving correspondence was due to electronic lodgments by tax practitioners which override any preferences set by the taxpayer. This has occurred even where tax practitioners were not engaged to assist with their client's PAYG instalment obligations.

## Relevant materials

3.18 As explained in Chapter 1, the ATO issues its welcome letter to the address listed on a taxpayer's ITA system account. However, Activity Statements are sent to the address listed on the ICA account of the taxpayer.

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<sup>68</sup> IGT, *Submission to the inquiry into taxpayer engagement with the tax system* (February 2017) para 4.45; IGT, *Annual Report 2015–16* (2016) pp 4 and 27.

3.19 In 2012, an own motion privacy investigation by the Office of the Australian Information Commissioner (OAIC), brought to the ATO's attention that Activity Statements were being sent to outdated addresses.<sup>69</sup> During the OAIC investigation, it was noted that if a taxpayer informed the ATO that their address had changed on their income tax return, the ATO Information Technology (IT) systems would only update the address listed for their ITA and not their ICA.<sup>70</sup> Hence, Activity Statements, containing confidential information, could be sent to an old address where the taxpayer no longer resided. The ATO sought to correct this issue by introducing a process for reconciling addresses<sup>71</sup> on the two accounts.

3.20 As a result of the inclusion of the new process, new entrants to the PAYG instalments system, who have not previously held an ICA, have their postal addresses on the ITA exported to their ICA.<sup>72</sup>

3.21 For new entrants that hold, or previously held an ICA, the ATO attempts to determine whether the ICA address is current. To do so, the ATO determines whether the taxpayer has an active Australian Business Number (ABN) and if so, whether the address recorded on the Australian Business Register (ABR) matches the address on their ICA. If the addresses are matched, the ATO systems will continue to use the address recorded on the taxpayer's ICA for PAYG instalments correspondence. Where there is no match, the ATO systems will import the address used on the taxpayer's ITA to their ICA.<sup>73</sup>

3.22 For taxpayers currently in the PAYG instalments system that have the same address for both their ITA and ICA, when an income tax return is lodged that provides a new address, both addresses will be updated. If the taxpayer has different addresses listed on their ITA and their ICA, the ATO's system will only update the address on the ITA. Such an approach allows taxpayers to have different preferred addresses for correspondence regarding different tax obligations.<sup>74</sup>

3.23 In 2013, the ATO had also identified issues concerning the manual updating of taxpayer addresses. In particular, the ATO Complaints Unit found that where taxpayers or their representatives telephoned the ATO to update addresses, ATO staff would only change the address on the taxpayer's ITA. However, taxpayers and their representatives had assumed that all their addresses for dealings with the ATO would be updated. This resulted in situations where the ICA addresses were not appropriately updated and led to complaints about recovery action being taken without prior notification of existence of the corresponding debt.<sup>75</sup>

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69 ATO, 'ATO Office Minute' (Internal ATO document, 1 June 2012).

70 Ibid.

71 ATO, 'Emerging Issue ATO Charter & Complaints, Pay As You Go Income Tax Instalment (PAYGI) address updates' (Internal ATO document, June 2013).

72 ATO, 'AP353 Service description - Client Contact details' (Internal ATO document, 8 March 2017) pp 71-77.

73 Ibid.

74 Above n 71.

75 Ibid.

3.24 As a result of the above, ATO scripting now requires staff to check with callers which addresses are to be updated and the reasons for updating.<sup>76</sup> Accompanying guidance explains the need for these questions to be asked.

### **MyGov and tax agent lodgment**

3.25 When taxpayers link their myGov account to the ATO, the screen asking taxpayers to accept the ATO's terms and conditions requires taxpayers to specifically agree to their myGov inbox being used to receive all ATO correspondence, including those that may have previously been sent to their tax or BAS agent. The screen also states that their agent will be able to access correspondence electronically.<sup>77</sup>

3.26 The ATO's terms and conditions also stipulate that:

*You have designated your myGov account and inbox as your address for the Australian Taxation Office (ATO) to send you correspondence. You will receive a welcome message from the ATO in your myGov inbox to confirm the service is enabled.*<sup>78</sup>

3.27 If taxpayers no longer want their myGov inbox to be the preferred address for ATO correspondence, they can only change this by contacting the ATO by telephone in which case such preference cannot be overridden by providing a different address on subsequent tax returns that they may lodge through the myGov.<sup>79</sup>

3.28 When a government agency, such as the ATO, sends correspondence to taxpayers' myGov inboxes, they will be alerted to that correspondence by either SMS or email.<sup>80</sup> Such notification is a generic message that does not indicate the type of correspondence or from which government agency it may have originated. Furthermore, only one message is sent per day regardless of the number of correspondence that may have been received.

3.29 As mentioned earlier, if a taxpayer has a tax or BAS agent and links their myGov account to the ATO, no notification is sent to the agent. However, tax and BAS agents, through the ATO's Client Communication List (CCL), are able to access PAYG instalments correspondence sent to their clients' myGov account.<sup>81</sup> To do so, the agent must log into the CCL and then search for such correspondence using their client's tax file number.

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76 ATO, 'Client details – add or modify address', (Internal ATO document, 5 May 2017).

77 DHS, 'Sign-in-myGov' (7 July 2017) <[www.my.gov.au](http://www.my.gov.au)> [agreement of terms of agreement].

78 ATO, 'ATO myGov terms and conditions and privacy notices' (28 March 2015) <[www.ato.gov.au](http://www.ato.gov.au)>.

79 ATO, 'myGov Link Orchestration AP353 – Service Description' (Internal ATO document, 11 May 2016).

80 ATO, 'ATO and the myGov Inbox' (30 June 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

81 Ibid.



3.30 Lastly, if a tax or BAS agent representative lodges an Activity Statement via their respective Portals or practice management software, all correspondence is then sent to them electronically by default.<sup>82</sup> This will override any separate postal address nominated by the taxpayer, whether that nomination was made by telephone or by accepting the terms and condition in linking their myGov account to the ATO.

### IGT observations

3.31 It is important that taxpayers are promptly made aware of PAYG instalment liabilities so that they may fulfil their obligations. Whilst the risk of sending correspondence to incorrect addresses may appear to be small, the resulting impact on taxpayers can be severe, for example, having their bank account garnished. Such action may be viewed particularly unfair as PAYG instalments are a pre-payment of estimated annual tax liabilities and, as observed in Chapter 2, the entire PAYG instalments system is not well understood by the general public.

3.32 Therefore, it is not surprising that those who do not receive any correspondence about their entry into the system feel frustration and initially regard any resulting debt recovery action as an ATO error. Not only is this an undesirable situation for those taxpayers, but it also delays ATO collection of liabilities.

3.33 In 2012, the ATO sought to address the system issues that cause Activity Statements to be sent to outdated addresses. However, as stated earlier, IGT complaints investigations have revealed that such errors are still occurring. These errors are another symptom of using two different accounting methods or systems to administer the PAYG instalments regime. The IGT is of the view that they cannot be fully eradicated until they are replaced by a single system as recommended above.<sup>83</sup>

3.34 In the meantime, some improvements may be realised through better handling of taxpayers' requests to update their addresses. Through complaint investigations, the IGT has noted that ATO staff are at times uncertain about dealing with such requests. Whilst ATO scripting indicates that staff are expected to ask taxpayers why they are requesting their address details to be updated, taxpayers may not be aware of the ATO's two different accounting systems. Without such awareness, taxpayers may respond by saying that they are changing address because they are moving, not knowing they are providing pertinent information about all their tax obligations.

3.35 The IGT is of the view that ATO scripting should require staff to determine whether the taxpayer has an existing ICA and to ask all necessary questions to determine whether the address associated with it requires updating.

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82 Above n 19.

83 See recommendation 3.1(a).

3.36 Furthermore, as many taxpayers do not always update their address with the ATO, the ATO should respond to indications that taxpayers may not have received ATO correspondence, for example, when instalment amounts are not paid. In these circumstances, the IGT believes that the ATO should take prompt action to confirm the taxpayer's address by alternative methods, such as telephone or SMS. Such an approach was previously explored in the IGT's Debt Collection review.<sup>84</sup>

### **MyGov and tax agent lodgment**

3.37 The ATO does provide an additional warning prior to an individual completing the myGov linking process to the ATO. However, terms and conditions are frequently accepted without considering the details in today's online environment.<sup>85</sup> Unsurprisingly, the IGT continues to receive complaints where taxpayers have not received correspondence and on investigation the underlying cause is that those taxpayers had linked their myGov account to the ATO without appreciating the consequences.

3.38 The myGov platform also causes difficulties for tax agents, as they are not notified that they will no longer receive instalment notices for their clients when their clients link their myGov account to the ATO. Whilst tax agents are able to review their clients' correspondence in the CCL, they are not notified to do so after such an event.

3.39 As PAYG instalments correspondence may continue to have the tax or BAS agent's postal address in the address block of the document, taxpayers may, understandably, form the view that their agent had received the correspondence but had not acted on them. The resulting debt, interest, potential penalties and resulting recovery action may further strain the client-agent relationship and may lead to diminished trust and confidence between the two parties.

3.40 The IGT is of the view that the long term solution would be to implement ATO and myGov systems changes that allow taxpayers to choose their preference for each type of ATO correspondence that they may receive. MyGov notifications should also be improved by sending a notification for every piece of correspondence received, indicating the level of importance, the subject matter and which agency has issued it. However, it is acknowledged that the myGov platform is managed by the Department of Human Services (DHS) and the ATO is limited to what it can achieve on its own.

3.41 The above improvements require significant changes to ATO and myGov systems. In the case of the latter the impact on other government agencies and the user of their services would also need to be considered.

3.42 In the meantime, the IGT believes that the ATO should explore other solutions to deliver improvements more immediately. One option would be for the ATO to engage with DHS to ensure that, on linking of myGov accounts to the ATO, the existing address for correspondence is not overridden where the taxpayer uses a BAS or tax agent.

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<sup>84</sup> IGT, *Debt Collection* (2015) p 103.

<sup>85</sup> The Guardian, 'Click to agree with what? No one reads terms of service, studies confirm' (4 March 2017) <[www.theguardian.com](http://www.theguardian.com)>.



## RECOMMENDATION 3.2

*The IGT recommends the ATO:*

- a) modify its call centre scripting, for dealing with taxpayers' request to update their addresses, to require its staff to check if a taxpayer has an existing ICA and ask all necessary questions to determine if the address on it needs to be updated;*
- b) where taxpayers have unpaid or unreported PAYG instalments, take prompt action to confirm the taxpayer's address by alternative means such as telephone; and*
- c) engage with the Department of Human Services and software developers to:*
  - i. consider, as a long term goal, providing functionality that allows taxpayers to set address preferences for where they wish to receive different types of correspondence and more detailed notification of any correspondence that has been received in their myGov inbox; and*
  - ii. ensure that, on linking of myGov accounts to the ATO, the existing address for correspondence is not overridden where the taxpayer uses a BAS or tax agent.*

## ATO RESPONSE

### (a) Agree

The ATO will explore where improvements can be made to call centre scripting.

### (b) Agree

The ATO already contacts taxpayers, or their authorised representative, using a range of addresses and channels, such as SMS, phone or paper.

### (c) Agree

- i)** Work is already underway in this area, including working with the Digital Transformation Agency.
- ii)** We will engage with stakeholders to improve myGov's notification about mail preferences, including improved provision of information about what mail has been sent. The ATO will recommend that these improvements include automatic notification to a client's BAS or tax agent when an address is updated. We will also progress an improved communication preference tool for tax agents.

## **ACTIVITY STATEMENTS FOR PAST PERIODS**

### **Stakeholder concerns**

3.43 Stakeholders have observed instances where the ATO systems simultaneously issue multiple PAYG instalment Activity Statements each corresponding to a particular past period but with the same due date for payment, adversely impacting taxpayers' cash flows.

### **Relevant materials**

3.44 The ATO has advised the IGT that the above issue occurs where an outdated address for a taxpayer is subsequently updated with hitherto incorrectly addressed ATO correspondence being reissued to the updated address. Correspondence requiring payment are reissued with an appropriate extension to the due date for payment. The length of any such extension is at the discretion of the issuing officer.

3.45 The ATO has also explained that the above issue will occur where the ATO cancels a taxpayer's ABN, but there is a delay in cancelling their GST registration.

### **IGT observations**

3.46 Voluntary compliance with the PAYG instalments system relies on taxpayers being aware of the payments required and the dates by which they are due so that appropriate budgeting can take place to minimise impact on cash flows. Accordingly, where multiple Activity Statements are received unexpectedly, there is a risk of non-compliance.

3.47 The IGT is of the view that, as soon as the ATO detects that an address may be outdated, for example by its correspondence being returned, it should take prompt action to update that address. Such action could include review of the ATO's data holdings to locate a more recent address and by attempting to contact the relevant taxpayers, by telephone or other means. Such prompt action would minimise the number of Activity Statements being sent to an incorrect address and corresponding instalments remaining outstanding.

3.48 The ATO does not seem to have documented procedures or policies for dealing with issuance of multiple Activity Statements following an address update. Without appropriate procedures or policies, it would be difficult to determine whether the ATO is consistent in its approach to deferring due dates in these circumstances. Accordingly, the IGT believes that the ATO should develop procedures and policies for these situations and train the relevant staff accordingly. Such policies would also provide clarity on the ATO's existing process to provide lodgment and payment deferral, including the relevant factors that should be considered.

### RECOMMENDATION 3.3

*The IGT recommends the ATO:*

- a) as soon as practicable after it has detected that a taxpayer's address is outdated, take prompt action to update the address, for example, by attempting to contact that taxpayer by alternatives means, such as telephone; and*
- b) develop procedures and policies for determining the appropriate deferred lodgment and payment dates when issuing multiple PAYG instalment Activity Statements and train its relevant staff accordingly.*

### ATO RESPONSE

#### (a) Agree

The ATO will explore the use of using data and analytics to improve taxpayer address data integrity.

#### (b) Agree

The ATO will look at current policies and procedures and determine if any updates are required. We will also explore further training and education opportunities.

### PAYG INSTALMENTS AND INCOME TAX 'WASH UPS'

3.49 The ATO systems operate on the premise that Activity Statements are lodged before the corresponding annual income tax return.<sup>86</sup> Where this does not occur, the PAYG instalment liabilities relating to those Activity Statements are not reflected in the NOA. As a result, the taxpayer, effectively, would have to pay tax on such income twice unless the relevant PAYG liabilities can be reversed. Such reversal requires ATO staff to manually change the relevant accounts and is commonly referred to as a 'wash up'.

### Stakeholder concerns

3.50 Concern has been raised with the ATO's delay in processing wash ups. Such delay may result in unnecessary debt collection action even though there is no outstanding income tax for the period in question.

3.51 Notwithstanding the ATO's 28 calendar day service standard for performing a manual wash up, it may take up to three months. In one case debt recovery action had commenced for over a quarter of a million dollars, albeit that such action was subsequently stopped when the wash up was completed.

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86 ATO, 'PAYG instalment Wash-up options' (Internal ATO document, 21 December 2010) p 1.

## Relevant materials

3.52 It should be noted that the problem is avoided as long as the income tax return is lodged after 21 July which is the due date on the Activity Statement for the fourth quarter.<sup>87</sup>

3.53 Where an income tax return is lodged before this date, the ATO has an automated process to avoid the need for manual wash ups<sup>88</sup> for all annual PAYG instalment taxpayers. This automatic process adjusts the instalment amount to nil once the relevant income tax return is lodged ('auto-finalise').<sup>89</sup> The ATO also auto-finalises quarterly PAYG instalments for taxpayers who have no other obligations to report on their Activity Statement.

3.54 However, manual wash ups are still necessary for other scenarios,<sup>90</sup> for example, taxpayers who are required to report their PAYG instalments and other tax liabilities on a BAS.<sup>91</sup> Upon finalising the manual process, the ATO issues correspondence to the relevant taxpayer explaining the actions that had been taken, including crediting the taxpayer for interest on any overpayments.<sup>92</sup>

3.55 The ATO had previously considered modifying their systems to automatically finalise the PAYG instalments label on a BAS once the due date has passed.<sup>93</sup> It was identified that this would eliminate an estimated 7,452 wash up cases and reduce ATO costs by \$179,631 in the 2011 year, with increased cost savings in each following year.<sup>94</sup> However, this approach was not adopted by the ATO, the reasons for which have not been communicated to the IGT.

3.56 In performing a manual wash up, ATO staff must apply an instalment credit to the taxpayer's ITA for the correct period. The ATO has assisted staff by developing a macro tool to automate some tasks required to complete the wash up. This tool has reduced wash up processing times from approximately 4 hours per case to 30 minutes.<sup>95</sup>

## IGT observations

3.57 The ATO has sought to address the risk of PAYG instalments being effectively required to be paid twice where the annual tax return is lodged prior to the corresponding Activity Statement(s). However, the lack of a fully automated response has meant that the problem has not been completely eradicated.

3.58 Whilst the ATO's macro tool to support staff has reduced the time to process manual wash ups to 30 minutes, the ATO's 28 days service standard has been exceeded and unnecessary recovery action commenced in certain instances.

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87 ATO, 'PAYGI Washups Option 7' (Internal ATO document, 10 December 2010) p 3.

88 Above n 86, p 2.

89 Above n 87, p 2.

90 Above n 86, p 2.

91 Above n 87, p 3.

92 Above n 86, p 2.

93 Above n 87, p 3.

94 Above n 87, p 4.

95 Above n 86, p 2.

3.59 The ATO had previously considered auto-finalising the PAYG instalments label in a BAS after the due date had passed. Such an option was not adopted despite the projected cost savings. This would significantly reduce the number of taxpayers affected as well as the corresponding ATO manual processing.

3.60 Similar options may be open to the ATO, for example, any outstanding obligations to report and pay PAYG instalments may be suppressed where an income tax return has already been lodged for the same period. If such an option was to be implemented, only quarterly instalment taxpayers, who lodge their income tax return before 21 July, would require a manual wash up. The ATO could also advise these remaining taxpayers to delay lodging their tax returns by, for example, alerting them through myTax or broader TaxTime communications.<sup>96</sup>

3.61 Where a manual wash up is still required, the ATO should take the precautionary step of preventing any debt recovery action from commencing until the wash up process has been completed. The debt recovery action can be resumed if there is any related debt after the wash up is complete.

3.62 It should be noted that those recommendations in the previous Chapter which are aimed at better informing affected taxpayers about the PAYG instalments system and in particular the consequences of not lodging Activity Statements promptly should assist in reducing the instances of lodging income tax returns before the relevant Activity Statements.

### RECOMMENDATION 3.4

*The IGT recommends the ATO:*

- a) for taxpayers who have lodged an income tax return but not lodged corresponding BASs by the due date, automatically suppress any obligations to report and pay PAYG instalments for that income tax period;*
- b) for taxpayers who would otherwise require a manual finalisation of the PAYG instalments label, issue targeted communications encouraging them to delay lodgment of their income tax return until 21 July; and*
- c) where a manual finalisation of the PAYG instalments becomes necessary, any related debt recovery action should be delayed pending the completion of this task.*

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96 ATO, 'Tax Time 2017' (29 May 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

## **ATO RESPONSE**

### **(a) Agree**

The ATO agrees that eliminating manual wash ups for early lodgers would result in an improved client experience. As noted, the ATO currently auto-finalises activity statements to avoid manual wash-ups for instalment only taxpayers. The ATO is investigating extending this automation to accommodate taxpayers with other BAS obligations not finalised by the lodgment of the income tax return, including the feasibility of revising to nil the BAS instalment obligation for early lodgers. Extending wash up automation will depend on funding, systems capability and the prioritisation process.

### **(b) Agree**

### **(c) Agree**

In conjunction with work to extend wash up automation, the ATO will also investigate different ways to improve the client experience where a taxpayer has a debt that is due to a wash up situation involving PAYG instalments. Implementation of a solution will depend on system changes and prioritisation.

## **CHAPTER 4 — ELEMENTS OF THE PAYG INSTALMENTS FRAMEWORK**

4.1 This chapter explores stakeholder concerns with the legislation and ATO processes regarding the following elements of the PAYG instalments system:

- entry into the PAYG instalments system;
- penalties and interest for under-reporting instalment amounts; and
- the instalment rate method for calculating PAYG instalment amounts.

### **ENTRY INTO THE PAYG INSTALMENTS SYSTEM**

#### **Stakeholder concerns**

4.2 Stakeholders raised concerns, in complaints and in submissions to this review, regarding the ATO's administrative criteria for automatic entry into the PAYG instalments system for individual taxpayers as well as voluntarily entering the system.

4.3 With respect to the ATO's administrative criteria, concerns were raised that the threshold for business and investment income:

- is too low resulting in a greater number of taxpayers in the system and over collection of tax which has to be refunded later;
- does not allow for situations where there is a one-off spike in income, for example, where interest may be temporarily earned between the sale and purchase of a family home; and
- is disruptive to taxpayers who move in and out of the system due to fluctuating income from year to year, creating cash flow difficulties and impacting savings habits.

4.4 Stakeholders have expressed concerns that some taxpayers are being refused voluntary entry into the system. They consider voluntary entry to be important in assisting new businesses to manage their cash flows, particularly after their first financial year, when they are required to pay their annual income tax and, shortly afterward, their first PAYG instalment in respect of their next year's income tax liability.

## Relevant materials

### PAYG instalments entry threshold

4.5 As stated in Chapter 1, subject to limited exceptions, taxpayers who have reported \$4,000 or more of business or investment income in their most recent annual tax return, are automatically placed into the PAYG instalments system.<sup>97</sup>

4.6 Since the inception of the PAYG instalments system on 1 July 2000 until 30 June 2014, the amount of the threshold criteria has doubled from its then base of \$2,000. The threshold for two of the exemptions referred to in Chapter 1 have similarly doubled.<sup>98</sup>

4.7 The ATO's tax statistics demonstrate that individual taxpayers comprised over 70 per cent of all taxpayers in the PAYG instalments system and are contributing an increasing amount towards total revenue collected through the PAYG instalments system (from 20 per cent in 2013–14 to 25 per cent in 2015–16).

4.8 The ATO statistics comparing the payment of PAYG instalments to their notional tax amount for the 2015–16 financial year is set out in Table 4.1 below.

**Table 4.1: Individual taxpayers' PAYG instalments liabilities compared to final income tax liabilities in the 2015–16 financial year by degree of variance**

PAYG instalments compared to notional tax (%)	Number of taxpayers
<50%	250,469
51 to 60%	50,699
61 to 70%	55,301
71 to 80%	61,855
81 to 90%	69,610
91 to 100%	79,333
101 to 105%	44,419
106 to 110%	39,627
111 to 120%	62,106
>120%	277,719
<b>TOTAL</b>	<b>991,138</b>

Note: The above statistics only include those individuals where a comparison can be made between the amount reported in their Activity Statements during the year and the calculation of their notional tax amount upon the lodgment of their income tax return. For example, individuals who exited the system part way through the year are not included.  
Source: ATO.

<sup>97</sup> Above n 13.

<sup>98</sup> Bruce Billson MP, Minister for Small Business, 'Changes to tax system drives \$56m in red-tape savings for small business' (Media Release, Nat 2014/37, 20 June 2014).



4.9 Table 4.1 shows 991,138 individual taxpayers remained in the PAYG instalments system by the end of the 2015–16 financial year.<sup>99</sup> Of these individual taxpayers, 423,871 or 42.8 per cent, paid PAYG instalment amounts greater than their notional tax amount during the 2015–16 financial year. However, 567,267 or 57.2 per cent of individuals had paid less than their notional tax amount for the year. It also appears that over 28 per cent of individuals (277,719) estimated a higher PAYG instalment liability by more than 20 per cent of their end of year tax assessment. Conversely, almost 25 per cent of individuals reported instalments lower than their notional tax amount by more than 50 per cent.

4.10 The Joint Committee of Public Accountants and Audit (JCPAA) in their 2008 report<sup>100</sup> considered that some over collection of tax via the PAYG instalments system, was appropriate. The main reasons for their view was that it was unreasonable to expect taxpayers to focus on their tax position and adjust their spending throughout the year, eliminating over collection in aggregate would result in more taxpayers in debt which would cause payment difficulties and that taxpayers prefer to receive tax refunds.<sup>101</sup>

4.11 It is worth considering the effect of increasing the threshold criteria for entry into the system on government revenue and the number of individuals that may be removed from the system. Table 4.2 includes some data in this regard.

**Table 4.2 Business or investment income threshold increase and corresponding impact on individuals and revenue**

Threshold	Number of individuals removed	PAYG instalment amounts reduced
\$4,000 to <\$5,000	14,653	\$24,072,282
\$5,000 to <\$6,000	14,585	\$24,717,354
\$6,000 to <\$7,000	14,029	\$31,463,097
\$7,000 to <\$8,000	13,649	\$27,002,991
<b>TOTAL</b>	<b>56,916</b>	<b>\$107,255,724</b>

Source: ATO.

4.12 Table 4.2 demonstrates that if the ATO increased the business and investment income threshold to \$5,000, \$6,000, \$7,000 or \$8,000, it would remove 14,653, 29,238, 43,267 and 56,916 individual taxpayers from the PAYG instalments system respectively. This is compared to the 1,447,035 total individuals in the system during the 2015–16 financial year.<sup>102</sup>

99 It is noted that these statistics do not match the statistics in Table 1.1.

100 Joint Committee of Public Accounts and Audit, Parliament of Australia, *Report 410 – Tax Administration* (2008).

101 Ibid pp 177–179.

102 ATO, 'Taxation statistics 2014–15' (20 April 2017) <www.ato.gov.au >.

4.13 It is also important to note the corresponding impact to revenue would be \$24,072,282, \$48,789,636, \$80,252,733 and \$107,255,724 respectively. This is compared to the \$21 billion collected from all individuals in the PAYG instalments system for the 2015–16 financial year.<sup>103</sup> It should also be noted that such amounts are likely to be recovered once tax returns for the relevant period are lodged.

4.14 The ATO statistics in Table 4.3 presents a sample of individuals who entered the PAYG instalments system during the period between 1 July 2016 and 31 May 2017 and how frequently they re-entered the system dating back to 1 July 2012.

**Table 4.3: Sample of individuals' re-entry into the PAYG instalments system between 1 July 2012 and 31 May 2017**

Market Segment	Entered x1	Entered x2	Entered x3	Entered x4	Entered >4	Total
Individual - non business	99,011	24,430	1,953	13	0	125,407
Sole traders	195,255	52,760	3,835	28	3	251,881
<b>TOTAL</b>	<b>294,266</b>	<b>77,190</b>	<b>5,788</b>	<b>41</b>	<b>3</b>	<b>377,288</b>

Source: ATO.

4.15 Table 4.3 only considers a sample of individual taxpayers who were in the PAYG instalments system during a portion of the 2016–17 year, specifically those who entered during the period 1 July 2016 to 31 May 2017. It demonstrates that of these taxpayers, 77,190 individuals were entered into the system for a second time, 5,788 for a third time and 44 for four or more times, dating back to 1 July 2012.

### PAYG instalments voluntary entry

4.16 Individual taxpayers can voluntarily enter into the PAYG instalments system by telephone or via their online myGov account.<sup>104</sup> Currently, there is no ATO commitment to provide additional functionality in the tax and BAS agent Portals to allow taxpayers' representatives to voluntarily enter their clients into the PAYG instalments system.

4.17 Table 2.4 shows the number of individuals that have voluntarily entered into the PAYG instalments system from 1 July 2013 to 21 June 2017, by financial year.

**Table 4.4 Number of individuals voluntarily entering the PAYG instalments system between 1 July 2012 and 21 June 2017, by financial year**

Period	1/7/2012 to 30/6/2013	1/7/2013 to 30/6/2014	1/7/2014 to 30/6/2015	1/7/2015 to 30/6/2016	1/7/2016 to 21/6/2017
Number of individuals	2,702	3,346	4,799	5,447	9,518

Source: ATO.

<sup>103</sup> Ibid.

<sup>104</sup> ATO, 'How to start paying instalments' (22 June 2017) <[www.ato.gov.au](http://www.ato.gov.au)>.

4.18 As depicted above, the number of individuals voluntarily entering the PAYG instalments system has steadily increased over the last 5 financial years, from 2,702 in 2012–13 to 9,518 in 2016–17. It should be noted that the largest increase was from the 2015–16 financial year (5,447) to the 2016–17 financial year (9,518).

4.19 The ATO also promotes voluntary entry by publishing information and introductory videos on the ATO's website.

## IGT observations

### PAYG instalments entry threshold

4.20 The PAYG instalments system aims to assist taxpayers with business or investment income to save and progressively pre-pay amounts of tax towards anticipated tax liabilities that arise at the end of the financial year. It also provides Government with more even revenue collection throughout the financial year.

4.21 Whilst the IGT acknowledges the importance of the role of the PAYG instalments system in maintaining an effective tax collection strategy, it is important to ensure that it continues to operate efficiently with minimal adverse impact on affected taxpayers. Therefore, it is important to monitor the entry and exit criteria such that the taxpayers that remain in the system are the very ones that the relevant legislation seeks to assist.

4.22 The ATO's PAYG instalments entry criteria were updated once in the last 17 years of operation. The IGT is of the view that, if the ATO were not to amend their entry criteria periodically, the efficient administration of the system may be compromised and some taxpayers adversely affected.

4.23 The ATO's data shows that increasing the threshold criteria to say \$8,000 for business or investment income, will allow almost 57,000 individuals to exit the system with a resulting reduction of \$107 million in instalments collection. However, such amounts are likely to be recovered a short time later when the relevant tax returns are lodged. In any event, it is a relatively small amount when compared to the \$21 billion which is the total amount of instalments collected from individual taxpayers.

4.24 Increasing the threshold would also have compliance cost savings to those individuals excluded from the system and administrative costs for the ATO. Whilst compliance and administrative cost savings data is unavailable, increasing the threshold to \$8,000 would completely remove the need for annual reporting. Annual reporting has a short timing benefit to government as the due date to pay annual instalments is 21 October compared to annual income tax payment which is due 21 days after the lodgment due date (generally 31 October for self-preparers).<sup>105</sup>

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<sup>105</sup> Taxpayers who lodge their annual income tax return with the assistance of a tax agent may be eligible for a deferred lodgement due date: ATO, *Lodgment obligations, due dates and deferrals*, PS LA 2011/15, 30 June 2017.

4.25 On the above basis, the IGT believes that the ATO should periodically review the threshold criteria taking into account the broader economic environment such as interest rates and credit availability.

4.26 The ATO's PAYG instalments entry criteria also does not account for situations where a taxpayer may experience a temporary positive or negative spike in income. This is because a taxpayer's entry into the system is only based on their most recently assessed annual income tax return. One option suggested by some stakeholders has been for taxpayers to indicate in their annual tax return that they have an increased one-off spike in business or investment income, thereby proactively preventing their entry into the system. However, other stakeholders observed, and ATO research suggests,<sup>106</sup> that many individuals do not have an awareness of the PAYG instalments system, particularly where they have not interacted with it previously. Therefore, such an option may not be effective.

4.27 Another option is to make taxpayers aware of the circumstances in which they may exit the PAYG instalments system. Currently, the ATO's welcome letter does not explain the circumstances in which taxpayers are eligible to exit the system. Chapter 2 of this report deals with the updating of the ATO's welcome letter and website to address this concern. Clearer guidance would better inform taxpayers and enable them to request an exit where there is a one-off spike in income.

4.28 Furthermore, providing tax and BAS agents with functionality to enter or remove their clients would also make it easier to exclude taxpayers who should not be in the system. In this respect, the IGT notes that the ATO is currently transitioning to its Practitioner Lodgment Service (PLS) whereby tax representatives use Standard Business Reporting (SBR) enabled software to interact with ATO systems. As part of this process, it would be beneficial for the ATO to seek additional practice management software functionality that allows tax and BAS agents to voluntarily enter their clients into or remove them from the PAYG instalments system.

4.29 The ATO's entry criteria for the system also cannot account for situations where individuals have fluctuating business or investment income from year-to-year, for the same reasons as for one-off spikes in income. The ATO's statistics in Table 4.3, show that for the 377,288 taxpayers entering into the system at some time for a selected 11 month period, 83,022 (or 22 per cent) of them had previously been in the system within approximately the last 5 years. This suggests that many taxpayers may experience disruptions caused by entry, exit and re-entry, into the PAYG instalments system.

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106 Above n 40, p 10.

4.30 For example, taxpayers, who held investment properties in a particular year where significant expenditure was incurred, would be required to report PAYG instalment Activity Statements in that year but would then be removed from the system in the following year. However, it would have been appropriate for them to remain in the PAYG instalments system as their expenditure had ceased and they would earn investment income greater than the entry criteria. This example illustrates the frustration experienced by taxpayers who regularly enter and exit the PAYG instalments system because the instalment amounts are calculated on the basis of information reported in their previous tax return.

4.31 The ATO could use a rolling average of income tax assessments, say for the previous three financial years, to determine whether a taxpayer should be entered into or exited from the PAYG instalments system. Such an approach could potentially avoid unnecessary system entry or exit unless the spikes in income are particularly significant. However, averaging the entry criteria could lead to greater concern amongst individuals who do not understand why they have been entered into the PAYG instalments system. Furthermore, averaging the threshold would add further complexity to the entry criteria, particularly as some aspects would be difficult to average such as the eligibility for the senior tax offset. Averaging would also delay system entry and exit, creating additional issues such as cash flow difficulties for new businesses.

4.32 Another option to minimise the disruption caused for individuals who continually enter and exit the PAYG instalments system, is for the ATO to keep individuals in the system even if they no longer meet the automatic entry requirements and instead notify them of their ability to exit the system. However, this would increase compliance costs as it would require taxpayers to request exit from the system.

4.33 In order to achieve an appropriate balance between the competing interests, the IGT believes that taxpayers, who are to be automatically exited from the system, should be alerted of the option to voluntarily remain in the system. Such an approach accords with the existing voluntary entry process and assist individual taxpayers in improving their financial management in terms of savings and consistently meeting their tax obligations.

4.34 In its exit letter to taxpayers, who no longer meet the automatic entry criteria, the ATO briefly mentions that they may voluntarily remain in the system. However, the low number of taxpayers who do so indicates that the matter may need to be raised more prominently, including stating the associated benefits.

### **Voluntary entry**

4.35 Voluntary entry into the PAYG instalments system provides individuals with an important means to better manage their cash flows and future taxation liabilities. Whilst statistics provided in Table 4.4 illustrate voluntary entrants are increasing, the IGT is aware of some cases where the ATO has not accepted pre-payment of their anticipated liabilities.

4.36 Some stakeholders have suggested that sole traders and small businesses should automatically be placed into the PAYG instalments system once they receive an ABN. However, the IGT considers that such a requirement may penalise those who have good saving habits. There may also be difficulties with estimating cash flows at the time of applying for an ABN. It has also been suggested that there should be a smaller PAYG instalment rate or a gradual part payment system to assist first year businesses identified by the ABN registration process. However, given the difficulties with estimation of income, these options are unlikely to be helpful in a practical sense.

4.37 The best option for helping new businesses may be to inform them and their trusted advisors about the system, particularly their ability to voluntarily enter into the system, and make it as easy as possible for them or their advisors to exercise such choices.

#### **RECOMMENDATION 4.1**

*The IGT recommends that the ATO improve its monitoring of the entry and exit criteria of the PAYG instalments system by:*

- a) periodically reviewing, at least every three years, the threshold entry criteria;*
- b) better informing those no longer meeting the entry criteria that they may choose to voluntarily remain in the system; and*
- c) seeking to provide additional functionality, in its new Practitioner Lodgment Service, to allow BAS and tax agents to voluntarily enter or exit their clients into or out of the system.*

#### **ATO RESPONSE**

##### **(a) Agree**

The ATO will ensure that the existing process to review the PAYG instalments entry/exit thresholds will occur at least every three years. Treasury will be contacted where changes are recommended.

##### **(b) Agree**

The ATO already provides this information in the taxpayer's PAYG instalments exit letter. However, we will consider using additional methods, such as behavioural insights, to bring this to the taxpayer's attention.

##### **(c) Agree**

The ATO plans to replicate the functionality in ATO Online to enable tax and BAS agents to voluntarily enter and exit their clients from PAYG instalments. These system changes will depend on funding and the prioritisation process.



## PENALTIES AND INTEREST

### Stakeholder concerns

4.38 As mentioned in Chapter 1, the 15 per cent Rule allows the ATO to apply a penalty equivalent to accrued GIC where varying instalments resulted in less than 85 per cent of the notional tax amount which should have been paid.<sup>107</sup> Some stakeholders have expressed concern that the safe harbour offered by the 15 per cent Rule is too low. They explained that this causes taxpayer apprehension against varying their instalments as they may be subject to penalties. Accordingly, taxpayers may overestimate their instalments which unnecessarily impacts their cash flows. These stakeholders are of the view that more leeway is required given the difficulty for taxpayers to accurately estimate their future tax liabilities.

4.39 On the other hand, some stakeholders consider that the ATO should take a more proactive approach to caution taxpayers who regularly vary their instalments to nil and have a large tax bill upon assessment of their annual tax return.

### Relevant materials

4.40 Although the ATO does not have an automated process in place to impose the 15 per cent Rule, it publicly warns taxpayers and their representatives that it is reasonable for them to assume that a penalty will apply if instalment amounts are underestimated. However, since the introduction of PAYG instalments, the ATO has advised the IGT that due to the complexity of the calculation, there have been very few cases where the penalty has been applied and in almost all cases where the penalty was imposed it was subsequently remitted upon review.

4.41 Pursuant to Part 4-25, of Schedule 1 to the TAA 1953, the ATO may also apply an administrative penalty where it is determined that an individual has knowingly made a false or misleading statement which results in a shortfall amount. The result may be a penalty equivalent to 25, 50 or 75 per cent of the shortfall amount depending on the behaviour which gave rise to the shortfall. Since the introduction of PAYG instalments, the ATO has advised that there have been no cases where a penalty for false and misleading statement penalty has been applied.

4.42 During this review, the compliance area of the ATO's PAYG instalments team has developed a strategy for educating taxpayers requiring assistance to meet their obligations, such as those who persistently vary their instalments to nil and have a large income tax bill on assessment. It is proposed that where such behaviour is not addressed through education, stronger compliance action will be considered such as the imposition of a penalty.<sup>108</sup>

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<sup>107</sup> *Taxation Administration Act 1953* subdiv 45-G.

<sup>108</sup> ATO, 'Treatment strategy for excessive variation and understatement of PAYG instalment income' (Internal ATO document, 16 March 2017); ATO, 'Executive Minute – Endorsement of treatment strategy to address excessive variations and understatement of instalment income' (Internal ATO document, 16 March 2017).

## IGT observations

4.43 Despite warnings, a lack of ATO action to enforce the 15 per cent Rule may have led to a perception amongst certain taxpayers that underestimation of PAYG instalments has little or no consequence. Indeed, some of these taxpayers may have acted on such perception. As noted earlier, the ATO statistics demonstrate that 25 per cent of individuals are underestimating their instalments amounts by 50 per cent or more.

4.44 Conversely 28 per cent of individuals pay instalment amounts greater than their notional tax assessment by more than 20 per cent. As some stakeholders have suggested, these taxpayers may be overestimating due to the combined complexity of calculation, low safe harbour provided by the 15 per cent Rule and fear of penalty.

4.45 Accordingly, whilst at present, the net position to revenue may not be significantly affected, there may be an uneven playing field with some knowingly underestimating whilst others are overestimating their PAYG instalment amounts. Furthermore, continued inaction to enforce penalties may lead to a broader trend of non-compliance with the PAYG instalments system.

4.46 It is understandable that taxpayers may experience difficulties with estimating future liabilities, for example, where an individual is earning investment income but only receives annual statements from the relevant financial institution. Furthermore, the ATO may also face challenges in imposing the 15 per cent Rule. Currently, it would have to manually compare instalment amounts reported in Activity Statements with income reported in income tax returns.

4.47 During the course of this review, the ATO has developed a risk treatment strategy to educate and warn individuals who repeatedly or excessively underestimate their PAYG instalment amounts and where appropriate impose penalties. The IGT supports such a strategy and believes that the ATO should refine and adopt it as soon as practicable. This strategy should also be widely publicised to influence taxpayer behaviour by, for example, highlighting it in a brochure that taxpayers may receive upon entry into the system as is discussed in Chapter 2. Additionally, the ATO should also consider reporting its enforcement activities, including the number and quantum of penalties imposed, in its Annual Report or website.

### RECOMMENDATION 4.2

*The IGT recommends the ATO:*

- a) educate and warn taxpayers of the risk of underestimation of PAYG instalment amounts particularly where repeated and/or excessive underestimations occur;*
- b) enforce penalties in appropriate circumstances where such taxpayers have repeatedly not adhered to warnings; and*
- c) publish statistics on its enforcement activities including the number and quantum of penalties imposed.*



## ATO RESPONSE

### (a) Agree

An education campaign commenced during the period of the review.

### (b) Agree

The ATO agrees that if after education and leverage activities taxpayers continue to underestimate their instalment income or excessively vary their instalment rate, then the ATO may impose penalties or interest in the future. This could start as early as 2018.

### (c) Agree

As part of the ATO's treatment strategy, the ATO will maintain, report and publish these statistics.

## PAYG INSTALMENTS RATE AND STATUTORY INCOME

### Stakeholder concerns

4.48 Stakeholders have expressed concern that statutory income, such as Employee Share Scheme (ESS) income derived under a deferred scheme,<sup>109</sup> are included in the calculation of PAYG instalments which results in individuals receiving an instalment rate significantly greater than their marginal income tax rate.

4.49 Taxpayers who elect to pay instalments using the rate method have explained that they must manually exclude the income in each reporting period causing unnecessary compliance costs. This is exacerbated when the taxpayer is required to continue this approach in subsequent financial years.

### Relevant materials

4.50 Individuals may choose between the GDP adjusted amount method and instalment rate method when reporting their PAYG instalment amounts. The instalment rate is calculated as:

$$\left[ \frac{\text{Notional tax}}{\text{Base assessment instalment income (BAII)}} \right] \times 100 = \text{instalment rate}^{110}$$

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<sup>109</sup> A deferred scheme is where shares will be received in a later income year.

<sup>110</sup> *Taxation Administration Act 1953* sch 1 s 45 -320.

4.51 Notional tax is the tax attributable to the taxpayer's business or investment income for the most recent assessment, based on current income tax rates.<sup>111</sup> BAIL is the amount of instalment income in the most recent assessment.<sup>112</sup> Instalment income in this context is defined to only include income according to ordinary concepts.<sup>113</sup>

4.52 Accordingly, statutory income is included in the numerator but not in the denominator of the equation. As a result, statutory income can produce an instalment rate higher than the top marginal tax rate and in some cases may be 1,000 per cent or more. This arises where very little ordinary income is earned but large amounts of statutory income are derived resulting in instalment amounts significantly higher than the annual tax assessment. Taxpayers who pay using the GDP adjusted amount method do not suffer the above outcome as it is purely based on the GDP adjusted notional tax.

4.53 Approximately 14,000 taxpayers, who use the instalment rate method, are issued with a rate higher than their marginal tax rate each year. The ATO provides guidance to such taxpayers each year to mitigate the confusion caused.<sup>114</sup>

4.54 In 2015, the ATO considered proposing a change to the current legislation to avoid high rates by aligning the definition of the two different types of income used in the equation.<sup>115</sup> However, as an alternative, the Commissioner has committed to exercising his general power of administration to cap the adjusted rate to 55 per cent for individuals from 1 July 2017 onwards.<sup>116</sup> The 55 per cent rate was chosen as it takes into consideration the highest marginal tax rate for individuals, plus the Medicare levy and the Higher Education Loan Program (HELP) debt rate. The ATO's system will automatically cap the rate, however, should individual taxpayers disagree with the rate, they may vary it.<sup>117</sup>

## IGT observations

4.55 The instalment rate method is preferred by some taxpayers as it is based on the income derived in the current period and may provide a more accurate estimate. However, as outlined above, it may result in excessively high instalment amounts becoming payable. Such amounts may be varied but it does involve an additional compliance burden. The ATO has sought to address the issue by capping the maximum rate that may be applied effective from 1 July 2017. Accordingly, it is too early to determine its effectiveness. If it proves ineffective, the IGT is of the view that a legislative change should be considered.

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111 *Taxation Administration Act 1953* sch 1 s 45 -325.

112 *Taxation Administration Act 1953* s 45-320.

113 *Taxation Administration Act 1953* s 45-120(1).

114 ATO, 'Advocacy Alert - Pay As You Go (PAYG) Instalments - High Instalment Rates' (Internal ATO document, 8 May 2015).

115 *Ibid.*

116 ATO, 'Executive Minute, Endorsement of Administrative solution to high instalment rates' (ATO Internal document, 4 November 2016).

117 *Ibid.*

## APPENDIX 1 — TERMS OF REFERENCE

The 'Pay As You Go' (PAYG) system aims to assist taxpayers meet their anticipated tax liabilities by minimising large end-of-year tax bills and provide Government with revenue during the income year.<sup>118</sup> It requires periodic reporting and pre-payment of income taxes during the income year either by withholding amounts at the source of income, such as salary and wages, or by payment of instalments where taxes are not withheld as is the case, for example, with interest and dividends.

The focus of this review is on the PAYG instalments system as it applies to individual taxpayers. Individual taxpayers who, in the prior year, have reported \$4,000 or more of income that was not subject to withholding tax at source, are required to periodically report and pre-pay amounts towards their anticipated end-of-year tax liabilities for the current income year.<sup>119</sup> The amounts of the periodic pre-payments are based on the previous year's tax assessment.<sup>120</sup>

Concerns with respect to the Australian Taxation Office's (ATO) administration of the PAYG instalments system as it applies to individual taxpayers have been raised with the Inspector-General of Taxation (IGT) both through his complaints handling service as well as in submissions to his current work program. In particular, these concerns include individual taxpayers:

- being unnecessarily entered into the PAYG instalments system due to one-off spikes in income in a particular income year;
- being unaware of automatic entry into the system or not receiving appropriate correspondence which may, for example, explain reasons for entry into the system and receiving unexpected tax debts;
- experiencing difficulties varying instalment amounts or lodgment frequency, making payments or exiting the system, all of which may result in tax debt errors or refund delays; and
- receiving unclear ATO communications and guidance on reporting and payment obligations, including how PAYG instalment debts are applied against income tax return assessments as well as how to vary instalment amounts and reporting frequency requirements.

This review<sup>121</sup> will examine individual taxpayers' experiences with the PAYG instalments system, and in particular the above concerns, in order to identify improvement opportunities for taxpayers, the ATO and the system as a whole.

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118 Explanatory Memorandum, House of Representatives, A New Tax System (Taxation Laws Amendment) Bill (No. 1) 1999.

119 ATO, 'Who needs to pay PAYG instalments' (November 2015) <[www.ato.gov.au](http://www.ato.gov.au)>.

120 Explanatory Memorandum, above n 1; section 45-15 of schedule 1 to the *Tax Administration Act 1953*.

121 This review is commenced pursuant to subsection 7(1) of the *Inspector-General of Taxation Act 2003* (IGT Act).

## SUBMISSIONS

We invite you to lodge a submission to this review. Please set out your experiences with the PAYG instalments system as it applies to individuals and describe the impact it has had on you. Your views on any potential improvements to the ATO's administration of this system are also welcomed.

The closing date for submissions is 30 April 2017. Submissions can be sent by:

Post to:           Inspector-General of Taxation  
                      GPO Box 551  
                      SYDNEY NSW 2001

Email to:         PAYGI@igt.gov.au

## CONFIDENTIALITY

Submissions provided to the IGT are maintained in strict confidence (unless you specify otherwise). This means that the identity of the taxpayer, the identity of the adviser and any information contained in such submissions will not be made available to any other person, including the ATO. Section 37 of the IGT Act safeguards the confidentiality and secrecy of such information provided to the IGT – for example, the IGT cannot disclose the information as a result of a Freedom of Information (FOI) request, or as a result of a court order generally. Furthermore, if such information is the subject of client legal privilege (also referred to as legal professional privilege), disclosing that information to the IGT will **not** result in a waiver of that privilege.

## APPENDIX 2 — EXAMPLE BUSINESS ACTIVITY STATEMENT

A2.1 The figures below provide an example of a Business Activity Statement (BAS).

Figure A2.1: Example BAS - front

This bar code is used by our electronic scanners to identify your activity statement.

The document ID is a unique identifier for each activity statement you receive.

Your Australian business number (ABN) or tax file number (TFN).

This is the option you complete if you are paying a PAYG instalment amount notified by us.

This is the option you complete if you pay your PAYG instalment by calculating your *instalment income x instalment rate*.

This is where you sign and date your activity statement.

This is the reporting period that the activity statement covers. It's usually a month or a quarter.

These are important dates. They indicate when you have to lodge your activity statement and when you have to make a payment.

These are your contact details. We use this information to contact you if there is a problem with your activity statement.

This is the section where you summarise your reporting obligations and calculate whether you are due a refund or you need to pay.

This is the payment advice that you use when making a payment.

**B**

Michael Jones  
123 Lower Mountains Road  
MT PLEASANT NSW 2222

Office use only

Document ID 12 123 123 123

TFN 999 999 999

Form due on 28 Oct 2012

Payment due on 28 Oct 2012

July to September 2012

When completing this form:  
 ■ print clearly using a black pen  
 ■ round down to whole dollars (do not show cents)  
 ■ if reporting a zero amount, print '0' (do not use NIL)  
 ■ leave boxes blank if not applicable (do not use N/A, NIL)  
 ■ do not report negative figures or use symbols such as +, -, /, \$.

**PAYG income tax instalment**  
 For the quarter from 1 Jul 2012 to 30 Sep 2012  
 Complete Option 1 OR 2 (indicate one choice with an X)

☐ Option 1: Pay a PAYG instalment amount quarterly

ATO instalment amount T7 \$ 5400 From XXXX amended assessment

Write the T7 amount at 5A, if varying the T7 amount, see over.

☐ Option 2: Calculate PAYG instalment using income times rate

PAYG instalment income T1 \$

ATO instalment rate T2 10.25% National tax of \$XXXX,XXX from your XXXX amended assessment

Write the result of T1 x T2 at 5A, if varying the T2 rate, see over.

**Amounts you owe the ATO**

PAYG income tax instalment 5A \$

Deferred company/fund instalment 7 \$

SA + 7 8A \$

**Amount the ATO owes you**

Credit from PAYG income tax instalment variation 5B \$

**Payment or refund?**

Is 8A more than 5B? ☐ Yes, then write the result of 8A minus 5B at 9. This amount is payable to the ATO.  
☐ No, then write the result of 5B minus 8A at 9. This amount is refundable to you (or offset against any other tax debt you have).

Your payment or refund amount 9 \$

**Declaration** I declare that the information given on this form is true and correct, and that I am authorised to make this declaration.

Signature Date / /

**Return this completed form to**  
 Australian Taxation Office  
 Locked Bag 1793  
 PENRITH NSW 1793

**HRS** ☐ **MINS** ☐

Deliver the form when to complete this form. Include the time taken to collect any information.

**PAYMENT ADVICE - 59**

Michael Jones

ATO code 0000 0156 03

ABN 97 999 999 999

Amount paid

EFT code 97999 999 999 9999

Australian Taxation Office  
 Locked Bag 1793  
 PENRITH NSW 1793

Source: ATO.

**Figure A2.2: Example BAS – rear**

Variation codes (T4)	T4 code
Reason for varying	
Change in investments	21
Current business structure not continuing	22
Significant change in trading conditions	23
Internal business restructuring	24
Change in legislation or product mix	25
Financial market changes	26
Use of income tax losses	27

### Option 1: PAYG instalment amount

If varying the T7 amount, complete T8, T9, T4

Estimated tax for the year    T8    \$

Varied amount payable for the quarter    T9    \$

Write the T9 amount at 5A on the front

Reason code for variation    T4   

**OR**

### Option 2: PAYG instalment rate

If varying the T2 rate, complete T3, T11, T4

New varied rate    T3       .   %

T3 x T1    T11    \$

Write the T11 amount at 5A on the front


Reason code for variation    T4   

You also need to complete these details if you want to vary the PAYG instalment amount notified by us.

You also need to complete these details if you want to vary the PAYG instalment rate notified by us.

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### Methods of payment



Bpay®: contact your financial institution to make this payment from your cheque or savings account. Quote biller code 75556 and your EFT code (shown on the front of the payment slip) as the customer reference number.

Credit card: payments can be made online or by phone, a card payment fee applies. Go to [www.ato.gov.au/howtopay](http://www.ato.gov.au/howtopay) or phone 1300 888 089.

Direct credit: you can electronically transfer funds to the ATO's direct credit bank account using online banking facilities. Use BSB 093 003, Account number 319 365 and your EFT code. Phone 1800 815 886 for assistance if required.

Direct debit: have your payment deducted from your financial institution account (not credit cards). Phone 1800 802 306 to organise a direct debit or to get further information.

Mail payments: mail the payment slip together with your cheque or money order using the envelope provided. Please do not use pins or staples. Do not send cash. See below for cheque information.

Post office: payments can be made at any post office by cash, cheque or EFTPOS (where available and subject to daily limits). A \$3,000 limit applies to cash payments. Your payment slip must be presented with your payment.

Cheques/money orders should be for amounts in Australian dollars and payable to "Deputy Commissioner of Taxation". Cheques should be crossed "Not Negotiable". Payments cannot be made in person at any ATO site or shopfront.

Source: ATO.

## APPENDIX 3 — PAYG INSTALMENTS WELCOME LETTER TEMPLATE

A3.1 The figure below outlines the ATO's template for its 'welcome letter'.

Figure A3.1: ATO welcome letter template

This section captures the layout of the correspondence and identifies the chunks/paragraphs in the letter.  
<Standard Header Block with Header Options Included here>

[Para 1]  
**Welcome to the PAYG instalment system**

[Salutation]  
Dear <Title> <First Name> <Surname><Sir/Madam>

[Para 2]  
This is a letter introducing you to the pay as you go (PAYG) instalment system.

Once your income from business and/or investment reaches a certain level, your income tax is required to be paid by instalments. This year, you met the PAYG instalments income criteria and will need to make payments <quarterly><monthly><twice yearly>.

We will credit these payments to your annual income tax account so that, when you lodge your next income tax return, you don't have to pay your tax in one lump sum. If you paid more than necessary, we will send you a refund. If you paid less, we will send you a bill for the shortfall.

[Para 7.10]  
When lodging your instalment activity statement, you will have two options:  
■ Pay the instalment that we calculate and send to you, or  
■ Calculate your own instalment using the instalment rate on the table below. Simply apply it as a percentage of your <monthly><quarterly> gross income.

You can vary these instalments if your income changes, using your activity statement.

[Para 13]  
**Your PAYG instalment details**

Your notional tax is: <V2\_Notional\_Tax>  
Your instalment rate is: <V1\_Instalment\_Rate>  
How often you pay: <Monthly><Quarterly>  
<Base Assessment  
Instalment income: <V18\_Base\_Assessment\_Instalment\_Income>>

[Para 14]  
Your first instalment amount is: <V5\_Instalment\_Amount>

This amount is calculated using information in your most recent income tax return, which is adjusted by the gross domestic product uplift factor.



### Figure A3.1: ATO welcome letter template (continued)

[Para 8]

We will send you an activity statement with the details of your instalment amount or rate and when you need to pay.

[Para 9]

We will send you an activity statement with the details of your instalment rate and when you need to pay. As your income is greater than <V17\_BAI Threshold>, you will need to work out your own instalment amounts using your instalment rate.

[Para 9.10]

We will send you an activity statement with the details of your instalment rate and when you need to pay. You will need to work out your own instalment amounts using your instalment rate.

[Para 10]

**You may prefer to pay your instalments annually**

If you prefer to pay one annual instalment, please phone <V8\_Business\_Self\_Help\_Phone\_Number> before <V9\_Due\_Date> and choose the 'Lodge pay as you go instalment annual election' option. Annual instalments are usually due by <V10\_Annual\_Instalment\_Due\_Date>.

If you received a quarterly activity statement prior to calling us and also report other taxes such as goods and services tax or pay as you go withholding tax, you still need to pay this by the due date. If you only report PAYG instalments, you can disregard it.

[Para 11]

If you have any questions, please visit our website at <V11\_ATO\_Web\_Address\_PAYGI> or call <V12\_Business\_Infoline\_Phone\_Number> between <V13\_Business\_Infoline\_Start\_Time> and <V14\_Business\_Infoline\_End\_Time>, <V15\_Business\_Infoline\_Day\_Span> and quote 'Our reference' at the top of this letter, your tax file number or your Australian business number.

[Valediction]

Yours <sincerely><faithfully>

<Standard Signature Block included here>



## APPENDIX 4 — ATO RESPONSE



Australian Government  
Australian Taxation Office

Second Commissioner of Taxation

Mr Ali Noroozi  
Inspector-General of Taxation  
GPO Box 551  
SYDNEY ACT 2001

Dear Ali

### **Review into Aspects of the Pay As You Go Instalments System**

Thank you for the opportunity to comment on your final draft of your report on the review into *Aspects of the Pay As You Go Instalments System*.

While the PAYG instalments system is working well, there is a population that finds the system confusing. The review has provided the ATO an opportunity to look at improvements to the PAYG instalments system.

We agree with 21 of the 22 recommendations. We disagree with recommendation 2.1(c):

- Recommendation 2.1(c) requests a brochure to be issued with the welcome letter. Due to the ATO taking a digital first approach and the cost involved in producing a brochure, we disagree with this recommendation. However, the ATO will improve the PAYG instalments area on the website to accommodate further information.

Our detailed response to your recommendations is attached at Annexure 1.

Finally, I would like to acknowledge the efforts of all involved in undertaking this review.

If you require further information on our response, please contact Michael Ingersoll on (02) 9354 3240.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Neil Olesen'.

Neil Olesen  
Second Commissioner  
22 December 2017

## SHORTENED FORMS

<b>ABN</b>	Australian Business Number
<b>ABR</b>	Australian Business Registrar
<b>ATO</b>	Australian Taxation Office
<b>BAII</b>	Base Assessment Instalment Income
<b>BAS</b>	Business Activity Statement
<b>CCL</b>	Client Communication List
<b>DHS</b>	Department of Human Services
<b>ESS</b>	Employee Share Scheme
<b>FOI</b>	Freedom of Information
<b>GDP</b>	Gross Domestic Product
<b>GIC</b>	General Interest Charge
<b>GST</b>	Goods and Services Tax
<b>HELP</b>	Higher Education Loan Program
<b>ICA</b>	Integrated Client Account
<b>IT</b>	Information Technology
<b>ITA</b>	Income Tax Account
<b>IGT</b>	Inspector-General of Taxation
<b>JCPAA</b>	Joint Committee of Public Accountants
<b>NOA</b>	Notice of Assessment
<b>OAIC</b>	Office of the Australian Commissioner
<b>PAYE</b>	Pay As You Earn
<b>PAYG</b>	Pay As You Go
<b>PLS</b>	Practitioner Lodgment Service
<b>SBR</b>	Standard Business Reporting
<b>SMS</b>	Short Message Service
<b>TAA</b>	<i>Tax Administration Act 1953</i>