BY MURRAY HOWLETT AND BRETT SCHMIDT, BRISBANE

But wait, there's *more*...

Pay As You Go

Get the GiST of PAYG too

Anyone who is following Australia's media treatment of Tax Reform could be excused for thinking that the Goods and Services Tax (GST) was the only change to our taxation system to occur within the next 18 months. Unfortunately, this could not be further from the truth. Under the auspices of Tax Reform we are currently facing the most dynamic taxation environment since 1985, and that's a fact.

A New Tax System

Under the guise of "A New Tax System" we have seen draft and finalised legislation to give effect to the following changes to our tax system:

- introduction of the GST;
- replacement of the provisional tax system with a new tax collection system;
- replacement of the company tax instalment system with a new tax collection system;
- replacement of the Pay As You Earn (PAYE) and other tax withholding systems with a new tax withholding system;
- introduction of new withholding obligations on specified payments;
- reform of the Capital Gains Tax (CGT) system for all taxpayers;
- reduction of the corporate income tax rate to 30%; and
- significant changes to depreciation entitlements.

The government is also considering further changes based upon the Review of Business Taxation undertaken by Mr John Ralph. Announcements have been made regarding the adoption of the following proposals, with more still to come:

- restrictions on the ability to claim tax deductions for prepaid expenditure;
- introduction of restrictions on the ability to claim tax deductions for "non-commercial tax losses";
- introduction of a Simplified Tax System (STS) for small business taxpayers;
- commencement of the entity taxation regime (under which trusts will be taxed in the same manner as companies);
- commencement of a "profits first" rule for loans made to closely held entities;
- introduction of refundable imputation credits;
- commencement of restrictions on the tax deductions available to vehicles used to "alienate personal services income".

Don't be misled, tax reform certainly does not end with the GST. Indeed, this is particularly so when you consider that neither of the above lists are exhaustive, they are only a guide to some of the major changes on the tax horizon, and also when you realise that ALL OF THE ABOVE MENTIONED CHANGES are to take effect by July 2001.

Rather than giving you only a cursory look at all of these measures, we have decided to focus on one particular change which is likely to have a significant impact on all legal practitioners.

Pay As You Go (PAYG)

The Pay As You Go (PAYG) system was introduced in Bill form in June 1999 and the legislation received Royal Assent on 22 December 1999. The PAYG system commences from 1 July 2000 (the same time as the GST).

Murray Howlett is a manager in the Taxation Services Division of Calabro Partners, Chartered Accountants. **Brett Schmidt** is a partner in the same firm. Level 5, 167 Eagle Street, Telstra House, Brisbane QLD 4000
PHONE (07) 3229 8733 **FAX** (07) 3229 1227
EMAIL calabropartners@calabro.com.au

In broad terms, the PAYG legislation may be split into two halves, the PAYG withholding system, and the PAYG instalment system.

- The PAYG withholding system largely repeals various existing tax withholding provisions (such as the PAYE system) and combines them into one new system. Although there are a couple of new withholding obligations which have also been introduced, the replacement provisions do not alter the existing withholding provisions markedly, and most businesses will not need to make major changes in the transition to the PAYG withholding system.
- In contrast, the PAYG instalment system will substantially alter the manner in which instalment taxpayers calculate and pay their income tax liabilities. Those affected will generally be companies, superannuation funds and individuals who are currently subject to provisional tax (that's you!).

As the PAYG instalment system is a substantial departure from the previous system it will impact upon anyone who is running their own practice, or is a partner in a practice.

Who is liable for PAYG Instalments?

Taxpayers will only be liable for PAYG instalments when the Australian Taxation Office (ATO) issues them with an Instalment Rate (this concept is discussed in more detail below). In broad terms, this rate will be issued to companies and superannuation funds that are paying income tax, and to individuals who are currently paying provisional tax.

WHEN ARE MY PAYG INSTALMENTS DUE?

Quarterly

The basic rule is that PAYG instalments are payable every quarter from the time an instalment rate is issued. The instalment is due 21 days after the end of the relevant quarter. For most taxpayers this means that the instalments for a tax year will be due by 21 October, 21 January, 21 April and 21 July.

In contrast, those taxpayers who were subject to quarterly provisional tax had to pay instalments for a tax year on the following dates: 1 September, 1 December, 1 March and 1 June. Accordingly, IN THE TRANSITION TO THE PAYG INSTALMENT SYSTEM, THE INSTALMENTS ARE DUE ROUGHLY 50 DAYS LATER THAN UNDER THE PROVISIONAL TAX SYSTEM.

The same PAYG instalment due dates apply for companies and superannuation funds. However, in contrast to individuals, THESE ENTITIES WILL BE PAYING THEIR PAYG INSTALMENTS SIGNIFICANTLY EARLIER THAN THEIR EXISTING TAX INSTALMENTS. The actual change will depend upon their classification as small, medium or large under the existing system, but MAY BE AS MUCH AS 14 MONTHS EARLIER than they are currently paying. As this article is focused mainly on the impact on legal practitioners, we will not be analysing the impact on companies and superannuation funds in further detail. However, you should be mindful of the potential impact of these new measures on your group structure.

Annually

Individual taxpayers may choose not to pay quarterly PAYG instalments and instead to pay an annual instalment provided they meet the following conditions:

- they are not registered, or required to be registered, for GST;
- they are not partners in a partnership which is registered, or required to be registered for GST; and
- they have Notional Tax (in general terms, the tax payable on income not subject to withholding taxes or CGT in their last income tax return) less than $8,000.

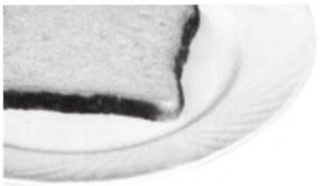
Given the first two conditions, MOST LEGAL PRACTITIONERS WILL NOT BE ABLE TO ELECT TO PAY ANNUAL PAYG INSTALMENTS. However, it may be applicable for spouses and others who receive distributions from service entities or earn only investment income.

The annual instalment will be due by 21 October in the year of income (with extensions of time until 31 March in the year of income for both the 2000/01 and 2001/02 tax years).

HOW DO I CALCULATE MY PAYG INSTALMENT AMOUNT?

Quarterly instalment payers - the general rule

The basic premise of the PAYG instalment system is that your quarterly PAYG instalment liability should approximate the tax actually payable based upon your results for the quarter. This does not mean that you are required to prepare a complete income tax return every three months. Instead you are required to pay an instalment calculated under the following formula: ▶



Instalment rate x instalment income for the relevant quarter

Obviously, the terms in the formula need to be explained further.

The *Instalment Rate* is generally the most recent rate advised by the ATO. Following the lodgement of your income tax return every year, the ATO will determine your individual *Instalment Rate*. In broad terms, the rate is calculated by dividing the income tax payable on any income which is not subject to PAYG withholding or CGT, by the gross assessable income for the year which is not subject to PAYG withholding or CGT.

The *Instalment Income* is the income that is subject to PAYG instalments (generally all assessable income which not subject to PAYG withholding or CGT). The Instalment Income is determined exclusive of GST collected on your fees. The taxpayer must calculate this figure each quarter and advise the ATO by way of your Instalment Activity Statement (IAS).

This is best illustrated by an EXAMPLE:

A solicitor who runs her own practice and earns income from no other sources showed the following figures on her last income tax return:

Gross fees	1,000,000
Deductible expenses	(800,000)
Net taxable income	200,000

Assume the income tax payable based on this tax return was $85,000.

Based upon these figures, the solicitor's Instalment Rate *would be 8.5% (85,000/1,000,000).*

The solicitor's Instalment Income *for the next quarter will be her gross fees for the relevant quarter. Hence, if she bills only $200,000 during the next quarter, her PAYG instalment will be $17,000 (8.5% x 200,000).*

Obviously this example is over simplified. The solicitor is likely to also have investment income such as dividends or interest which would also need to be included. In addition, there are SPECIAL RULES FOR PARTNERS AND BENEFICIARIES OF TRUSTS. These rules require partners and beneficiaries to include their proportionate share of the relevant partnership's/trust's instalment income in determining their own instalment income.

For partnerships and trusts which do not have fixed entitlements (for example, discretionary trusts), taxpayers must include a proportion of the partnership's/trust's instalment income for the quarter based upon the distributions made in the previous tax year. This is the case regardless of the distribution (if any) to be received the following year.

Similarly to the provisional tax system, taxpayers who believe that their PAYG instalments will be too large are able to lodge an estimate to reduce each quarterly payment. However, under the PAYG instalment provisions, you cannot estimate your annual tax liability, instead you are required to estimate a

revised instalment rate. As you may expect, underestimates of a varied instalment rate which give rise to under payments of income tax will give rise to penalties. Accordingly, great care is required in determining a varied instalment rate.

Quarterly instalment payers - the alternate rule

Quarterly PAYG instalment payers are able to use an alternate method to calculate their PAYG instalments if they satisfy the following conditions:

- taxpayer must be an individual;
- taxpayer must not be registered for GST, or required to be registered for GST;
- taxpayer cannot be a partner in a partnership which is registered for GST, or required to be registered for GST; and
- taxpayer's most recent Notional Tax must be at least $8,000.

Again, given points 2 and 3 above, MOST LEGAL PRACTITIONERS WILL BE UNABLE TO USE THIS ALTERNATIVE.

Individuals who satisfy the conditions may determine their quarterly PAYG instalments based upon their "GDP Adjusted Notional Tax". This method is very similar to the provisional tax system except that it applies a GDP linked gross-up factor instead of the standard 6%.

Annual Instalment Payers

Annual PAYG instalment payers have the choice of three methods in determining the amount of their annual instalment:

1. standard PAYG instalments formula, i.e. instalment rate x instalment income for the relevant year.
2. pay the most recent notional tax notified by the ATO (the income tax payable from their last tax return on any income which is not subject to PAYG withholding or CGT).
3. an estimated amount (penalties apply for underestimation if this alternative is used).

How Do I Prepare for the PAYG Instalment System?

To ensure you are prepared for the commencement of the PAYG instalments system in July 2000 you should take the following steps:

- ensure you understand when your PAYG instalments will be due for your cash flow budgeting purposes;
- keep an eye out for your *Instalment Rate* and consider checking the figure for reasonableness;
- make sure you receive an Instalment Activity Statement (IAS) personally, you will need the IAS to meet your PAYG obligations, even if you are not personally required to register for the GST;
- ensure that any partnerships/trusts that make distributions to you and your family are able to advise the relevant proportion of their gross income (exclusive of GST) to you each quarter to enable you to determine your *Instalment Income* by the due date. PL

INTERNATIONAL INJURED WORKERS CONFERENCE

19-21 MAY, 2000 NIAGARA FALLS, NY, U.S.A.

This year the Injured Workers of New York Inc. are hosting the above conference.

Injuries Australia at first thought that it was beyond our financial means to attend, but the Injured Workers of New York graciously offered to host all accommodation, conference and meal costs for two members of Injuries Australia, all we had to do was fund the round trip airfare & incidental costs.

The conference offers a unique opportunity for representatives of Injuries Australia to represent the Injured Workers of Australia at an international event. Items on the proposed agenda include discussions on an International Bill of Rights for Injured Workers, Reforming the Workers' Compensation System, and a paper by us on "Australian Workers' Compensation Systems".

We have within our ranks directors who, having suffered extensive work injuries themselves, are well experienced in the workers' compensation system and would be honored to represent our Country at this conference.

We ask that you the members of APLA give consideration to sponsoring us in this venture. A full report will be furnished to APLA for insertion in Plaintiff upon return.

PLEASE CONTACT JANE STALEY AT APLA, PHONE (02) 9698 1700