

# Provisional Tax Facts

**What is provisional tax?** Provisional tax is the regime by which tax payments are spread throughout the year instead of a lump sum at the end of the year. It is common for taxpayers to pay provisional tax in three instalments, however this depends on the calculation method you choose.

## Who is required to pay?

You will be required to pay provisional tax when your residual income tax for the previous year is greater than \$2,500 or you can choose to pay on a voluntary basis.

## What is Residual Income Tax (RIT)?

Residual income tax is the total amount of income tax for the year less any tax credits. Examples of credits are PAYE, RWT, foreign tax credits and imputation credits.

## When is it due?

Provisional tax is generally due on the 28th of the 5th, 9th and 13th months after balance date. The dates are changed for Christmas and Easter meaning that for a March balance date, provisional tax will be paid on 28 August, 15 January and 7 May.

## How do you calculate provisional tax obligations?

There are four options available for calculating your provisional tax being standard (default), estimation, GST ratio and Accounting Income Method (AIM)

### 1. Standard (Uplift) Method

Under this method, the provisional tax payable for a tax year is 105% of the previous year's residual income tax, or 110% of the residual income tax of the year, two years prior, if the prior year's tax return has not been filed. This is the default option used by most people.

### 2. Estimation Method

The estimation method is useful if you expect your income to decrease significantly over the next year. Under this method, provisional tax is calculated based on an estimate of residual income tax for the income tax year. It is important that the estimation made is fair and reasonable. Interest and penalties may be charged if you underestimate your provisional tax.

### 3. GST Ratio Method

This method is suitable for taxpayers whose income varies or who have seasonal income. You must be registered for GST and file on a one-monthly or two monthly basis. Under this method, provisional tax is calculated based on your GST return.

### 4. Accounting Income method

This method is available to taxpayers with turnover less than \$5 million a year and use an approved AIM capable system. Provisional tax is calculated based on actual accounting income on a year to date basis. You only have to pay provisional tax when your business is operating at a profit, however this method has a higher compliance cost.

### Early Payment Discount

If you use the standard or estimation method, you can choose to make voluntary payments (you have no obligation if your previous year RIT is less than \$2,500) in your first year of business and receive an early payment discount of 6.7%.

## Use of Money Interest

Taxpayers will incur/earn use of money interest on any underpayment or overpayment of provisional tax. These rates are generally higher than loan rates and less than deposit rates.

From the 2017-18 year, UOMI will not be charged on the first two provisional tax instalments if the standard (uplift) method is used unless you are a new provisional taxpayer.

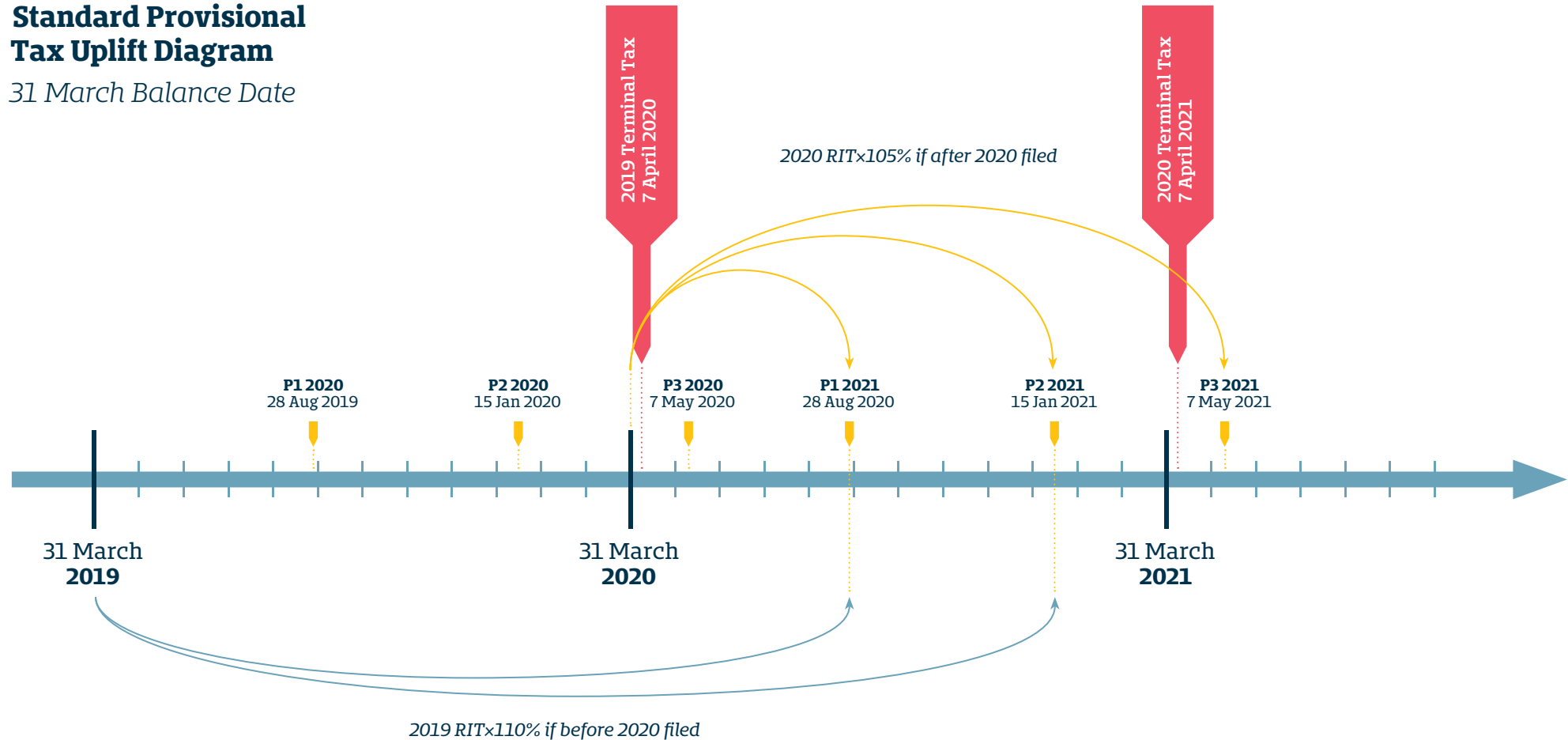
The current use of money interest rates are 8.35% for underpayments and 0.81% for over payments (from 29 August 2019)

### Safe Harbour Taxpayers

From the beginning of 2017/2018, UOMI will not apply until after their terminal tax date for taxpayers (including individuals, trusts and companies) who are provisional taxpayers if their residential income tax is below \$60,000 and they use the standard (uplift) method.

# Standard Provisional Tax Uplift Diagram

31 March Balance Date



2019 Tax return filed (2020 not filed):

## 2020/2021 Provisional tax

- **P1:**  $110\% \times 2019 \text{ RIT} \times 1/3$
- **P2:**  $110\% \times 2019 \text{ RIT} \times 2/3 - P1$
- **P3:** must be based on 2020 return or 2021 position

2020 Tax return filed:

## 2020/2021 Provisional tax

- **P1:**  $105\% \times 2020 \text{ RIT} \times 1/3$
- **P2:**  $105\% \times 2020 \text{ RIT} \times 2/3 - P1$
- **P3:**  $105\% \times 2020 \text{ RIT} - (P1 + P2)$

No provisional tax is due in the first year of business resulting in terminal tax 13 months after year end. Provisional tax in the 2nd year will depend on when the tax return for the first year is filed. However, if this is after 15/01, both last year's terminal tax and this year's provisional tax will be due within one month i.e. 2 years of tax due in short succession., this often requires careful cash flow management.

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