Fact sheet: Understanding the Provisional Tax System

Provisional tax is a way of managing your income tax by paying instalments during the year on the tax due for the coming year.

COVID-19 and other adverse events affecting provisional tax

If your business has been affected by COVID-19 or certain other adverse natural events such as flooding, cyclones or earthquakes which affect your income, you may be able to request tax relief. If:

- you need to re-estimate your provisional tax as your income falls short of the estimate and provisional tax has been overpaid, it may be possible to arrange early refunds
- you are unable to pay tax by the due date, Inland Revenue has discretion to write-off penalties and interest. As soon as you can, you should indicate when tax can be paid, or request instalment arrangements. You may be eligible for a UOMI write-off.

It's important to keep your tax plan current. If circumstances change for your business, we need to adjust your plan. Keep us updated about the situation for your business.

You may be liable for provisional tax

If the tax to pay on your last income tax return is more than $5,000, you may have to pay provisional tax for the following year. You will not be required to pay provisional tax so long as your previous year's residual income tax (RIT) is $5,000 or less.

The number of provisional tax instalment payments you make depends on how you work out your provisional tax. If you're GST registered, how often you file GST returns will determine how many provisional tax instalments you're required to make.

Even if you are not required to pay provisional tax, you may still elect to do so.

What is residual income tax (RIT)?

Residual income tax is the amount of tax you have to pay, less any tax credits you may be entitled to and any PAYE deducted. RIT is used to calculate the amount of provisional tax you are required to pay.

What happens if I don't pay provisional tax?

If you are liable for provisional tax and you don't pay, or you underpay or pay late, you may incur both penalties and use of money interest (UOMI). Some methods of calculating provisional tax will give you some protection from use of money interest.

Calculating your provisional tax

You can use one of these options to work out your provisional tax (see the table at the end for detail):

1. Standard
2. Estimation
3. GST Ratio — only if you're registered for GST
4. Accounting Income Method (AIM)

When do you have to pay provisional tax?

The number of times you need to pay provisional tax each year depends on the option you use to calculate your provisional tax, and how many times you pay GST (if registered). If your balance date is 31 March and you use the standard or estimation options to calculate your provisional tax payments, your provisional tax due dates are:

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	Not registered for GST	GST registered and pay monthly or bi-monthly	GST registered and pay 6 monthly
1st instalment	28 August	28 August	28 October
2nd instalment	15 January	15 January	7 May
3rd instalment	7 May	7 May	

If you use the GST ratio option, you pay your provisional tax and GST at the same time on a combined GST and provisional tax return. If your balance date is 31 March, your provisional tax due dates are:

1st instalment	28 June
2nd instalment	28 August
3rd instalment	28 October
4th instalment	15 January
5th instalment	28 February
6th instalment	7 May

Safe harbour taxpayer & GST Ratio taxpayer: use of money interest

A safe harbour taxpayer is a taxpayer who:

- uses the standard method for determining and paying his or her RIT for the current year
- has RIT for the current year which is less than $60,000, and
- has not, during the tax year, held a certificate of exemption from resident withholding tax

As a safe harbour taxpayer, from the 2022–23 tax year, you will only be charged UOMI if an amount remains unpaid after the due date for the end of the tax year even if provisional tax instalments have not been paid in full and on time. Late payment penalties will still apply.

If you choose to opt out of the safe harbour by estimating your provisional tax, you will be subject to use of money interest on any underpayment of provisional tax from your first instalment date.

If you used the GST ratio option to determine your provisional tax payments for the whole year you will be safe harboured from use of money interest if your payments fall short of the year-end liability.

If you are a safe harbour taxpayer or use the GST ratio option, you will not be entitled to receive use of money interest if you overpay provisional tax during the year.

Election to be a provisional taxpayer

Even if you are not required to pay provisional tax you may elect to become a provisional taxpayer. You will be eligible to do this if you have paid income tax of more than $5,000 and if you had the expectation on the date you made the first payment that you would be a provisional taxpayer for that year. The election is made in the relevant annual tax return.

If you pay provisional tax and subsequently find that you were not required to do so you may receive use of money interest on your overpaid tax (the overpayments rate is currently 4.67%). Use of money interest will run from the day after the date of payment. If you are a safe harbour taxpayer, you will not receive use of money interest.

Voluntary payments of provisional tax

It may be to your advantage to make voluntary provisional tax payments. This will help reduce use of money interest charges on any known tax shortfalls. If you are a safe harbour taxpayer, you can avoid making an estimation as well as any liability for use of money interest.

While voluntary payments will earn interest, it is typically at a lower rate than interest rates offered by commercial banks. From 29 August 2023, the Inland Revenue's overpayment rate is 4.67%.

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Penalties and interest for unpaid provisional tax

Late payment penalties and use of money interest (UOMI) apply to underpaid provisional tax.

Late payment penalties	How much	When charged	Calculated on
initial	1%	day after due date	Tax owed
	4%	at end of 7th day after due date	Tax + penalties owed

Late payment penalties do not apply if the unpaid tax is $100 or less. Late payment penalties are only calculated once your actual RIT liability for the year is known. This is because a late payment penalty will only arise on unpaid provisional tax to the extent that your provisional tax payable exceeds your provisional tax paid. The amount of provisional tax payable will be the lesser of

- the amount of provisional tax calculated as payable (under the chosen method applied); and
- the appropriate proportion of your RIT for the year

Use of money interest also applies on underpayments and overpayments of provisional tax from the day after your first provisional tax payment is due if you are not a safe harbour taxpayer. The interest rate currently charged by Inland Revenue from 29 August 2023 on unpaid tax is 10.91% and that paid by Inland Revenue on overpaid tax is 4.67%.

Provisional taxpayers who are not safe harbour taxpayers using the standard uplift method will not be liable for UOMI on the first two provisional tax instalments, but interest will be payable on any total shortfall or overpayments of provisional tax calculated from the third instalment date. As the third instalment falls after the end of the income year, if the tax liability can be accurately calculated, the correct amount of provisional tax can be paid at the third instalment to reduce the exposure to UOMI.

Early-payment discount for new small businesses

If you are a new business, you are not required to pay provisional tax until the income year immediately after the income year in which your RIT first exceeds $5,000. In practice, however, this means that you effectively have 2 years' worth of tax to pay in the year in which you are first required to pay provisional tax.

If you are self-employed or a partner in a partnership you may be entitled to a discount of 6.7% on the income tax payable on business income received (ie not interest, dividends, royalties, rents or beneficiary income) before the income year in which you are due to pay provisional tax for the first time.

The discount encourages new business owners to pay tax early and helps to relieve the financial strain in the year in which provisional tax is first paid.

Tax pooling

Tax pooling allows you to finance your upcoming provisional tax payments and defer upcoming provisional tax payments to a later date without incurring Inland Revenue late payment penalties or use of money interest.

You pay an authorised intermediary such as Tax Management NZ (TMNZ) a one-off, tax-deductible fee and it arranges the upcoming provisional tax payment on your behalf. This is held in an Inland Revenue account, overseen by an independent trustee. When you repay the principal at the date agreed with the intermediary, the independent trustee instructs Inland Revenue to transfer the tax into your Inland Revenue account. Inland Revenue treats the tax as being paid on time once the transfer is processed.

Our recommendation

The provisional tax regime can be hard to understand. If your business is liable to pay provisional tax, there are various options, some of which could suit your business better than others. It is important to have a tax plan in place, so you meet your tax obligations without incurring additional penalties or interest or squeezing your business' cashflow.

Provisional Tax payment options: comparing the features

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Standard	Estimation	GST Ratio	Accounting Income
Instalments are calculated on…			
105% of the previous tax year's residual income tax, OR 110% of your RIT from two years ago (use this option if you have not filed last year's return yet, eg due to a tax agent's extension of time). ***Example:*** For the 2023 income year, John was liable for RIT of $55,000 but he has not yet filed his 2023 income tax return. John's RIT for the 2022 income year was $65,000. Using the standard method, John would calculate his 2024 provisional tax payable like this: RIT 2022 $ 65,000 plus 10% $ 6,500 Provisional tax due for 2024 $ 71,500 If John had filed his 2023 income tax return, his 2024 provisional tax payable under the standard uplift method would be $57,750 (that is $55,000 x 105%).	A fair and reasonable estimate of your RIT for the income tax year. File the estimate online or phone 0800 775 247.	A percentage of your GST taxable supplies. Send Inland Revenue an election before the beginning of the income year. Inland Revenue calculates the ratio and advises you before your first provisional tax payment is due.	Your software works out payments, and dates for filing and payment. You only pay provisional tax when your business makes a profit. If your business makes a loss, you can get your refund straightaway rather than waiting till the end of the year.
Am I eligible to use this method?			
No eligibility criteria — it's the default option.	No eligibility criteria. Just file your estimate of your RIT for the income tax year on or before the due date for an instalment of provisional tax.	Criteria: ▪ you've been in business and registered for GST all the previous tax year, and part of the tax year before that ▪ your RIT for the previous year is greater than $5,000 and up to $150,000 ▪ you file your GST returns monthly or twice monthly ▪ you're not a partnership ▪ the ratio that Inland Revenue calculate for you is between 0 and 100%	You are eligible if you have turnover of less than $5m a year and you use approved AIM-capable accounting software such as MYOB, Reckon or Xero. You don't need to enrol or register to use AIM. Complete the set up in your software.
How you make payments…			
3 instalments (usually). File your return and make payments in myIR.	3 instalments (usually). File your return and make payments in myIR.	Every 2 months (6 instalments). File your return and make payments in myIR.	Aligned to GST returns. File a statement of activity through your software and send your payment.
Useful if…			

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Your income is steady or increases over the next year.	You know your income will decrease over the next year. You can avoid paying too much tax.	Your business income is decreasing or fluctuates during the year.	Your business is growing. You're new to business. You have irregular or seasonal income. It's hard to forecast your income accurately. You have accounting software or want to start using accounting software.
Do I have to pay use of money interest (UOMI)?			
Not payable on the first 2 instalments. Applies from 3rd instalment. "Safe harbour" provisional taxpayers are not subject to UOMI (except for tax not paid by terminal tax date).	Payable if you've underestimated.	Not charged.	Not charged, if payments are in full and on time.
Watch out for…			
You can change from the standard to the estimation option at any time. You can't change to the ratio option or AIM during the same tax year.	You must revise your estimate for the tax year if circumstances change during the tax year and your estimate is no longer fair and reasonable. You may be liable to shortfall penalties if you underestimate. Overestimates are not a problem.	If you decide to stop using this option ***before*** your first provisional tax instalment date, you can elect to use the standard or estimation methods. However, if you stop using this option ***after*** your first provisional tax instalment, you must estimate provisional tax payments for the rest of the income year.	Mistakes made while entering data into your software will produce mistakes in the software's provisional tax calculations. Make sure you monitor to ensure data is correct.

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