craiganderson
CHARTERED ACCOUNTANTS

Provisional tax

Provisional Tax is not a separate tax but a way of paying your income tax as income is received through the year. You pay instalments of income tax during the year, based on what you expect your tax bill to be. The amount of provisional tax you pay is then deducted from your tax bill at the end of the year.

From the 2020 income tax year, if your residual income tax (RIT) is $5,000 or more, you will have to pay provisional tax for the following income year. RIT is the tax you need to pay after subtracting any rebates you are eligible for and any tax credits (excluding provisional tax). RIT is clearly labelled in the tax calculation in your tax return.

There are several ways of working out your provisional tax. The two main ones are the standard option and the estimation option. If you are also registered for GST and meet the other eligibility criteria, the GST ratio option may be available to you. You may also be able to pay provisional tax using the Accounting Information Method (AIM).

Due dates

The due date and number of instalments you need to make to pay your provisional tax each year depends on which option you use, your balance date, and how often you pay GST (if registered).

If you have a 31 March balance date and use the standard or estimation option, provisional tax payments are due on:

First instalment	28 August
Second instalment	15 January
Third instalment	7 May

Interest

If the provisional tax you have paid is less than your RIT, you will be charged interest in most circumstances. If the provisional tax you pay is more than your RIT, Inland Revenue may pay you interest on the difference.

Standard option

Inland Revenue automatically charges provisional tax using the standard option unless you choose the estimation or ratio options.

The standard option takes your RIT for the previous year and makes an adjustment. The calculation for the adjustment from the current year is:

- your previous year's RIT with an uplift of 5% added, OR
- your RIT for the year prior to the previous year with an uplift of 10% added, if last year's income tax return has not been filed yet

Estimation option

If you can estimate what your RIT is likely to be, this option may suit your business. When working out the tax, keep in mind:

- To get the right tax rate -
    - Add up all your estimated income
    - Work out the tax on the total
    - Subtract any tax credits (like PAYE)
- Using the estimation option, if your estimated RIT is lower than your actual RIT for that year, you may be liable for interest on the underpaid amount
- You can estimate your provisional tax as many times as necessary up until your last instalment date. Each estimate must be fair and reasonable

The GST Ratio Option

If you are also registered for GST, you can pay your provisional tax at the same time as your GST. To use this option, you elect with Inland Revenue to use the option, then Inland Revenue calculates the ratio and advises you before your first provisional tax payment is due. You will be able to use the ratio option if:

- You've been in business and GST-registered for all the previous tax year, and the tax year prior to that
- Your RIT for the previous year is greater than $5,000 and up to $150,000
- You are liable to file your GST returns every month or every two months
- The business you're operating is not a partnership
- Your ratio percentage that Inland Revenue calculates for you is between 0% and 100%

The Accounting Information Method (AIM)

This option allows you to calculate and pay provisional tax using AIM-capable software which calculates provisional tax based on current year accounting income information. Payments are due in line with your GST filing dates. At present this option is only available if you have gross income under $5m.

Where payments have been made using the calculated amounts under the AIM-capable software, you will not be liable for any interest due if the actual year-end tax liability differs from the calculated tax liability.

It is important to choose an option that suits your business. Strategies such as tax pooling can also ease your concerns and costs. We suggest that you discuss your options with us.

For further information on provisional tax give us a call or refer to the Inland Revenue website.