Tax Facts – Provisional Tax

Provisional Tax is not a separate tax but a way of paying your income tax as the 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.

If your residual income tax is $2,500 or more you will have to pay provisional tax for the following year. Residual income tax is basically the tax to pay after subtracting any rebates you are eligible for and any tax credits (excluding provisional tax). Residual income tax is clearly labelled in the tax calculation in your tax return.

There are two ways of working out your provisional tax. One is the standard option and the other one is the estimation option. If you are also registered for GST and meet the other eligibility criteria, the ratio option may be available to you as well (see below for more on the GST Ratio option).

Standard option

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

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

- your previous year's residual income tax with an uplift of 5% added
- if the previous year's income tax return has not been filed, it will be the year prior to the previous year with an uplift of 10% added

Estimation option

The other way to work out your provisional tax is to estimate what your residual income tax will be. When working out the tax, keep the following points 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 residual income tax is lower than your actual residual income tax 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

Due dates

The due date and amount of instalments you need to make for payment of your provisional tax each year depends on your balance date, which of the above options you use 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

In most circumstances you will be charged interest if the provisional tax you paid is less than your residual income tax. If the provisional tax you pay is more than your residual income tax, the IRD may pay you interest on the difference.

Another Option – the GST Ratio Option

If you are also registered for GST you are able to pay your provisional tax at the same time as your GST payments. You will be able to use the ratio option if:

- You've been in business and GST-registered for all of the previous tax year, and the tax year prior to that
- Your residual income tax for the previous year is greater than $2,500 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 IRD calculates for you is between 0% and 100%

This method of paying provisional tax may not suit everyone. Solutions such as tax pooling can also be used to ease taxpayers' concerns and costs in calculating provisional tax. We suggest that you discuss your options with your accountant.

For further information on provisional tax give us a call or refer to the IRD Website.