Provisional Tax – avoiding the pitfalls

Talk to us about your tax plan. Limit your exposure to penalties and interest and maximise cashflow.

If you are liable for provisional tax and you don't pay, or you underpay or pay late, you may be liable for both penalties and use of money interest (UOMI). There are ways to minimise your exposure to these and to manage provisional tax to best suit your business.

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 because 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.

Penalties

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

Late payment penalties:

- do not apply if the unpaid tax is $100 or less.
- 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 is more than the provisional tax you have already 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

In addition to penalties, UOMI applies from the day after your first provisional tax payment is due unless you are a safe harbour taxpayer (see below).

From 9 May 2023 the interest rate charged by Inland Revenue on unpaid tax is 10.39%.

Options to minimise penalties and interest

The method that you choose to use to pay provisional tax can limit your exposure to penalties and interest.

Standard option

Provisional taxpayers using the standard uplift method will not be liable for UOMI on the first two provisional tax instalments (provided they have paid the correct amounts calculated under the standard uplift method), but interest will be payable on any total shortfall/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 calculated accurately, the correct amount of provisional tax can be paid at instalment reducing the exposure to UOMI.

Safe harbour and GST Ratio taxpayers

A safe harbour taxpayer is a taxpayer who:

- uses the standard method for determining and paying their 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.

Note that 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.

AIM and UOMI

If your business uses the Accounting Income Method (AIM) to calculate and pay provisional tax, you should no longer have terminal tax liabilities (as tax payments will be made in near real-time and are based on actual results). We should be able to identify any shortfall and makes sure it is paid by the final instalment where the adjustments are easy to calculate.

However, under AIM, if you pay less than the amount calculated by the software for any instalment, UOMI will apply on the shortfall between the lesser of your residual income tax and the amounts of provisional tax due as calculated by AIM throughout the year. Late payments of tax may also attract late payment penalties.

Voluntary payments of provisional tax

You may find it to your benefit to make voluntary payments of provisional tax. This will help reduce UOMI charges on any known tax shortfalls. If you are a safe harbour taxpayer, you can avoid making an estimation and avoid liability for UOMI.

While voluntary payments may earn interest, it is typically at a lower rate than interest rates offered by commercial banks. From 9 May 2023, Inland Revenue’s UOMI overpayment rate is 3.53%.

Other options

Choosing 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 provisional 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. You make the election 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 UOMI on your overpaid tax. In this case, UOMI will run from the day after the date of payment.

Early-payment discount for new small businesses

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

If you are self-employed (operating as an individual) or a partner in a partnership you may be entitled to a discount of 6.7% of the income tax on business income received before the year in which you are first due to pay provisional tax. The idea is to encourage you to make voluntary payments of tax before you are actually required to pay provisional tax and help relieve the financial strain in the year provisional tax is first paid.

Tax pooling

Tax pooling is a way to finance upcoming provisional tax payments and defer upcoming provisional tax payments to a later date without incurring late payment penalties or UOMI.

You pay an authorised intermediary such as Tax Management NZ (TMNZ) a one-off, tax-deductible fee and it arranges the upcoming 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 IRD account. Inland Revenue treats the tax as being paid on time once the transfer is processed.