Tax & Legislative Information Series…

… about Provisional Tax

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About - Provisional Tax

- **Some Background**
  - The majority of South African taxpayers only receive **income from a single source throughout the tax year**, i.e. their Employer (of which there could be multiple). This is generally referred to as taxable remuneration.
  - Tax on this remuneration (PAYE) is deducted by employers in accordance with the Tax Tables as determined by National Treasury each year and is based on specific earnings bands – i.e. **the more an individual earns, the higher % tax is deducted.**
  - The percentage tax (PAYE) rates vary between 18%, 26%, 31%, 36%, 39%, 41% and 45%, **depending on where in the tax table that individual's earnings are located**.

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- **Some Background**
  - Employers are **obliged to deduct the necessary tax each month** and pay it to SARS through the **monthly EMP201 process.** This is the process which **informs SARS as to how much tax (PAYE) was deducted in total** from employees in a specific month, and which will subsequently **be paid to SARS** in that specific month. There are **various methods that an employer can use to actually pay over to SARS** the total PAYE that is due for the month, the most common and accurate method is through the SARS e-filing service.
  - By the end of the tax year (i.e. February), the total amount paid over to SARS via the EMP201 **needs to balance back to the annual return**, known as the EMP501 process. This process also includes the submission of detail regarding each employee and what was earned and what tax was deducted for that year. The detail of the employee information is reflected on what is know as the **Tax Certificate (i.e. the IRP5).**
  - The EMP501 and employee Tax Certificate process is **used by SARS to check that the correct amount of tax was calculated and paid over** by the employer for the full year. In many cases it is found to be incorrect and the individual either gets a refund of needs to pay in if there is a shortfall.

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- **Some Background**
  - Things get a little different (and complicated) when:
    - an individual is **not formally employed** and derives income from a **variety of sources** – i.e:
      - income from a home-based activity (i.e. a "side hustle"),
      - commission (often ad-hoc) received from various sales type activities,
      - or income from an investment of some form (e.g. a retirement product),
      - rental income, interest received, income from annuities, etc.
    - or the individual who is in **formal employment (i.e. receiving remuneration) also receives other income** from activities (as above).

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- **Standard PAYE vs Provisional Tax – so what's the difference ?**
  - **PAYE (Pay-As-You-Earn) – this is predominantly tax from Employment Income**:
    - Individuals receive employment income and are **taxed through the monthly PAYE system.**
    - Employers calculate tax (PAYE) monthly **using SARS tax tables**, based on income brackets published annually.
    - PAYE is governed by **Paragraph 2(1), Fourth Schedule** to the Income Tax Act 58 of 1962.
    - Employers deduct the PAYE and **submit it to SARS via the EMP201 return process by the 7th of each month**.
    - At the end of the tax year, the **total PAYE deducted usually equals the individual's total tax liability for that year**.

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- **Standard PAYE vs Provisional Tax – so what's the difference?**
  - **Provisional Tax: Tax on Non-Salaried or Additional Income**:
    - Provisional tax isn't a separate tax—it's a way to **pay income tax throughout the year** on income earned outside of a regular salary. The goal is to align tax payments with when the income is earned, so the South African Revenue Service (SARS) receives taxes closer to real-time. This applies to income from:
      - Freelancers, commission earners, landlords, and investors.
      - Anyone with taxable income not fully covered by PAYE (Pay As You Earn).
    - Provisional tax is governed by Paragraph 3 of the Fourth Schedule of the Income Tax Act.
    - The bottom line is:
      - SARS doesn't want to **wait until the annual tax assessment to collect taxes on these earnings**. Instead, they require individuals to estimate and pay taxes during the year, with a final "square-up" by February.
      - If they get this right, it means:
        - Fewer individuals will owe SARS money
        - SARS get its taxes throughout the year, as opposed to year-end only. Makes a big difference in SARS' cash flow.

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- **When does Provisional Tax apply?**
  - Provisional tax applies when individuals **earn non-salaried income or have multiple income sources** not fully taxed at source.
  - Examples include:
    - Freelance or independent contractor income.
    - Rental income.
    - Investment income (interest, dividends, annuities).
    - Commission from multiple employers or platforms.
  - **Paragraph 1 of the Fourth Schedule** defines who is a "provisional taxpayer".

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- **Paragraph 1 of the Fourth Schedule Definition:**
  - “provisional taxpayer” means—
    - (a) any person (other than a company) who derives income by way of—
      - (i) any remuneration from an employer that is not registered in terms of paragraph 15; or
      - (ii) any amount which does not constitute remuneration or an allowance or advance contemplated in section 8(1);
    - (b) any company; and
    - (c) any person who is notified by the Commissioner that he or she is a provisional taxpayer,
    - but shall exclude—
      - (aa) any public benefit organisation as contemplated in paragraph (a) of the definition of “public benefit organisation” in section 30(1) that has been approved by the Commissioner in terms of section 30(3);
      - (bb) any recreational club as contemplated in the definition of “recreational club” in section 30A(1) that has been approved by the Commissioner in terms of section 30A(2);
      - (cc) any body corporate, share block company or association of persons contemplated in section 10(1)(e);

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- **Paragraph 1 of the Fourth Schedule Definition:**
  - “provisional taxpayer” means—
    - (dd) any—
      - (A) person in respect of whose liability for normal tax for the relevant year of assessment payments are required to be made under section 33;
      - (B) natural person who does not derive any income from the carrying on of any business, if—
        - (AA) the taxable income of that person for the relevant year of assessment does not exceed the tax threshold; or
        - (BB) the taxable income of that person for the relevant year of assessment which is derived from interest, dividends, foreign dividends, rental from the letting of fixed property and any remuneration from an employer that is not registered in terms of paragraph 15 does not exceed R30 000;
    - (ee) a small business funding entity; and
    - (ff) a deceased estate;

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- **Who Must Register as a Provisional Taxpayer?**
  - As per Paragraph 1 of the Fourth Schedule, the following individuals and entities are required to register:
    - **Individuals** (excluding companies) who earn income other than remuneration or from an unregistered employer.
    - All **companies.**
    - Persons **notified by SARS.**
    - **Labour brokers** with exemption certificates.
  - **Exemptions from Provisional Tax:**
    - Natural persons whose taxable income:
      - Is below the tax threshold for the year.
      - Consists only of passive income (interest, foreign dividends, rental, etc.), not exceeding R30,000.
      - Public Benefit Organisations (PBOs).
      - Recreational clubs.
      - Body corporates, share block companies, homeowners associations.
      - Non-resident owners/charterers.
      - Deceased estates.

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- **Provisional Tax Periods & Deadlines**
  - Outlined in Paragraphs 21, 23, 23A, and 25(1) of the Fourth Schedule:

Period	Payment Due	Notes
1st	6 months after start of tax year	e.g. 31 August for individuals (March year-end)
2nd	Last day of tax year	e.g. 28/29 February
3rd (Optional)	6 months after tax year-end	Used to avoid interest/penalties on shortfall

  - No first payment required if the year of assessment is shorter than 6 months (e.g., death or emigration).
  - Paragraph 23A of the Fourth Schedule (voluntary third/top-up payment) lays out the details for the voluntary third payment.

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- **The IRP6 Return**
  - The IRP6 return is a self-assessment form used by provisional taxpayers to:
    - Declare **estimated taxable income** for the current year of assessment.
    - Calculate and submit provisional tax payments to SARS.
  - It is not based on actual earnings to date, but on an estimate of total taxable income for the full tax year.
  - **Key Features of the IRP6**:
    - Separate IRP6 returns must be completed for:
      - The **first period** (6 months into the tax year).
      - The **second period** (end of the tax year).
      - The **optional third/top-up period** (6 months after year-end, to avoid interest or penalties).
    - The form requires the taxpayer to **include**:
      - **Estimated income** (excluding exempt amounts like retirement lump sums).
      - **Deductions and allowable expenses.**
      - **Tax already paid** (e.g. PAYE, foreign credits)Applicable rebates and medical credits.

- **Calculating Estimated Taxable Income**
  - Provisional taxpayers must estimate their total taxable income for the current year of assessment as part of the IRP6 return submission.
  - This estimate forms the basis for calculating the provisional tax due.
  - What Must Be **Excluded**:
    - Retirement fund lump sum benefits and withdrawals: These are taxed separately under a different regime and should not form part of estimated taxable income.
    - Severance benefits: Also taxed separately and not included in provisional tax calculations.
  - What Must Be **Included**:
    - All income sources not subject to PAYE, such as:
      - Self-employment income.
      - Rental income.
      - Investment income (interest, dividends).
      - Freelance/commission income.
      - Taxable capital gains.
      - Capital gains must be included when they form part of your income for the year, as per Eighth Schedule to the Income Tax Act.

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- **Calculating Estimated Taxable Income**
  - **SARS Scrutiny of Estimates**:
    - SARS may request supporting documentation to justify your estimate under Paragraph 19(3), Fourth Schedule.
    - If the estimate is deemed unreasonably low, SARS may:
      - Increase the estimate.
      - Recalculate your liability.
      - Impose underestimation penalties (up to 20%) under Paragraph 20.
  - **Using the "Basic Amount" to Estimate**:
    - The basic amount is the most recent assessed taxable income, from:
      - The latest assessment (ITA34), usually for the previous tax year.
      - It excludes once-off items such as:
        - Retirement fund lump sums.
        - Capital gains on a primary residence disposal.
    - If the assessment is older than 18 months, the basic amount must be increased by 8%.

Using the basic amount as a starting point offers protection against penalties if your actual income differs from your estimate, provided certain thresholds are met.

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- **Calculating Estimated Taxable Income**
  - **A practical example:**
    - Bob is 67 years old and has retired and receives a pension from his retirement fund. His employer asked him to keep doing some assignments for them and they pay him for this through the payroll. He also has a property that he rents out.
    - Below is a breakdown of is annual income:

Type of Earnings	Source	Income Amount	Income Tax Already Paid or deducted	Tax Bracket Used	Rebates Applied
Remuneration from Employer	Employer (IRP5)	R 162 000.00	R 2 481.00	18 %	Primary: R 17 235.00 Secondary: R 9 444.00
Rental income	Cash	R 138 000.00	R 34 500.00	25 %	None
Income from a retirement fund	Retirement Fund (IT3(a))	R 840 000.00	R 252 787.00	41 %	None
Total Taxable Income		**R 1 140 000.00**	**R 289 768.00**		

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- **Calculating Estimated Taxable Income**
  - **A practical example:**
    - Bob has tallied up all his income for the tax year, and his final taxable income amounted to R 1 114 000.00.
    - **He had only declared (up to this point) R 946 227.**
    - The final tax on his total taxable income would be (using the 2022 Tax Year Tables):
      - Applying the Tax Table Bracket:
        R 229 089.00 + (R 1 114 000.00 – R 782 200.00) * 0,41 R 365 127
      - Applying Primary and Secondary Rebates:
        R 17 235.00 + R 9 444.00 -R 26 679
      - **Final Tax:** **R 349 108**
    - Bob will need to do the following:
      - **Submit a top-up IRP6 for a value of:**
        - The difference in the total income and what has been declared up to this point.
        - R 1 114 000.00 - R 946 227 = R 193 772.70.
      - **Pay an additional tax of:**
        - The difference in total tax for the year minus tax paid up to this point.
        - R 349 108.00 – R 289 768.00 = R 59 340.00

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- **Compliance**
  - SARS will calculate tax based on the tax liability.
  - **Tax liability includes:**
    - Estimated taxable income.
    - minus:
      - Primary rebates
      - Medical Scheme Fees Tax Credit.
      - Additional Medical Expenses Credit.
      - Solar Panel Tax Credit if applicable.
      - Foreign tax credits.
  - **Penalties & Interest:**
    - Underestimation Penalty – Paragraph 20 of the Fourth Schedule:
      - If income ≤ R1 million: Penalty applies if estimate is < 90% of actual and < basic amount.
      - If income > R1 million: Penalty applies if estimate is < 80% of actual income.
      - Penalty = 20% of the shortfall in tax after accounting for PAYE and provisional tax already paid.

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- **Compliance**
  - **Late Payment Penalty – Paragraph 27 of the Fourth Schedule**:
    - 10% of the unpaid amount.
  - **SARS may reduce penalties if**:
    - The delay wasn't due to an intent to avoid tax.
  - **Interest – Sections 89bis and 89quat of the Income Tax Act**:
    - Charged for late or underpayments.
    - Prescribed rate changes periodically (currently 11.00% as of May 2025).
    - Interest is not tax-deductible.

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- **In Summary**
  - Provisional tax is a way to **prepay income tax on earnings not fully taxed through PAYE** (e.g. freelance, rental, investment income).
  - It applies to all companies and individuals **earning non-salaried income or income from unregistered employers.**
  - Exemptions apply if taxable income is below the threshold or if passive income is under R30,000.
  - Payments are due in two periods during the year, with an **optional third top-up to avoid penalties**.
  - Taxpayers must submit IRP6 returns with estimated annual taxable income (excluding lump sums and severance).
  - SARS **may review low estimates** and charge a 20% underestimation penalty.
  - A **10% penalty applies to late payments**, and interest (currently 11%) is charged on unpaid amounts.
  - Using the most recent assessed income (basic amount) helps reduce penalty risk.

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