



Hamish Edwards

Plan ahead to meet your tax liabilities

AFTER Bob's first year of business he completes his tax return in July 2003. He finds he has \$90,000 profit with tax of \$26,000.

This triggers a 2004 provisional tax assessment of \$28,000. Based on \$90,000 profit, Bob is faced with tax to pay of \$54,000. Bob's cash is tight because of his growing business so he estimates his provisional tax at \$21,000, thinking if he has no cash, then he cannot be making much profit.

Next year Bob completes his tax return in July 2004 and discovers his profit is \$150,000, resulting in tax of \$50,000. Bob has short paid his income tax by \$29,000. He has IRD use of money interest payable at a rate of 11.93 per cent of \$2500 and under-estimation penalties of \$3200. To make matters worse, Bob's 05 Provisional tax assessment is \$52,500. Bob has \$87,200 tax to pay. Bob is in trouble. Where did Bob go wrong?

- He did not correctly estimate his future tax liability.
- He did not understand the costs of getting it wrong.
- He did not save money for tax.

Minimising the impact of tax is dependent on careful tax planning, cash flow forecasting and understanding the impact of penalties and interest. We outline below the steps to effective tax planning.

1. Always pay the minimum. You need to know what your prior year tax liability is and what your provisional tax liability is. As an absolute minimum you should always pay this. This will remove any under-estimation/payment penalties.
2. Forecast your net profit before tax. Calculate total income and expenses, make sure you have included payables and receivables. Consider items like depreciation, interest on loans and non-deductible costs such as entertainment costs. The more accurate you are with this forecast, the better your tax estimate will be.
3. Calculate the tax. Which taxpayer is going to pay the tax and what tax rates are they on? If the profit is retained in a company, then a flat tax rate at 33 per cent is payable. If you are a sole trader or pay some or all of the profits out to the shareholders, use the individual tax rates of 19.5 per cent up to \$38,000, the 33 per cent up to \$60,000 and 39 per cent on income over \$60,000. An individual has the advantage of the safe harbour from interest on underpaid provisional tax if the total tax is less than \$35,000 and the minimum amount of provisional tax has been paid.
4. When is the tax due? Consider the different due dates for payment of tax and build a monthly cashflow to calculate how much you need to save per month.
5. Update the forecast. Revise your calculations before each provisional tax date. Have you paid the right amount of tax? Will you need to increase future payments?
6. Never estimate your provisional tax. You can always pay additional tax at each instalment date if you have forecast an increased liability, but do not estimate it up.
7. Always file your tax returns on time. If you have a tax agent, then you get an extension of time to file. But aim to get your tax returns completed quickly so you know what your minimum provisional tax amount will be and if you are due to pay terminal tax so you can start saving.
8. Forecast two tax years ahead. If you are forecasting your 05 provisional tax requirements, then you can use the 105 per cent uplift basis and start considering your 06 provisional tax requirements also.

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