September 2015

Provisional Tax Options in a Dairy Downturn

All the talk of low payout for dairy farmers would indicate they have no tax to worry about.

This is not necessarily the case, and therefore now would be a good time to understand how the tax structure operates.

Provisional tax is paid in instalments during the year the income is generated, and this is topped up by terminal tax in the following year if the provisional tax paid wasn't sufficient for the amount of profit earned. With the changing dairy payout from one year to the next it can be difficult to establish what amount of provisional tax should be paid.

The majority of dairy farmers have a May balance date, which means their first tax payment for the 2016 year is due on 28 October 2016. The following discussions will assume a May balance date.

The Fonterra payout price yet to be confirmed for the 2015 milk produced is $4.40, and the forecast for the 2016 year is $3.85. This is a drop of 55 cents per kg milk solids. However, if we look at the income for the tax year taking into account deferred payments it shows another story again.

The table below illustrates that the income for the 2016 tax year is forecast to be approximately $2.40 down from the 2015 year. Note that this does not include the dividend, and also figures are dependent on the amount of milk supplied early in the 2015 season when the advance base rate was higher than the anticipated final payout.

Fonterra Payout		
	2015 Tax Year Actual	2016 Tax Year Forecast
June to Oct (Deferred)	1.50	0.15
June to May (Advance)	4.25	3.19
Total	5.75	3.34

The usual method of calculating provisional tax is based on the last tax returns filed. In many cases the most recent filed is for the 2014 year. As this was the year of high payout and profit using 2014 figures would result in most taxpayers overpaying provisional tax. Better to file the 2015 returns so the lower income can be used in the tax calculation. However the expected 2016 drop in payout means the tax would still be too high.

The estimation method for paying provisional tax is therefore likely to be used by most farmers for calculating their tax due on 28th October to allow for the lower income levels. This involves the accountant notifying the IRD prior to the tax due date of the amount of tax which is forecast. The problem with estimating too high is giving up cashflow, afterall no one likes to over pay the IRD. The problem with estimating too low being the IRD will charge use of money interest at 9.21% for any shortfalls.

If the formal estimation is not done and the tax the IRD are expecting is simply left unpaid, there will also potentially be late payment penalties charged. Initially 1% late payment penalty will be charged on the day after the due date. Then a further 4% penalty will be charged if there is still an amount of unpaid tax (including penalties) at the end of the 7th day from the due date. Every month the amount owing remains unpaid, a further 1% incremental penalty will be added. These penalties can be costly.

Many farmers will not have any tax to pay, but on the other hand many will still be making a profit. Budgets for 2016 vary from farm to farm depending on levels of debt, efficiencies of production and regular attention to the cost structure. Also it must be remembered that Fonterra is not the only dairy company. For example, Tatua suppliers are still being paid good returns on their milk. Their current advance price is $4.20. So up to date financial records for these farmers will be invaluable in ensuring any tax estimations are as close as possible to the final outcome, which will not be known until after the end of the 2016 year. And of course it is not just payout which is affecting this, but also interest rates and the weather.

The crystal ball is spinning rapidly at the moment and no one can get inside to see what is in there!

The old saying is that nothing in life can be more certain than death and taxes. Perhaps it should be added that nothing can be more uncertain than the dairy payout!

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