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Tax News Update

TaxTimes

Planning for income tax payments

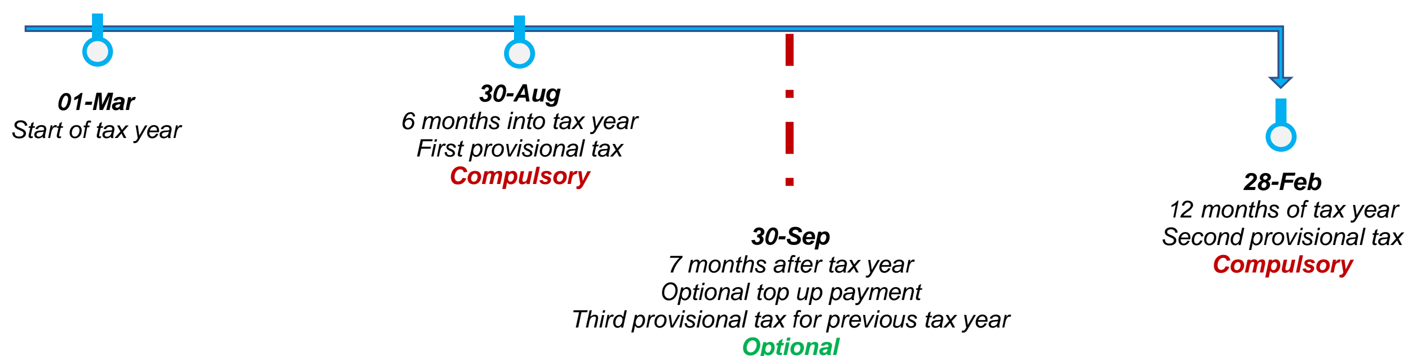
Provisional tax payments are prepayments for annual income tax. Provisional tax is not a separate tax from income tax. The provisional tax payments must be included in cash flow projections, budgets, and plans for 2021. An understanding of how provisional tax works will allow for better planning and financial decisions by management. We will detail the periods for payment of provisional tax, how it must be calculated, the penalties for late or nonpayment, and what COVID – 19 relief measures are available to lessen the cash flow impact arising from the provisional tax payments. We intend to assist financial managers and their tax compliance officers plan their tax cashflows effectively and lessen its impact on working capital.

Annual income tax is prepaid twice a year, every 6 months. These payments are based on the estimated taxable income for the year. There is an option to make a third payment, within 7 months after the end of the tax year. The third payment is made to reduce the shortfall from the payments already made and save interest on the shortfall. It is typically referred to as a top-up provisional tax payment.

Most companies have their year-end as February. They submit and pay provisional tax at the end of August, the first provisional tax which is the end of 6 months of trade, and at the end of February, the second provisional tax which is at the end of the 12 months of trade, the company year-end. The third payment may be made at the end of September, in the following tax year, for payment of any identified shortfall from the provisional tax payments made in the previous periods. The shortfall is the actual tax for the year less provisional taxes paid.

AM PhakaMalele Inc.

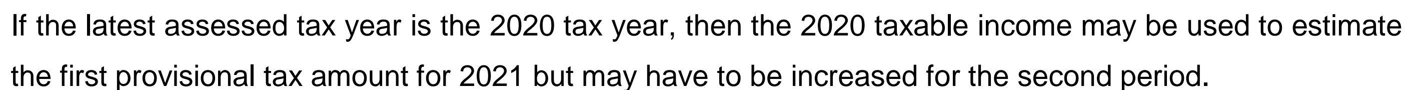
Please see below timeline:



First provisional tax

The first provisional tax amount payable is half the estimated tax for the year. The estimated tax must be based on the most recent tax years assessment. However, an estimate lower than the amount based on the most recent tax years assessment can be made if the circumstances justify an estimate lower than the amount based on the most recent assessment[1]. This amount is referred to as a basic amount. It is the estimated taxable income for the tax year, estimated using the most recent tax years taxable income assessed by SARS. If the most recent taxable income assessed by SARS falls more than 18 months after the end of the tax said tax year, then the basic amount must be increased by an amount equal to 8 percent per annum. To put it differently, this means if you are estimating the provisional tax for 2022 tax year and the latest tax assessment is for the 2019 tax year (a year that is more than 18 months after the end of the latest preceding year of assessment, the 2020 tax year), then the basic amount must be increased by 8 percent per annum.

[1] Paragraph 19 (1) (c) of Fourth Schedule of Income Tax Act No.58 of 1962.



If the latest assessed tax year is the 2020 tax year, then the 2020 taxable income may be used to estimate the first provisional tax amount for 2021 but may have to be increased for the second period.

If the company submits an estimate lower than the basic amount, then SARS may request justification of the estimate submitted and if dissatisfied with the estimate, SARS may then increase the amount to an amount they consider reasonable. This increased amount is not subject to objection or appeal.[2] A company intending to submit a lower estimated taxable income amount for the 2021 tax year must document its reasons, use the most up to date financial accounts, justify its assumptions that underlie the estimates made, test the assumptions, and keep all the documents and calculations safe. For example, the company may not simply state COVID -19 as the reason for the lower estimate. It must prove why COVID – 19 will result in actual lower taxable income. Keeping detailed records and information on the impact of COVID – 19 and other matters is necessary to justify any reduction of the basic amount.

We assume that most companies are currently negatively impacted by COVID – 19 and are likely to submit taxable income estimates that are lower than the basic amount. Therefore, we recommend that they document all decisions made, keep accurate management accounts, keep updated cash flow projections (with actual results compared to previous projections), detailed assumptions and detailed reasons for these assumptions, and tax calculations compiled to support the lower taxable income amount. In doing this, they will ensure that should SARS request justification of the lower amount, then the company can present information that is valid, appropriate and applicable, and well-considered. Thus, avoiding a SARS increase in the tax amount payable.

A considered lower estimate will result in a lower tax payment which complies with the Income Tax Act (ITA).

Second provisional tax

The second provisional tax payment **must** be carefully and thoroughly calculated to avoid incurring an understatement penalty. Unlike with the first provisional tax payment the company cannot rely on the basic amount, if not submitting a lower taxable estimate, to estimate the tax payable. It must calculate the final estimate for the year based on reliable, accurate and comprehensive data to ensure that the final taxable income estimate is as close as possible to the amount that will be assessed for the year by SARS. This is because of the heavy penalties that are levied if the estimate is incorrect. There is a flat 10 percent penalty for late payment of unpaid provisional tax (applicable to both the first and second provisional tax payments).

[2] Paragraph 19(3) of Fourth Schedule of ITA

And there is a 20 percent penalty for underpayment of provisional tax as a result of underestimation, underestimation penalty.

Underestimation penalty

An underestimation penalty is calculated differently depending on the actual realised taxable income of a company, those that realise an actual taxable income exceeding R1 million, and for those that realise taxable income less than R1 million.

- If the company's actual taxable income is more than R1 million, and the final estimate of taxable income is less than 80 percent of the amount of actual taxable income, then the penalty is
  - 20 percent of the difference between tax payable based on 80 percent of the taxable income less provisional taxes paid for the year.

    Put differently, if for 2022 the actual taxable income after the financial statements is prepared, approved, and signed off exceeds R1 million and the provisional tax payments were based on estimated taxable income less than 80 percent of the actual taxable income, then a penalty of 20% * (tax on 80% of actual taxable income - provisional taxes paid) will be levied.

Provisional Tax	Estimate	Actual
Taxable income	7 000 000	10 500 000
80 percent (%) of actual		8 400 000
Tax for the year	1 960 000	2 352 000
Tax paid	1 960 000	1 960 000
Shortfall		**392 000**
20 percent (%) penalty on underestimation		78 400

- If the company's taxable income is R1 million or less, and the final estimate of taxable income is less than 90 percent of the amount of actual taxable income and is also less than the basic amount, then the penalty is 20 percent of the difference between
  - The lesser of
    - tax payable on 90% of taxable income
    - tax payable on the basic amount
  - provisional tax paid for the year.

The following example indicates how this penalty is calculated:

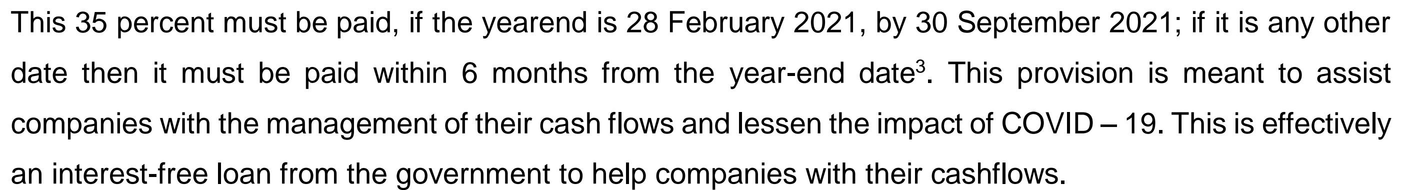
Provisional Tax	Estimate	Actual
Taxable income	750 000	900 000
90 percent (%) of actual		810 000
Basic amount	950 000	950 000
Tax for the year	210 000	226 800
Tax paid	210 000	210 000
Shortfall		**16 800**
20 percent (%) penalty on underestimation		**3 360**
Estimate is less than basic amount, R950 000, and 90% of actual R810 000.		
Penalty is based on tax on the lesser of R950 000 and R810 000		
The tax on R810 000 is used to calculate the penalty		

SARS may remit the underestimation penalty, in whole or part of it, if satisfied that the taxable income estimate was seriously calculated with due regard to the factors having a bearing on the taxable income and was not deliberately or negligently understated.

Payment date

Payments for provisional tax must be made when the return is submitted, on or before the last day of February and of August. If these days are on a weekend, then the payment must be made by the last Friday of that month.

The Disaster Management Tax Relief Administration Act 14 of 2020 (DMTRA) provides for the payment of 65 percent of the estimated provisional tax liability during the periods 1 April 2020 ending 31 March 2021. No penalty will be levied on the 35 percent deferred.



This 35 percent must be paid, if the yearend is 28 February 2021, by 30 September 2021; if it is any other date then it must be paid within 6 months from the year-end date[3]. This provision is meant to assist companies with the management of their cash flows and lessen the impact of COVID – 19. This is effectively an interest-free loan from the government to help companies with their cashflows.

Conclusion

The second provisional tax estimate which must be calculated before the end of February 2021 is likely to have a significant impact on both cash flow management and working capital management decisions for companies negatively affected by COVID – 19 and are lucky enough to still generate some profit. The uncertainty of the economic impact of the second wave is a serious factor affecting these decisions. As a result, working capital management and funding decisions should consider how best to fund the provisional tax payment and the impact, if any, of penalties and interest charges on the cash flows.

The impact of a 20 percent underestimation penalty, 10 percent late payment penalty and interest on outstanding capital – all these are not tax-deductible costs – should be compared to funding costs on an interest-bearing loan from a financial institution. The current prime rate is 7 percent per annum.

This is very low, and it is most likely tax deductible, meaning the real after tax interest cost is 5.04 percent. It is cheaper than the 20 per cent underestimation penalty and the 10 percent late payment penalty. Therefore, management must consider the impact of SARS levied penalties and interest on cash flows when making working capital management decisions under the current difficult operating constrained environment.

The deferral of 35 percent of the provisional tax payment due at end of February 2021 provides relief to companies to stretch their resources for longer. We advise companies to consider using this deferral and gain from the "interest-free loan" equal to the 35 percent provisional tax liability. This deferral should assist company's to avoid understatement penalty if they calculate their provisional tax properly and disclose it correctly to SARS. It is a significant working capital management measure available for free.

We hope that the above will help you understand when provisional tax is due for submission and payment, what gives rise to penalties being levied and how they are calculated, how interest on a bank loan, at current rates, is cheaper than funding the business by paying SARS late, and how the 35 percent provisional tax deferral can help with cash flow management.

[3] Section 3 of DTRMA

As you plan your cash flows for the year, consider the above and make better tax planning decisions that impact positively on your company cash flows.

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