NEWSLETTER

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UNDERSTAND YOUR BALANCE SHEET

Every business owner should have an understanding of the financial position of their business. The balance sheet, together with the Profit and Loss Statement and the Statement of Cash Flow, provide a complete understanding of your finances at a specific point in time. We're going back to basics and looking at understanding the elements of your balance sheet.

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UNDERSTAND YOUR BALANCE SHEET

The balance sheet has three sections: assets, liabilities and equity.

What are Assets?

Assets are things and resources that a company owns. They have current and future value and are usually measured in currency. Assets may be subdivided on the balance sheet into bank accounts, current assets (receivable within one year), fixed assets, work in progress, inventory, non-current (or long-term) assets, intangible assets and prepayments. These include banks, accounts receivable (trade debtors), supplier deposits or bonds, stock on hand, equipment, vehicles, properties, investments, and intellectual property.

What are Liabilities?

Liabilities are amounts owed to suppliers and creditors for goods or services already received. Liabilities may also include payments received in advance for future services yet to be provided by the business.

Liabilities are generally subdivided into current (payable within one year) and non-current liabilities. These include accounts payable (trade creditors), payroll obligations (salaries, taxes, superannuation), interest, customer deposits received, warranties and loans.

What is Equity?

Equity includes owner funds contributed, drawings, retained earnings and stocks. The value of the equity equals assets minus liabilities.

Transactions that affect profit and loss accounts also affect balance sheet accounts. For example, providing a service increases the accounts receivable balance, which therefore increases the equity.

The Balance Sheet Equation

The balance sheet must always balance! Asset value = liabilities + equity.

For example, if you buy a new vehicle for the business at, say $70,000, having paid a $15,000 deposit and taking out a $55,000 loan, the value of fixed assets increases by $70k, but the bank asset value decreases by the $15k deposit paid. The value of liabilities increases by a $55k loan, thus leaving the balance sheet balanced on both sides of the equation.

The balance sheet equation shows you how much money you would have left over if you paid all your bills and debts and sold all your assets on a given date. This amount is the Owner's Equity.

Note that the balance sheet equity total is not necessarily how much the business is worth at market value. Business value is calculated on the balance sheet figures and many other factors.

THE BALANCE SHEET EQUATION SHOWS YOU HOW MUCH MONEY YOU WOULD HAVE LEFT OVER IF YOU PAID ALL YOUR BILLS AND DEBTS AND SOLD ALL YOUR ASSETS ON A GIVEN DATE.

IRD SAYS "NO MORE MR NICE GUY"

Due to the COVID pandemic, the Inland Revenue Department (IRD) has been taking a much more relaxed approach to outstanding tax debt – but now IRD is ready to crack down. Since the start of July, the IRD have stepped up their efforts to pursue outstanding amounts from taxpayers.

PAYE and KiwiSaver payments will be the first priority

The amount of outstanding PAYE and employee KiwiSaver payments have doubled, and overdue GST has tripled, over the past five years. This is obviously a major problem, particularly the KiwiSaver payments, because if these remain unpaid the employee is missing out on compounding gains that contribute to their retirement savings. It's probably no surprise, then, to hear that the first priority for the IRD, when it comes to chasing debt, will be businesses that have failed to pay their employee deductions.

If, for any reason, you think you might be short on paying PAYE, get in touch with us immediately. We can work with IRD and find solutions to help you – the sooner we start, the better, and the more effectively we can minimise any penalties.

Other areas of focus for the Inland Revenue Department

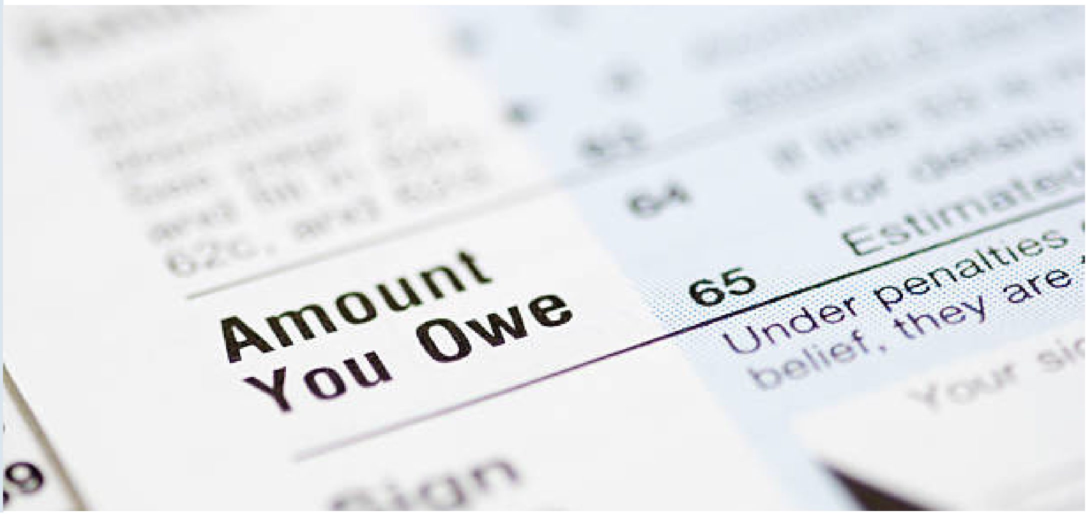
Over the past year, IRD has also been taking a tough approach to some other specific types of tax concerns:

- High earners who think they might be able to avoid paying the new 39% top tax rate using companies and trusts
- Ute owners who avoid paying Fringe Benefit Tax
- Real Estate agents overstating their expenses or underreporting their income
- GST on land purchases by developers
- Phoenix companies that are shut down and restarted to avoid tax debts

If you owe tax, don't bury your head in the sand

The people at Inland Revenue can be very understanding and helpful, but they don't have the opportunity to help if you simply bury your head in the sand and hope the problem will go away. Such an approach often compounds the problem. It's best if you can be proactive and engage with Inland Revenue about the problem. Don't let your tax debt get out of hand – we're here to support you and work on your behalf with IRD to help your tax get paid. This is just one of the areas in which we can help your businesses succeed.

IT'S BEST IF YOU CAN BE PROACTIVE AND ENGAGE WITH INLAND REVENUE ABOUT THE PROBLEM.



CAN YOU CLAIM DEPRECIATION ON YOUR BUILDING?

A major tax difference between commercial and residential buildings is that you can claim depreciation on commercial buildings.

Depreciation for buildings was removed across the board in 2010, then reinstated – but only for commercial buildings – as part of a 2020 emergency pandemic support package.

Residential landlords cannot claim depreciation, but there are some grey areas where it's not immediately obvious whether a building is residential or not. Inland Revenue has recently released a fact sheet to help you find the right depreciation rate for your building.

Claiming depreciation can save you a considerable amount. For instance, IRD provides an example of a motel building with a tax book value of $3 million. The depreciation rate of 2% means the company can claim a $60,000 deduction, paying $16,800 less tax. If your building is non-residential, you can also depreciate the fit-out.

If you have questions about depreciation on your building, your fit-out or various tax deductions on any properties, please get in touch with us – we're here to help.

Non-residential properties that *can* claim depreciation	**Residential properties that *cannot* claim depreciation**
Buildings used mainly for commercial or industrial purposes	Any building used mainly as a residence
Hotels, motels, inns, boarding houses, serviced apartments and camping grounds	Garages and sheds included as part of a residence
Short-stay accommodation (such as Airbnb) with four or more units	Short-stay accommodation (such as an Airbnb) with fewer than three units
Retirement villages and rest home accommodation except housing used for independent living	Retirement village properties used for independent living

IS BUILD-TO-RENT TAX UNFAIR ON PRIVATE LANDLORDS?

The Government recently announced a new tax incentive targeted at build-to-rent developers – and 'mum and dad' property investors aren't happy.

The new bill gives these developers an exemption from the tax deductibility limitations that are placed on most private landlords. Private landlords feel this new regime is unfair, according to Stuff. However, these build-to-rent developments have some features that make them quite different from the average rental property.

What makes these build-to-rent projects different?

Build-to-rent developments are different to individual rental properties in several important ways, according to the new definition:

- The development must comprise at least 20 dwellings in one place.
- These types of rentals must offer tenants leases of at least 10 years. Tenants can break their tenancy agreements at any time, with a 56-day notice.
- The development must have a single owner. This means individual units cannot be sold; the whole development must be sold as a single entity, so only a small buyer pool will exist.
- Tenants can personalise their spaces.

Incentivising the construction of long-term rental communities is designed to increase the supply of high-quality dedicated rentals.

Could you take advantage of the new tax regime?

If you are considering a 20-unit development project, and you're prepared to run the finished project as a long-term rental community, you will reap the benefits of having no limitation on tax deductibility.

For most rental property owners, however, the restrictions will apply. However, you have the advantage of being able to sell your rental at any time.

THESE BUILD-TO-RENT DEVELOPMENTS HAVE SOME FEATURES THAT MAKE THEM QUITE DIFFERENT FROM THE AVERAGE RENTAL PROPERTY.

FRINGE BENEFIT TAX BASICS

FBT IS COMPLEX, AND THE LIST OF ITEMS LIABLE FOR IT CAN BE DAUNTING FOR AN SME OWNER.

As an employer, if you provide fringe benefits to employees, or others associated with your business, you must generally pay fringe benefit tax (FBT) on the value of these benefits.

So, when are you liable for FBT? Any time you provide non-cash benefits to your staff. The list is potentially endless but in practice, most non-cash benefits fall into one of these categories:

- motor vehicles
- subsidised transport
- staff vouchers/gifts
- offsite carparks
- insurance premiums

Of these, most FBT revolves around company vehicles, so let's look at what Inland Revenue expect from you if you provide vehicles for any of your staff:

- the company policy on motor vehicles
- any private use restriction letter in place, signed by the directors and the employee
- documentation that shows regular checks on the vehicle to ensure it's not being used for private matters
- the employee's job description and employment contract
- the employee's performance review notes confirming they're sticking to company policies.

For an SME owner, that list can be daunting, and a good reason to talk to us. As an independent set of eyes, we can help you determine what you need to do, what you don't need to do, and how to go about doing it (including creating proper documentation).

The value of expert advice is heightened by some of the finer points of FBT legislation. For example, did you know:

- if an employee takes a vehicle home one evening and returns to work with it the next morning, the laws say it's been available for private use on two days
- Inland Revenue expects you to check that employees are adhering to restricted use policies at least once every quarter
- because a vehicle has your company logo on it, it doesn't automatically make it a work vehicle, so it's not automatically exempt from the usual requirements of FBT
- there is an option for some companies that have one or two vehicles to elect to use the motor vehicle expenditure rules rather than pay FBT in certain circumstances.

If you didn't know all those things, you're in great company! FBT is complex. IRD recognises this and will work with you to help you comply. The best approach is to get professional advice (that's us!) and, where appropriate, with our help go to IRD for a private binding ruling (short process ruling) in relation to any matters that aren't clear. The alternative approach is to get a written tax opinion from a tax adviser (again that's us!) and that way, even if Inland Revenue disagrees with your FBT return, they'll see that you've taken reasonable care to get things right and are not likely to impose a penalty for lack of reasonable care.

WHY YOU NEED A BUSINESS CONTINUITY PLAN

Sudden unexpected threats can catch you on the hop. What if something unexpected comes up that derails your usual operational procedures? How will you cope? What will you do to overcome the issue? And how will you get the business back on target?
The answer lies in having a thorough business continuity plan.

A business continuity plan is a strategic plan that describes the risks that exist in the business, your strategy for dealing with these known and unknown risks, and how you and your team will overcome any issues, emergencies or gaps in trading etc.

None of us truly know what lies around the corner. Most businesses were not expecting the 2008 economic crash, or the 2020 Covid-19 pandemic. If you can plan ahead and put contingency plans in place, you'll be better prepared when a worst-case scenario does appear.

How Do You Formulate Your Plan?
Every organisation's business continuity plan will be different. We all have different business models, different company structures and risks that are particular to our own sectors. But the fundamental basis on which you create your business continuity plan will be the same however your company works.

- Identify the critical areas of your business – look at your operations and think about where they are most likely to break down under pressure. Are you reliant on a specific supplier to operate? Is there a particular machine/machinery that would halt production if it breaks down? Are you reliant on IT and therefore more vulnerable to cyberattacks or IT malfunction? Is there a key person or people that would affect the business' ability to function if they are unexpectedly absent or resign? In short, look for anything that could go wrong or break down and how this could affect the whole business.
- Depending on the size or nature of your business, it may be necessary to create back-up continuity plans for each critical area as well as an overall continuity plan to cover the entire business.
- Consider who is the best person to be responsible for the business continuity plan and therefore tasked with periodically reviewing and updating it. In small businesses, this will typically sit with the owner/manager. Being responsible for keeping it current is important so that it is always fit for purpose.
- Make sure everyone knows the continuity plan – a business continuity plan is useless unless all staff are aware of the plan and know what to do.
- Ultimately, your continuity plan exists to keep the company operating in challenging times. It could be that your premise is flooded out and has to be closed down and moved to a temporary location. It may be that significant employee sickness hits you, leaving only a skeleton staff to run everything. Unexpected supply chain issues might leave you short of key goods or materials without warning. Your plan needs contingencies in place, so you and your remaining staff can continue to trade, make sales and bring in revenue.

Talk To Us About Building A Business Continuity Plan
No plan can completely remove the threat of the unknown – that's impossible. But with a continuity plan that's well-conceived and ready to implement, you can reduce the potential risks and give you and your team a practical strategy and tactics to work with.

ULTIMATELY YOUR CONTINUITY PLAN EXISTS TO KEEP THE COMPANY OPERATING IN CHALLENGING TIMES.

SETTING YOUR GOALS FOR A BUSINESS EXIT

Every business has a finite lifespan. Some may last for decades, and some may only last a couple of years. As the owner of a business, the life of your business is likely to be strongly aligned with your own life goals and personal plans for the future. When the time comes to sell up, it's important to know what your goals are for the sale. Are you looking to retire? Or do you have a burning ambition to start a new venture?

Define your exact goals from the sale of the business

At the point of planning an exit, you need to think carefully about WHY you're selling up and WHAT you want to achieve. This is a huge change in your life, your business career and the fortunes of your company and employees.

Ask yourself what your true goals are from this exit:

- Do you want to retire, ease the pressure and enjoy some freedom?
- Has this business journey come to an end and you need a new challenge?
- Do you need to free up your capital to invest in other business or personal projects?
- Is there a worthy successor who's itching to jump into the hot seat?

Whatever the motivation for a business exit may be, be sure to consider your options and decide on some concrete end goals.

Who is going to take over the business?

Business sales are rarely a simple process and by putting the company on the market you're opening yourself up to a complicated process of negotiation, financial agreements and legal wrangling.

Knowing who will take over the business can be difficult to predict, but you do have several options when it comes to the end outcome. For example, you could:

- Sell the business outright to a new owner and remove yourself from the company
- Sell the business but remain on as chairperson or a non-executive director (NED)
- Merge the business with a sympathetic competitor to aid their growth
- Agree to a partial or complete acquisition from a competitor or private equity firm
- Pass the business on to the next generation of your family
- Agree to a management buyout from your existing team.

Outline how the sale proceeds will be used

Once any sale, merger or acquisition is complete, you could be on the receiving end of a substantial amount of money. But what do you intend to do with this money? The way you use the funds from the sale will vary, depending on your end goals for the business exit. As the seller, this money can fund various different life goals for you, so it's crucial that you have a clear understanding of what you want to do with the sale proceeds.

Will the funds be used to:

- **Build a nest egg for retirement** – if your goal is to retire, the price you sell the business for will need to provide enough funds to see you comfortably through your retirement. This means understanding your life goals, your outgoings and budgeting accordingly.
- **Form the capital for a new business idea** – you might be ready for a new business challenge. If so, your sale price needs to cover the startup costs of a new business, while also covering your personal financial needs in the early stages.
- **Gift money to your family and the next generation** – it could be that you want to pass on your wealth to your family. If that's the case, you must factor in the money you plan to gift, while considering your own future financial needs.
- **Make donations to charities, social causes or political interests** – if you have particular charities and causes that are close to your heart, you may want to donate some of your sale proceeds to these institutions. Whatever you decide to donate, make sure that you're aware of the tax implications and how this affects your tax bill.
- **Invest the money to create a return** – you may want to invest the sale proceeds with the objective of creating a healthy return and increase your overall wealth. This could mean investing in other startup projects, buying shares in growing companies or putting your money into a pension scheme or high-interest savings account. Again, knowing the tax implications of any kind of investment is vital if you're going to invest in a tax-efficient way.

Selling your business is a big move, where it's invaluable to have the best possible support and advice to guide you through the sale process. Talk to your accountant, tax agent and other business advisers and run your exit goals past them. As a founder, it can be difficult to be objective about your business. But external advisers have the advantage of being able to look from the outside in, with real objectivity. This helps you get independent, expert advice on your exit goals, your strategy and your tax planning.