Grant Thornton

Business Adviser

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Cash is king

Cashflow is vital to the survival of any business. While the profit or "bottom line" often takes the spotlight, cashflow is even more critical for business success. Relationships with suppliers and staff depend on your ability to pay them. Many profitable or asset-rich businesses can fail because they run out of cash.

So what is the difference between cashflow and profit?

Profit is the difference between income and expenses. This can include non-cash items such as depreciation, foreign exchange gains or losses, and amortisation of goodwill. Profit is frequently used as a measure of growth and performance in a business.

Cashflow is the amount of cash available to pay bills. However, cashflow is a comprehensive measure that includes not only net cash received from the business activities, but also encompasses debt repayments, asset sales and purchases, GST payments, and capital introduced from owners. The timing of these movements also affects cashflow.
The relationship between cashflow and profit is not always straightforward. Think of the ideal property investment, where cashflow is positive, but the property makes a loss for tax purposes due to depreciation claims. Conversely, profitable businesses can struggle with high levels of debt repayment.

Preparation of a cashflow forecast is the best way to identify potential issues. This allows planning in advance to reduce the impact of any period when you may be short of cash. The forecast will give you a month-by-month prediction of the amount of cash you are likely to require and when you will need it. It will also give you an idea of whether you may need to arrange finance and the repayment terms required.

There are a number of ways to improve cashflow which include:

- invoice regularly
- insist on payment immediately
- for large bills let the customer pay by instalment
- do credit checks to avoid having customers who don't pay
- consolidate your loans
- sell for cash or credit card rather than on credit if your industry practices permit
- add late payment charges, fees or interest for late payments
- pay bills only on their due date, unless there is a discount for early payment
- spread out payments to your suppliers over the month
- reduce stock on hand to only the most necessary items
- have a sale to move old stock
- lease instead of purchasing equipment
- avoid over estimating provisional taxes
- deposit cheques and cash daily
- increase sales volumes
- increase prices
- if you have traditionally sold to clients – look at selling to the general public. They will expect to pay for goods and services immediately.

Your Grant Thornton business adviser can help identify the best ways for your business to improve its cashflow. We can also prepare a cashflow forecast that will help you plan. These may also be used when arranging finance through your bank.

Contents

Is your shareholder agreement a ticking time bomb?

Shareholder agreements between the enterprise owners, and sometimes the enterprise itself, often seek to establish the mechanism for the transfer of ownership interests. They range from the pre-emptive clauses contained in a company's constitution to valuation clauses contained in specific formal agreements. Properly drafted, they should help to ensure an interest is transferred efficiently and effectively. However, from Grant Thornton's involvement in many share and business valuations prepared under such agreements, the way in which the valuation clauses are drafted often delivers agreements that hinder, rather than help, the transfer process.

A shareholder agreement gone wrong

For example, we were recently asked to prepare a valuation of shares pursuant to a shareholder agreement between a company and a departing shareholder employee who held a minority 10% interest. Ultimately, what should have been a relatively straight forward exercise became almost unworkable, due largely to the onerous valuation requirements under the agreement. These included:

- its requirement to appoint three valuers, one for each party, and then for an umpire to determine the final value
- uncertainty as to whether the shares should be valued on a fair value or fair market value basis, affecting the level of minority discount to be applied
- its requirement for valuation costs to be shared equally, despite the significant differences in financial resources between both parties
- athough the agreement set a timetable for the completion of the process, it failed to specify any penalties for any failure to comply with that timetable, and
- the ambiguous drafting of the formula to be used in the calculation of the employee's total interest, including related funding arrangements.

The combined effect was that the transfer process took nearly 18 months, with total professional fees exceeding the value of the employees' interest. Sadly, what had begun as a relatively amicable exercise degenerated into one of confrontation and conflict, with neither party fully satisfied with the final outcome.

Rule rather than the exception

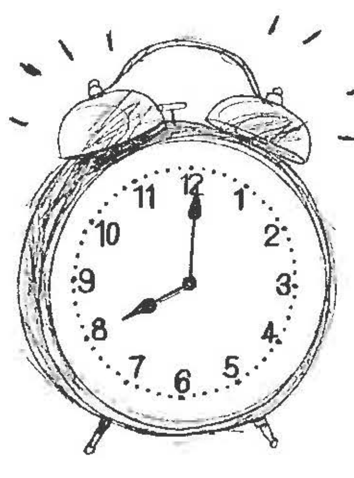
Unfortunately, difficulties with valuation clauses under shareholder agreements such as the above tend to be more the rule, rather than an exception. We believe a primary reason for the ineffectiveness of many shareholder agreements is that they inadequately address the key valuation aspects relating to the transfer. With valuation being more an art than a science, this limited guidance invites subjectivity into the valuation process, and a greater opportunity for widely disparate views on value between buyer and seller. And with that increased subjectivity often come increased costs and delays in the transfer process.

Introducing greater certainty

Greater certainty may be introduced by clearly defining in the agreement the terms of both an appropriate valuation process and the valuation elements relevant to that process. Issues to be considered in defining the valuation process include setting a valuation timetable, the appointment of appropriate valuers and identifying the information to be relied on. Valuation elements to be defined might include the definition of value to be adopted, the date of valuation, the extent to which adjustments for control or strategic benefits should be made, and the funding mechanism to be utilised in the transfer. All of these issues must also be considered within a wider cost / benefit analysis.

The above issues may be considered in relation to the drafting of new agreements and also in reviewing whether existing agreements are likely to deliver a successful transfer. If it appears they will not, obtaining consent of the parties to amend the agreement may be far simpler than resolving any potential differences that arise once the agreement is tested. In that way, the 'ticking time bomb' that may be your existing shareholder agreement can be amended to one that is more likely to deliver reasonable, consistent and workable results. We also see considerable merit in involving the chartered accountant, company legal advisor and in some cases, the company insurer, to ensure that all issues are dealt with appropriately.

Please contact Grant Thornton Corporate Finance for assistance in drafting or amending valuation clauses associated with shareholder agreements.



Inland Revenue crackdown

A year ago the Government allocated an additional $14.6 million to the Inland Revenue to fund wider investigations on 'speculative' land transactions. In response, the Inland Revenue has developed specialist property investigation teams throughout New Zealand and its scrutiny has increased in a number of areas including:

- investigating GST claims on property acquisitions;
- targeting property 'hotspots';
- data matching of buy/sell information registered with the Land Titles Office to target potential revenue risk areas;
- an increased focus on the mis-use of loss attributing qualifying companies (LAQC's) to obtain tax advantages on what are essentially seen as private living costs.

In November 2007 Inland Revenue issued a Revenue Alert outlining their particular concern involving cases of individuals selling private homes into LAQC's but remaining in the homes under tenancy agreements. In these cases the rental costs such as mortgage interest, rates, insurance and depreciation invariably exceed the market rental paid by the shareholder/tenant thereby giving rise to a rental loss within the LAQC. The annual LAQC loss is then attributed back to the shareholder and is offset against other personal income such as salary and wages thereby lowering the shareholder's personal tax liability. The Inland Revenue's concern is that this type of arrangement secures a tax advantage to the shareholder for expenditure that is in substance private in nature and which would not otherwise be deductible if the home were owned personally. The Revenue Alert indicates that such an arrangement is likely to be viewed as an abusive tax position. While the Alert focuses on cases where the family home is owned personally and is subsequently transferred to an LAQC with the former owner becoming the tenant, Inland Revenue's real target is much wider and focused scrutiny is now evident in all cases involving shareholder / tenancy arrangements even where the LAQC is the upfront owner of the property.

The taxman cometh

"The taxman cometh", was the heading in a recent article talking about Inland Revenue's latest public alert over the use of LAQC's (Loss Attributing Qualifying Companies) to buy private homes, and its focus on land transactions. It's a simple statement in itself, but signals that the Inland Revenue will be trying to "throw the book" at anyone whom it does not think is complying.

The public alert came out last November and was one of the first following the Government's move to bankroll the Inland Revenue to investigate land/ property transactions.

At the heart of this particular alert is the fact that people have been purchasing their private homes under limited liability companies known as LAQCs. An LAQC is a unique vehicle because, as its name implies, it allows the company to pass its losses to the shareholders. The shareholders can use the losses to lower their personal tax.

Despite the legislation allowing such structures, the Inland Revenue thinks this use boils down to tax avoidance. They argue that taxpayers are not entitled to deductions for items of personal use, and this structure provides a home for the shareholder, which would not be allowed as a deductible expense without the LAQC being involved.

In a unique approach, Inland Revenue has also sent personal letters to each taxpayer they currently know has this type of structure in place. These letters advise the taxpayers they have limited time to voluntarily disclose the structure and right their affairs. But don't be fooled. This is no goodwill gesture. Although it gives a taxpayer the chance to "right any wrongs", it also allows the Inland Revenue to impose higher penalties - and possibly prosecute any taxpayers that have not corrected their position before the given deadline. The letter, therefore, serves more as a warning as to the severity of the penalty rather than any leniency.

This position set out in the public alert is a general argument and although correct, as far as general principles of avoidance arrangements go, the answer is not as clear as suggested. There may be situations in which the avoidance provisions would not necessarily apply. Saying to Inland Revenue that the structure was used, and wrong, would increase the risk of liability for tax and penalties, when the particular situation is justified. After all, Inland Revenue seems to accept LAQCs are all right as long as the tenant is an arms-length party. Many cases are not as simple as suggested.

If you have received a letter from the Inland Revenue or think that you might be in a situation where the Inland Revenue could ask questions, you need to seek professional advice immediately. This should be done before making any statements to the Inland Revenue, as these could and will be used against you at a later stage.

Getting advice is important. not only to ensure you are actually in a position that might find you liable, but also to assist in limiting any shortfall penalty to which you may be exposed. The shortfall penalty for tax avoidance is 100% of the tax that should have been paid. This is often discounted, but penalties and interest can be a severe burden.

Shane Kilian

Changes to provisional tax regime

Several changes have been made to the timing and method of making provisional tax payments. It is important to be aware of these as getting payments wrong can lead to penalties and interest charges. Grant Thornton advisers will be working with clients to ensure the changes are understood and correctly applied.

Change in payment dates

Provisional taxpayers have traditionally paid provisional tax on the 7th day of the 4th, 8th and 12th month of their financial year. To minimise the number of payments taxpayers have to make to Inland Revenue, the Government has aligned provisional tax payments with GST payment dates. Payment dates for provisional tax are now on the 5th, 9th and 13th month of the tax year. The following table illustrates the changes for the common balance dates of 31 March and 30 June:

Balance date

	31 March		30 June	
Instalment	**Old date**	**New date**	**Old date**	**New date**
First	7 July	28 August	7 October	28 November
Second	7 November	15 January	7 February	28 March
Third	7 March	7 May	7 June	28 July

We make the following observations about these changes:

1. Taxpayers get a one-off "holiday" or deferral in making provisional tax payments. For example, a March balance date taxpayer gets a one-off deferral of 69 days for their second instalment of provisional tax.
2. March balance date taxpayers have a number of different dates to deal with. The standard "formula" would see the second instalment payable on 28 December; it has been moved to 15 January due to the holiday season. Clients need to make arrangements to ensure that they are fully aware of their taxation commitments for 15 January 2009 if they are taking their summer holidays at that time. Similarly, the third instalment should be due on 28 April but has been deferred to 7 May because of Easter and Anzac holidays around that time.
3. The final instalment of provisional tax is now due after the close of the relevant year. Company taxpayers looking to use tax payments to impute dividends for the current year should think about paying earlier.

Paying provisional tax with GST

All GST registered taxpayers should now have their GST periods aligned with their balance dates. Please contact your Grant Thornton adviser if you are not sure about this. For GST registered provisional taxpayers, the following rules apply:

1. If you are on a one monthly GST basis, you pay provisional tax with your 4th, 8th and 12th GST returns in each financial year.
2. If you are on a two monthly GST basis, you will pay provisional tax with your 2nd, 4th and 6th GST returns in each financial year.
3. If you are on a six monthly GST basis, you will pay provisional tax twice a year, with each GST return (due 28 October and 7 May), assuming a 31 March balance date.

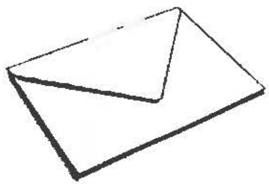
Whilst the GST return forms have been amended to incorporate space for making your provisional tax payments together with GST by paying with a single cheque, we still anticipate advising clients of their provisional tax obligations before they are due in a similar manner as has occurred in the past.

GST ratio method

The aim of this new method of paying provisional tax is to match the payments to turnover by using GST turnover as an indicator. There are a number of requirements for using this method. Our view is that it is best suited to small sole traders. While the intention in devising this method is commendable, it requires a number of calculations and greater liaising with your adviser. If you are contemplating adopting this method, please contact your Grant Thornton adviser first.

Key Points

- Provisional tax payment dates have changed
- Contact your adviser to ensure you are prepared



If you require further information on any of these topics or would like details on other accounting matters, contact your local Grant Thornton office:

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