Larsen, Patterson & Willson Limited
t/as LPW Accounting
M Northcote Office Park, Unit 11, 80 Grey Street, P O Box 28,
PALMERSTON NORTH 4440
P 06 357 5793, F 06 357 5773, E office@lpw.co.nz, W www.lpw.co.n

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NEWSLETTER

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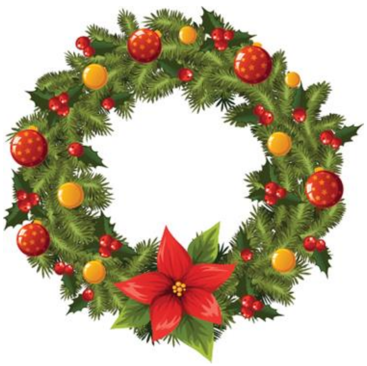
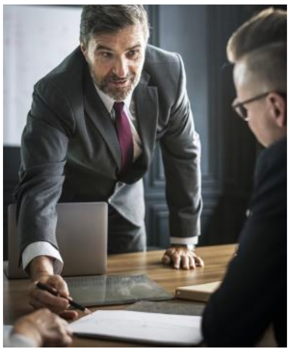
INSIDE THIS EDITION



Corporate governance for small businesses

Good corporate governance is often viewed as important for large companies with an established board of directors. However, the principles that underpin good corporate governance can benefit any organisation, irrespective of size.



Why is it then that the term governance often raises alarm bells with small business owners? Perhaps it's the fear of losing control over their business, or the assumption that they must report to someone else. When in fact, good corporate governance should lead to business owners feeling more empowered, more supported and more equipped to make good quality decisions.

In a nutshell, governance is all about thinking strategically and taking a 'big picture view' as opposed to focusing on day-to-day operations. In the context of small businesses, owner-operators are often bogged down with the day-to-day running requirements of the business, leaving little time to devote to long-term strategy and sustainability. One of the key benefits of governance structures is the ability for small business owners to take time to work "on" the business as opposed to work "in" it. This subtle switching of 'hats' is one of the first steps toward building a governance structure.

However, there is no 'one-size-fits-all' approach to governance; it will look different for each and every business. The approach will depend on the size and stage of the business, the operating environment, the risk profile and the key stakeholders. It is therefore crucial that all businesses take time to think about their governance practises. Broadly, governance structures typically fall into one of three categories: no formalised governance structure; an advisory board; or a full board. The idea of a full board may be overwhelming for SMEs or not appropriate given the size and scale of the business, but they may still benefit hugely from establishing an advisory board.

At one point or another, SME owners will inevitably need expert advice, that's where an advisory board comes in. An advisory board is an informal group of business professionals who help advise owners on a number of business issues. Generally, an advisory board should have a legal advisor, an accountant, a marketing expert, a human resources expert, and a financial advisor.

The ability to draw on these different areas of expertise offers SMEs the benefit of a variety of different perspectives, knowledge, experience and most importantly support. Opting for an advisory board also ensures overall decision making authority remains with the owner, removing any apprehension owners may have about loss of control.

As entities progress through the business life-cycle, they may eventually find that their advisory board grows into a full board. There is an abundance of resources available that outline the composition and responsibilities of boards, including guidance issued by the Financial Markets Authority (FMA) which includes eight key principles that underpin best practice. The topics include areas such as ethical standards, board composition and performance, risk management, and reporting and disclosure. Whilst it is unlikely that all of the principles will be relevant for small businesses, they provide sound guidance on the fundamental areas and help simplify the underlying objectives of governance.

Court case – tax avoidance arrangement

Two recent (connected) cases at the Taxation Review Authority (TRA) demonstrate that unnecessarily complex transactions can raise a red flag for IRD.

Both cases related to a taxpayer referred to as Mr Brown, who acquired a 2/3 interest in a joint venture known as the NPN Partnership (NPN) back in 1981. NPN held several residential property investments, of which a 2/3 share was transferred into one of Mr Brown's family trusts.

Over a period spanning 20 plus years, the income rights to the rental income derived by NPN were sold from one of Mr Brown's family trusts to another on three separate occasions. Although each transaction was slightly different, broadly, on each occasion the trust acquiring the income rights funded the purchase by way of vendor loan, with the interest capitalised and not payable until the expiry of the loan.

Close to the end date of each loan, the trust would sell the income rights to a newly settled family trust for a price equivalent to the outstanding loan with accumulated interest. In effect, each of these sales from trust to trust created a new loan. On each occasion, the new loan gave rise to an interest expense which the trust claimed as tax deductible, offsetting the rental income derived from NPN such that no tax was paid.

The Commissioner contended that the arrangements constituted a tax avoidance arrangement pursuant to BG 1 of the Income Tax Act, and sought to deny the interest deductions whilst reconstructing the income derived by NPN onto Mr Brown. The Commissioner contended that during the time the income rights were held in trust, the rental income was used my Mr Brown for his personal and family expenses. The taxpayer contended that the transactions were all standard commercial transactions, and there was no artificiality in the trusts obtaining the interest deductions.

However, the TRA supported the Commissioner, ruling that the transactions were driven with a tax motive in mind, with no commercial reality, given that the loans resulted in no economic cost to the trusts. The structure was artificial and contrived.

In sentencing, the TRA allowed IRD to impose re-assessments dating back to 2001, as they considered Mr Brown's tax returns to be wilfully misleading. As a further sting in the tail, it was deemed that the Trustees of the family trusts had failed to meet their tax obligations, hence the income was taxable at the 'non-complying trust rate' of 45%.

A good reminder that whilst all taxpayers are entitled to arrange their affairs in a tax efficient manner, tax should not be the main motive for a transaction with no commercial substance.

Generation Z – our future workforce

The rise of Generation Z ('Gen Z') is imminent in today's workforce. Comprised of those born between mid-1990s and early-2000s, Gen Z has grown up in a world with technology at their fingertips. Common traits include: confidence, desire to succeed, thriving on recognition, being adaptable and tech-savvy. However, their most valuable aspect is they represent an organisation's future.

Fast forward 10 years from now – baby boomers will be retired and employers will have no choice but to recruit an increasing number of Gen Z employees. As Gen Z members are currently young, they are perhaps not a priority when it comes to recruitment planning. However, it is crucial employers learn to understand this generation and how to attract, recruit and retain them.

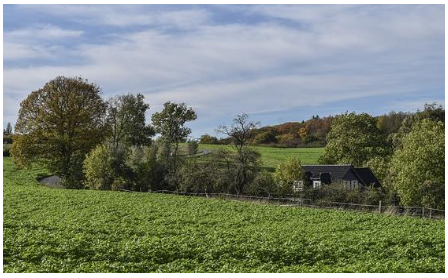
If Gen Z members are not being challenged, recognised or rewarded for their efforts, they will have no hesitation to search for opportunity elsewhere. Today, it is increasingly common for employees to change jobs after spending only months with their employer. It is clear that the fierce, unparalleled loyalty that was once displayed by previous generations will not be as prevalent in the future. Being adaptable and tech savvy also means Gen Z will demand remote working and flexible working – such "perks" will become expected, rather than incentives.

To attract Gen Z into their organisations, employers should be aware that the approach to job searching is significantly different to the traditional methods. Often, Gen Z begin their job search on the organisation's website – looking for the organisation's culture to impress them. They then head to social media to learn more. Hence, organisations need to get creative with different social platforms and use them to reach out to potential candidates.

Organisations should also assess whether existing recruitment processes remain appropriate. For example, it is currently commonplace for psychometric testing, essay writing, and even written case studies to be requested before interview stage. An absence of face-to-face communication can make Gen Z candidates feel like just a number. Understandably, this lack of human interaction does not initiate feelings of loyalty. Extensive recruitment processes can also dissuade Gen Z workers from applying at all, meaning employers are missing out on potential candidates. To combat this, organisations should prioritise the key aspects of the recruitment process, and eliminate any unnecessary stages.

Ultimately, whether an organisation can tailor their recruitment plan for Gen Z will depend on its individual circumstances. Nonetheless, it is important for employers to understand this generation and how to best attract, recruit and retain them.

Property sales - business premises exclusion



The land taxing provisions deem certain sales of land to be subject to income tax, subject to a limited number of exceptions. One such is exception is for 'business premises'. However, the circumstances in which it applies can be a grey area. Hence, two recent 'Questions We've Been Asked' (QWBA) issued by Inland Revenue (IRD) are welcome.

The treatment of business premises is different depending on the situation.

The first situation is the bright-line provision that taxes the sale of residential property sold within five years of acquisition. For the bright-line test to apply, the land must not have been used 'predominantly as business premises'; irrespective of whether there is a dwelling on the premises. 'Predominantly' has both a time and space element to it. Hence, the land must have been used as a business premises for more than 50% of the ownership period, and more than 50% of the land area must have been used as business premises. The test does not require the landowner to occupy the land for the purpose of their own business – the test can be met where the land is let and used as the business premises of a tenant. Bare land (zoned residential) can also be classified as business premises where it is used for business activity. The exclusion operates on an all or nothing basis.

Providing the land is used ‘predominantly’ for business premises, the sale of land will not be taxable pursuant to the bright-line test. However, if the land was only used, say 40% of the time as business premises, the test will fail and 100% of the profit on disposal will be subject to tax.

The second situation is the use of the business premises exclusion contained in section CB 19, which overrides the application of the broader land taxing provisions (e.g. the dealer, developer or builder provisions). When using this provision, the business exclusion can be claimed if the land is the premises of a business and the person acquired or erected, and occupied the premises to carry on a substantial business from them. This requires the land to have been used in the business of the owner; if however, the land was let and used as business premises of the tenant, the exclusion cannot be used. It also requires the business activity to be “substantial”, which comes down to the application of case law. Although this is more stringent than in the first situation above, this exclusion can apply to part of a sale. For example, the sale of 100% of a mixed use commercial and residential property could be taxed under the brightline if the residential use area is larger than the commercial area, i.e. it is not predominantly business premises. However, in the second situation, the CB 19 exclusion can shelter the profit on the commercial portion of the building.

Overall, these recent QWBA publications provide clarity on the application of the business premises exclusion to different scenarios, and contain some good examples, so they are worth a read if you think they may apply.

Snippets

Wacky business ideas

Ever dreamt of being your own boss? Well, millions of people have turned that dream into a reality and some even claim it’s easy! Recent studies conducted by the Global Entrepreneurship Monitor reveal that 40% of respondents thought starting a business was easy and 46% thought there were plenty of opportunities to start a business. Based on some of the strange, yet successful, business ideas out there, they might just be right.

Have you ever had the urge to send someone a message on a potato? Well now you can! Potato Parcel lets you send a potato with a personalised message written on it. They’ve already sold over 70,000 potatoes! If gifting a vegetable isn’t quite your style, perhaps a pet rock is more appropriate? Entrepreneur Gary Dahl launched the Pet Rock back in the 1970s and despite the craze only lasting about six months, it was still enough to make Dahl a millionaire.

Another common sector for new businesses is the fitness industry. New exercise fads are constantly emerging; one of the more unusual ideas are “rage rooms”. Originating in Tokyo, the rooms are designed to provide patrons with a chance to hurl cups or plates against concrete slabs in an effort to relieve stress. Today, they’ve spread all over the world with more than 100 scattered across the USA alone.

So, get your thinking cap on, the more unusual the idea, the better!

Times are changing

Developments in electronic payment methods and improved ease of online payments from your smartphone or tablet, means processing cheque payments has become a rather laborious task.

However old habits die hard, and a significant amount of people continue to use cheques – Inland Revenue (IRD) alone received more than 430,000 cheques in the year ended June 2019. Although this is a large number, it represents just 5% of all payments to IRD for the same period, and over time reflects a 20% year on year decrease in the proportion of cheque payments.

IRD and ACC have announced that from March 2020 they will no longer accept payment by cheque; other than for customers that are unable to use alternative payment options.

Besides internet banking, both IRD and ACC accept payment by debit/credit card over the phone, via direct debits, and cash or eftpos payments at Westpac Bank branches. In addition, IRD payments can be made through MyIR, and for ACC through your MyACC for Business accounts. Doing away with cheques will impact a range of taxpayers/businesses; however, it is a reflection of the digital world we live in today and a definitive move away from the paper based era of payments.

If you have any questions about the newsletter items, please contact us, we are here to help.