NEWSLETTER

Issue 4
November 2008 – January 2009

Inside this edition

All information in this newsletter is to the best of the authors' knowledge true and accurate. No liability is assumed by the authors, or publishers, for any losses suffered by any person relying directly or indirectly upon this newsletter. It is recommended that clients should consult a senior representative of the firm before acting upon this information.

Remaining Robust in Times of Uncertainty

Global economic crisis, credit crunch, financial meltdown – all terms that have been echoing around the world in recent months. What has been happening around the world will inevitably affect New Zealand businesses. The state of the world economy is such that New Zealand cannot ignore what is happening – after all, given the relative size of the New Zealand economy, it is not able to influence the outcome of the current crisis.

From a New Zealand perspective, the question is whether businesses do nothing and hope for the best, or take appropriate measures to strengthen themselves for the storm to come and emerge on the other side in a relatively healthy state.

The majority of New Zealand businesses are small to medium sized enterprises (SMEs). Given the uncertainty for businesses at present, they need to make every attempt to safeguard themselves against the downturn in the economy. The mantra for businesses, to ensure survival in difficult times, must be "Cash is King!" Cash is the life blood of businesses.

What follows are some reminders for businesses of sensible and good business practice in uncertain times. They are by no means anything extraordinary that businesses must do; they are merely reinforcements of how to maintain a strong and healthy business.

Cash Position

Businesses will need to take a more focussed approach to what their cash requirements are. What are the business cycles for the business? If cash resources are inadequate, it will need to talk to the bank to make appropriate arrangements. The business will need to review its overdraft facilities for adequacy.

For a large number of businesses in New Zealand, their stakeholders' lifestyles are funded by the business. In the current economic climate, businesses should be prudent about how much funds are being extracted by stakeholders by way of drawings or otherwise.

Stock

Businesses must determine the levels of stock required for operating the business at an optimal or efficient level. Too little stock means the business could be caught short; however, too much stock means cash is tied up unnecessarily. To get stock levels at as optimal a level as possible, the management should review turnover levels of the business, which will in turn provide information about when stock should be re-ordered. As part of the stock review process, any obsolete or slow moving stock should be cleared as soon as possible – they could become sale or discounted items. To move stock quickly, the business should also review its sales and distribution strategies.

Debtors

The first thing to remember about debtors is that they represent money belonging to the business – money that is sitting in someone else's bank account. This is the time to ensure that the business has robust credit control policies. To encourage prompt or early payment, discounts could be given. Debtors, who may have been lax in the past with payment, may need reminders to prompt them for payment.

Cost Management

Businesses must also review their cost structure and, where possible, savings should be made. Wherever feasible, businesses should concentrate on their core functions and costs. Where there is "dead wood" within the business, consideration should be given to pruning that part of the business. The business should identify which parts are operating efficiently, and which parts are not. Can efficiencies be improved upon? Where there are inefficiencies, management should isolate the reasons for the inefficiencies, and work on improving those parts of the business.

These are a few areas that businesses can focus on. There are many more areas and strategies that businesses can look at to ensure a robust future in difficult economic times. Businesses that have a strategy now are more likely to come out at the other end of economic unrest unscathed.

Charities – The Ongoing Saga

The deadline for registration of charities came and went on 1 July 2008. Dire warnings had previously been issued that any existing organisations with tax exempt status that were not registered by that date could be taxed on income received from that date to the date they became approved by the Charities Commission ("the Commission").

Inevitably, there have been applications received after 1 July 2008 from organisations that had tax exempt status. The Commission has the discretion, within the Charities Act 2005, to allow it to backdate the registration of those organisations to 1 July 2008. This was to allow for the time it would take the Commission to process all the applications received close to the 1 July 2008 deadline.

To help matters along, the Income Tax Act 2007 has been amended to accommodate late registrations. The effect of the amendment is that the IRD can use its discretion to allow the tax exempt status of the organisations to continue where they had been tax exempt before 1 July 2008 – provided they can show that they had taken "reasonable steps" to register by the deadline, and that they intended to complete the registration process.

The key to being able to take advantage of the IRD discretions is, of course, the ability to show that "reasonable steps" have been taken to start and complete the process. What would constitute "reasonable steps"? Examples would be:

- A documented plan of action of steps being taken towards registration by 1 July 2008.
- Evidence of assistance being sought from professional advisers to advise on the registration process, and
- Trustee or Board minutes to show that formal decisions had been made to have the organisation registered by 1 July 2008.

If the organisation is able to show such reasonable steps were taken, the IRD should exercise its discretion to allow backdating of tax exempt status to 1 July 2008.

Another issue that may be currently overlooked is the difference between tax exempt status and donee status. Obtaining tax exempt status under the Charities Act does not automatically mean the organisation has donee status. Donee status is granted by the IRD. An organisation does not need to be a registered charity to obtain donee status. Organisations that had donee status before 1 July 2008 retain that status after that date, regardless of whether they have registered with the Commission as charities.

Managing Staffing Levels in Tough Times

For the last couple of years employers have been saying that the lack of good staff is the biggest constraint to the growth of their business. In stark contrast with this, over the last few months as the economy has tightened, employers have started laying off staff. It is never an easy thing to do, and it is really tough breaking up a good team.

This article explores some of the alternatives to avoid having to break up the team and some of the pitfalls that employers have walked into.

Firstly, if employers are having a tough time with sales, they shouldn't kid themselves that the staff do not know. The good ones take pride in their work and productivity and they know if they are busy with orders, or filling in time with otherwise low priority tasks. They will be waiting and watching to see how the employer deals with the situation. The longer the employer tries to avoid dealing with it, the more nervous they will get. Even in tough times, the good ones will have other options and they will take them if they don't feel confident with the employer's handling of the situation. The good staff are also the ones the employer can least afford to lose.

If labour costs have to be reduced, several options can be applied. Start with controlling the hours of work. Unless it is absolutely critical, stop all overtime and casual / temporary workers. Where staff on wages are working more than the minimum hours stated in the employment agreement, their hours should be reduced to the minimum. Where staff have accumulated annual leave, they should be encouraged to take it.

The next step is to look at reducing the contracted hours of work. To do this the employer will need to have the agreement of the staff affected, otherwise it is a unilateral change to the employment agreement. If this option is being considered, the employer will need to reflect on what is fair for the individuals. A reduction of 4 hours a week is a 10% pay cut for a full time staff member but a 20% cut for a person who works 20 hours a week.

If this hasn't achieved the desired savings, the employer will have to look at reducing staff numbers. Identifying those who want to go and pursue other options is the least painful approach. Are there any staff who are considering retiring or resigning? Is anyone planning to do their 'overseas experience' and do they want to bring it forward?

Finally, there might come the decision to actively lay off individuals. It is really important that there is genuine consultation with the staff, explaining the situation and the options. How should this be done? Should a team be removed, should all part time jobs be stopped or should there be a selection of individuals? Whichever choice is made, it has to be justifiable in the eyes of the law. That includes both a fair process and a genuine need for change.

In one case, an employer developed a comprehensive method for assessing and rating the suitability of the employees they were considering making redundant. But instead of appointing those who got the best ratings, they selected the individuals they wanted and ignored the ratings. The redundancies were found to be unjustified dismissals.

Therefore, employers who find themselves having to cut staff costs should seek advice before embarking down a path that may turn out to be the incorrect one. It is cheaper to get good advice than to get it wrong.

Structuring For a New Investor

Anyone who is wanting to start a business, considering an investment, restructuring an existing business/investment or trying to attract investors, will want a structure that:

- provides limited liability (where possible) to third parties
- offers tax benefits
- offers the option of a management role in the investment

Limited Partnerships (LP) and Joint Ventures (JV) are useful vehicles that can provide the above advantages. Economic uncertainty increases the attractiveness of a JV as investors are not joint and severally liable – they are only liable in proportion to their share of the JV. A JV can be either an incorporated joint venture (IJV) or an unincorporated joint venture (UJV).

An IJV is not able to flow-through its profits and losses. Profit distribution is by way of dividends and losses are trapped within the company. For these reasons they are not as tax advantageous as UJVs.

Generally, the distinction between a partnership and a UJV appears to depend on whether or not the parties are engaged in a joint undertaking for a common profit (in which case the relationship is one of partnership) or not (in which case the relationship is a joint venture). Perhaps the primary importance of joint venture status (as opposed to a partnership) is that, as a general rule, joint venturers should only be liable to third parties for their proportionate share of the liabilities incurred by the joint venture (as opposed to being joint and severally liable in the case of a partnership).

Limited partnerships will have both separate legal status (like a company) and flow-through tax treatment (like a partnership).

Key elements of LPs and UJVs

	LP	UJV
Structure	• One or more general partners manage the partnership • One or more limited partners invest in the partnership	• Two or more parties enter into a joint venture and manage it as per the joint venture agreement
Tax	• Taxable income/losses of the LP flow-through to the limited partners in proportion to their investment	• Taxable income/losses of the UJV flow-through to the joint venturers • Parties may take different tax positions regarding the UJV, for example – they may use different depreciation methods
Liability	• Limited partners' liabilities are limited to their investment in the LP, but lose their limited liability status if they manage the partnership outside certain "safe harbour" activities • General partners have unlimited liability and are joint and severally liable for the debts of the LP	• Liability to third parties is limited to the party's proportionate share in the UJV, regardless of any management activities performed (subject to due care, etc). But the UJV itself does not have limited liability • Parties are not joint and severally liable
Administration	• Partnership agreement required • Must be registered with the Companies office • Annual returns must be filed • Winding up requires a formal liquidation	• UJV agreement is required • When the UJV project is completed, the UJV can be dissolved with no formal liquidation required

It is unlikely that any one vehicle will be suitable for all situations. Therefore, investors will need to consider what their priorities and requirements are before deciding on the most appropriate vehicle to suit their circumstances.

Snippets

Family Tax Credit Increase

The annual amount of the minimum family tax credit, which guarantees a family's after-tax income, rises from $18,460 to $20,540 from 1 April 2009. This increase was approved by Order in Council on 6 October 2008.

FBT Interest Rate for Low-interest Loans

The prescribed rate used to calculate fringe benefit tax on low-interest, employment-related loans rose from 10.57% to 10.90% from 1 October 2008.

New Secondary Tax Rate

The Government announced on 7 October 2008 that Cabinet has agreed to a new, bottom secondary tax rate of 12.5%, from 1 April 2010. Hon. Peter Dunne said, "Secondary tax rates are not intended to tax income earned from two or more jobs more heavily than the same income derived from a single job."

Lowering the secondary tax rate is not actually a tax cut. Taxpayers' tax obligations do not change - lowering the secondary tax rate merely reduces the chances that taxpayers will be overtaxed during the course of the year. Where taxpayers have been overtaxed, they will be entitled to a tax refund at the end of the year.

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