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Commentary, opinion and intelligence for the New Zealand business community

GLOBAL ECONOMIC UPDATE

NZ export expectations highest recorded in six years

Jay Shaw appointed to IVSC Business Valuation Board

PLUS

Fringe benefits tax in the Not for Profit sector

Boosting Board diversity: the why and the how

Little impact on business from BEPS tax plan

Global economic update

Grant Thornton's Global CEO, Ed Nusbaum considers the ripple effects of Brexit and the US election on the world economy

A quarterly global business survey by Grant Thornton finds sinking levels of business optimism stirred up by global political events. The UK and EU countries most exposed to Brexit are experiencing the greatest knock in confidence with US companies feeling shaky in the wake of the presidential election.

New research from Grant Thornton's International Business Report (IBR), a quarterly survey of 2,600 business executives in 37 economies, reveals a pronounced change in mood over the last quarter in the UK (-19pp), Ireland (-24pp), France (-18pp) and Spain (-19pp), with the EU and the Eurozone both suffering a 7pp decline. In the US, optimism dropped by 1pp, contributing to a significant 11pp fall over the year, while Mexico took a 22pp tumble in the last three months alone. Globally, business optimism stands at net 33%, rising 1pp from the previous quarter but falling 11pp over the year.

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Political events like Brexit and the US presidential election understandably rattle the global economy and test the resilience and elasticity of businesses worldwide. In general, businesses do not like uncertainty, and that is what is happening.

A downturn in confidence in the UK closely mirrors the unfolding of Brexit. Before the turn of the year, optimism was riding high at 74%. But then, in the lead up to the vote, it fell away sharply to 40%, reaching its lowest levels since the start of 2013 with news of the result. This is consistent with declining expectations across seven out of eight business indicators. Confidence has been hit across parts of Europe, too, where economies are waking up to a post-Brexit reality.

In the US, lower levels of confidence are also expected to affect performance, with companies anticipating a fall in revenue (-5pp), a decline in investment in plants and machinery (-4pp) and selling prices (-2pp).

UK businesses expect their economic fortunes to begin to slow down, with low optimism reflected in expectations of a weaker performance. Only export prospects have risen, up 10pp to 19%, owing to the cheaper pound. The US, which is also going through a politically uncertain time, tells a slightly different story. Export expectations are up just 1pp, while some areas of investment are holding up a little better.

Globally, fluctuations are marginal across business indicators such as revenue (-1pp), selling prices (-2pp) and profitability (-2pp); but spill-over effects are likely to show in the next quarter. The data already shows a significant increase in economic uncertainty (+6pp) over the last three months, which is now the biggest constraint for businesses worldwide.

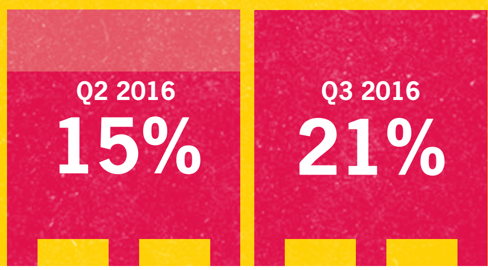
Businesses react to the macro-economic uncertainty, shelving deals, delaying investment decisions and freezing recruitment. The outcomes of political events take time to unfold and we have little choice but to be patient. During the unfolding, however, policymakers must ensure open dialogue with the business community, so that shocks and surprises are kept to a minimum.

Ed Nusbaum
Grant Thornton Global CEO

Contents

NZ export expectations highest recorded in six years

Despite a major dip in export prospects throughout Asia Pacific's developed economies earlier this year, the latest Grant Thornton International Business Report (IBR) reveals that export expectations have now shot up throughout the region from 15% in Q2 2016 to 21% in Q3 2016 – the highest quarterly figure ever recorded.

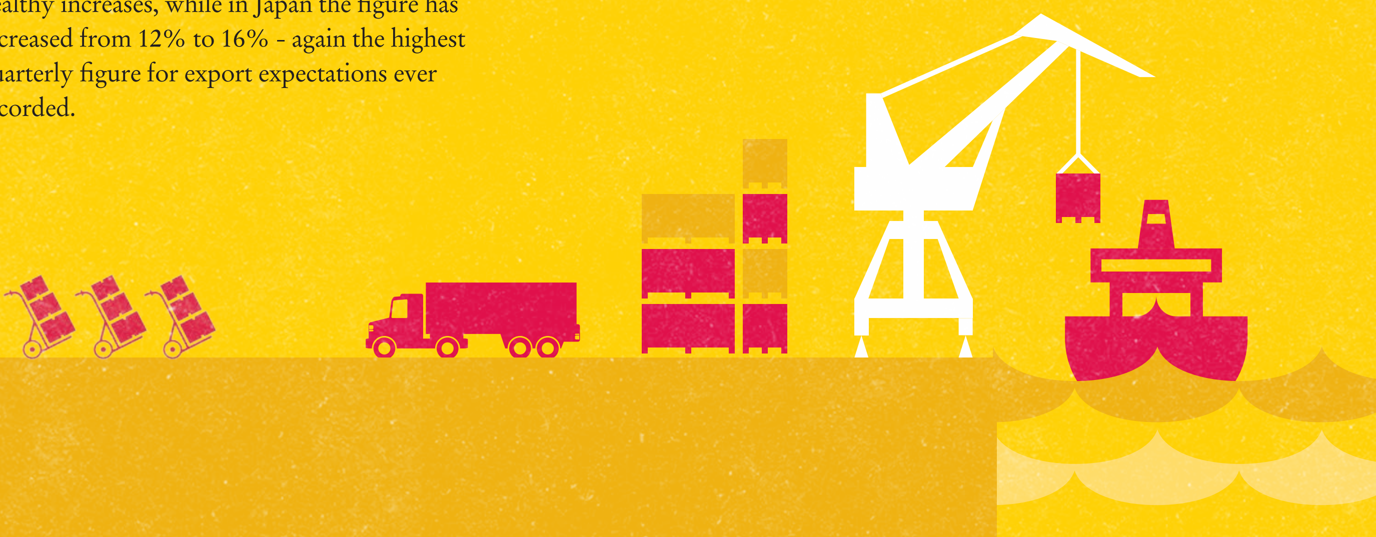


Export expectations since Q2 2016

New Zealand's export expectations more than doubled from 22% in Q2 2016 to 48% in Q3 2016 and is the most positive response from businesses surveyed since 2011. This also puts New Zealand at number one in a league table of 37 countries surveyed.

Australia (28% in Q2 to 38% in Q3) and Singapore (-6% to 6%) have also recorded healthy increases, while in Japan the figure has increased from 12% to 16% - again the highest quarterly figure for export expectations ever recorded.

Export hopes among businesses in Asia Pacific's developed nations are higher now than we've recorded in any previous quarter. Despite uncertainty across the wider global economy, these firms are looking overseas with enthusiasm. It suggests a bounce in expectations since the Trans Pacific Partnership was signed in February, despite the threat of it stalling.



But these export figures also provide encouraging evidence that in many economies, reliance on China as a trading partner is reducing. China will undoubtedly remain an important export destination for many, but not to the same extent as in previous years.

The IBR reveals that although businesses in developed APAC economies are more expectant when it comes to exports, overall economic optimism paints a different picture. Business optimism in emerging APAC nations has fallen 8% in Q3 2016 but still sits at 42%. In developed APAC nations, optimism has increased 12% but is much lower overall at -8%.

New Zealand business optimism has remained stable at 76% since the beginning of the year and sits in fourth place out of 37 countries surveyed.

Optimism in Asia Pacific is travelling in different directions this quarter when split between emerging and developed economies. However, the fact is that emerging nations are still much more optimistic. Most of the ASEAN nations fall into this category and their higher optimism levels are evidence that the ASEAN Economic Community, established in 2015, is creating a belief that greater cooperation between businesses in these countries will become a reality.

The outlook for Asia as a whole is mixed, but opportunities exist for the most dynamic businesses to make the most of trade flows both domestically and overseas. New partnerships and agreements will open new doors, but firms must be ready to capitalise.

New Zealand business optimism has remained stable at 76% since the beginning of the year and sits in fourth place out of 37 countries surveyed.

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Global survey finds little impact on business from OECD BEPS tax plan

A global survey of 2,600 businesses in 36 countries finds little impact from the OECD Base Erosion Profit Shifting (BEPS) programme which was finalised last October, as 78% of businesses say they have not changed their approach to taxation, even though more than 80 countries have agreed to adopt at least the minimum elements of the BEPS Action Plan. This is despite the fact that the action plan should, in principle, change the landscape for businesses operating in foreign countries.

The lack of impact is even greater in the G7 (83%), with 89% of US businesses and 86% of UK businesses saying that BEPS has had little impact on their tax planning. In New Zealand, 92% of businesses surveyed have not changed their approach to taxation.

According to the businesses surveyed, BEPS has had the greatest impact on business tax planning in Indonesia (35%), Nigeria (38%) and India (36%).

As part of the BEPS plan, businesses are being asked to provide corporate tax information to local and international authorities and the two greatest concerns with the practice is the additional administrative burden it creates (25%), followed by cyber security concerns (15%). New Zealand businesses' top concern is also the administrative burden (30%), followed by concerns about how the information will be interpreted (28%); the third biggest concern in New Zealand is cyber security (16%). Additional administrative burden was also cited by 35% of businesses in UK and by 32% in the US.

It is fascinating that after the initial excitement around BEPS, and its potentially game changing elements, so few survey participants have taken active steps to change what they are doing.

There will be lots of reasons for this. A number will hold back until they've seen what others are doing in their industry or region. Governments haven't yet explained how or even if they will implement BEPS in some countries, so that leads to business caution.

Limited change has occurred in New Zealand because our Government has taken a more measured approach and will incorporate BEPS into the country's existing tax policy process. Some parts of the BEPS programme are already in law, some in consultation and a few more parts are detailed in Inland Revenue's recently released tax policy work programme for the next 12 months. Examples of change include the GST on imported services, taxation of hybrids, information sharing agreements, foreign trust disclosure requirements, and thin capitalisation changes.

While Inland Revenue is not charging ahead with wholesale change, businesses operating in the international environment face a different approach from tax authorities in every country.

Businesses would undoubtedly benefit from more guidance on what they should do next internationally. Many will have been bitten by retrospective legislation or rule changes on tax in recent years; they will be nervous about taking action before the ground rules are clear. The recent EU action against Apple and its agreements with Ireland does not help make these tax issues any clearer for businesses.

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Fringe benefits tax in the Not for Profit sector

Paying fringe benefits tax (FBT) on cars can cause a lot of confusion for taxpayers. The desire to pay the minimum FBT may lead to misconceptions about how to apply certain FBT exemptions, or cause oversights when an entity's circumstances change.

There are a few recurring issues regarding FBT in the Not for Profit sector – here, we've focused on these; particularly motor vehicles, carparks and airpoints.

Motor vehicles - what is the benefit?

Put simply, a fringe benefit arises where a motor vehicle is made available for the private use of an employee by an employer. So it is important to remember that a vehicle may not actually be used by employees, but if it remains available for private use, it will be subject to FBT on that particular day.

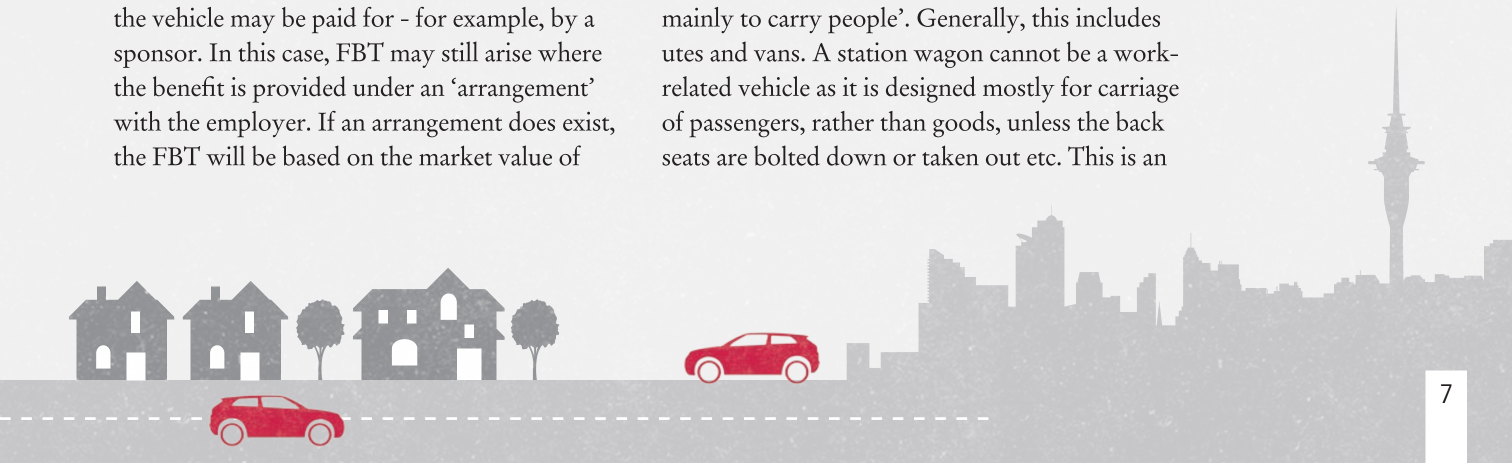
For quarterly filing, FBT on vehicles is calculated on 5% of the vehicle's cost – regardless of whether it is leased or owned by the employer. Sometimes, there is no 'cost' to the employer as the vehicle may be paid for - for example, by a sponsor. In this case, FBT may still arise where the benefit is provided under an 'arrangement' with the employer. If an arrangement does exist, the FBT will be based on the market value of the vehicle at the start of the arrangement, or when a fringe benefit is initially provided to the employee. For example, where the vehicle is funded by a sponsor, and was not initially available for private use, but becomes available for private use, then fringe benefit tax is still based on the market value at the time of purchase or entering into the arrangement.

From there, a multitude of exemptions may apply, including:

- the type of vehicle provided (ie, a work-related vehicle)
- the type of entity (ie, charities)
- the ever topical carparks.

Work related vehicles

These are vehicles 'not designed exclusively or mainly to carry people'. Generally, this includes utes and vans. A station wagon cannot be a work-related vehicle as it is designed mostly for carriage of passengers, rather than goods, unless the back seats are bolted down or taken out etc. This is an



extreme, but necessary requirement for the FBT exemption to apply to a station wagon.

Another requirement of the work-related vehicle exemption is that it must be sign written with the employer's name and that signage must be 'permanently and prominently' displayed on the outside of the vehicle. This requirement is usually well understood.

Another requirement of the work-related vehicle exemption is that it must be sign written with the employer's name and that signage must be 'permanently and prominently' displayed on the outside of the vehicle.

What is commonly overlooked?

- The vehicle will not be a work-related vehicle on any day on which the vehicle is available for the employee's private use – other than incidental private use. Generally home to work travel is allowed, but it is vital to have some form of formal prohibition of private use of the vehicle in place, such as a letter to the employee. Even then, the letter may not be sufficient where private use is in fact more than incidental. So it is even more vital to document the private use from time to time, just in case Inland Revenue asks for proof
- The nature of the job must require a vehicle of this type. So, if your job involves visiting farms and/or carrying goods, then it makes sense to have a ute as a work vehicle. If you're a CEO or an office worker, then not so much; so the risk in that case is that a ute, even if sign written, would not qualify for the exemption
- FBT will apply equally if the employer owns or leases the vehicles or if provided for free through a sponsorship deal

Charities

Charities are broadly exempt from FBT – other than for benefits provided mainly in connection with business activities that are outside an entity's benevolent, charitable, cultural or philanthropic purposes.

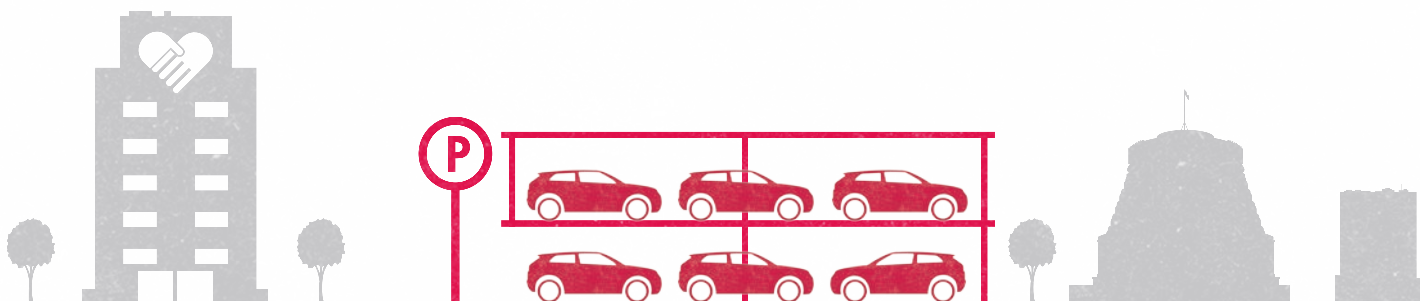
To apply this exemption, the entity must be registered as a charitable organisation under the Charities Act 2005.

But what happens when an entity is removed from the charities register?

Assuming that the entity has complied with its constitution over time, FBT will apply from the last day of the quarter or income year which includes the day of Charities Services' final decision to deregister the charity. So, prior to deregistration, it makes sense to check the extent of any fringe benefits being provided to employees and then consider registering for FBT. It is worth keeping in mind that there is a risk that FBT will apply retrospectively for those entities which have not complied with their constitution.

Carparks

Carparks are often provided to staff to use – either for the company vehicle or a private vehicle. Historically, Inland Revenue have accepted that 'leased' carparks are exempt from FBT, but 'licenced' carparks were not. Essentially, with a lease, the lessor has exclusive rights of possession, meaning



that they can tow away wayward parkers. Licence holders do not have that legal right. The importance of this difference may have been overlooked, meaning that FBT should have been paid.

If this is news to you, and you have that sinking feeling that you should have paid FBT on that carpark (perhaps for many years), the great news is that Inland Revenue have recently changed their position on the FBT treatment of some licenced carparks.

In a recently issued ruling, Inland Revenue have stated that a licenced car park will be exempt (ie, treated as being on the employer's premises) if the employer can show that their right to use the carpark is, in effect, 'substantially exclusive'; reserved car spaces work well in this instance.

There's also more great news. If you have paid FBT on licenced carparks in the past, then Inland Revenue may be open to reassessing past FBT returns.

Airpoints

If an employee is a member of an airpoints programme, FBT generally doesn't apply to any airpoints they accrue after their employer reimburses them for travel costs. The exception is if the employer has entered into an 'arrangement' for FBT purposes with the airpoints programme provider, in which case, FBT may arise.

Not sure if you've accounted for FBT correctly?

Inland Revenue can come down severely on organisations that are not properly accounting for FBT. With a recent increase in Inland Revenue reviews in this sector, you could be sitting on a ticking FBT time bomb. If you have concerns you have been accounting for FBT incorrectly or not at all, then contact your advisor to clarify whether a liability does arise and if it is material. They can then advise you whether to lodge a voluntary disclosure with Inland Revenue.

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Boosting Board diversity: the why and the how

Grant Thornton recently released its 2016 corporate governance report, *Boards of the future: Steering organisations to thrive*. The report draws on insights from our International Business Report (IBR), plus data and interviews from Grant Thornton teams around the world. It explores what skills the Boards of 2025 will need, and what needs to happen between now and then to get there, and I think that organisations will benefit from the section about boosting diversity on their Boards.

Greater diversity on a Board widens its peripheral vision. Research by the Kellogg Institute has found that diverse groups outperform Boards comprising the same types of individuals; not necessarily because of an influx of new ideas, but because diversity 'triggered more careful information processing that is absent in homogeneous groups'.

This is vital when Boards are not only trying to focus on the road ahead, but preparing for what is coming round the corner. Evidence suggests the vast majority of business leaders understand that more needs to be done to spot threats and opportunities earlier. 88% of IBR respondents surveyed in 36 countries recognise that their Board needs to do more to encourage and increase diversity. This sentiment is strong in New Zealand as well; 86% of organisations surveyed said their Boards need to encourage diversity.

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Many of the business leaders around the world who took part in the research felt that while all these forms of diversity were important, they will be relevant in different degrees depending on the nature of the company, its stage of development, its strategy and the industry it is in.

There was also a feeling that Board diversity should be aligned with customers, markets, sectors and target audiences.

What can Boards do to ensure appropriate diversity?

- Increase the scope to not only include gender, but other forms of inequality which will increasingly receive societal attention. Prioritise groups where representation does not yet reflect your organisation's culture

- Identify the skill gaps you need to fill and then widen the Board's pool of talent and experiences to meet these emerging skillsets. These could include transformational economic development (eg, not just building a school but knowing how to use local labour and materials)
- Recognise that some of the future challenges and opportunities will be less visible - especially to homogenous Boards than to those which comprise a range of experiences and backgrounds
- Invest in mentoring schemes. 30% of IBR respondents believe Boards should be active in this area. In New Zealand, this was cited as the top priority by the businesses surveyed.

The benefits of greater diversity among leadership teams

Of all strands of diversity, gender diversity is the one which has been the biggest topic of conversation to date. It is generally accepted that a better gender balance among leadership teams is a good thing. But does it make a material difference to company performance? The answer is yes.

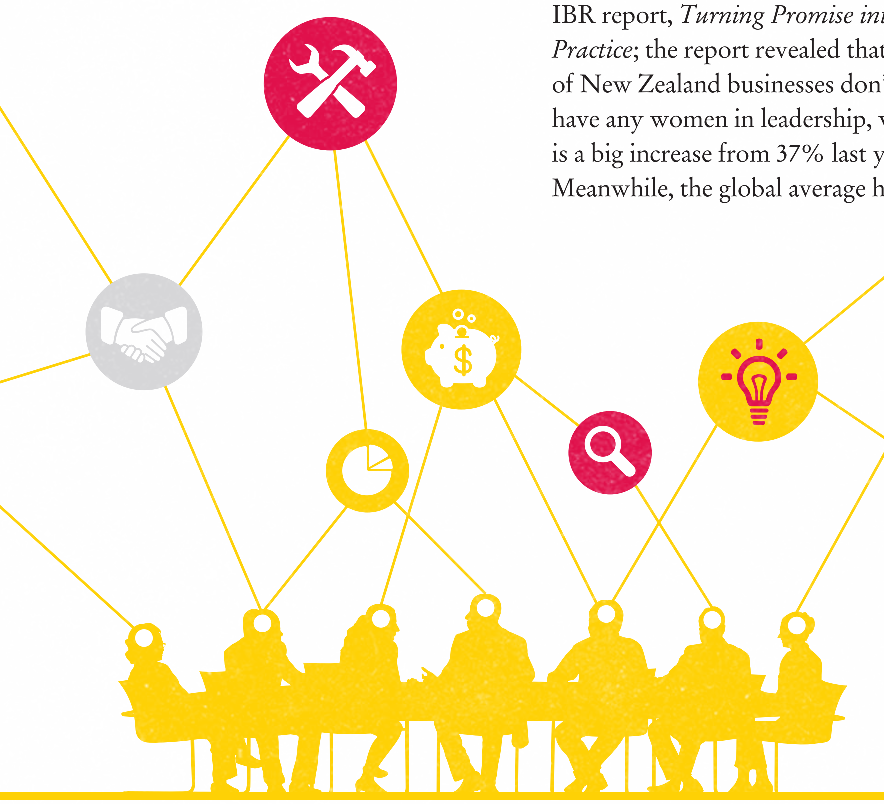
Research Grant Thornton conducted in 2015 revealed that companies with diverse executive Boards offer higher returns on investment compared with those run solely by all-males. The study covered listed companies in India, UK and the US and estimates the opportunity cost for companies with male-only executive Boards (in terms of lower returns on assets) at a staggering US$655 billion in 2014.

Earlier this year, Grant Thornton released its latest Women in Business IBR report, *Turning Promise into Practice*; the report revealed that 42% of New Zealand businesses don't have any women in leadership, which is a big increase from 37% last year. Meanwhile, the global average has remained relatively static at around 33% over the last five years.

Furthermore, the University of Singapore has compared the performance of companies with and without ethnic diversity on its Boards. It found that Boards that comprised at least two ethnic groups scored much better than those that did not, with an average return on assets of 2.9% versus 0.8% respectively.

Imagine if these figures were extrapolated for all companies globally – or applied to diversity in all its other forms too – they would undoubtedly grow even further. The data shows the differences in return on assets for companies with and without women directors. It covers the FTSE 350, S&P 500 and CNX 200. Analysis was conducted between April and June 2015.

To access the reports referenced in this article visit grantthornton.co.nz/insights



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Jay Shaw

appointed to IVSC Business Valuation Board

Grant Thornton New Zealand is delighted to announce Jay Shaw's appointment to the Business Valuation Board of the International Valuation Standards Council (IVSC), the pre-eminent global valuation standards setter for the business valuation profession.

Jay is a Partner with Grant Thornton New Zealand specialising in business valuations and forensic accounting. He has extensive business valuation experience both in New Zealand and overseas, and enjoys working with businesses across a wide range of industries, from entrepreneurial privately held businesses through to large listed multinational companies.

Jay is looking forward to directly contributing to the IVSC's mission to develop high quality and internationally accepted business valuation standards to underpin consistency, transparency and confidence in valuations in New Zealand and globally.

He also looks forward to sharing the insights he'll gain with New Zealand business owners who are interested in learning more about the key value drivers affecting their business.

Based in London, the IVSC is an independent, Not for Profit, private sector organisation. As the established international standard setter for business valuations, the IVSC develops and maintains standards for the reporting and disclosure of valuations, and various classes of assets and liabilities. IVSC's updated 2017 International Valuation Standards are due to be released soon.

Grant Thornton New Zealand's National Managing Partner, Tim Downes says that this is an outstanding accolade for Jay and for Grant Thornton; it underlines Grant Thornton's focus on quality and the highest standards of professionalism and excellence across all of our services, all of the time.

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