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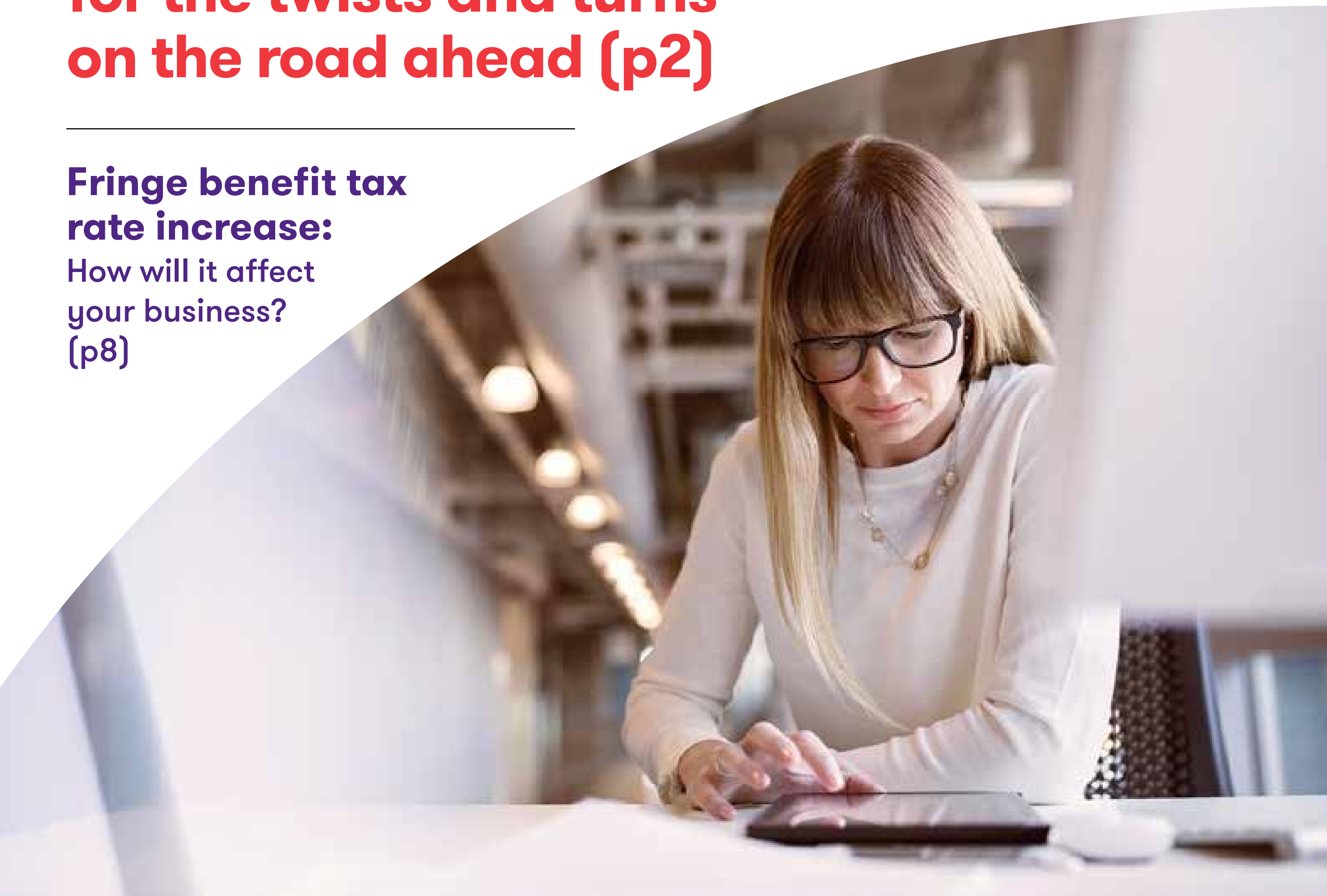

PLUS

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Retune your business for the twists and turns on the road ahead

In our last issue of Business Adviser, Stacey Davies discussed ways businesses could retune their organisations in times of economic uncertainty including understanding customers, preparing for a new competitive landscape and how to put your people first. In part two of this series, Stacey offers more advice about how businesses can go beyond short-term survival.

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Raise finance to invest in change

Finance is the engine oil of any company and preparing your business to raise capital could be critical to keeping you on the road to recovery.

During the country's various lockdowns, businesses looked to improve their cash flow management and focus on day-to-day survival, leaning heavily on government support packages. But longer-term, businesses will need greater liquidity, so raising finance is essential.

Understand what banks are looking for

Being a good bank customer has never been more important for businesses. Banks are being supportive of their existing clients, but most are tightening new lending conditions. Banks want to deal with people who are a pleasure to lend to. They don't like businesses that are short on collateral, explanations for missing budget, or short of business plans.

Having a banker who understands your business, knows where you're going, your critical reasons for being and what your business model is about is key. They love lending to people who are in control, who do what they say they're going to do, and who can articulate their plan.

Prepare your balance sheets and have a good story to tell about your future

Preparation is key to raising finance, but successful applicants will also have a compelling vision for growth in a new business environment.

We encourage clients to prepare by having a well-articulated story, particularly about what the business will look like in over the couple of years as it come out of COVID.

Businesses that are working on their resilience and recovery plans are identifying the market opportunities and their accompanying investment requirement.

Preparation is key, but successful applicants also have a compelling vision for growth in a new business environment.

Smart businesses are moving ahead of the pack by getting their balance sheets ready to take advantage of the situation. Having a robust story about how you are going to adapt to the new paradigms and where the demand is going to be will help you stand apart.

Technology can accelerate a more resilient future for businesses

Technology moved from a growth enabler to a business continuity factor in lockdown. As businesses readjust for the future, it needs to do both.

Reassess IT systems for capacity and security

Following rapid adoption of technology in the first phases of the crisis, it now pays to review what measures and systems were put in place and assess whether they are sustainable on a new scale and for new ways of working that allow secure and efficient operations. For example, doing video calls are great, but you've got to make sure it all works and that your bandwidth is adequate going forward.

Consider performing a remote hardware and software audit to ensure that workforces have the necessary tools to perform their jobs over an indefinite period.

Look to automation to execute routine tasks

One aspect of the crisis is the level of pressure staff have come under to fulfil specific routine processes from home, while often juggling other commitments. This is where automation through robotics can help. Building automations in a few days can offer real value and allow you to remove pressure from staff. Furthermore, Robotic Process Automation (RPA) can deliver consistent service. Outsourcing the implementation of RPA can be a quick and affordable way of achieving productivity gains.

Use technology to provide you with actionable data

Data has always been critical to business success and keeping up to date with the changing environment. Once transformed into usable information, data is a valuable asset in building resilience and retuning your business when matched with your scenario planning.

Ensure that you have the right analytics, dashboards, report sets, and data structures to help with decision-making.

Leaders need access to a range of indicators outside their business that will help them find and realise new opportunities, such as a rival facing financial difficulties that may be open to selling. Use sources such as customer insights, employee surveys, information from trade bodies or market analysts to help shape your understanding.

Stay vigilant around cyber security risks

Cyber criminals' attack surface has become larger due to the increased number of people working from home – the opportunities to hack into company systems, as well as compromise individual employees - will increase.

Cyber risks are continually evolving, and businesses face unprecedented security and compliance risks through data leaks as a result of remote working. Businesses must now ensure their cloud systems and infrastructure are secure and that there is clarity as to who is responsible for securing and monitoring them.

Businesses should also implement privacy-by-design and data segmentation policies, so they have insight and control over who has access to data in both first and third-party environments. They should also ensure suppliers of technology services meet basic security standards and that they have an understanding of the risks through the supply chain.

Consider performing a remote hardware and software audit to ensure workforces have the necessary tools to do their jobs over long a period.

Good governance precedes a healthy recovery

Risk management and governance are essential enablers of growth; they are the controls that allow you to accelerate safely.

The global pandemic has provided an enormous shock to businesses and it has fundamentally tested their ability to deal with crisis and disruption.

But those businesses with robust governance and contingency were able to respond to disruption more quickly and, in doing so, minimise their exposure to risk and improve their reputations accordingly. As businesses look to the future and attempt new initiatives, a proactive risk and governance approach can successfully deliver innovation and growth.

Start thinking of risk assurance as realising the opportunities

There is often a tendency to look upon risk and governance as solely defensive measures. Often focused on compliance - and aimed at avoiding negative consequences – the benefits of good governance is frequently overlooked.

Good risk management and governance come from appreciating that they are intrinsically linked to new business initiatives and operations – not an afterthought to them. You need to look at the opportunity and cover off the risk management piece that goes with it.

Review your strategy more regularly

In the past, businesses would develop a plan and perform a refresh and review with the board quarterly. Today, companies need to do that more regularly. If you don't keep your eye on the ball, someone else will eat your lunch, or the economy takes a dive or government policies changes. The pace is fundamentally different and much more tech-driven.

Those thought processes around sense checking your strategy, and your priorities are almost a daily, real-time imperative now. And this is also where technology plays an important part. Businesses need to keep track in real-time through the use of technology. They should embrace powerful tools that distil complexity and provide data through dashboards, such as monitoring highly complex supply chains.

Use this time to check and fix behaviours

Culture is fundamental. If you look at the major frauds and errors, it mostly comes down to poor behaviour, judgement and culture.

A culture audit can bring to the surface some of the beliefs and behaviours within the management teams that enable people to act badly and take unnecessary risks.

Culture is not an accident. You determine the culture you want. And some drivers deliver that around strategy, leadership, people management, and the process within the business so that you hire the right people, you train them the right way, and you reward and promote them in line with the culture you want in the business.

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Fringe benefit tax rate increase:

How will it affect your business?

From 1 April 2021, a new 39% personal tax rate applies on income above $180,000. To ensure a consistent taxation of non-cash benefits, fringe benefit tax (FBT) rates have also significantly increased.

The single rate alone has increased from 49.25% to 63.93%, and the top mixed rates have similarly increased. For most employers, if no additional action is taken, their FBT cost of providing non-cash benefits could be expected to increase by up to 30% in the 2021 year.

The good news - particularly for employers who provide non-cash benefits to employees earning less than $180,000 - is that these increased costs may well be avoided with good (and early) planning, and with some changes to the FBT filing options selected.

Current practice

Due to the relatively low top PAYE/FBT thresholds, approximately 90% of employers have paid their FBT using either the single rate or short form alternate rate FBT calculation methods.

Single rate method

This process provides the simplest method of calculation. FBT is calculated and returned quarterly on non-cash benefits at the single rate which is now 63.93%; previously it was 49.25%. The rate is set to result in the same tax cost as if an equivalent taxable payment were made to an employee on the top marginal tax rate; this enables the employee to purchase the non-cash benefit.

Short-form alternate rate method

Under this method, employers pay FBT on non-cash benefits at the ‘alternate rate’ in quarters one to three - 49.25% or 63.93% for benefits to major shareholder employees (previously this was 43% and 49.25%). In quarter four, employers ‘square-up’ the tax on all attributed benefits paid during the year to 63.93% (previously 49.25%). Non-attributed benefits are pooled and taxed at the ‘alternate rate’ - 49.25% or 63.93% for benefits provided to major shareholder employees (previously 42.86% and 49.25%).

Full alternate method

Use of this method has been less common.

Employers pay at the ‘alternate rate’ in quarters one to three (49.25% or 63.93% for benefits to shareholder employees, previously 49.25% and 42.86%). The quarter

39%

income tax rate will rise from 33% to 39% for those earning over $180k.

four calculation is then a 'square-up', calculating the FBT on allocated benefits for the year at a rate which correlates with each employee's marginal tax rate. These rates are set to result in the same tax cost as if an equivalent payment were made to an employee at their marginal tax rate (enabling them to purchase the non-cash benefit). Non-allocated benefits are taxed at a standard rate of 49.25%, or 63.93% for shareholder employees.

Employers paying under the 'single rate' or 'short form alternate' methods will have usually concluded there is either no tax advantage to performing a 'full alternate' method calculation in quarter four (as the receiving employees earn in the top marginal tax rate), or they may have simply accepted the less favourable FBT cost on fringe benefits to avoid the additional time and complexity to calculate the 'full alternate' method.

With the significant increase in the FBT rates, and when employees receiving non-cash benefits may no longer earn the top marginal tax bracket, this rationale may well no longer be valid.

The benefits of changing to the 'full alternate' method

While this method has a reputation for some complexity, a 'full alternate' calculation can be carried out by a business with relative ease once business processes are setup for this.

At its easiest, relevant benefits simply need to be valued and attributed in the calculation to the employee receiving the benefit. Specific categories of benefit, and those below certain thresholds of value, are not required to be attributed and tax is calculated on these at the non-attributed rate.

'Full alternate' process setup

Some businesses already calculating FBT under one of the other methods may wish to implement this change by simply carrying on with their existing FBT compliance during the year either at the single rate or alternate rate, while collecting sufficient information to allow for a 'full alternate' square-up calculation in the quarter 4 FBT return; this can be carried out by the company or an accountant.

Employers with cash flow restrictions or with large FBT bills may wish to obtain the cash flow advantage of a change to the 'alternate' method early in the year and would get benefit from a quarter one move to an 'alternate' basis.

Employers looking apply the 'full attribution' method will often benefit from adopting a purpose designed spreadsheet/web tool to assist with collecting necessary information and performing the FBT calculations. These tools are usually designed to apply FBT rules to assist in calculating the FBT liability from the data provided, and may have functionality to assist in storing data, notes and other records relevant to supporting the filing position.

The best tools calculate the most favourable FBT filing position by taking account of available options under tax legislation (including pooling benefits) and can provide all the figures for the preferred option with guidance on how to input these in the FBT return.

How we can help

Your Grant Thornton advisor can help you understand the likely value of any FBT savings from adopting a full alternate rate calculation based on your planned 2021 fringe benefits.

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Incorporated Societies:
New legislation is on the way – here's how to prepare

The Incorporated Societies Bill

Incorporated societies make a major contribution to New Zealand's culture, sporting and recreational activities, education, health, social services, and environmental protection. For well over 100 years the Incorporated Societies Act 1908 has enabled community related organisations to become incorporated for a wide variety of purposes. However, this Act is now outdated and deficient in many respects. A new Bill was introduced into Parliament on 17 March 2021 to modernise the legislation governing New Zealand's estimated 24,000 incorporated societies.

The purpose of the Bill is to put in place a modern framework of basic legal, governance, and accountability obligations for incorporated societies, and those who run them guided by the following broad policy objectives:

- Members of a society have the primary responsibility for holding the society to account
- A society should promote the trust and confidence of its members
- A society should be self-governing
- A society should not distribute profits to its members

The Bill seeks to hold members to account by putting in place six explicit duties on the officers of a society. The duties are closely aligned to directors' duties in the Companies Act 1993. As such, officers who might have previously accepted positions of responsibility on purely philanthropic grounds and wanting to 'do their bit' in the local community will need to give due consideration to their explicit obligations under the proposed law.

Specifically, officer holders:

- should act in good faith and in best interests of the relevant society
- must exercise their powers for a proper purpose
- must not act, or agree to the society acting, in a manner that contravenes the Bill or the constitution of the society
- must show the care and diligence that a reasonable person with the same responsibilities would exercise in the same circumstances
- must not let the activities of the society be carried on in a way likely to create a substantial risk of serious loss to the society's creditors
- should not agree to a society incurring an obligation unless they believe that the society will be able to perform the obligation when it is required to do so.

The Bill contains a range of offences, financial penalties and potential terms of imprisonment for breaches of officer holder duties.

Among the many other provisions contained in the Bill, particular highlights include:

- specific rules about the distribution of society property if the society is dissolved
- a requirement for a minimum number of 10 members
- an incorporated society will have the powers of a natural person (e.g., to enter contracts),
- a prohibition on operating for financial gain of any member
- allowing a Court to recover any financial gain a member has made from the society
- requiring each society have a Constitution, including details of the minimum requirements for that Constitution
- that each society must have a management committee consisting of at least three office holders with specific rules regarding eligibility for becoming an officer or a committee member
- rules about the level of financial reporting including the requirement to complete an annual return together with additional obligations (if applicable) guided by the requirements to prepare financial statements under the Charities Act 2005 or the Financial Markets Conduct Act 2013
- rules about how incorporated societies might amalgamate with other societies
- a range of other administrative provisions relating to the operation of a society together with various offences for failing to comply with the provision outlined in the Bill.

The Bill contains a range of offences, financial penalties and potential terms of imprisonment for breaches of officer holder duties.

If you are a member of an incorporated society, and particularly if you are an officer or a committee member of a society, we suggest that you start planning for changes that will almost certainly be coming. It is all but inevitable that nearly every society will need to agree and register a new Constitution (often called Rules) that will need to comply with the new Act.

Transitioning from Special Purpose to Public Benefit Entity (PBE) Financial Reporting

Many incorporated societies currently prepare special purpose financial statements. Once the Bill becomes law, many societies will be required to prepare financial statements based on PBE reporting standards for the first time. PBE reporting standards have differing requirements depending on the size of the entity, as determined by the total operating expenditure of the society.

Each society will need to transition from their current reporting framework to the relevant PBE tier. For example, an entity transitioning to tier 3 will follow the relevant standard from the start of the year of transition. In that case comparative information is not required. However, the entity shall attach its previous financial statements and a list of its previous accounting policies.

Further guidance entity size thresholds and transitioning from special purpose reporting to the relevant tier can be on xrb.govt.nz.

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Budget 2021:
Large on spending, low on surprises

Our industry experts provide some insight into what Budget 2021 means for certain sectors. Discover what they think the key implications are for health, housing and construction, and the environment.

ENVIRONMENT: We're falling short on climate change

Michael Worth, environment and sustainability expert says:

With climate change one of our Government's top three priorities, I found Budget 2021 hugely underwhelming. We have only nine years left until we reach our tipping point: by 2030 New Zealand aims to have greenhouse gas emissions at 30% below 2005 levels. By 2050, we aim to be at net carbon zero. These are not the kind of deadlines you can meet by pulling an all-nighter in a last-minute panic.

Very little has been done to address climate change in this Budget. There are a few nods toward reducing emissions and $300 million toward investing in green technology, decarbonising public transport and the waste and plastic sectors.

The uptake of low-emissions vehicles is being incentivised, there's a little for reducing farm emissions, and an extension on the Warmer Kiwi Homes programme.

None of this provides the kind of large-scale investment we need to see in order to meet our targets and protect our future. It feels as though we are wasting precious time. James Shaw says they weren't ready for this Budget, which surprised me, so announcements will apparently come at the next Budget. If we need to wait another year, we could have at least ring-fenced a large sum of money to spend on climate change initiatives.

The longer we drag our feet, the fewer opportunities we have to implement major changes.

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HEALTH: Sorely needed spending for the healthcare sector

Healthcare experts, Pam Newlove and Joel Gauntlett say:

A few surprises, but mostly this Budget delivered as expected. Major spending allocated to the roll-up of the DHBs and the establishment of the Māori Health Authority were already well signalled. This is very welcome news, because although the last Budget provided a chunk of money for DHBs, a lot of it was used for debt repayment, which meant very little funding trickled through to those at the coal face.

Also welcome were some of the smaller funding announcements, such as an additional $100 million for air and road ambulance services. They have been crying out for support for some time – we felt this was a case of the squeaky door getting the oil.

The $700 million earmarked for capital projects is also desperately needed and will be extremely well received, as will the $517 million for improving records systems. We think that there will be a lot of interest in how these funds are actually applied in practice.

Primary healthcare and GPs got just under $50 million, which isn't going to go far when you spread it across all the GPs in New Zealand, so I think they may feel a bit hard done by. There will also be some disappointment about Pharmac funding: Pharmac requested around $400 million per year and was allocated just half of that over the next four years.

For middle NZ the only tangible benefit they may gain from the health budget is being able to access the $1.5 billion spend to buy Covid-19 vaccines and run the immunisation programme. Not an area of spending that anyone will question, and it highlights the significant costs that a pandemic brings to an economy.

Overall, the increase in health spending is badly needed. With a total of $2.7 billion for DHBs over the next four years, hopefully we can use some of that extra funding to attract people to work in our healthcare sector as it grows. Without better pay, local healthcare workers will leave for Australia and international workers will choose to go elsewhere.

Finally, although it's not direct spending on healthcare, the boost in benefits should have a positive flow-on effect. We hope that families with a little extra money in their pockets can spend it on a visit to the doctor that they might otherwise have avoided. Healthcare is tightly aligned with meeting social goals, and spending in this area helps reduce the number of people below the poverty line.

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PROPERTY & CONSTRUCTION: Housing initiatives are positive, but need to go further and faster

Property and construction expert, Dan Lowe says:

The Government is making the right moves on housing, but I would like to see it go further and move faster. The moves to boost apprenticeships and training are excellent and will help to address some of the skills shortages in the construction sector, but they could definitely have gone further with this initiative. The same can be said of the $380 million in Māori housing investment, which is excellent, but those houses will quickly be soaked up by existing unmet demand. And ditto for the 18,000 new housing places by the end of 2024: we could fill those tomorrow. And without more detail, we don't know how fast or when these new houses will be rolled out.

Also frustrating is the slow pace of action on reforming the Resource Management Act. Yes, there's been $130 million set aside to try to tackle the RMA, but it looks as though it will be 2024 before anything is achieved. I've seen this too many times before; every government talks about giving the RMA an overhaul, then it falls into the too-hard basket and gets pushed back. I have clients in the industry who feel as though they've spent years banging their heads against the wall of this particular piece of legislation. The cost of the red tape continues and they keep on passing it on, leading to ever-higher construction costs.

I would have quite liked to have seen more for first-home buyers, too. Australia has just announced some incentives for people on moderate incomes – who can service debt but struggle to save a 20% deposit – to get a loan that is partly government-guaranteed. We could have swiped that idea.

Really encouraging is the outlook for construction. Looking across at the other sectors covered in the Budget, you can see big chunks of money allocated for new infrastructure and maintenance, particularly in education and health, as well as direct infrastructure spending. These all add up to massive sums going into the construction industry, ultimately to produce facilities and services that will raise the standard of living for all New Zealanders. A really positive sign for the future of the industry.

Another somewhat encouraging move is the Three Waters programme, which will create new entities to deal with water infrastructure. In theory, larger organisations should create better efficiencies and superior buying power.

Overall, no big surprises on housing. It's great to see the Government taking steps in the right direction, but we could be making bigger strides.

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Creating certainty in sale and purchase agreements

For some time, Inland Revenue have been concerned about the lack of common treatment for income tax purposes between vendors and purchasers of businesses and assets.

In theory, there is one balanced transaction between the parties.

However, it is common for the consideration to be a global sum, and each party takes their own view of how to allocate the purchase price between the underlying component parts. While Inland Revenue has the power to contest and override values in transactions, the difficulty arises during an audit which is generally done several years after the transaction has completed; valuation is an art not a science, and it is problematic to contest a value allocation as a result.

The solution comes into law effective for transactions which are entered into on or after 1 July 2021.

To comply with the new rules, there are a series of steps to work out what the allocation will be between the underlying assets.

The first is where the allocation has been described in the sale and purchase agreement for different classes of assets (as opposed to every single asset). For example, these could besplit between land, buildings, trading stock, software, trademarks, furniture and fittings, goodwill etc.

Where this has occurred, that price allocation will be binding on both parties and nothing more is required. However, there is an override; if the Inland Revenue considers this not to be at market value, it can adjust that allocation. This right only arises where the original cost of a particular item is greater than $10,000 and the total allocated amount for the item and for any identical property is less than $1 million, and that amount allocated is greater than its original cost and its tax book value.

Essentially, they are only looking at large transactions with significant capital gains.

Even though the parties have agreed at arm's length certain values, there could still be a non-market outcome

from a New Zealand tax perspective which the Inland Revenue would seek to counter e.g. the purchaser is overseas so the asset leaves the NZ tax base, or the vendor has tax losses it can't use so it is happy to create an advantage for the purchaser.

If the sale and purchase agreement is silent, and the parties have not subsequently agreed in a document the allocation of purchase price prior to either party filing their income tax return, then there is a different process that needs to be followed, and it applies where:

- the total purchase price exceeds $1m, but won't apply where the only property disposed of is residential land including chattels for less than $7.5m, and
- the transaction includes two or more items of prescribed property (including trading stock, timber, depreciable property other than buildings, depreciable buildings, and financial arrangements).

In this situation, the vendor must advise the Inland Revenue and purchaser of the allocation which will be binding for income tax purposes, but must be at the greater of the market value of the class of property, or the vendors tax book value ie, it cannot generate a tax loss on disposal.

However, if the vendor has not provided the necessary notification within three months, the purchaser can then, within a further three months of the date of the transaction, make similar notifications to the Inland Revenue and vendor which must reflect the relative market values between the classes of property.

Should neither party provide the required notifications then the Inland Revenue has the right to allocate, and the purchaser is not able to claim a deduction for any expenditure or loss until the Inland Revenue has made such a determination.

While the new legislation creates certainty of the tax treatment, it does introduce a new dynamic in the relationship between vendor and purchaser for the negotiations that will arise in a transaction.

Often the reason for the silence of an allocation of the purchase price is that there is contention as to how to make such an provision, and the issue has been avoided to date by remaining silent simply to get the transaction completed. Now this is a matter that must be addressed in the agreements, or the balance of power for allocation shifts to the vendor who can choose an allocation.

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