

Health Adviser

Winter 2008

Issue 33

Owning Your Practice Premises

– Should you take the plunge?

We often get asked by clients for our views on whether or not they should expand their practice facilities and services which in most cases means constructing new premises, maybe in a new location.

This discussion usually leads to a practitioner contemplating:

- can we afford it?
- do we need to attract additional practitioners?
- should we merge with other practice(s) in the area?
- is the area likely to grow in population?
- would the practice benefit from other medical services being available?

These and many other questions need to be answered before progressing further with any plans for expansion and further investment.

The costs involved in acquiring additional land and constructing new buildings can be significant. Early on decisions need to be made regarding the financing options. Various external parties are available to assist with the financial appraisal process. Various forms of bank finance may be available with differing levels of owner equity. It is essential to engage in a cashflow forecasting exercise with your chartered accountant at this point. This process allows you to see what impact this investment may have on your practice

both in terms of increased revenues but also allows you to understand the impact of financing the expenditure. We can create differing scenarios showing “what” if certain events, both positive and negative, were to occur? Would the project still be affordable?

Sometimes a property investor with no interest in the clinical side of the practice may be willing to undertake the investment risk and manage the construction process, knowing that they have a long term tenant (the medical practice) signed up. This option releases the practice owners from making the initial financial commitment but they will ofcourse still be bound to a lease.

A further issue to consider is ownership of fitout. The medical practice may wish to undertake that investment instead of leasing this from the building entity. The benefit of this is that the tenants can control the costs and quality of the fitout rather than accepting the decisions of the landlord. This may mean however that the tenant themselves needs to raise some finance to fund the fitout. Again cashflow forecasting is a valuable tool to assist in predicting affordability of the fitout finance.

Other options may include some or all practice owners undertaking the initial investment in a separate legal entity from the medical entity. A formal lease should be in place between the building entity and medical practice, and rentals should

be independently assessed by a registered valuer both to satisfy Inland Revenue requirements and also to ensure building owners are getting a fair return on their investment. Building investment can provide more senior practitioners with an ongoing revenue stream after they have ceased their medical practice.

For any practice, the decision to invest in premises (new or existing) should be an investment decision that is not clouded by the growth pains of the practice. What is the potential return on your investment? Could you get a better return on your funds somewhere else taking into account the differing levels of risk involved?

Once the decision is made, advice should be obtained from your Grant Thornton adviser and lawyer around appropriate ownership structures and financial arrangements. You want to ensure that the ownership structure enables the returns to flow through to shareholders in a manner that is efficient and tax effective.

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Tips for improving cashflow and debt management

Well managed cashflow will be one of the key differentiators between those businesses that are able to grow stronger in the current environment and those that will struggle. Fortunately, there are ways to improve cashflow that are relatively simple to implement:

Bill promptly, bill correctly

Aggressively managing accounts receivables has an immediate and positive impact. This course of action not only includes heightened follow-up on late payments, but also identifies inefficiencies in your billing and collections processes, such as reducing the number of invoices issued with errors. Using debt collection agencies for troublesome debtors may be successful, but negotiate a good deal for their charges beforehand.

Evaluate credit policies

Now is a good time to review your credit standards and your patient's ability to meet them. You may choose to make special arrangements with some, but it is best to have a policy in place to ensure that staff make these decisions methodically.

Pay judiciously

Work with your suppliers to arrange appropriate payment terms. Evaluate vendor discounts carefully. It may or may not be advantageous to take advantage of early payment discounts based on your specific circumstances.

Find savings

This can mean simply reducing expenditures where possible in areas such as office supplies or communication costs.

Control costs

Evaluate all new requests for expenditure against practice goals and objectives.

Review debt and financing arrangements

While banks may have tightened credit requirements, interest rates are still

relatively low. It can be tempting to purchase capital assets with lines of credit. But aligning financing with asset life will help you avoid a cashflow crisis in the future.

Keep financial records up to date

That way you can pick up warning signs early on, before it is too late to rectify the situation. Work with your accountant to assess and manage your position.

Create a cashflow modelling system and use it

Creating or updating your cashflow projections provides an insight into opportunities for additional efficiencies. And once developed, it should be used to compare actual with budgeted cashflow.

Consider outsourcing options

If it is often easier to start by evaluating non-core activities such as payroll processing for a small number of employees maybe more efficiently handled by your chartered accountant for example.

Mind your bank

If you are on a cost cutting mission, take a look at both the bank fees and interest payments that you are making. The current business environment has highlighted the need for business owners to think about their banking relationships.

• **When to borrow**

Money should only be borrowed to pay for a growth strategy. Debt should not be taken on to boost a failing business - you need to look at how you got into financial strife in the first place before delving into other people's funds.

• **Short-term working capital**

This can be a good way to fill in the peaks and valleys in cashflow. This type of lending should only be done when you are sure you will be able to pay it back quickly - within a year.

• **Term loans**

These generally have a life-span of around four to five years. They can be used for working capital or buying equipment for expansion. You should only use these types of loans when you have a growth strategy in mind.

Remember shop around and get at least two bids on your loan needs. In the current environment Banks are very keen to get your business and are usually willing to negotiate the terms of the loan so that they get your business.

Good Debt versus Bad Debt

Debt is part and parcel of everyday business. Not many businesses can say they are debt free. Financing a company on debt can be risky business but there are ways to avoid making costly mistakes.

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 following article by Shane Kilian of the trans-Tasman law firm Duncan Cotterill investigates this subject in greater detail.

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.

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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

Instalment	31 March		30 June	
	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.

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

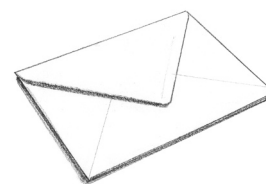
The aim of this new method of paying provisional tax is to match the payments to turnover by using GST turnover as an indicator. There are a number of requirements for using this method. Our view is that it is best suited to small sole traders. While the intention in devising this method is commendable, 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.

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:

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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