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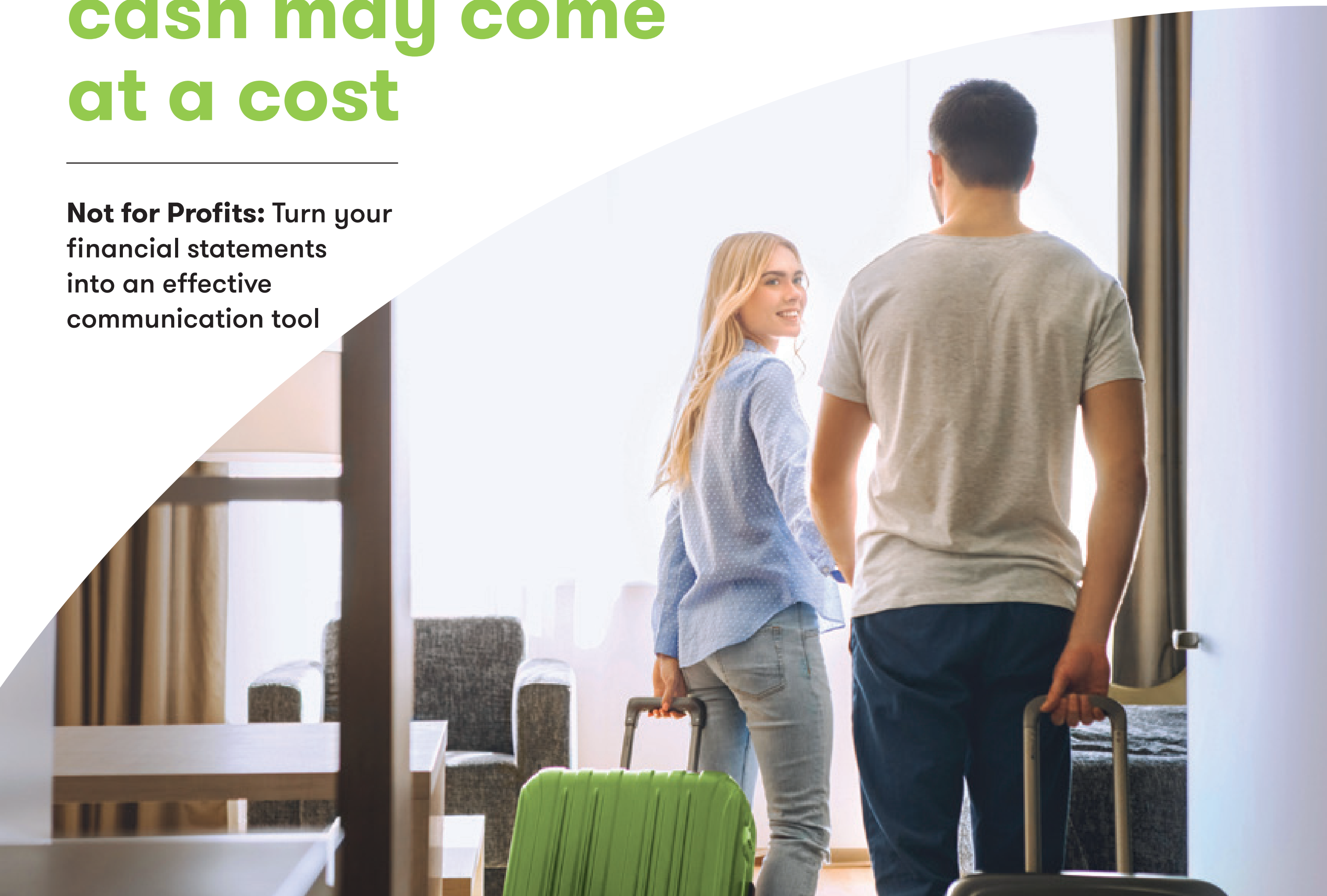
Commentary, opinion and intelligence for the New Zealand business community

That extra Airbnb cash may come at a cost

Not for Profits: Turn your financial statements into an effective communication tool



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That extra Airbnb cash may come at a cost

An increasing number of property investors are steering away from the traditional landlord model and favouring short term accommodation in the 'sharing economy'.

The returns certainly appear more attractive than your standard residential tenancy arrangement, but I have recently seen a number of situations which have created significant unintended complications from an unlikely source…GST.

But I thought GST didn't affect residential property?

Correct. But the moment you start to use the property less like a residential dwelling, and more like a serviced apartment, motel or other types of short term accommodation, the problems can start to compound. GST does of course apply to the provision of accommodation in 'commercial dwellings' and if the income generated from this activity exceeds the registration threshold (currently $60k), then you have no choice but to register for GST.

Consider a property owner that owns two three-bedroom central city apartments. Current annual residential rental income for both properties is $62k. However, the decision was made to increase this return by renting them on a short term basis – now the annual income from these properties is $93k. The increased gross revenue is a superb result, but as the GST threshold has been breached, the owner has an obligation to register and account for GST. What does this mean for them?

- GST must be returned on all income generated. On $93k that is approximately $12k.
- GST can be recovered on all costs incurred (those that are subject to GST)
- There may be the ability to recover GST on the purchase price of the property (if purchased from an unrelated person). This claim will be based on the original cost and staged over a period of time (usually about two years) depending on specific circumstances
- Any subsequent sale of the property will be subject to GST (think of it as a 15% capital gains tax)
- Ongoing GST compliance responsibilities
- There is also the recent introduction of the 'bed tax' in Auckland which can be up to

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$6,771 per annum depending on the location of the property and the number of nights it is let out. There is no tax for the first 28 nights, and then:

	Zone A[1]	Zone B[2]	Zone C[3]
29 - 135 nights	$1,673	$1,248	$822
136 - 180 nights	$3,346	$2,495	$1,645
181 - 365 nights	$6,771	$5,069	$3,383

[1] **Zone A:** Albert-Eden, Devonport-Takapuna, Mangere-Otahuhu, Maungakiekie-Tamaki, Orakei and Waitemata
[2] **Zone B:** Henderson-Massey, Hibiscus and Bays, Howick, Kaipatiki, Manurewa, Otara-Papatoetoe, Puketapapa, Upper Harbour, Waiheke and Whau
[3] **Zone C:** Franklin, Great Barrier, Papakura, Rodney and Waitakere Ranges

Then there is of course the commission payable to Airbnb not to mention the ongoing management of the properties, cleaning, laundry etc, and whether you will pay someone to do this for you or opt for the self-manage option.

Even if the rental income from the short term accommodation falls below $60k, there are still instances where GST can be problematic and create unintended consequences. A recent situation I came across involved a person purchasing a beach house in their family trust. To assist with ongoing costs they periodically rented out the bach through Bookabach for about 30 nights of the year at $400 per night. The complication with this particular situation was that the family trust was already GST registered as they owned a separate commercial property, meaning that the bach rental activity was inadvertently pulled into the GST net.

As the bach would be a 'mixed use asset' it is subject to periodic adjustments for GST purposes based on how the property was actually used. For example, say the bach cost $1,150,000 and was rented out for 30 nights, used personally for 30 nights and remains unused for the balance of the year. This would allow 50% of the GST component to be recovered – in this case $75k, a nice cash injection for sure.

However in the next year, the bach is only rented for 10 nights but used personally for 50 nights. This means that over this two year period, the bach has been used to generate income for 40 of the 120 nights that it has been used – this equates to 33%. As 50% of the GST has already been claimed, 17% must be repaid ($25,005).

These adjustments are required annually and can swing wildly depending on actual use which in turn can create significant cash consequences for the owner.

When the bach is sold in the future, the full sale price will also be subject to GST after adjusting for GST claims previously made. Alternatively, if the rental activity stops this will also trigger a GST repayment event that would create further cashflow pressures.

This all equates to increased compliance, potential wild cashflow swings and the heightened possibility of taking incorrect tax positions.

We know Inland Revenue is actively focusing on this area, so be sure to obtain advice before you make any investment decisions to mitigate your risk.

How a property is used can have significant tax implications. Acquiring a property with the intention of using it for short term accommodation can, in some instances, be a useful strategy, because if it is bought from a non-registered GST vendor, you can use the upfront GST refund to help fund the acquisition. But this approach does come with increased complications and compliance responsibilities.

Before any decisions are made, be sure to run the numbers to understand what your real returns look like when comparing classic residential rental with short term letting. We know Inland Revenue is actively focusing on this area, so be sure to obtain advice before you make any investment decisions to mitigate your risk.

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Not for Profits: Turn your financial statements into an effective communication tool

Whether you want to communicate your organisation's purpose and objectives, or to attract new sources of funding, your annual financial statements are a powerful tool for telling your story, but all too often the opportunity for making an impact is lost.

The drive for greater transparency has created innovation in reporting; successful New Zealand Not for Profits are part of a global trend of finding new ways to better tell their stories. These organisations don't see telling their story as a compliance exercise, but as an opportunity to connect with their stakeholders.

The increasing challenges that the NFP sector faces has created an undeniable gap between "winners and losers" in the struggle for revenue as funders demand more (and better) outcomes for less.

What's more - as more disclosure requirements are added to financial statements, there is a reluctance to deviate from well-established practices leading to repetition year on year; but financial statements don't need to be stale documents created only for compliance. When the focus is shifted to the financial statements being a communication tool, many organisations have found they enhance the effectiveness of telling their story.

Here are four techniques NFPs can use to communicate in an engaging way while still complying with standards and regulations.

1. Comply but communicate

Your financial statements are just one part of your communications with your stakeholders. Depending on jurisdiction requirements, annual reports typically include your financial statements, a management commentary and information about governance, strategy, and operational activity (often including corporate and social responsibility).

There is also a growing trend toward integrated reporting, which explains to investors how an organisation creates value over time. In a nutshell, this method of reporting demonstrates the links between an organisation's strategy, governance and business model. In a world where transparency along with business sustainability are becoming more and more important, integrated reporting offers a powerful solution.

2. Omit the immaterial

Make effective use of materiality to enhance the clarity and conciseness of your financial statements. The concept of materiality is used throughout financial reporting and auditing. Put simply, information is material if it could influence the decisions made by users which are based on your financial statements. Using materiality when deciding how to account for transactions is familiar. For example, some organisations use a 'capitalisation threshold' below which purchase of property, plant and equipment is expensed immediately. But materiality also acts as a 'filter' for deciding what non-financial information to disclose – and what to omit.

3. Re-think the notes

The disclosure (or notes) will be the largest section of your financial statements. As such, they can have the greatest impact on the effectiveness of your financial statements as a communication tool. Many organisations have been experimenting with the traditional way of organising the notes to better tell their story and emphasise the most important information. Notes can be combined in different ways to achieve a more effective communication outcome. For example, you can combine a note that sub-analyses a balance sheet line item, information about the accounting policy and any critical estimates and judgements affecting that item. While traditional approaches to notes have their merit (and they are required by the External Reporting Board), re-ordering notes can help communicate information in a more powerful way. Re-ordering can be carried out by:

- grouping notes into categories that cover related areas
- placing the most critical information more prominently
- a combination of both.

4. Prioritise the policies

The financial statements should disclose your significant accounting policies. Your disclosures should be relevant, specific to your organisation and explain how you apply your policies. The disclosure of significant accounting policies is often the longest note in the financial statement. Done well, it helps your investors and other stakeholders to properly understand your financial statements. Done badly, it contributes to clutter without adding value. You should ask whether your accounting policy disclosures:

- cover the transactions and balances that are significant to your organisation?
- remain relevant or need updating?
- are specific to your organisation?
- are positioned in the financial statements in a way that best meets your users' needs?
- capture your key judgements in applying your policies and your major source of estimation uncertainty?

Financial statements give the opportunity to provide insight into your organisation through management's eyes. Language should be kept simple as some areas of financial statements can prove to be difficult for non-experts to follow and understand. Using plain English will ensure the reader's interpretation and understanding of the financial statements.

These four practices are interdependent and can be used to create clear and compelling documents. Each is a 'tool' that should be used to a greater or lesser extent to tell the story of your organisation depending on its circumstances.

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Recommendations for business leaders to increase gender diversity

The slow pace of change in gender diversity at a leadership level indicates there needs to be a shift in NZ's business culture.

We may have a young, female Prime Minister, but in business there is a lack of gender balance in senior leadership. Grant Thornton International's 2018 Women in Business Report revealed that the female proportion of senior management teams in New Zealand has hit an all time low of 18% since the report began in 2004 (31%), compared to 20% in 2017. What is more discouraging is the marked increase in the number of businesses with no women in senior management roles at 56%, compared to 37% last year and a general sense of complacency creeping in. The public sector has achieved nearly 46% of gender balance, it's time the private sector upped its game.

Although many businesses adopt gender balancing policies and practices, this does not always lead to or motivate significant change. Minister for Women, Julie Anne Genter has laid down a challenge for the private sector to make progress, indicating that the Government may need to introduce incentives if things don't improve. For change to happen it needs to be driven from the top; business leaders need to focus on creating an inclusive culture where everyone feels that they are valued and where their voices can be heard.

Some of the major benefits of gender balance in businesses are they can handle the disruption facing every industry, make better decisions and are more resilient. Research Grant Thornton conducted in 2016 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 US and estimates the opportunity cost for companies with male-only

Research revealed that companies with diverse executive Boards offer higher returns on investment compared with those run solely by all-males.

executive Boards (in terms of lower returns on assets) at a staggering US$655 billion in 2014.

So how can you increase gender diversity? Here's 10 recommendations business leaders can adopt:

1. **Champion the cause:** this is the foundation to making inroads to gender diversity. Senior leadership need to take the issue seriously and lead from the top.
2. **Make diversity and inclusion a core value:** organisational values drive behaviour, so it's important the whole business is signed up to diversity and inclusion. Translating good intentions into practice is an ongoing challenge for businesses.
3. **Set goals:** making gender diversity a core value is not enough in itself; business leaders should set clear goals by which they will measure progress.
4. **Set up balanced scorecards:** they say that what gets measured gets managed, so business leaders should make diversity and inclusion goals part of the leadership team's compensation packages to encourage change.
5. **Avoid tokenism:** simply putting one woman in the senior management team is not enough to ensure a range of voices is heard, and for the business to reap the rewards of diversity.
6. **Reduce 'mini me' recruitment and promotion:** it's easy for both men and women to inadvertently recruit and promote other men and women. It takes courage from leaders to choose diversity. Providing support to understand why this happens and how it can be avoided will forge a better process. Unconscious bias training can help people at all levels of the business avoid the temptation to hire and promote employees who look, speak and think in the same ways.
7. **Introduce sponsorship:** sponsorship can have a significantly greater impact on gender diversity in leadership than simple mentoring schemes.
8. **Investigate the benefits:** evidence of the commercial gains brought by gender diversity will help convince sceptics of the need for change and provide justification for investment in new initiatives.
9. **Be comfortable with discomfort:** creating an inclusive business environment that supports gender diversity in leadership will not be easy, so leaders need to be in it for the long haul. A key to this is a change in attitudes, then real progress will be seen. A willingness to talk about gender diversity will help drive any change; good leaders will spend time with their employees listening and interacting with them to try and dismantle the barriers to openness and honesty.
10. **Share your story:** business leaders should be open about what is driving change in their own companies and encourage others and help them overcome the complexity of turning theory into action. It can be challenging for business leaders to feel like they can be transparent about internal ways of working, and particularly about mistakes they've made. But without this, we are unlikely to see widespread progress.

If in doubt, it always helps to get a fresh perspective about your organisation's culture by seeking independent expert business advice; a balanced approach is key to exploring opportunities that foster diverse teams that are resilient and collaborative. From exploring your strategic growth options and understanding how to manage risk and opportunity, to getting the best from talent, specialist support can help you thrive in a fast changing business environment.

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Lack of investment biggest threat to global economy

Grant Thornton International's research reveals that NZ is ahead of the curve.

According to Grant Thornton International's latest International Business Report (IBR) survey, New Zealand business leaders are becoming less confident about the economic outlook with optimism falling from 76% in Q1 2018 to 60% last quarter. This is consistent with the global average which has fallen from an all-time high of 61% in Q1 to 54% in Q2.

Strategic investment is the way forward for businesses, but our research shows overseas, businesses aren't taking steps to counter the risks that this lack of investment presents. These businesses should be taking advantage of the rising revenues the global economic recovery has provided to invest for long term structural growth.

However, in New Zealand despite a dive in optimism in between the first and second quarter, investment in research and development has doubled, growing from 26% to 50%; this follows $1billion earmarked for R&D in this year's budget. Investment in technology is also starting to follow suit, and expectations for employment also leapt to 60% from 46%.

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50%

These figures tell us that although there's some anxiety about the economy, a lot of business leaders are still doing well and making all of the right moves to future proof their operations.

The R&D investment figures are particularly promising, because although there's a tax credit regime in the pipeline, business owners know they will still have to invest in further resources and technical abilities to meet the Government's requisite standards - businesses don't make this sort of commitment if they're not confident they can pay the bills.

New Zealand businesses look to be taking the opportunity to invest, but they will need to make sure they are investing to a level which will help them ride out the economic shift predicted in the future.

There is a sense that 2018 may be as good as it gets for the global economy. The bottom line for businesses is to ensure they can still make hay as the sun sets over what has been a boom during the last few years; history tells us it's just around the corner.

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Anxiety over available workforce threatens NZ business optimism

New Zealand's optimistic business outlook is under threat by a potential shortage of skilled workers.

According to Grant Thornton International's latest International Business Report (IBR) survey, business optimism throughout the country is coming off its high from the last two years; this quarter, 60% of businesses surveyed were optimistic about the country's economic outlook - this is a sharp dive from 76% last quarter.

Changes to the skilled migrant immigration category made under the previous government and a cooling in migration could be a key factor impacting continued optimism.

The latest IBR has revealed that New Zealand businesses surveyed are becoming increasingly concerned about the availability of skilled workers; 44% cited a lack of availability compared to 36% last quarter and this time last year.

A booming economy depends on a robust workforce, but there are factors at play that could jeopardise our economic success.

Businesses are doing well and profits are up, but there is a real concern with the ability to hire and retain staff.

Construction is a good example; the industry is already struggling to find enough qualified builders or people who want to train to become builders. With the success of the Kiwibuild scheme hinging on a workforce ready to deliver what the coalition government has promised, there will need to be some considerations made to achieve this.

Businesses also need to keep a close eye on what's happening overseas, particularly with our biggest trading partners. ASEAN businesses are currently optimistic, but if they see the war of words on trade develop between China and the US, that confidence could start to evaporate.

Aside from the trade talks, the global economy is firing more strongly than it has in many years. Economic predictions are positive for the short to medium term, but history tells us that growth tends to come in cycles. For businesses across Asia, now represents a window of opportunity to invest in their future.

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We've moved back to Christchurch's CBD

Grant Thornton New Zealand is delighted to relocate back to Christchurch's CBD after more than seven years since the 2011 earthquake caused irreparable damage to Grant Thornton House in Cathedral Square.

Today, Grant Thornton House is back up and running in The Terrace development situated on the Avon River, amongst the city's flourishing business hub.

After imposing on the penguins at the International Antarctic Centre, and another move to Addington, the team feels like they're back home again after a somewhat intrepid journey.

The timing is also quite fortuitous as the establishment of a new leadership team over the past two years is now complete; the firm has welcomed business advisory partners **Paige Cuthbert, Kylie Meyer, Matt Hannah** and **Helen Fortune,** as well as tax partner **Don Mackenzie** who also joined Grant Thornton's Board this year. They join **Michael Stewart** who has been an audit partner with Grant Thornton since 2005.

These new appointments along with brand new and improved staff and client amenities has refreshed the firm with a new energy along with the rest of the city where businesses are now thriving again.

The Christchurch office is part of Grant Thornton New Zealand, a fully integrated national firm offering leading accounting, tax and business advisory services to privately held businesses and public interest entities.

Grant Thornton has offices in Auckland, Wellington and Christchurch. The firm's advisors use their insights, experience and instinct to understand their clients' complex issues and to improve business outcomes.

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