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SMALL TO MEDIUM BUSINESS GUIDE

WHAT YOU NEED TO KNOW WHEN STARTING OR BUYING A BUSINESS

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OVERVIEW OF SMALL TO MEDIUM ENTERPRISES (SME'S)

Business is very complex with a huge number of facets which influence the outcome of any one enterprise. These include technology, financing, human resources, government regulations, raw material resources, to name a few, with many books written covering an in depth analysis of each of the components that make a business successful. We, in this booklet, hope to highlight some of the areas that you will need to consider if starting out in business.

New Zealand is a country of SME's with 95% of all businesses being defined as small.

In New Zealand (as at June 2010) 96.4% of business entities employed fewer than 19 people, while 84% of enterprises employed less than 5 people. Together, these companies employed more than 60% of the total work force.

WHO ARE SMALL BUSINESS OPERATORS?

- The majority of people operating small businesses are self motivated and seek business independence. Statistics highlight that a considerable number of small business operators, whilst having skills in their own particular trade, occupation or profession, have very little knowledge of general management and bookkeeping skills, nor do they understand the reasons for management reports.
- They do not understand the "business of business"
- A large number of small business operators consider that they can ignore the peripheral activities such as management, marketing, advertising, accounting and finance. They consider that this is not why they are in business. However, the neglect of these peripheral activities can do more to erode the business base than anything else.



LACK OF SUCCESS

Undoubtedly the most disturbing statistic of all is that out of every 100 new small businesses that commence each year, 75 will be out of business within 3 years.

This particular statistic highlights the magnitude of the problem, as the economic costs, social problems, and psychological damage to the small business operators, their families and employees from these failed businesses is immeasurable.



PROBLEMS AND SOLUTIONS FOR SME'S

PROBLEMS

Pre startup:

Not understanding what business you are in.

Poor Location

Poor choice of partner

Not understanding the market

Inadequate Planning:

Identifying potential problems and solutions

No formal business plan

No formal cashflow forecast or budget

No strategic planning

Owner Drawings:

Taking too much money from the business

Not separating personal from business expenses

Insufficient Capital:

Insufficient capital at start of business

Insufficient capital for growth

Over dependence on debt financing

Lack of sources of equity

SOLUTIONS

Examine what you want to do and why

Closely examine whether location is satisfactory

Test this relationship with some "what ifs"

Conduct a market survey before starting a business

Continually update your product and technology knowledge

Prepare a business plan, Budget and Cashflow forecast

Review budgets and cashflows regularly-quarterly

Know how much your business can afford to pay

It is easy to lose track of how much you cost your business when personal spending included.

Do not underestimate the cost of setting up a business. In order to avoid this problem, you need to plan, plan, and plan again!

Using other people's money costs money – make sure it's in the plan

Lack of understanding re:

What cashflow means

Cash Management

What profit actually means

Staffing:

Importance of a good management team

Weak relationships with staff

Employment of relatives

Inadequate accounting:

Inadequate bookkeeping & accounting systems

Poor control of debtors, stock and work in progress

Customers:

Lack of contact with major customers

Staff to build relationship with customers

Management pitfalls:

Failure to delegate

Disinterest by owners – often 2nd generation

Inadequate management – especially in the areas which are not strong points of the owner

Failure to provide for succession

Problems caused by outside organisations

Professional advice:

Initial planning should include meetings with - chartered accountant, banker, solicitor.

Lack of advice from chartered accountant when business is starting. This is one of the most significant reasons for the high failure rate of small businesses

Get advice from your accountant

Hire and keep good staff – having a high staff turnover is a huge cost. Good staff are one of your most important resources

Be aware of some of the things that can happen when relatives are employed in your business – go through some “what if” scenarios.

Maintain appropriate accounting records. Get advice from your accountant.

Take the time to identify and develop good relationships with your major or regular clients.

If you don't want to spend the rest of your life doing everything – learn to delegate

Make sure you have ongoing reviews of control procedures and use your financial data to manage your business

Identify and work out solutions that fit.

Get advice before you start the business – accounting, legal, banking

Ensure that you receive financial reports on your business on a monthly basis

ACHIEVING EXPECTATIONS

Small business has a vital role to play in the development of this country and is at the heart of the very existence of the free enterprise system. In New Zealand, it is relatively easy to start a new business and statutory regulations are such that they encourage the development of SME's.

Having said this, it is one thing to start a small business, it is another to successfully sustain and grow a business over a long period. Most small business operators do not have all of the skills necessary for them to adequately manage all aspects of their businesses. They need to appreciate that they will need expert advice to enable them to succeed in small business and achieve their expectations. Ideally, there needs to be greater co-operation between Bank Managers, Solicitors, Accounting Firms and other Professional Advisors so as to ensure that adequate advice is given to clients to enable them to survive and grow in the small business environment.

It is essential that your chartered accounting firm is recognised as being an integral part of the decision making process of a small business. Many forward thinking accountancy practices now supply services that exceed the standard accountancy and taxation services that many people have come to expect accountants to perform.

Finally, small business operations should be fun! It should be a daily challenge and at the end of the day you should be able to reflect on the success attained from the day's endeavours. Adequate planning in the beginning, consistent attention to management controls in your business and with the ongoing help and support from professional advisors – you should be able to look forward to achieving your expectations from your business.



STRUCTURING YOUR SME

The type of business structure you choose will affect your taxation position, your personal legal liability and the life of your business. It is important, therefore to choose the right structure.

The four main structures used to operate a SME are:

- 1) Sole Trader 2) Partnership 3) Company 4) Trading Trust

SOLE TRADER

- Personally owns the business
- Easiest to set up
- Taxable income includes the entire taxable income of the business
- There is no limited liability protection
- Limited ability to spread the income between family members and make tax savings

PARTNERSHIP

- Two or more people can run the business
- Partners are jointly and severally liable for partnership debt
- Profit/Loss is split evenly between partners unless there is a partnership agreement (which we would recommend)
- Partnerships can be flexible and comparatively simple in structure
- Accessing capital and losses is clean and easy.

COMPANY

- This is a separate legal entity
- Limited Liability protection
- Flexible as to the number of parties owning shares and directors
- Rules for company can be set up in company constitution and/or shareholders agreement
- Capital gains generally only distributable on liquidation
- Majority of SME's are set up as a standard company and therefore are understood by business people

TRADING TRUST

- Flexible means of distributing income and assets amongst various family members to provide some income tax savings
- There is no limited liability
- Where a trust is breached, the entire structure is unwound which can be a major set-back in asset protection and succession planning

THE PAPER WAR - SO IMPORTANT TO CONTROL

KEY TO BUSINESS SUCCESS

Good financial records are a key to business success. By keeping accurate records, small business operators can make better business decisions and will find it easier to raise funds and sell their business should they wish to do so. Up-to-date Business Records - can tell the businessperson

- How the business is performing
- The current position



- What the future is likely to bring
- Information about immediate and long term operations
- Changes in turnover and their effect on the profit of the business
- When they may need specialist advice re tax planning
- When it may be necessary to look for additional financing

Types of Records To Be Kept - Small business operators are often confused about the type of records they should keep to monitor their finances. The type of records that should be kept include:

- Sales records
- Deposit books
- Debtors records
- Order books
- Creditors records
- Cash Payment book
- Cash Receipts books
- Bank Reconciliation statement
- Cheque butts
- Payment Records (Tax Invoices and Statements from suppliers of goods and services)
- Production records
- Stock & Work in progress records
- Payroll and other employment records
- Petty Cash records
- Inland Revenue documents
- ACC records
- Insurance Records
- Fixed asset register
- Prescribed Payments Systems Records

Whilst this list may appear to create a large amount of work, many of the records are interrelated and do not require a lot of time to maintain.

Maintain on a Daily Basis - Once a bookkeeping system is up and running it can be a simple procedure to update records on a daily basis.

Consult a Chartered Accountant

It is best to consult a Chartered Accountant to ensure the business' record keeping system is effective and practical and will allow the small business operator easy access to important information. Your accountant has the expertise to advise on and oversee suitable accounting systems that will meet the specific needs of the business. This advice will take into account the amount of involvement the business operator wants to have in the accounting process.

Better Position For Success - By keeping accurate and up-to-date records, business operators put their businesses in a better position for success.

Software Choices

A wide range of software choices now exist and it is important to look at your business needs to determine the software that will best suit your specific circumstances.

This will depend on your level of understanding of bookkeeping and how "hands on" you want to be -or would you rather leave it to your accountant.

Consideration needs to be given as to the time you will spend operating your software and the accuracy of the results that you will achieve as well as ongoing costs of upgrading software.

A number of options are available such as MYOB, Quickbooks, Xero, Banklink – as well as various industry developed software packages for quoting and job costing and of course payroll. Some require a reasonable amount of accounting knowledge and/or training whereas others (like the "cloud accounting" options) allow your accountant independent access to complete the more difficult tasks while allowing business owners/staff to undertake the more simple bookkeeping.

We can help you choose the best solution because we have had experience with a variety of software packages and a wide range of industries. It pays to sort this out before you buy!



CLAIMABLE BUSINESS EXPENSES

In general terms, expenses incurred in relation to providing taxable income are deductible against that income in determining the tax payable. No deduction is allowed where the expense is:

- Of a capital nature
- Of a private nature
- Incurred in deriving exempt income

ENTERTAINMENT EXPENSES: As a general rule, if you provide entertainment for your team or clients, some of your business entertainment expenses are tax deductible.

The following tables help indicate which expenses are 100% deductible and which are only 50% deductible. For unusual entertainment items, contact our team for advice.

Entertainment Expenses Table : 50% DEDUCTIBLE		50% deductible	100% deductible
Friday night drinks for team members or clients in the office.		✓	
Friday night drinks for team members or clients in the pub.		✓	
Hire of a launch to entertain clients.		✓	
Restaurants providing food and drinks to team members at a social function in their		✓	
Sponsoring local sports teams and receiving tickets to their corporate box in return. 50% of the value of the tickets would be deducted from the total sponsorship.		✓	
Sponsoring a sports team by providing a meal for the team at their grounds after each game.		✓	
Staff Christmas party on or off the business premises.		✓	
Taking a client out to dinner while you are out of town on business in New Zealand.		✓	
Taking a client out to dinner.		✓	

Entertainment Expenses Table : 100% DEDUCTIBLE	50% deductible	100% deductible
Dinner for Sales Rep while out of town selling and no client present.		✓
Donating food to a Christmas party in a children's hospital.		✓
Employee's salary package includes a taxable allowance for entertaining clients.		✓
Golf club subscription for business owner paid by the Company.		✓
Gym membership for team member paid by employer.		✓
Providing a meal for a journalist while reviewing your business for their column.		✓
Providing morning and afternoon tea for your team.		✓
Sandwiches provided at a lunchtime meeting of supervisors.		✓
Sponsoring a local sports team.		✓
Taking a client out to dinner while you are out of town on business outside New Zealand.		✓

Our Advice - GST adjustments at year end may be necessary if only 50% deduction is allowed – Get our advice for big ticket items!



HOME OFFICE EXPENSES

Where a self-employed taxpayer uses his or her home partly to conduct a business, you are entitled to a partial deduction for the outgoings which relate to the use of the home for the work related activities.



These include:

- Heating
- Lighting
- Rates
- Insurance
- Mortgage interest
- House and contents insurance
- Repairs and maintenance
- Telephone rental

It is not absolutely necessary to set aside a specific room for business purposes, nor is it necessary for your home to be physically changed to suit the business.

However in cases where a separate room is not set aside, it may be appropriate to apportion the outgoings based on criteria such as the amount of time spent on income-earning activities at home as well as the area used.

Examples of areas likely to be used for business purposes include:

- An office or office area
- A storeroom or storage area
- A workshop
- A garage or part of a garage which is used to house a business vehicle

PAYING WAGES TO SPOUSES AND CHILDREN

If you are a sole trader, no deduction is permitted for wages paid to a spouse, unless the Inland Revenue Department consents in writing to that deduction. There are no special rules for payments to spouses if you are trading as a partnership, trust or company.

Where your children work for you or your business, we suggest you draw cheques for work done and regularly pay them into their bank account during the year.

IRD can make adjustments to such wages if payments are considered to be excessive.

MOTOR VEHICLE EXPENSES

For sole traders and partnerships in business the owners need to complete a logbook to calculate the business percentage versus the private percentage use of the vehicle.

A logbook is required to be kept for 3 months and covers a three year period as long as there is no major change in business usage.

The percentage that is calculated as business related, can be applied against all vehicle costs and claimed as an expense. In the event that the business is paying 100% of the expenses then an adjustment for personal use is made at year end. The capital cost of the vehicle can be depreciated for the business use.

If a vehicle is used for less than 5000km business in a year then the owner can claim

back as an expense actual business mileage based on the IRD or AA mileage rates. If a log book is not kept then a claim of 25% of the expenses can be made.

For companies providing vehicles for employees or shareholder employees, a number of issues arise with the triggering of FBT (Fringe Benefit Tax) and GST. Whilst the expenses of the vehicles can be claimed it may require that a payment be made for FBT.

Also, consideration needs to be given as to the type of vehicle the company owns such as a work related van or ute as opposed to a sedan as different rules apply.

Our Advice - This is an area where you may wish to consult with your accountant before purchasing a vehicle for your business.

TAXES AND ACC (ACCIDENT COMPENSATION COMMISSION)

There are a number of forms of taxation in New Zealand but the main ones are Income Tax, Goods and Services Tax (GST) and Fringe Benefit Tax. (FBT)

Income Tax

Income tax is imposed on the taxable income of a taxpayer for each tax year. A tax year runs from 1 April to the following 31 March. A person is taxed on their taxable income for the year less any losses or deductions available to them. Taxpayers are individuals, companies and trusts.

A New Zealand resident is liable for tax on their world wide income and may get some tax relief where New Zealand has a double taxation agreement with other countries from which the resident has earned income.

A non-resident is liable for New Zealand income tax only on income that is derived in New Zealand.

It is very important to be clear as to your tax residency status in New Zealand to ensure that you comply with the regulations. Check with your accountant or tax advisor if you are not sure.

Current Rates of Tax

Rates of tax are changed by the government and that may depend on the party in power etc. However, for the year ended 31 March 2012, the rates are as follows:

- Companies - a flat rate of 28%
- Trusts - a flat rate of 33%
- Individuals tax rates are based on their level of income, and you are taxed at the following marginal rates:

Income under \$14,000	10.5%
Income \$14,001 - \$48,000	17.5%
Income \$48,001 - \$70,000	30%
Income over \$70,000	33%

Payment of Taxes

Individuals - if they are employed by someone else will have PAYE (Pay As You Earn) tax deducted from their gross pay on pay day.

Contractors - may have a flat rate of 20% WHT (Withholding Tax) deducted when paid.

Self employed people, companies and trusts - have tax calculated at year end and pay terminal tax. They are also, if over a certain threshold of residual tax, required to pay provisional tax during the year in three instalments. The dates of instalments relate to their balance date. With a 31 March balance date, the provisional tax dates are 28 August, 15 January and 7 May.

As payment dates differ depending on your balance date it is important to ask your advisor as to when these payments are due for you.

GST (GOODS AND SERVICES TAX)

GST is a broadly based consumption tax on the supply of goods and services in New Zealand and on goods imported.

There are some Zero rated supplies such as exported goods and there are also exempt supplies such as supplies of financial services.

The current rate of tax is 15%.

This is a tax paid by the end consumer so if you are in business and are charging customers GST you can offset the cost of GST that you have incurred in getting the goods or services to the end consumer. The amount you have collected in GST if greater than what you have paid in GST will then be paid to the IRD. If it is in reverse then you will receive a refund.

To add GST when invoicing a client you must multiply by 15%. E.g. a product worth \$100 x

15% = \$15. Add this to the \$100 and the client is charged \$115.

To calculate the GST in the value of a product or service when it is priced GST inclusive, then it is calculated by multiplying the amount by 3 and dividing by 23. E.g. a product valued at $\$115 \times 3 / 23 = \15.00 .

As with income tax there are a number of complex rules surrounding GST so we recommend you speak with us should you be unsure of your actions.

FBT (FRINGE BENEFITS TAX)

FBT is a tax payable on the value of fringe benefits provided to employees and shareholder employees by an employer.

Forms of fringe benefits are:

- Making available to an employee a motor vehicle for private use
- An employment related loan
- Contributions to accident and sickness insurance or specified insurance premium

- Any contribution to any superannuation scheme
- Any benefit of any kind received by an employee

The calculation of FBT is complex and can be filed annually. The FBT paid to IRD is a deductible income tax expense.

We recommend that you contact us should you believe that you may have a liability for FBT.

ACC (ACCIDENT COMPENSATION COMMISSION)

This is another complex area where anyone who suffers injury by accident is covered by accident insurance through the Accident Compensation Commission.

This is funded by levies payable by employers, employees and self employed persons.

The rate of levy is based on your occupational classification and these rates can change on an annual basis. Annual levy invoices are based on wages paid to employees and shareholder employees and are generally issued around mid year. They are made up of 2 parts – one part for the previous financial year and the other part an estimate for the current financial year.

There are minimum and maximum earnings that the levies are calculated on and there are alternatives if you are self employed as to the type of cover and amount of cover that you want.

There are however compulsory minimum amounts that are required to be paid.

For PAYE wage earners the levies are included with your tax deductions from your gross pay. For employers and self employed people the

levies are invoiced annually. This is a tax deductible expense for a business.

Our advice for self employed people – Contact your accountant if you would like to know your other options for ACC cover.



SUMMARY

Setting up a business or taking over a business can raise a number of complex issues which may have serious consequences for the new business owner. Our advice to anyone in this situation is to get a professional advisor to help you with the highly specialised areas of tax and company law and ensure that you do the planning that is necessary for success.

If you are going into business, make sure you're having fun! Understand the business you are in what you hope to achieve.

Should you wish to discuss any business issues with us we provide a free 1 hour consultation to all new clients to help you on the way to success.

We can be contacted at:

Phone 09 415 2334

email: info@middletonholland.net.nz

Our website is: www.middletonholland.co.nz



Chartered Accountants

Talk to us

To arrange a consultation call

09 415 2334 or email us

info@middletonholland.net.nz

Our full range of services can be
viewed on our website

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