mcculloch + partners for growth

Navigating through Covid-19

As at 16 April 2020

A Note From Us

As the dust settles from the shock of border closures and a country wide lockdown, business success in the face of Covid-19 will look much different to what was anticipated at the beginning of 2020.

Unfortunately for a lot of New Zealand businesses there is no obvious solution, particularly when there is little revenue. More than ever, now is the time to plan. Ad hoc responses won't work, you must lay the groundwork for recovery now.

We have outlined some high-level steps, which can guide you as you work through this crisis as well as help manage your liabilities on current cash reserves until the full impact unravels.

Further, we have collated and provided comments on the numerous government incentives and tax packages available to New Zealand business

As always, we are here to help. Please reach out to us if you would like to take advantage or hear more about the funding available under the Regional Business Partner Network.

McCulloch + Partners

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What You Should Consider Now

With some immediate actions and plans already implemented, involving some exceptionally difficult conversations with your employees for many of you, now is the time to sit down and consider taking the following actions:

1. Prepare a short term cashflow (at least 3 months) forecast with sensitivities – and update
2. Review and take advantage of various support packages
3. Identify and plan how to manage your key stakeholders including employees, customers and creditors
4. Communicate
5. Strategize and plan for the recovery

1. Cash is King – Short Term Cash Flow

One the of key survival tools is your cash planning. The importance of this process cannot be understated.

A cash flow forecast will help you identify funding needs and help assist with the approval process with your bank. It does not need to be fancy. It simply needs to be prepared in a way that can guide your thought process.

A short term cash flow forecast (at least 3 months) should include:

a. Different types of possible recovery scenarios (specifically around your revenue);

b. Identify and categorise liabilities/expenses into Critical, Deferrable, Negotiable and Non-Essential; and

c. Identify how much money you currently have and use the inflows and outflows of cash to determine how much you will need to get through the next 3 months.

Hot Tip: Update your cash flow at least weekly

2. Take Advantage of Support Packages

There are a number of support packages available for business. Unfortunately a lot of these packages lack detail or do not provide immediate cash relief.

Central Govt.	IR Tax Changes	Major Banks	Other
Wage Subsidy	Various targeted tax packages	Business Finance Guarantee Scheme	RBP Business Consultancy Support
Changes to insolvency laws	Some leniency regarding tax payments		
	Tax loss carry-back		

We have provided further high level detail of each package in the Support Packages section of this report.

3. Management of Key Stakeholders

Given the significant uncertainty around revenue and cash collection, a sharp focus on managing and negotiating with key creditors is critical to manage timing of payments.

Key creditor groups should be identified and categorised in line with your cash flow forecast with the aim to reduce, defer, negotiate or stop these liabilities.

You need to prepare a Plan B and Plan C options for if your preferred supplier cannot help you and be ready to enact these plans.

Below is a typical analysis by grouping:

Group	Critical	Deferrable	Negotiable	Non-Essential
Employees	Yes	Maybe	Maybe	No
Landlords	Yes	Likely	Likely	No
IRD	No	Yes	Likely	Yes
Bank	Yes	Yes	Likely	No
Suppliers	Maybe	Maybe	Maybe	Maybe
Other	Maybe	Maybe	Maybe	Maybe

4. Communicate

You need to plan how you are going to keep all stakeholders informed of actions taken.

Communication with Key Stakeholders will be determined based on the category assigned. Critical stakeholders like employees will need to be communicated with frequently.

There must be a clear assignment of communication responsibility. Any communications need to be relevant and to the point, particularly given the significant number of e-mails.

To avoid confusion and inconsistent communication prepare a communications plan that is updated regularly and shared with the appropriate people within your organisation.

Also be prepared to share your plans and cash flow forecasts with your bank for their review. You will need to document and detail all your assumptions to explain and justify why you have made them.

5. Strategize and Plan

Upon dealing with the immediate impacts of COVID-19, attention must be turned to considering the various scenarios possible for how your business can strategically respond and position for the short to medium term.

Your cash flow forecasts should be developed into a medium term tool and should incorporate these scenarios. Time horizons may change from weekly to monthly or quarterly dependent on your business.

There are a number of frameworks and tools available to assist with strategic planning. Find one that is relevant to your business and that resonates with you.

We have adapted a 5 P's Strategic Framework into something we believe is relevant for the COVID-19 crisis.

Use the following as a guide to assist in developing your strategic plan.

Ad hoc responses won't work, you must lay the groundwork for your recovery now.

Strategic P's	Where to start:

POSITION:
What position can you attain during and after COVID-19?
	You need to take steps now to map your probable position. Key considerations should include:
	• Who are you in your market?
	• What role do you play?
	• Who are your main competitors?
	• Where are you heading?
	    • Can you shut down and simply re-open the same?
	    • Can you regain lost ground?
	    • Can you emerge as a market leader due to development during the lockdown?

PLAN: What is your plan for recovery?	A lack of planning will only exacerbate disorientation in an already confusing environment. When drawing up your plan: • Think broadly and deeply and take a long view, • Work collaboratively and seek assistance from others to help challenge and share ideas, • Ensure your plan has clear actions, without these you will create fake productivity where you are busy but attention is not focused on those things that will help you achieve tomorrows objectives, A plan will help set a course of action focusing you on critical tasks that you need to do today to help achieve your objectives tomorrow.
PERSPECTIVE: How will your organisations identity change?	• Your corporate identity and reputation is your lifeblood. Customers and suppliers will remember how you react during this crisis. How key stake holders view you now and in the future will be a key driver of your future success. • There is a significant risk that actions taken today can damage your future reputation. The consequences of todays actions on the future needs to be carefully evaluated considering customer satisfaction, cash flow etc.
PROJECTS: What new projects do you need to launch, run and coordinate?	• Using the above you should now develop a set of projects to help tackle the recovery of your business. • The challenge is to prioritise and coordinate initiatives that will help future proof the business. • Beware of starting numerous projects that all depend on the same critical resources. Ensure you diversify your recovery plans.
PREPAREDNESS: How prepared are you to execute your plans and projects?	• How plans and projects are executed has changed considerably given the general shift to remote working. • Systems and processes need to be strong in order to adapt to this new environment, relying on physical meetings etc will need to change. There is a significant risk that if systems and processes are not robust execution and delivery will be at difficult, and how these are executed is crucial to your success. • Extra attention needs to be placed on how decisions are being made, who is making them and what is the quality and speed of those decisions.

5 P's Strategic Framework Worksheet

What is your Strategy?	During	Right After	New Normal
Position (Where to go)			
Plan (What to do)			
Perspective (What we see)			
Projects (what to prioritise)			
Preparedness (how to get ready)			
Position (Where to go)			

Support Packages

A number of support packages have been announced by:

- Regional Business Partner Network
- Inland Revenue (IR)
- Central Government
- Major Banks

Some packages are frustratingly light on detail and appear to be designed to create headlines but unfortunately fall short of providing the immediate and targeted relief required.

We have outlined the various packages and schemes available that we see relevant for our clients. We will continue to keep this updated.

Please contact us if you require any further information on any of these support packages.

RBP Business Consultancy Support

On 15th of April 2020 the government announced further, but limited, funding for New Zealand businesses to assist with cashflow management and finance advice through a qualified provider.

McCulloch + Partners are qualified advisors under this scheme. Please contact Karen Duthie (Karen.Duthie@mcp.co.nz) if you would like to enquire about funding assistance. Karen will provide you with the registration instructions and a way forward including details about the needs assessment required to be completed.

To access this support, your business will need to meet the following criteria:

- Have fewer than 50 full-time equivalent employees;
- Be registered for GST in New Zealand;
- Be operating in a commercial environment; and
- Be a privately owned business or are a Maori Trust or incorporation under the Te Ture Whenua Maori Act 1993 or similar organisation managing Maori assets under multiple ownership.
- Have undergone an assessment with a Regional Partner Growth Advisor.

Please contact us if you would like further information.
Funding is very limited.

IR Tax Changes

- New Tax loss carry-back scheme
- New Changes to due dates
- New Changes to tax loss continuity rules
- Write-off of use-of-money interest (UOMI)
- Increased provisional tax threshold
- Depreciation and low-value assets
    - Increasing low-value asset threshold
    - Allowing depreciation on commercial and industrial buildings
- Difficulty paying tax – instalment arrangements

Only applicable to taxpayers significantly adversely affected by the COVID-19 outbreak

IR Tax Changes

Tax Loss Carry-Back Scheme:

This temporary change should be introduced in a bill in the week beginning 27 April.

Businesses expecting to make a loss in either the 2019/20 year or the 2020/21 year would be able to estimate the loss and use it to offset profits in the previous year only. It is not possible to carry a loss from 2021 back against profits in 2019.

This change means we could refund some or all the tax already paid for the year they were in profit. It means firms could cash out all or some of their losses in 2019/20 or 2020/21. Without this change, firms would have to carry forward any loss to a year when they make a profit.

If this process is used you will be exposed to use of money interest if losses are overestimated.

IRD have advised that Taxpayers do not need to rush to re-estimate their provisional tax before 7 May. Part of the proposed law change would make it possible for them to re-estimate it after the date of the final instalment. This will give them more time to work out any estimated loss for the 2020/21 income year.

Between now and 27 April, officials will consult with tax advisors to ensure the law and administrative guidance is as clear as possible.

We will continue to update you on any further developments on this from the IRD

IR Tax Changes

Changes to the Tax Loss Continuity Rules

While this scheme does not create an immediate cash injection, the Government proposes relaxing the tax loss continuity rules. It intends passing legislation before the end of March 2021, and for it to apply to the 2020/21 and later income years.

Currently, if a company has more than a 51% change in ownership it cannot keep its tax losses.

The introduction of a ‘same or similar business’ test, means a business could carry forward losses. To meet the test, the business must continue in the same or a similar way it did before ownership changed. This test is modelled on Australia’s rules.

Some companies will be looking to raise capital to keep afloat now and to recover in the future. Raising capital may result in a change to the existing shareholder structure. Relaxing the rules will ensure companies in this position could carry losses forward to offset income when they return to profit. Being able to carry forward losses makes the business more valuable to investors. The rules should improve access to capital for businesses.

There will be public consultation on the proposed changes in the second half of 2020. It is important the law changes prevent loss trading.

We will continue to update you on any further developments on this from the IRD

IR Tax Changes

Changes to due dates

The Government proposes giving Inland Revenue discretion to temporarily change dates, timeframes and procedural requirements outlined in a number of Acts administered by them. This provision will apply to businesses and individuals affected by COVID-19.

We have been advised that IRD will publish further guidance in the coming weeks after targeted consultation with tax advisors.

We will continue to update you on any further developments on this from the IRD

Tax Changes	Information
Write-off of UOMI	For payments due on or after 14 February 2020. Eligibility: • Has been significantly affected by Covi-19 • Has revenue reduced by at least 30% compared to the same month 12 months earlier • Have you explored other options for financial support (talking with banks about additional finance / re-negotiating other loans) UOMI could be remitted for a maximum of 2 years, actual length is dependent on individual circumstance. IR has released limited guidance on this process, which appears to be potentially burdensome for the taxpayer given the level of information required to be provided to support and application. Please contact us if you would like further guidance on the application process,
Provisional Tax Threshold	Increase of the provisional tax threshold from $2,500 to $5,000 • This means for current provisional taxpayers with provisional tax payments of less than $5,000 they will have until 7 April following the year they file to pay their tax bill Permanent change will take effect from the 2020-2021 income year • For most taxpayers, this will mean 1 April 2020 You can opt to continue paying in instalments throughout the year
Depreciation and Low-Value Assets	**Depreciation:** If your business is eligible you will be able to claim depreciation deductions in your tax return for commercial and industrial buildings (Residential buildings are <u>not</u> included in these changes). From the 2020-2021 income year. • Whether or not you can claim depreciation on buildings used for “short-stay accommodation” depends on whether it is seen as residential or commercial • *Generally, if there are 4 or more separate units within the same property and they're used for short-stay accommodation, they can be depreciated.* **Low-Value Assets:** Increase of the low-value asset threshold from $500 to $5,000 • Threshold is only raised until 16 March 2021, thereafter the threshold will be permanently increased from $500 to $1,000
Instalment Arrangements	If faced with difficulty paying outstanding tax, the IRD has provided the ability for some to set up an instalment arrangement in myIR. You can also apply for a write-off due to serious hardship if you know you won't be able to pay the full amount. • If IRD grant relief from payment due to hardship and you have losses to carry forward, these losses will be reduced in proportion to the amount written off. Setting up an instalment arrangement: *(Note: Only applicable for certain types of tax – refer to IRD)* • Need to provide details of current financial situation (including weekly after tax income) • The IRD charge interest on unpaid amounts after the due date. • You need to pay any interest charged during the instalment arrangement as part of the overall instalment arrangement amount.

Central Government - Wage Subsidy

Most businesses would have applied for the wage subsidy by now and have received a payment. Please contact us if you would like to confirm your eligibility.

A number of common business scenarios were not addressed in the initial policy release or the initial policy has changed. The government has included a Q&A section within the MSD website that has helpful information to try an address this issue.

We are now receiving queries from clients regarding paying back the wage subsidy received for employee who have resigned, been terminated, leave, finished their contracts or are made redundant.

The advice Government has provided the Ministry of Social Development is:

> "If you have employees in any of the above situations during the subsidy period you are not required to repay subsidy – you should use this to assist with making final payments to resigning/terminated staff and if there is additional money left over you could use this for supporting other employees / your business."

This appears to be a change in policy by the Government therefore please contact us if you are in this situation to work through your options.

Central Government - Insolvency

The Government has recently announced **two relief measures** for directors and companies from insolvency provisions in the Companies Act 1993 (“the Act”).

1. Safe Harbour of Directors Duties

Provides a safe harbour to directors’ duties contained in section 135 (create substantial risk or serious loss to creditors) and 136 (incurring obligations that cannot be performed) of the Act if certain conditions are met, including:

- in the good faith opinion of the directors, the company is facing or is likely to face significant liquidity problems in the next six months as a result of the impact of the COVID-19 pandemic on them or their creditors; and
- the company was able to pay its debts as they fell due on 31 December 2019; and
- the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within the next 18 months (for example, because trading conditions are likely to improve or they are likely to be able reach an accommodation with their creditors).

These changes are subject to the agreement of Parliament. The Government will be asking Parliament to agree that the safe harbour be backdated to the 9th of April.

2. Business Debt Hibernation

Enables companies to request a Debt Hibernation, which allows a moratorium on the payment of debts for up to six months. For a company to be placed in a Debt Hibernation:

1. The directors must first assess whether they meet the threshold test.
2. If met, the directors can give notice to creditors.

A one month moratorium on enforcement action against the company from the date of the proposal and a further six month moratorium if the proposal is passed if 50% or more (by number and value) of the company’s creditors vote in favour of the proposal.

During the six month period the company can continue to trade, subject to any restrictions agreed with creditors as condition of entering into it but all other rights of enforcement against the company will be suspended.

During this period the directors will be able to further assess: whether the company can resume trading as normal, propose a further formal compromise to creditors, enter into administration or decide to liquidate the company

Business Finance Guarantee Scheme

Under the BFGS, businesses with annual revenues between NZ$250,000 and NZ$80 million will be able to apply to banks for loans of up to NZ$500,000 for a period of up to three years. Lending will only be made on normal bank criteria i.e. adequate security is provided. Any loans received will need to be repaid within the three year period.

The loans will have 80 percent of the risk guaranteed by the Government, with the banks guaranteeing the remaining 20 percent. This is a major benefit for small to medium-sized businesses.

The purpose of the BFGS is to get vital funding through to businesses, while leveraging the strength of the Government balance sheet as guarantor.

While the individual terms and conditions may slightly vary between lenders, the loan is intended to only be used to meet urgent liquidity or bridging financing needs due to disruption COVID-19 has caused your business and not for any excluded purpose.

More details of the BFGS will be available on the websites of each of New Zealand bank participating in the scheme. However our initial feedback is that funding through this scheme may be difficult in some circumstances.

Please contact us if you would like to discuss the pros and cons of entering the BFGS

<u>Disclaimer</u>

The content of this document is a summary only and is accurate as at 16 April 2020, the time of publication. This document does not constitute advice; if you wish to understand the potential implications of current events for your business or organization please get in touch.