KEEPING ON TOP OF

Tax planning and its effects on business cashflow.

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For new or growing businesses, cashflow is vital. Receiving a shock tax bill can heavily and negatively impact your cashflow. Tax planning offers effective strategies and solutions which can help you plan and prepare – and now is the time you should be doing it.

Running a business is hard enough when you think about all the trigger events you need to be in control of. Things like sales pipeline, operational procedures, delivery timelines and quality control, just to name a few. Then add on all the book work and admin you need to be on top of and it's tough to juggle it all.

But then you need to look at the tax side of things and suddenly it goes from a delicate but manageable juggling act to a frantic attempt to keep everything in the air.

For someone running a business there can be multiple layers of tax liabilities keeping you up at night. These may include:

- GST and PAYG on staff
- company tax
- fringe benefits tax (FBT)
- personal income tax.

Unfortunately, there is no silver bullet to setting aside money for these taxes as each business will have different variables that impact how much tax will be payable, in each category, at different times. But it is important to have a good understanding of the tax system and be prepared – so there are no surprises.

HOW THE TIMING OF INCOME TAX PAYMENTS MAY IMPACT A NEW OR GROWING BUSINESS

Unfortunately, the tax system is reactive. Although you lodge your business activity statements (BAS) quarterly, the ATO doesn't monitor these in relation to your income tax liability at the end of the financial year.

This means that in the first year of your business (or the first year you make a profit) you will not pay any tax until after you lodge your income tax return. For most businesses, this will often be many months after 30 June.

Once this return is lodged, the ATO gets the first snapshot of what profits the business is making and what tax is due based on your previous year. Not only does the ATO want their tax money for the previous year, but now that they know you are making money, they also want you to start paying tax in advance (PAYG instalments) for the current financial year.

WHAT DOES THIS MEAN FOR YOUR BUSINESS?

In year one you will not pay any physical tax and your bank account will look nice and healthy. However, in year two you will end up paying two years' worth of tax in what is typically only a six-month period.

This six-month period is the single biggest cause of business failure in the first two years of business, and if you have not been putting tax money aside for this you risk becoming a statistic. This does not mean that those businesses may fail straight away, but they will begin a painful cashflow struggle while most of their profits are having to be put towards their legacy tax issues. This can often stretch out for multiple years before a business finally gets in the clear.

SETTING UP A SEPARATE ACCOUNT FOR TAX

In my experience, the common outcome for businesses that have a strategy of putting money aside in a separate bank account for tax is that they are always better placed to pay these liabilities when they are due than those who do not do this. If nothing else, I recommend you set up a separate bank account and start putting something aside as soon as possible.

The next step to be ahead of the curve is to build a custom formula for your business which gives you a percentage of sales to set aside each week. This is best done with your tax advisor, so you can make sure all variables in your business are taken into account. This can include the number of staff, your net GST figures and your company/personal

average tax rates.

This will never be an exact science, but if done right you should always have most of your tax money set aside when things fall due. Making up any shortfall is substantially easier to do than finding the whole amount.

HOW TAX PLANNING CAN HELP

Setting up a separate account for tax is just one example of a step that can be put into place to help prepare you for tax time.

When the calendar ticks over to 30 June, it's actually too late to make big changes to your net tax outcome.

Get advice before the end of the financial year to ensure you assess how you are looking for the current financial year – then you can make changes, implement action and be prepared for the 2021 tax bill.

DON'T AVOID TAX

Tax is a consequence of business, but it should never be the main driver when making decisions within your business.

So many small-business owners ask, "What can I do to not pay tax?" But if reworded what you are really asking is, "How can I not run a successful business?" Paying tax means you are making money – which is great news. That is what your business was made to do.

Minimising your tax legally or using structures to your benefit are things you should be employing in your business. But you should not be actively sabotaging your earnings or spending your hard-earned cash – just for the benefit of a tax deduction.

THE ATO IS COMING

While the ATO has been pretty quiet during the COVID times in relation to debt collection, they are starting to warm up again. With a shortfall in revenue collection, and their debt levels soaring, the ATO has warned businesses that they will ramp up their collection activity sooner rather than later.

The best way to deal with any existing ATO debt is to enter into an affordable payment plan with the ATO as soon as possible. But secondary to that, plan for any future liabilities that you will incur to ensure there is sufficient cashflow to meet them.

Tax, like any business cost, can be managed with budgeting and knowledge. This is where understanding your finances is crucial. Business owners should be analysing their financial performance monthly at least. While revenue is important – how is your profit looking? Are you doing better than the previous month or quarter? – analysing this will allow you to make informed financial decisions within your business. Especially when you are a new business where every dollar counts. Technology is your friend here; accounting software makes it easy to run reports on a variety of business KPIs. But the key here is to reconcile your accounts properly and often!

Knowledge is power and knowing where your money is going is vital to the success of your business. Utilise the technology you have within your business to your advantage. Run reports regularly, implement and track budgets within your software, have meetings with your advisors to run through these figures.

Tax costs can all be factored into these discussions to ensure that you don't fall into the trap of continuously owing the ATO. ■