*By **Tracy Hickman**, Staples Rodway, Auckland*

Taxing cash flow challenges

Keeping on top of tax payments can be challenging, particularly in the building industry where payments can be lumpy and some contractors unreliable payers. Avoid getting behind with a few simple strategies.

BUSINESSES may recognise their accounting income, but this doesn't mean they have the cash to pay the GST, PAYE or provisional tax that may be due.

Often taxman at back of queue

Rapidly growing businesses usually require greater working capital to meet the demands of increased payments to suppliers, wages, taxation and capital expenditure. If additional working capital facilities have not been put in place, Inland Revenue (IRD) payments are often, dangerously, given a lesser priority. Business owners may focus instead on maintaining the supply of products or services and paying wages.

Similarly, the cash flow for underperforming businesses usually reflects insufficient revenue generated to meet costs. Business owners who haven't scaled back production and overheads to match reduced demand are likely to face hard decisions around prioritising payments.

Always file IRD returns on time

In situations where cash flow has not kept up with tax obligations, it is best to contact your advisor and discuss notifying the IRD before a tax payment is missed. Keep in mind that tax returns still need to be filed as they fall due, even if making payment by the due date is unlikely.

By contacting the IRD before the due date and continuing to file on time, the taxpayer may be eligible for reduced penalties and will be in a good position to work with the IRD to get payments back up to date.

Start with cash flow forecasting

If you are behind with your tax payments, we strongly suggest that your first step is to create a robust cash flow forecast, ideally covering the next 12 months. This should enable you to assess whether the financial position is likely to improve or whether you need to take further action to address the problem.

There are several forecasting and budgeting tools that can help. Spotlight Forecasting and Modano are two examples of software that we use when helping clients in this area.

The key is to produce an integrated forecast cash flow, balance sheet and profit and loss account. By preparing three-way financial statements, you are less likely to miss important items. The output should help you decide whether you are likely to need to organise further funding or scale back operations to address the lack of cash. It also provides a monthly plan for the repayment of any outstanding principal amounts.

Look at the options

Once you have assessed the bigger picture, review whether the forecast cash flow issues are temporary or permanent. If the latter, talk to business recovery experts to determine the options, such as restructuring, refinancing, a creditor compromise, receivership or liquidation.

For temporary cash flow deficits, consider negotiating a bank overdraft. The financial forecasts that you have prepared should help to support your application and show how the overdraft will be repaid over time.

Other measures that can provide temporary relief include using tax financing for income tax payments and negotiating payment plans with the IRD for historical GST and income tax. In most circumstances, the IRD would expect PAYE to be paid up to date and for the payment of current taxes to be made on time.

Tax financing can smooth tax cash flows

There are several companies offering tax financing services, acting as tax intermediaries between businesses and the IRD. Your advisor can obtain quotes and organise the tax financing for you.

The tax intermediary sets aside an agreed amount in a tax pool, as at the date of the arrangement. The business pays interest on this until cash flows enable full payment, when the backdated principal amount (held at the date on which the financing plan was initiated) is transferred to the IRD. This clears any use of money interest and penalties imposed by the IRD, so the only cost to the business is the tax financing rate.

The IRD use of money interest rate is currently 8.22% on underpayments. Compared to this, the indicative tax financing rate is from 4.4% at the time of writing. In contrast to other borrowing rates, such as a business overdraft, the tax financing rate offers a highly competitive way of smoothing out tax cash flows.

Set up payment plan with the IRD

It is possible to request payment plans for overdue GST and income tax payments. The main option available is an instalment arrangement whereby an agreed amount is repaid over a set period of time. To initiate this, the taxpayer needs to provide the IRD with an instalment arrangement proposal. The aim of this should be to pay off the outstanding tax in the shortest possible time while keeping current tax obligations up to date, particularly those relating to PAYE and GST.

An agreed arrangement plan needs to be adhered to in order to avoid reputational issue with the IRD and increased penalties. This is where a robust cash flow forecast and forecast financial statements could assist in ensuring the arrangement plan is realistic given the taxpayer's cash flows.

For more This is intended as general advice only. For specific advice, contact your advisor or local Staples Rodway office.