How to avoid tax break cash trap

The Government's dangling of a fat tax carrot to business owners with the aim of stimulating the economy may actually be having a negative impact on small business, warns 10X East Adelaide director, Christopher East.

The Small Business Tax Break, which encourages small business owners to invest in eligible assets through a 50% tax deduction, has driven what xxx-based accountant and business development expert, Christopher East, calls "inefficient spending" by business owners.

"What seemed like a lucrative incentive for SME owners could actually be a misleading lure that encouraged some to buy assets they couldn't afford or that would be much more wisely spent on marketing activities to generate customers," Christopher says.

"The tax break applied only to tangible, depreciable assets like cars, computers and hardware, laptops, smartphones, and furniture – in other words, expensive items that businesses don't necessarily need for growth.

"Unfortunately, many businesses jumped at the opportunity, as evident in the sudden resurgence of the previously-failing car industry, which experienced an 11.3% growth in commercial vehicle sales after the introduction of the 50 percent allowance."

Christopher says the thousands of dollars some business owners have spent on cars and computers with the allowance would have been more effectively spent on production and marketing-related activities, which help attract customers and contribute to business growth.

Christopher East says the many businesses which have spent to obtain the allowance could be harmed in the following ways:

- Decreased profits threatening business futures: "In focusing on reducing tax, many businesses have actually tried to reduce their profit as well, truly losing sight of the bigger picture," he says. "Lower profits lower the value of your business, which for baby boomers can seriously affect their retirement plans when the time comes to sell their business."
- Increased outflows affecting business growth: "Interest rates may be low and conditions may look as if they're improving, but whether you're purchasing an asset outright or financing it this purchase represents an outflow that will restrict your cashflow in some way and inhibit your ability to grow."

Christopher believes the strong push to spend has made many business owners forget the allowance was not a refund or a rebate.

"SME owners shouldn't assume all government initiatives are in their best interests," he says.

"Although this increased spending benefits the economy, it's a knee-jerk reaction that has encouraged hasty spending, and does not give businesses any real cash advantage in the end."

Christopher believes the government-recommended spending and a focus on trifling tax matters has left many business owners out of pocket for the new financial year. They have less cash to spend on activities more critical to surviving tough times and growing their businesses.

In addition to this, some business owners have been advised to buy stock for the next financial year, pre-pay their overhead expenses and delay debtor collections until the new year, in order to reduce their profits and their tax bills.

Christopher says that advice creates a challenging situation in the new financial year, with the following factors impacting on their business: Reduced cashflow, restricted by the increased expenditure; Limited ability to attract new business, due to less cash to invest in marketing and production resources; A decreased value of the business, as a result of reduced profit and; Inability to accurately measure and analyse business performance, due to the delaying of account receivables and prepaying of expenses.

"It's critical business owners consult with their accountant now and put into place a tax management plan and business growth strategy for 2010," he says.

Christopher offers his Top Five strategies for businesses to start afresh in the new financial year:

1. Create a financial growth strategy for the next 12 months. "Businesses need to be setting 2009-2010's KPIs and performance drivers now," says Christopher East. "Use these as a framework to work against over the next year to boost the performance and success of your business."
2. Increase marketing and initiative-based expenses. "It's imperative to keep these up, as they are vital for increasing customers and generating revenue. Marketing is the key driver in growing your business and securing future revenue and cashflow."
3. Reduce non-marketing, non-advertising and non-production expenditure. "It's simple – the less cash you spend, the more you have. Ask for better deals from suppliers, and reduce the high value expense items, whose absence doesn't disrupt the business, first."
4. Collect from debtors straight away. "You don't have to do what everyone else is doing and carry out jobs on account. You are entitled to ask for payment on completion, or even in advance. And the sooner you collect what is rightfully yours, the sooner the pressure that last year's expenditure may have had on your cash flow will be eased," says Christopher East.
5. Get rid of your obsolete and surplus stock. "Focus on moving your stock and selling it as quickly as possible. Converting your stock to cash will again free up money available to you in your business."

The new financial year presents the best time for business owners to seek more than just tax advice, and develop a strong working relationship with their accountant. "Your accountant has all the information about your business, and is in the best position to help you achieve your performance goals," says Christopher East.

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