# Tax pooling
## An unexpected source of working capital


There's a source of funding available to most businesses seeking finance that they do not know about (or have perhaps overlooked) – their provisional tax payments.

STORY
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Most would typically never dare prioritise utilising money set aside for Inland Revenue (IRD) elsewhere, even if they knew it would ultimately generate a higher return. That's because the threat of IRD's high interest rates – increased to 8.35% on 29 August, despite market rates heading in the opposite direction – and late payment penalties, usually provide more than enough incentive to err on the side of caution by complying and paying their obligations on time.

As you are likely to be aware, a service called tax pooling provides provisional tax payment flexibility to anyone who requires it. Tax pooling allows businesses to defer these payments to future dates of their choosing, without facing the consequences from IRD. The reason there are no consequences is because the service is approved by IRD. However, despite operating since 2003, it is not as commonplace as it could be.

## Why consider tax pooling when market lending rates are so low?

The tough lending environment. These are complicated times for businesses requiring finance.

The cost of credit is cheap, largely due to the Reserve Bank of New Zealand cutting the official cash rate to a record low as it attempts to rev up a slowing economy by encouraging more people to exchange their hard-earned money for goods and services.

Yet getting access to these funds may not be so easy.

Amid the backdrop of deteriorating business profitability and confidence (the latter has reached its lowest level since April 2009) and the dreaded 'r-word' (recession) is dancing the foxtrot in the minds of many, our banks appear to be playing things cautiously as far as lending goes. According to the Financial Institutions Performance Survey for the June quarter, the amount loaned to borrowers by New Zealand banks increased only one per cent.

Businesses are picking up on this decreased appetite for lending. A net 40 per cent of firms surveyed as part of ANZ's New Zealand Business Outlook for September expected it to be tougher to get credit. Banks becoming increasingly more selective about who they lend money to is being keenly felt at the smaller end of town. The OECD's report, Financing SME and Entrepreneurship 2019: An OECD Scorecard, shows loan rejection rates for small- and medium-sized business have more than doubled since 2016. The proportion of SMEs reporting credit as being available to them on acceptable terms is also down for companies with 6 to 19 and 20 to 49 employees.

Added to this is the possibility of our Reserve Bank following Australia, with regulations requiring banks to hold more capital. The full ramifications of such a move are unclear. A safer, more robust banking system may make accessing credit even harder in this current economic climate. After all, the riskier banks deem an investment (or the applicant), the less inclined they are to greenlight a request for credit, given they may end up having more of their own skin in the game.

Banks turning business away presents a bit of conundrum for those requiring credit for investment. Some are being forced to explore second-tier, non-bank lenders to secure finance.

Which brings us back to tax pooling.

Tax pooling offers a potential solution for those looking elsewhere for the working capital they require. It does this by freeing up funds put away for provisional tax so they can be put to better, more productive use now (rather than tied up at IRD as a deadweight cost) and then paid back later.

Businesses often choose tax pooling because approval is guaranteed. No security is required, and it allows someone to keep headroom in their existing lending facilities. A taxpayer will have interest to pay with tax pooling, but this is lower than what IRD charges when tax is not paid and is generally less than a taxpayer's existing finance rates.

## The mechanics of tax pooling

So, how does it work?

Assume you wish to defer the full payment of a provisional tax amount to a time that better suits your business.

Ahead of your upcoming provisional tax payment, you would pay a commercial tax pooling provider (such as Tax Management NZ) a fixed, upfront finance fee and the tax pooling provider would make a deposit on your behalf into its IRD account. This deposit is date stamped as at the date the tax is due (e.g. 15 January 2020).

The upfront finance fee is based on the amount of tax required and the date in the future you wish to pay.

At the agreed upon future date, you pay the tax pooling provider the core tax and the tax pooling provider transfers the provisional tax deposit it is holding on your behalf from its IRD account to your IRD account.

As the deposit the tax pooling provider is transferring has been paid, and date stamped as at the original due date, IRD treats it as if you have paid your provisional tax on time when it processes this transfer. This, therefore, eliminates any IRD interest and late payment penalties.

The arrangement can also be set up to be paid in instalments.

The only difference when paying in this manner is the tax pooling provider's interest is recalculated on the core tax owing at the end of each month. This is because you are choosing to pay off your tax liability as and when it suits your business cash flow. This means the tax pooling provider is only transferring to your IRD account an amount of tax that matches the amount of every part payment you opt to make. IRD interest and late payment penalties will be eliminated once the arrangement is paid off in full.

## Final thoughts

It goes without saying that being able to source finance is of utmost importance for those wishing to invest or seize upon a business opportunity. Without it, you might as well try to conquer Everest while wearing a pair of jandals.

As banks react to the economic uncertainty denting New Zealand business' confidence by tightening their lending criteria, anyone in search of finance needs to survey all options available in the marketplace to secure the funds they require.

That may include tax pooling.

**Chris Cunniffe is the CEO of New Zealand's first and largest tax pooling provider, Tax Management NZ. Prior to joining Tax Management NZ, he was one of its clients as the head of tax at BNZ and Air New Zealand. Chris is also a member of the Chartered Accountants ANZ Tax Advisory Group.**

**Baker Tilly Staples Rodway works with a wide range of tax pooling providers, including Tax Management NZ. If you are interested in establishing whether tax pooling suits your situation, please speak to your usual advisor.**