Business Issues – Leases & Goodwill, International tax traps

Contents

Look out – someone just took your business!

Imagine that you own a small supermarket. You've been operating in the same location for just under a decade. Since you opened, the business has established a regular customer base and business seems fairly consistent. You might look to sell in a few years to capitalise on all the time and effort you put into building the business, and find something new. But this is something to think more seriously about in a few years time. Then, your landlord contacts you and says that the lease is due for renewal in a few weeks and gives you an ultimatum: pay double the current rent along with a hefty annual increase, or get out.

You have a valuation of the current market rent completed and find that what you're paying now is about right. Doubling the rent will put your rent well outside of market rates.

If you sign the lease, the business will be difficult to sell as the rent will be an impediment for any purchaser. If you leave, you walk away from the goodwill you have generated. And, particularly for small retailers operating under franchise arrangements, the franchise arrangement often ends when the lease ends. If you leave the landlord could set up a new business, identical to the one you created, and then run it under management until they can sell the business – effectively appropriating the goodwill you have worked hard to create.

While there is specific retail tenancy legislation in each State and territory to address bargaining imbalances the reality is that it is a common tactic to limit a tenant's bargaining power by seeking to negotiate at the very last minute.

The number one rule is that you cannot rely on your relationships. If the terms and conditions are not in writing, or if the process for managing lease agreements is not adhered to, disputes can quickly escalate. Generally, if you have already signed the contract, it's too late to do anything about the terms unless you have grounds to claim that the agreement was signed under duress. Like with any legal agreement, you need be fully aware of what you are agreeing to. And, if you have experience in the industry and access to advice, then the likelihood of redressing any issues is diminished.

In most cases, retailers leasing a space of under 1,000 sqm are protected by specific legislation. For example, in NSW the legislation sets out what is believed to be unconscionable conduct taking into account bargaining power, the use of undue influence or unfair tactics, and the amount for which an identical lease could have been obtained.

In general however, the landlord has the right not to renew your lease. As a result, you need to operate with the understanding that your current location just might not be available when your lease ends. While you can't be forced to vacate immediately, the move (assuming you have the capacity to move), will still be disruptive.

The loss of goodwill is not uncommon in these sorts of scenarios – either directly by pushing the client out or surreptitiously by gouging the profit out of the business.

Goodwill is an important part of the value of your business and often a misunderstood one because most owners expect a payoff for all their hard work and effort. It's important to understand what goodwill is and what you can do to ensure that the goodwill value rests with you, not someone else. There are different types of goodwill, including corporate, personal and location goodwill.

Corporate goodwill is the value items such as brand, business presence, an excellent client database, and repeat customers add to the value of the business. When we talk about a brand, we are talking about something that is recognised, not just a logo.

When we ask business owners what differentiates their business from others, one of the commonest responses is "personal service". Your customers or clients come to you because they like dealing with you. That's personal goodwill. Your customers stay with you because of the strength of the relationship that you have developed with them. That's excellent if you are the owner but when it comes to selling your business, personal goodwill is generally worth less to the new owners.

Location goodwill is where the location of your business delivers a result for the business. For example, a service station on a major road that is convenient for motorists to enter and exit. If you have location goodwill, the value of the goodwill is determined by factors such as whether you own or lease the location, how long your lease is for and anticipated changes and development in the area. Security of tenure is critical to location goodwill.

The international tax trap

Increased globalisation means that more and more SMEs deal with customers or suppliers outside of Australia. While this can open up some lucrative opportunities, it also introduces a range of new tax issues that need to be addressed – particularly if your business has dealings with a related entity overseas.

Transfer pricing is a tax trap for unwary companies. The transfer pricing rules often affect Australian companies that have dealings with an international parent. For example, an Australian subsidiary of a foreign parent company may rely on that parent company to supply products or management services. The Australian Tax Office (ATO) is looking closely at these relationships to ensure that the prices charged for goods and services between related parties are consistent with the prices that would be charged by a completely independent provider (i.e., the "arm's length" principle) to avoid profits being shifted outside of Australia (e.g., a foreign parent company may charge management fees that exceed the value of the services provided). If the ATO believes that a profit shifting arrangement is in place or the profits being reported in Australia are not appropriate, the Commissioner can make adjustments for tax purposes.

All this means that not only do you need to have your pricing right, but your paperwork must be in place as well.

Generally, this means the creation of some documentation that would not otherwise be created in the ordinary course of business. The ATO expects SMEs with related party dealings to carry out the following four-step process:

1. Identify and record the nature of transactions with foreign related parties and how these transactions fit into the everyday business.
2. Select the most appropriate transfer pricing methodology and document the choice that is made.
3. Apply the transfer pricing method and determine the arm's length outcome. This would typically involve a benchmarking study to demonstrate that the outcome is consistent with arm's length transactions.
4. Review the transaction pricing and benchmarking study on a regular basis to ensure that any material changes are reflected and documented.

One of the key things the ATO will look for in a transfer pricing review is whether the business has maintained "contemporaneous documentation". This refers to documentation that existed or was created at or before the time of preparing the tax return for the relevant income year.

This issue is particularly relevant for businesses that need to disclose details of international related party dealings on an International Dealings Schedule. This schedule must be lodged with the tax return when a business has dealings with foreign related parties of $2m or more (including loan balances) and is used by the ATO to identify situations where there might be a risk of profit shifting.

Putting a comprehensive transfer pricing file in place is a great way to satisfy the ATO's expectations and provide the first line of defence in the event of an ATO review or audit.

Quote of the month

"From a commercial point of view, if Christmas did not exist it would be necessary to invent it."
Katharine Whitehorn

Checklists and Templates

To make the compilation & reporting task for 2012 tax returns easier, clients of **Property Tax Specialists** receive checklists and templates to facilitate the process ... **saving them time and money** ... the 'write' way is having clear documentation. ATO way means time/money wastage with audit investigation.

Two heads are better than 1? Discuss your plans? Call to chat ...

Contact us if you would like to

- review & discuss your current property & tax situation ... maybe the next deal or
- whether or not to sell a property, which one in the portfolio should be sold
- your asset protection strategy. What is your risk profile? High ..medium ..low
- structuring your next investment property. In whose name should it be?
- Should you rent out your home and live closer to work in a rented space
- Should you invest your capital in 1 Main Residence or 2 smaller rental properties
- planning to legally minimise your tax position or just to explore the possibilities
- Subdividing a block or your Main Residence … Capital Gain or Business Profit?
- Is your Self Managed Super Fund ready to acquire a property
    1. with limited recourse loans
    2. from lending institutions or yourself
- prepare your next tax return or application to reduce your PAYG Withholding tax

We look forward to being of service. We also look forward to your **referrals**.

To improve our service we welcome all constructive comments on this newsletter and other materials.

Call/email **Shukri Barbara** at Property Tax Specialists at Shukri@propertytaxspecialists.com.au

---

Checklists and Templates

To make the compilation & reporting task for 2011 tax returns easier, clients of **Property Tax Specialists** received checklists and templates to facilitate the process ... **saving them time and money** ... the 'write' way is having clear documentation. ATO way means time/money wastage with audit investigation.

Disclaimer

The material and contents provided in this publication are informative in nature only. It is not intended to be advice and you should not act specifically on the basis of this information alone. If expert assistance is required, professional advice should be obtained. Contact your accountant or Property Tax Specialists at info@propertytaxspecialists.com.au or call 02 9411 8133

Kind Regards

Winner - **Readers Choice Awards** *Your Investment Property* Magazine

2012 - **Property Tax Adviser of the Year**

2011- **Property Tax Specialist of the Year**

Tax Columnist – Smart Property Investment magazine

Property **Tax** Specialists – Prosperity & Peace of Mind

Barbara & Co **cpa**

phone 02 9411 8133
fax 02 9412 2833
mobile 0410 588 305
post: P.O.Box 665 Chatswood NSW 2057
office : Level 5 suite 509, 71-73 Archer Street Chatswood NSW 2067
website www.propertytaxspecialists.com.au <http://www.propertytaxspecialists.com.au>