



## Growing your business value

You probably have a view of what your business might be worth and the factors that influence business value. Over the next decade, as the baby boomer bubble of SME business owners look to sell or hand over their businesses, we will see the largest transfer of business wealth that the SME community has ever experienced.

**“...buyers will generally pay a premium for a built in level of growth.”**

Traditional supply demand theory says that as supply increases, price will be driven downwards. This theory will likely not hold true when we look at the SME sector. The much greater probability is that we will see a dramatic polarisation in price in small and medium sized businesses for sale. The outcome of

this will be twofold. High quality businesses will command premium prices. Low quality businesses will be highly price sensitive and in many cases unsaleable.

This scenario means that forward planning for succession is a critical issue for SME owners who want to exit their business in the current decade. This planning, with an adequate time frame, allows business owners the opportunity to actively enhance the value of their business.

The key question then is what do you need to focus on to enhance business value?

There are four key areas – growth, capacity, profitability and risk management.

**Growth** – buyers will generally pay a premium for a built in level of growth. Growth, if well managed, will produce increased profits. So a potential buyer knows that the revenue stream they are purchasing with the business comes with a growth increment. Not only does this growth factor offer future profit increments it also insulates the business against the ‘what if’ factor. Any major change in a business, such as a sale, can cause disconnections to established patterns, such as customers leaving. These disconnect events can impact revenues and profits. Built in growth patterns offer some protection against this.

**Capacity** – provides for the present and future capability of the business to facilitate growth. Areas where capacity needs to exist include infrastructure, systems capability and management capability. Systems and management are often the areas given the least amount of focus yet they are the very areas where value can be leveraged and enhanced the most. One of the reasons why franchises command price premiums is because they offer a level of systems and management. These same factors can be built in to any business.

**Profitability** – a history of profits and strong cash flows are normally the two greatest influences on business value.

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## Property tax tips and traps

*This month, we take you through some of the tips and traps of property investment that every investor and property owner should know.*

### Income

#### *Division of Income & Expenses*

They must be divided on the basis of legal interest. Joint tenants always are divided 50:50 whereas tenants in common may be 50:50 or interest may be held unequally, such as 80:20. It is important to read the title deed if interests are held as tenants in common. Any agreement between the co-owners stating a different split is ineffective for tax purposes.

#### *Non-commercial rentals*

If you let a property in whole or in part at less than normal commercial rates you may have your deductions limited to the amount of income earned. This is particularly relevant when it comes to holiday homes. Even if properties are let for part of the year at commercial rates, while deductions are allowable, the difficulty is in deciding what proportion of expenses is deductible. It’s a good idea to seek advice about what you are entitled to claim as this is an area that the ATO is looking at closely.

### Rental property traps

Generally, expenses are deductible if the property is rented or available for rent. Some things to watch out for with the above expenses follow:

#### *Land tax*

Have you registered for land tax? If you own an investment property, you need to check to see if you need to register for land tax. Each State and Territory has different thresholds and requirements for Land Tax. We have seen many examples of people with investment properties who have learned the hard way when selling their property that they are up for several years of land tax.

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### Property tax tips and traps

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#### *Interest*

The interest component of your investment property loan is generally deductible. Take care if you have made redraws on your investment loan for personal purposes. A portion of the loan may be non-deductible.

#### *Borrowing costs*

You are able to claim a deduction for borrowing costs over 5 years such as application fees, mortgage registration and filing, mortgage broker fees, stamp duty on mortgage, title search fee, valuation fee, mortgage insurance and legals on loan. Life insurance to pay the loan on death is non-deductible even if taking out the insurance was a requirement to get finance. Don't forget if the loan is repaid early or refinanced, the whole amount including mortgage discharge expenses and penalty interest becomes deductible.

#### *Travel expenses*

If you fly to inspect your rental property, stay overnight, and return home the following day, all of the airfare and accommodation expenses would generally be allowed as a deduction. Where travel is combined with a holiday, your travel expenses need to be apportioned. If the main purpose of the trip is to have a holiday and the inspection is incidental, a deduction for travel is not allowed. In these circumstances you can only claim a deduction for the direct costs involved in inspecting the property such as the cost of taking a taxi to see the property and a proportion of your accommodation expenses.

#### *Repairs and maintenance*

Deductions claimed for repairs and maintenance is an area that the Tax Office is looking very closely at so it's important to understand the rules. An area of major confusion is the difference between repairs and maintenance and capital works. While repairs and maintenance can be claimed immediately, the deduction for capital works is generally spread over a number of years.

Repairs must relate directly to the wear and tear resulting from the property being rented out. They generally involve a replacement or renewal of a worn out or broken part – for example, replacing damaged palings of a fence or fixing a broken toilet. The following expenses will not qualify as deductible repairs, but are capital:

- replacement of an entire structure (for example, a complete fence, a new hot water system, kitchen cupboards, etc)
- improvements, renovations, extensions and alterations

Also remember that any repairs and maintenance undertaken prior to when the property was let out are not deductible.

*If you have investment properties and would like us to review your situation, please call us today. **Next month, we look at property sales and Capital Gains Tax.***

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When assessing your profitability you need to compare yourself at two levels. First compare your performance against the top quartile of your industry sector. Top quartile businesses always attract higher valuations. Then, look outside your own business sector. Measure your Return on Investment (ROI). Potential purchasers of your business will not only compare you with your industry, they might be looking for investment return more than they are looking for a specific business. So in a potential sale you may be competing with a business from another industry to secure your buyer. You should be looking for a ROI in excess of 25%.

**Risk Management** – business owners are becoming more sensitive about risk. Strong corporate governance and risk management policies will enhance business value. Buyers will look for a history of compliance and the existence of a risk adverse culture. Risk management can include the existence of current employment contracts, operating licences, customer and supplier agreements and OH&S procedures.

These four areas will normally be high on the business value hierarchy and are the areas where change can most significantly impact on business value.

If business succession is on your agenda then you need to assess your business under these criteria. Where your performance or position is below what it needs to be, you can identify the issues that you need to focus on to change your business value. This process may not simply mean the difference between an ordinary sale price and a good price. It may be the difference between a sale that releases your business capital and no sale at all.

