



Terms of Trade – How to retain ownership? – Legal Question

Issues that we bring up with clients:

Romalpa Clauses – goods do not pass ownership until paid for. Harder than it seems, what condition will the goods be in.

Personal Property Securities Register – lodge with the companies office – not a straight forward process, important to get the documentation correct.

Insurance – where does the insurance on your goods start and finish? It is no use having a romalpa clause if the goods are destroyed and you have no insurance on them.

Terms of trade in general – think of them like an employment contract. You can't employ someone without an employment contract and you shouldn't have debtors without written terms of trade. Legal document so get good legal advice. Standard terms of trade from your associated organisations may be a starting point, then get this individualised by your legal advisor.

Personal guarantees – how useful are these?

Accounting Issues

1. When do you have to include the income?

Unfortunately in NZ on the date you raise an invoice you are liable to include the income as sales and therefore as taxable income.

(Other jurisdictions including Australia allow small businesses to prepare their tax information on a cash basis – which would be a lot simpler).

2. What if you don't get paid?

Until it is absolutely certain that you are not going to get paid and you remove the debtor from your system (that is you have written the debt off and will not be continuing to try and collect it) you are unable to reverse this income.

The IRD rule is that the debt must be “bad” and the debt must be “written off”.

To reverse the income you take up a bad debt transaction in your accounts at the time that you write the debt off. The deduction for the bad debt is in the year you write the debt off, it cannot be backdated to when the income was incurred.

3. What about GST?

If you are on a cash basis then you don't pay the gst until you receive the funds so if you haven't received the funds you will not be out of pocket for the gst.

Alternatively if you account for gst on an invoice basis then you may have included the income in a gst return. There is provision in the GST Act to allow you to claim back the gst at the time you write off the debt. Again there can be some detrimental timing problems with tax.

4. Cost of collecting debt

All costs associated with trying to collect the debt are deductible expenses at the time they are incurred.

5. The cost of a bad debt.

From a business perspective the hidden cost of a bad debt can be crippling.

If you sell something for \$100.00 and you usually make a \$10 profit then once you are paid you have made \$10. (Sale less cost = profit).

If you then don't get paid the \$100 you have still incurred the \$90 cost associated with that sale. You then have to sell \$900 worth of sales (or 9x the sales) just to get you back into the same position you were before the sale, that is without the cost of stock holding and collection costs.

Recommendations

- **If you are in the service industry – get a deposit – you cannot reclaim the product.**
- **Don't give credit unless you have thoroughly checked out the debtor and have a good terms of trade document.**
- **Have an on to it credit controller. In the past we used a contract credit controller and she was very successful, low cost for good results. From personal experience you always pay first the ones that persist the most.**
- **Offer other payment methods, credit card, eftpos so that people find it easy to pay you.**
- **Some companies have success with factoring but there is a cost involved.**

“Be very wary when giving credit, have a good policy around this”.



Ensuring your future is clear!

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