



POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Extending tax relief for donations of trading stock made by businesses in response to the COVID-19 outbreak

Date:	9 December 2021	Priority:	Medium
Security level:	In Confidence	Report number:	IR2021/624

Action sought

	Action sought	Deadline
Minister of Finance	Agree to recommendations	17 December 2021
Minister of Revenue	Agree to recommendations	17 December 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
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9 December 2021

Minister of Finance
Minister of Revenue

Extending tax relief for donations of trading stock made by businesses in response to the COVID-19 outbreak

Purpose

1. This report seeks your agreement to extend a COVID-19 relief measure concerning the income tax treatment of donated trading stock. Officials recommend that this relief, due to expire on 16 March 2022¹ is extended for a further 12 months until 31 March 2023.

Background

2. In 2020 stakeholders from both the charitable and commercial sectors informed Inland Revenue officials and your office about their concerns that the Income Tax Act 2007 disincentivises businesses from donating goods by imposing tax on the market value of the donated trading stock. This is a long-standing issue within the tax system.
3. A donation of trading stock is deemed to be a disposal. A deemed income rule in the Income Tax Act effectively reverses the deduction that was claimed when the trading stock was purchased and imposes tax on a deemed profit. You agreed to turn this rule off, as a temporary COVID-19 relief measure, for a two-year period starting 17 March 2020 (IR2021/051 refers). As a result, where a business donates trading stock to a donee organisation or public authority they are not subject to tax on deemed income and are eligible for a deduction. The purpose of the temporary measure was to provide immediate tax relief to businesses, while officials continued work on whether a more enduring solution should be inserted into the Income Tax Act.
4. This deemed income rule was introduced principally as an integrity measure. However, it arguably overreaches by imposing tax in situations where tax avoidance is not a concern. The overreach of this rule is not limited to COVID-19 but has been exacerbated by it, for example by increased donations to food banks or of masks and consumable medical equipment (such as personal protective equipment).
5. Prior to introducing this exemption, it was believed there was widespread non-compliance with the deemed income rule. Therefore, tax relief for donated trading stock has likely aligned the law with common business practice, rather than changed behaviour. Inland Revenue has limited data on trading stock donations.
6. There is public interest in this issue, with a submitter raising it with the Finance and Expenditure Committee during their hearing on the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill.

Proposals

7. The temporary relief provided that where a business donates trading stock to:

¹ Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021, s 84.

- 7.1 public authorities and donee organisations (an organisation whose donors can claim a tax concession for donations made to the organisation) they are not subject to the deemed income rule and are eligible for a tax deduction.
 - 7.2 non-associated persons (which are not public authorities or donee organisations) they are not subject to the deemed income rule. However, the donor will only be able to claim a tax deduction where they can demonstrate the donation is made for business purposes.
8. The legislation allows for the COVID-19 response measure to be extended by Order in Council if you are satisfied that people in New Zealand are likely to continue, beyond the expiry of the existing period, to be significantly adversely affected by COVID-19. Officials are working on assessing the case for a more enduring solution, but the issues are complex, paragraph 13 refers. The question of allowing deductions for donated trading stock touches on a wider tax issue of recognising expenses that do not have a clear relationship with earning taxable income.

Rationale for extending the relief and consultation

9. The economic and social impacts of COVID-19 continue to be felt throughout New Zealand, for example, through increased demands on community foodbanks. Officials therefore consulted a select group of stakeholders² in November 2021 on the possibility of extending the relief measures. All responses we received were in favour of a one-year extension to provide certainty for businesses and donee organisations. Stakeholders were confident that the impacts of COVID-19 will continue beyond March 2022.
10. Stakeholders considered that taxpayers and businesses who have donated trading stock have been motivated by the need of the community rather than incentivised by specific tax rules. However, they did emphasise the need to address the potential that the tax law settings could discourage donations at this time of greater need if the relief from the deemed income rule is not extended.
11. When consulting with stakeholders on a possible extension we also asked for examples of how the temporary relief measure has made a difference to taxpayers. Federated Farmers provided the example of Meat the Need, a nationally based charity established in April 2020 to supply meat to city missions and foodbanks. Meat the Need has advised Federated Farmers that when farmers donate livestock, they often comment that the tax implication of their donation is part of their reason for donating.

An enduring solution

12. Stakeholders also voiced a strong preference for an enduring solution to the deemed income rule to ensure it does not disincentivise donations.
13. Officials note, however, that a permanent solution:
 - 13.1 would be a departure from providing tax benefits for monetary donations only,
 - 13.2 raises broader tax integrity concerns about providing tax benefits for non-cash donations where valuation of the gift can be problematic, and

² Corporate Taxpayers' Group, Chartered Accountants Australia New Zealand, Federated Farmers, Fonterra, EY, PwC, The New Zealand Law Society, and Auckland City Mission. This is the same group of stakeholders consulted on the introduction of the relief measures (IR2021/051 refers).

- 13.3 the integrity of the trading stock rules also needs to be considered alongside the original anti-avoidance purpose of the deemed income rule.
14. However, the current legislation does allow for the deemed income rule to be turned off by Order in Council whenever you are satisfied that a Civil Defence Emergency event has occurred and people in New Zealand are being significantly adversely affected as a consequence of the event.
15. Officials can progress work on an enduring solution in 2022 subject to other Government priorities on the Government's tax policy work programme.

Consultation

16. The Treasury has been consulted in the preparation of this report.

Financial implications

17. The estimated fiscal cost of the tax relief provided by the 2021 change earlier this year was \$10 million, which was spread across the 2020/21 to 2022/23 fiscal years (the change applied only to one tax year, but the impact is spread across multiple fiscal years because taxpayers file at different times). An extension has an estimated fiscal cost of \$5 million, spread across the 2022/23 and 2023/24 fiscal years.
18. Notwithstanding the recent review of the Tax Policy Scorecard (IR2021/551 refers), officials are satisfied this change meets the criteria for the Scorecard funding. This is because, although motivated in part by providing relief from COVID-19, it is an extension of an existing policy responding to a long-standing issue within the tax system.

Administrative implications

19. There are no significant administrative implications to extending this relief from the deemed income rule.

Next steps and process

20. If you agree to the recommendations in this report:
 - 20.1 officials will prepare a paper to the Cabinet Legislation Committee seeking its approval to an Order in Council that would extend the relief from the deemed income rule to 31 March 2023.
 - 20.2 officials will instruct the Parliamentary Counsel Office to draft an Order in Council.
21. Legislative and policy approval will need to be sought from Cabinet at the same time to ensure that an extension can come into force prior to 16 March 2022. We will report again on 27 January 2022.

Recommended action

We recommend that you:

1. **agree** to extend the exclusion from the deemed income rule for donated trading stock for a further 12 months ending (31 March 2023);

Agreed / Not agreed Agreed/Not agreed

2. **note** the following change as a result of the decision in recommendation 1 above, with a corresponding impact on the operating balance and net core Crown debt:

	\$m – increase/(decrease)				
Vote Revenue Minister of Revenue	2021/22	2022/23	2023/24	2024/25	2025/26 & outyears
Tax Revenue	-	(2.000)	(3.000)	-	-
Total Operating	-	2.000	3.000	-	-

Noted

Noted

3. **agree** that the cost of the reduction in tax revenue shown in recommendation 2 above be charged against the Tax Policy Scorecard;

4. **direct** officials to provide drafting instructions to the Parliamentary Counsel Office;

Directed / Not directed Directed /Not directed

5. **agree** that officials work on an enduring solution to address overreach in the deemed income rule, subject to prioritisation of the tax policy work programme.

Agreed / Not agreed Agreed/Not agreed

s 9(2)(a)

Peter Frawley
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Policy and Regulatory Stewardship
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Hon Grant Robertson
Minister of Finance
13/ 12 /2021

Hon David Parker
Minister of Revenue
/ /2021