



Inland Revenue
Te Tari Taake

Disposals of trading stock at below market value

An officials' issues paper

July 2023

First published in July 2023 by Policy and Regulatory Stewardship, Inland Revenue, PO Box 2198, Wellington 6140.

Disposals of trading stock at below market value - an officials' issues paper

ISBN 978-1-98-857357-1 (Online)



© Crown Copyright

This work is licensed under the Creative Commons Attribution 4.0 International Licence. In essence, you are free to copy, distribute and adapt the work, as long as you attribute the work to the Crown and abide by the other licence terms.

Please note that this licence does not apply to any logos, emblems and trademarks in the publication. Those specific items may not be re-used without express permission.

The document is available at

<https://www.taxpolicy.ird.govt.nz/publications/2023/2023-ip-disposal-tradingstock-below-mktvalue>

CONTENTS

CHAPTER 1 Introduction	5
Background.....	5
Document outline.....	5
Consultation questions	6
Making a submission	6
 CHAPTER 2 Background and context	 7
The rationale for the current rules.....	7
When does the deemed market value rule apply	7
Trading stock definition	8
Problem definition	8
The rules for temporary emergency relief.....	8
Associated provisions	11
Other deeming provisions	11
Section FC 2	11
Section EB 24	11
Section GC 21: Purchase price allocation rules	11
GST and disposals of trading stock	11
 CHAPTER 3 Trading stock disposals that are not gifts.....	 13
Where there is a business purpose for the transaction	13
Transactions with associated persons	14
Policy options	14
Option 3.1: Status quo – requirement to treat disposals as made at market value	14
Option 3.2: Make the temporary relief (for disposals made for business purposes to non-associated persons) permanent	15
Option 3.3: Deemed income and deemed expense subject to deduction rules	16
 CHAPTER 4 Gifted trading stock.....	 18
The gift deduction framework	18
Current law	19
Non-emergency times	19
Emergency times	19
The charity deregistration tax rules	19
Policy options	20
Option 4.1: Status quo – temporary relief in emergency times	20
Option 4.2: Make the temporary relief permanent	21
Option 4.3: Make the temporary relief permanent, with several limitations	22
Option 4.4: Deem all donors to derive income at cost or opening value of the donated trading stock	23
Option 4.5: Remove the deemed income rule for gifts of food made to approved donee organisations and non-associates	24

CHAPTER 5 Trading stock disposals that are for personal use 26

APPENDIX A Trading stock disposals: Policy options summary 27

CHAPTER 1

Introduction

- 1.1 This officials' issues paper considers the tax policy settings for disposals of trading stock at below market value. The rules for such disposals are important because they protect the revenue base from the artificial reduction of business profits through transfers of trading stock. They have been the subject of various temporary, emergency policy measures taken over the past two decades, most recently in response to the COVID-19 pandemic.
- 1.2 The paper distinguishes between two types of disposals below market value: disposals made in the ordinary course of business and disposals in the nature of a gift.
- 1.3 The distinction is important because each type of disposal engages different but overlapping policy frameworks and questions. In relation to disposals that are not gifts, there is a question of both base protection and potential overreach that should be analysed through the application of normal income tax principles. In relation to disposals in the nature of a gift there is a policy question about tax concessions and the role of the tax system in incentivising gifting behaviour.

Background

- 1.4 Since before the COVID-19 pandemic, tax practitioners have sought revisions to the rules for disposals of trading stock at below market value. Our targeted engagement in 2020 highlighted a strong general perception of unfairness amongst practitioners and businesses in relation to the rules.
- 1.5 Although temporary measures put in place for the COVID-19 response and potential future emergencies did alleviate some of the more immediate concerns, we are aware that further consideration is required, particularly given the emergency provisions were developed under relative urgency.
- 1.6 A review is also warranted given the rules in question have been a part of the income tax settings for many decades. The rules address various avoidance concerns and so careful consideration is required before any changes are made.
- 1.7 The options outlined in this paper will be relevant to businesses and approved donee organisations.

Document outline

- 1.8 This document discusses the disposal of trading stock at below market value by considering two aspects of the topic – trading stock disposals that are made in the ordinary course of business and trading stock disposals that are in the nature of a gift. Options for addressing these two aspects are in the chapters as outlined below.
- 1.9 Chapter 3 looks at other disposals of trading stock at below market value that are not gifts, and whether there might be overreach of the law in this area.
- 1.10 Chapter 4 focuses on disposals of trading stock that are gifts, and the appropriateness of current temporary policy considering the well-established framework for gifts of money.

- 1.11 Chapter 5 outlines the law as it relates to trading stock taken for private use.
- 1.12 The proposed policy options are summarised in Appendix A.

Consultation questions

- 1.13 The consultation questions are at the end of Chapters 2, 3 and 4.

Making a submission

- 1.14 We invite submissions on the proposals in this document, including the specific questions asked and any other issues raised in the document.
- 1.15 Include in your submission a brief summary of the major points and recommendations you have made. Please indicate if officials from Inland Revenue can contact you to discuss the points raised, if required.
- 1.16 The closing date for submissions is **6 September 2023**.
- 1.17 Submissions can be made:
- by email to policy.webmaster@ird.govt.nz with "Trading stock disposals" in the subject line, or
 - by post to:

Trading stock disposals
C/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
PO Box 2198
Wellington 6140
- 1.18 Your submission will be proactively released on Inland Revenue's tax policy website. Please clearly indicate in your submission if any information should be withheld on the grounds of privacy, or for any other reason (contact information such as an address, email, and phone number for submissions from individuals will be withheld). Any information withheld will be determined using the Official Information Act 1982.

CHAPTER 2

Background and context

- 2.1 This chapter outlines the existing and historic policy and legislative settings for disposals of trading stock at below market value.

The rationale for the current rules

- 2.2 The deemed market value rule in section GC 1 of the Income Tax Act 2007 applies when a person disposes of trading stock at below market value. On disposal, the person is treated as deriving an amount equal to the market value of the trading stock at the time of disposal. Further, an amount equal to the market value of the trading stock at the time of disposal is treated as expenditure incurred by the other person in acquiring the trading stock.
- 2.3 A key rationale for the provision is the potential for tax minimisation arrangements to take place in its absence. For example:
- stock can be taken for private consumption by the business owner or their family
 - stock can be sold at a deep discount to associated persons, or
 - there may be scenarios within a particular industry where exchanges of stock could take place at cost, or less, to generate timing or other benefits for both businesses involving creation of effective short-term deductions.
- 2.4 We consider it necessary to maintain rules to protect against transactions which would otherwise result in a net deduction for the business, despite the argument that the business has chosen to forgo the income from the trading stock.

When does the deemed market value rule apply

- 2.5 The purpose of the disposal is not relevant to whether section GC 1 applies. Hence, the rule does not require a tax avoidance purpose or motive over and above the mere fact that tax will be reduced in any situation where a deduction is given for the acquisition of trading stock, but the disposal proceeds are not taxed.
- 2.6 The section has wide application. For example, it will apply to trading stock that is gifted, and where trading stock is taken by business owners for personal use.

Example 1

Sam is a beef farmer and wants to support a local foodbank, which is a registered charity. Instead of giving cash to the foodbank, which would qualify for a 33⅓% donation tax credit, he gifts one of his steers to an organisation that will process it into meat for the foodbank.

When Sam disposes of the steer, section GC 1 would apply. The steer is deemed to have been sold at its market value on the day of disposal. The price that is deemed to have been realised must be reported by Sam as gross income.

At the end of the year of disposal, the steer is no longer in Sam's closing stock. Sam must pay tax on a deemed profit margin, being the difference between the deemed market value on the day of disposal of the steer and the value of the steer at the start of the year.

Trading stock definition

- 2.6 Trading stock is defined specifically for the purposes of section GC 1 – the Act's general definition is extended. As well as property that a person holds for the purpose of selling or exchanging in the ordinary course of business, it includes anything produced or manufactured and anything acquired for the purposes of manufacture or disposal. It also includes timber, livestock and disposals of land that would result in income, commonly referred to as revenue account property.

Problem definition

- 2.7 Many businesses perceive section GC 1 to be unfair in some circumstances.
- 2.8 For disposals made for business purposes, either for no consideration or consideration at below market value (for example, for marketing purposes), there is a view that the rule may "overreach" by taxing amounts that are never actually derived, and that it should not apply to transactions between non-associated parties.
- 2.9 For disposals made for charitable purposes, either for no consideration or consideration at below market value, there is a view that the rule may "overreach" by taxing amounts that are never actually derived, and that it can disincentivise the donation of trading stock.

The rules for temporary emergency relief

- 2.10 To address concerns raised at the time of emergency events, there have been three overrides of the rule. In 2004 a permanent override was put in place for donations to farming, agricultural or fishing businesses during an adverse event. From 2010 to 2012 a temporary override was put in place for an 18-month period in response to the Canterbury earthquakes. From 2020 to 2024 a temporary override was put in place for a four-year period in response to COVID-19. The latter override ends on 31 March 2024.
- 2.11 For the Canterbury earthquakes, section GC 1 was over-ridden for disposals of trading stock to a person who was not an associated person for the purpose of relief from the adverse effects of the Canterbury earthquakes.

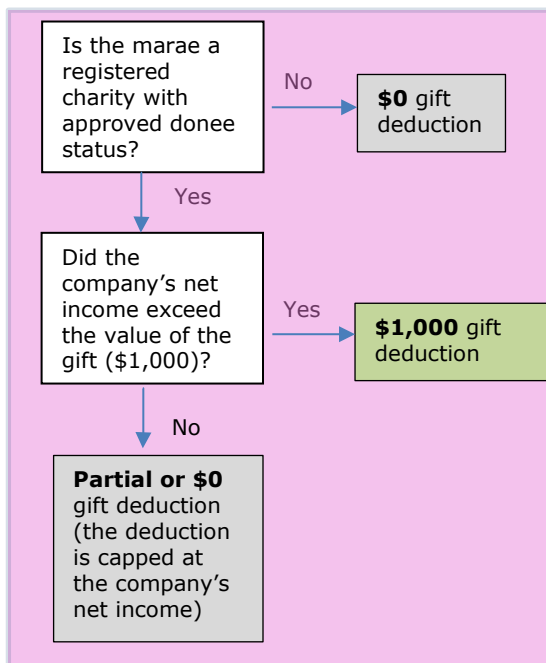
- 2.12 For COVID-19, the override applied when trading stock was disposed of to approved donee organisations, public authorities and non-associated persons.
- 2.13 There was a complete override for disposals to approved donee organisations and public authorities.
- 2.14 Trading stock disposed of to non-associated persons (which were not approved donee organisations or public authorities) were not all eligible for a complete override. If the trading stock was not donated and instead was disposed of for business purposes to non-associated persons (such as for marketing purposes), the override applied. However, for trading stock donated to non-associated persons, the deduction a business would normally take for the trading stock, being either the cost or the value under section EB 3 at the end of the previous income year, was offset by an equivalent deemed income amount.
- 2.15 The rationale for the COVID-19 approach was to provide the same net tax effect as a gift of money when the trading stock was donated to approved donee organisations and public authorities (that is, there would be a net tax deduction). Gifts of trading stock to other persons that were not associated would result in neither a net tax deduction nor a deemed profit margin - the rule effectively removed the trading stock from the tax base with no tax impact. Disposals of trading stock for business purposes to persons that were not associated would effectively be eligible for a net tax deduction, given that there was a connection between the disposal and business income.
- 2.16 Under this relief, land and forestry were excluded from the definition of trading stock. The intention was to restrict the fiscal cost of the relief and to minimise unintended consequences (given that donations of land and forestry were unlikely to provide relief to people suffering from COVID-19).
- 2.17 The provisions enacted in response to COVID-19 contain a permanent relief rule. The COVID-19 relief can be switched on in future if the Minister of Revenue is satisfied that an event has occurred that meets the definition of emergency in section 4 of the Civil Defence Emergency Management Act 2002 and people in New Zealand were being significantly adversely affected. This provision will make it easier to provide relief from section GC 1 in circumstances where Parliament did not have time to respond in the past.

2.18 An example of how the provisions enacted in response to COVID-19 apply to both gifts of trading stock and disposals in the ordinary course of business is shown below.

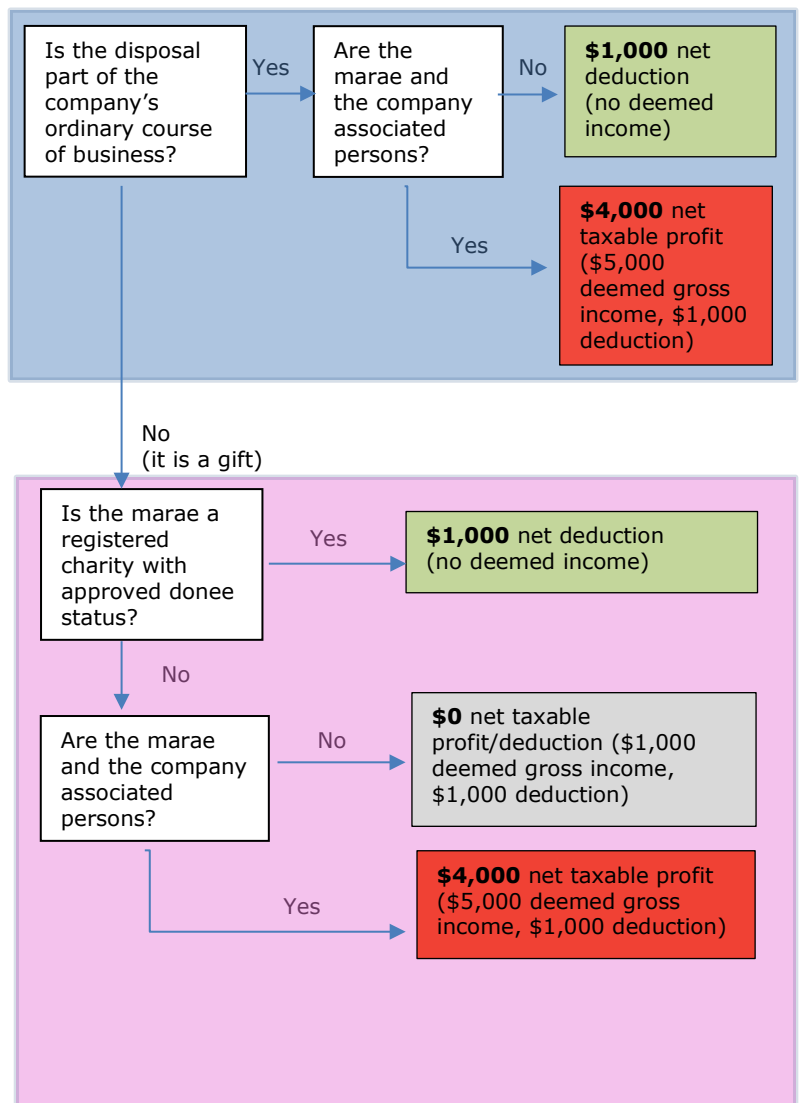
Example 2

A company in the business of selling food decides to donate \$1,000 cash to a local marae and it also provides food (trading stock) to the marae that has a cost of \$1,000 and a market value of \$5,000. The flowchart below shows the income tax treatment under the current (temporary) emergency-time rules.

Cash donation



Trading stock disposal



Associated provisions

Other deeming provisions

2.19 Section GC 1 is connected to other provisions, mainly in subpart GC. The other subpart GC provisions are not addressed in this issues paper, as they are specialised in their nature. Additionally, many other provisions in the Act deem transactions (for example, the granting of leases in some circumstances) to occur at market value. We touch on just three of these rules below.

Section FC 2

2.20 There is one provision of a general nature, which overlaps with section GC 1 (deeming the disposal to take place at market value), that may require further consideration. That provision is section FC 2, which, together with section FC 1, captures a range of disposals of property. It was enacted in 2005 (following release of an officials' issues paper, Tax Implications of Certain Asset Transfers, in April 2003), to resolve the tax treatment of "in-kind" or "in specie" transfers under insolvencies, trust settlements and estate distributions.

2.21 The scope of section FC 2 includes gifting of property. "Property", though not fully defined, encompasses revenue account property such as trading stock. Therefore, where it is gifted, the transaction could be affected by both section GC 1 and section FC 2.

2.22 If any modifications were made to section GC 1's application to trading stock disposals, it could mean making the same limitation apply to section FC 2. For instance, disposals of trading stock as gifts from an estate to a beneficiary could be required to be valued at market value.

Section EB 24

2.23 This provision applies where trading stock is disposed of together with other assets of a business. It provides that a fair apportionment must be made, and the trading stock valued at market rates, which links it closely to section GC 1. As with section FC 2, we note that if permanent amendments are made to section GC 1, consideration should also be given to whether appropriate amendments to section EB 24 are required.

Section GC 21: Purchase price allocation rules

2.24 These rules apply to agreements to dispose of and acquire property of differing categories ("mixed supplies") (including trading stock) entered into after 1 July 2021. They seek to ensure consistency of pricing allocation where assets are sold as a bundle, between vendor and purchaser (similarly to section GC 1 in respect of trading stock – or section EB 24 above). We do not currently consider that changes are necessary, even if section GC 1 were amended.

GST and disposals of trading stock

2.25 This officials' issues paper does not review or otherwise consider the GST treatment of disposals of trading stock. The GST exemption that applies to supplies of donated goods and services by non-profit bodies is also outside the scope of this officials' issues paper.

2.26 For completeness (and as a point of comparison), however, we note that the treatment of disposals of goods and services by GST-registered persons in the course or furtherance of a taxable activity is for the most part determined by

the contractual price agreed by the supplier and the recipient.¹ If the consideration is nil, that is, the goods and services are supplied for free in the course or furtherance of a taxable activity, the supplier's input tax deduction entitlements (in respect of GST paid by the registered person to supply the free goods and services) is left undisturbed. However, in situations where the disposal is:

- an "associated supply",² GST is calculated by reference to the market value of the goods and services (a rule equivalent to section GC 1), or
- the subject of a "change in use"³ adjustment (such as private use), the input tax originally deducted is denied (a rule equivalent to section GZ 5).

Question for submitters

- Are your concerns with section GC 1 adequately articulated in the problem definition section (paragraphs 2.7–2.9)? If not, what are your concerns with section GC 1?

¹ If the supply is treated by the Goods and Services Tax Act 1985 as an "exempt" supply of donated goods and services, GST does not apply and the supplier is unable to recover GST (for example, on overheads) incurred in making the exempt supply.

² The GST Act generally requires associated supplies, such as supplies between associated persons, to be valued at market value, except transactions between GST-registered persons where the recipient is entitled to an input tax deduction. Broadly, the purpose of the market value requirement is to ensure the integrity of the GST base in respect of supplies to final consumers or deemed final consumers.

³ If there is a change from taxable to private use, or use in making an exempt supply, the GST-registered person needs to make an output tax adjustment (that is, pay GST) to reverse the input tax (or part thereof) they previously claimed. In these situations, GST effectively becomes a tax on the production of goods and services by GST-registered persons when the application or use of those good and services is not for the purpose of making taxable supplies.

CHAPTER 3

Trading stock disposals that are not gifts

- 3.1 This chapter considers how section GC 1 could apply to disposals of trading stock at less than market value made in the ordinary course of business.
- 3.2 We consider that different outcomes could apply when there is no connection with a “business” purpose. In this paper, we treat “business” as meaning any context in which trading stock, as defined for the current purposes of section GC 1, is held. This includes some situations where revenue account property is involved, as well as the standard definition of trading stock in section EB 2.
- 3.3 One such outcome should arise where the disposition is a gift. This scenario is dealt with separately in [Chapter 4](#).
- 3.4 In all cases we consider it important to balance factors such as:
- the degree of connection between the income earning process and the disposal of stock
 - any risks to the revenue base if market value is not recognised at the time of the disposal
 - relative compliance costs imposed on businesses
 - the types of trading stock in question, and
 - the relationship between the business and the person to whom the stock is disposed of.
- 3.5 We note that if any change is made, it would be necessary to consider consequential changes to section FC 2, see [Chapter 2](#) above. This would need to ensure as far as possible that the amendments to section GC 1 were not essentially reversed, in whole or part, in the circumstances to which subpart FC applies.

Where there is a business purpose for the transaction

- 3.6 Since the introduction of the first version of section GC 1 in 1949, it has been argued that there are legitimate business reasons (that is, not tax evasion) for selling stock at less than full market value (and therefore the rule should not be applied).
- 3.7 For instance, businesses may often dispose of trading stock for commercial purposes such as marketing or sponsorship arrangements, and in that case some direct profit on those disposals is foregone in the hope that the activities will generate greater future revenues.
- 3.8 When this happens, there may be an argument that the trading stock is not disposed of for less than market value because the business is receiving market value in advertisement and promotion in return.
- 3.9 It is common for some product lines to be sold at a discount in order to clear older stock or to accelerate cashflow for the business, even though viewed in a vacuum, such sales may be considered to be made at less than market value.

- 3.10 Attributing market value, or adequacy of consideration, is often subjective, likely to be inaccurate and expensive.
- 3.11 In situations of this type, it can be argued that requiring recognition of market value results in some legislative overreach. Further, there is also uncertainty whether section GC 1 applies in any given case.
- 3.12 Under the current temporary rules in section GZ 5 (suspending the section GC 1 provisions for the COVID-19 period until 31 March 2024) disposals to non-associates are not subject to the deemed income rule where the disposals have a business purpose. The legislation does not seek to define that term, but the Commissioner will accept that businesses sometimes forgo revenue in the hope that their actions will maximise the future value of the business. Some of the options below include that concept. (Note that section GZ 5 assumes section GC 1 applies in the first place, that is, the arguments that market value consideration has been received are assumed to be incorrect.)
- 3.13 It is possible that trading stock could be disposed of cheaply for no business purpose. This chapter does not specifically deal with that scenario, but the result is likely to be that section GC 1 as it currently stands, would continue to apply.

Transactions with associated persons

- 3.14 Transfers to associated persons allow greater potential for tax planning which may undermine the integrity of the tax system.
- 3.15 This is because of the implicit scope for disposals made at a deep discount without a clear arms-length business reason, to benefit, for example, family members (or the owner of the business – see [Chapter 5](#) below). This has the effect of using the tax system to generate a private benefit (existing deductions for the cost of the stock are not offset by the generation of a market value transaction, or even the recovery of that cost, unless a rule like section GC 1 is applied).
- 3.16 We have accordingly taken as a given that the section GC 1 principle would continue to apply in all scenarios involving transactions with associated persons, and that as a minimum it will remain necessary to calculate, and pay tax on, the market value of trading stock transferred from the business.

Policy options

Option 3.1: Status quo – requirement to treat disposals as made at market value

- 3.17 Option 3.1 would continue to require businesses to report deemed income when trading stock is disposed of at below market value to both associated and non-associated parties. There would be no change to the law.

Advantages

- 3.18 This option recognises that the trading stock rules generally require some form of rule to protect the revenue base from artificial reduction of business profits through transfers of trading stock in ways that result in an incorrect reflection of the real income generated by that business. Section GC 1 is that rule – it is also easier to understand and apply than the general anti-avoidance rule.
- 3.19 Retaining the status quo will ensure there is a backstop principle for goods exchanges. Without section GC 1, goods exchanges even between non-associated parties, for example, businesses in a similar industry, could be made by agreement at less than market value where parties see advantages in assisting each other.
- 3.20 Retaining the rule also ensures consistency with a variety of other rules that deem some transactions to take place at market value, such as transfers of revenue account property, transfers under the bright-line rules or sales of standing timber. If section GC 1 were to be amended, some attention would be required to achieve consistency. Section FC 2 is one example, discussed in [Chapter 2](#).

Disadvantages

- 3.21 This option will not address the perceived overreach outlined in paragraphs 2.7–2.9 (other than in times of emergency when section GZ 5 will apply).
- 3.22 Further, where a business purpose exists, a deduction should be available (in principle). In these situations, the trading stock has been used to acquire a business benefit. The status quo does not provide a net deduction for acquiring that benefit.

Option 3.2: Make the temporary relief (for disposals made for business purposes to non-associated persons) permanent

- 3.23 Option 3.2 is to make the current temporary emergency regime permanent, meaning that it would also apply in normal, non-emergency times. This would mean:
- removing the deemed income rule for disposals with a legitimate business purpose to non-associated persons, and
 - retaining a deemed income rule for transactions with associates (and for trading stock that is forestry and land), and for any transactions lacking any connection with the business (we do not expect this to be a common scenario).

Advantages

- 3.24 This option has the advantage of relative simplicity given that the legislative regime is already established in the emergency context, and reasonably easy to understand.

Disadvantages

- 3.25 This option has the disadvantage of still requiring application of a “business purpose” test to establish whether any amount of deemed income is to be added back. These types of calculations can involve some compliance costs, especially where it may be unclear (for example, if there is a charitable and business component of the disposal).

- 3.26 Where there is no business purpose, or the transfer is to an associate, it is still necessary to calculate the market value of the trading stock disposed of.

Option 3.3: Deemed income and deemed expense subject to deduction rules

- 3.27 Under this option, section GC 1 would be modified to deem the market value income adjustment to be an expense of the taxpayer. This expense would then be deductible if the expense met the general permissions (that is, there is a connection to business income).

Example 3

- Deemed trading stock market value \$1,000
- Deemed expense (\$1,000)
- Trading stock deduction (cost) (\$900)
- Taxable income could be either (\$900) or \$100.

In this example, the taxable income depends on whether the expense is deductible under ordinary principles.

A \$900 deduction is the same answer as for Option 3.2 – a deduction equal to the trading stock’s cost. The difference is that this option requires an explicit testing of the expense’s deductibility under ordinary principles.

Advantage

- 3.28 This option makes the market value and business expense components of a disposal transparent.
- 3.29 This option also makes explicit the need for a business purpose for a net deduction to be available.

Disadvantage

- 3.30 Compared to Option 3.2, which has an implicit requirement for a business purpose, there will be compliance costs – to establish the market value of the trading stock and to determine whether a connection exists for deductibility for the business advantage acquired. This may not be an issue for businesses that already recognise this treatment for their financial statements.

Questions for submitters

- What is your view on the options outlined in this chapter? What additional advantages or disadvantages of each option should officials consider?
- Are there any other options you believe officials should consider in relation to disposals of trading stock that are not gifts?
- Are there any issues with applying any option to revenue account property that is not business trading stock? (Note that "business purpose" includes a connection to income producing activity so assumes that the general permission would be satisfied.)

CHAPTER 4

Gifted trading stock

- 4.1 This chapter considers whether there should be permanent relief for gifts of trading stock made by businesses to certain organisations during non-emergency times, and if so, in what form.
- 4.2 Our assumption is that the temporary relief developed with the COVID-19 emergency in mind will remain available in times of emergency.
- 4.3 However, outside of emergencies, the concerns raised in the problem definition at paragraphs 2.7–2.9 of this paper are still applicable.
- 4.4 This chapter outlines five possible policy options to address the above concerns as they relate to gifts of trading stock.
- 4.5 These options are being considered because the Government recognises that donee organisations make important contributions to the wellbeing of New Zealanders. One of the ways the Government supports donee organisations is by providing favourable tax treatment for donors, through gift deductions, donation tax credits and payroll-giving tax credits. However, that favourable tax treatment must be targeted and effective, both in meeting policy objectives and relative to alternative methods of aiding donee organisations.

The gift deduction framework

- 4.6 A donation or gift is made voluntarily and provides no material advantage to the giver. In line with basic income tax principles, this means a true gift does not have a connection with income, and therefore, a business is not allowed a deduction for the cost of that gift.
- 4.7 However, in order to reinforce and encourage gifting, the income tax system allows businesses and Māori authorities to claim deductions for gifts of money in certain circumstances. Companies and Māori authorities who gift money to approved donee organisations are entitled to a deduction for the gift. There are limits on the available deduction to ensure the concession is appropriately targeted towards charitable or other public benefit giving and to contain fiscal cost. Namely:
 - The gift must be made to an approved donee organisation.
 - The total deduction taken cannot exceed the company's or Māori authority's net income in the corresponding tax year. This "net income cap" has been in place since the 2008/09 tax year.
- 4.8 Limiting deductions to gifts of money means there is no added compliance cost for donors, or administrative cost for Inland Revenue, in respect of the valuation of the donated goods or services. When tax concessions are available for non-cash donations, complex valuation rules may be required, and anecdotal evidence from other jurisdictions suggests this can give rise to tax planning opportunities.
- 4.9 The gift deduction concession also generally aligns with many charities' preference for donations of money, which provide them flexibility to target their work where it is most needed.

Current law

Non-emergency times

- 4.10 As discussed in [Chapter 2](#), a business that gifts its trading stock is treated as deriving an amount equal to the market value of the trading stock at the time of disposal under section GC 1. In cases where the market value of the trading stock is greater than the cost, the business will be required to pay tax on a deemed profit margin as if the trading stock had been sold at market value.
- 4.11 The non-emergency settings for donated trading stock require businesses to determine the market value of trading stock at the point of gifting and include this as income in their tax return.
- 4.12 If the recipient of the gift is another taxpaying business, for tax purposes the recipient is deemed to have purchased the stock at its market value on the day of receipt. If the recipient of the gift is a registered charity, accounting standards for public benefit entities may require the charity to determine the fair value of that gift at the date of acquisition and record that value in its financial statements.

Emergency times

- 4.13 There is scope under the current law to turn on relief for gifts of trading stock to approved donee organisations and public authorities in times of emergency. As discussed in [Chapter 2](#), this relief has two aspects:
- a concessionary rule allowing a net deduction for donations of trading stock to approved donee organisations and public authorities, and
 - a rule deeming a person to derive income equal to the cost of trading stock gifted to non-associated persons (who are not approved donee organisations or public authorities).
- 4.14 This relief can be turned on in times of emergency as defined under the Civil Defence Emergency Management Act 2002.⁴
- 4.15 The concessionary relief for gifts to approved donee organisations and public authorities is specifically targeted to the emergency gifting context. For example, unlike the gift provision for donations of money, the net deduction that arises from the temporary relief is not subject to a cap equal to the donor's net or taxable income. The cap exists in the donations framework primarily to limit the fiscal cost of donation concessions. It means that a donation cannot give rise to a tax loss (which would raise base maintenance concerns).

The charity deregistration tax rules

- 4.16 The charity deregistration tax rules in sections CV 17 and HR 12 impose income tax on the value of the net assets of certain charities that have been deregistered under the Charities Act 2005. These rules are intended to be a disincentive to transfer net assets out of the charitable base once they are settled there.

⁴ See section 4, definition of "emergency" paras (a) and (b). A key aspect is that the event may result in loss of life or injury, or general endangerment to the safety of the public in New Zealand or any part of it.

- 4.17 Under current law, the deregistration tax rules contain a carve-out for gifted assets that are not money. In other words, the deregistration tax will not apply to gifted assets that have not benefitted from a tax concession at the donor level.
- 4.18 If a change was made to allow businesses a permanent concession for gifts of trading stock to donee organisations, businesses would effectively be able to claim deductions for disposing of trading stock to registered charities. A consequential change to the deregistration tax rules may therefore be required to ensure that gifted trading stock that has benefited from a tax concession are not carved-out from the deregistration tax. This would generate compliance costs and a higher deregistration tax liability for some charities.

Policy options

- 4.19 Officials have identified the following policy options in relation to gifts of trading stock that address, to differing extents, some of the concerns mentioned above. We welcome stakeholder feedback on the options and the related questions outlined at the end of this chapter.

Option 4.1: Status quo – temporary relief in emergency times

- 4.20 Option 4.1 maintains the status quo in respect of donated trading stock.
- 4.21 The status quo consists of temporary relief that removes the deemed market value rule for gifts in limited emergency times. For businesses donating trading stock to approved donee organisations and public authorities, a concessionary (compared to a cash donation requirement) net deduction is allowed during the emergency period. For businesses donating trading stock to other persons that are not associated, the business is instead deemed to derive income equal to the cost of the trading stock, resulting in neither a net deduction nor net income for tax purposes.

Advantages

- 4.22 This option recognises that during times of emergency there may be a more pressing need for gifts of trading stock and a greater desire on the part of businesses to gift. This targets the relief to short periods of time and so generally maintains the broad base low-rate system.

Disadvantages

- 4.23 While businesses can support approved donee organisations in non-emergency times by gifting money (from the sale of trading stock for example), some businesses have expressed a preference for donating trading stock. The current settings do not encourage this behaviour outside of limited emergency times.
- 4.24 Although approved donee organisations may generally prefer donations of money, which are incentivised under the current gift deduction framework, the receipt of trading stock in some cases will still be beneficial to them in carrying out their purposes.
- 4.25 Outside of emergency times, section GC 1 may be overreaching to the extent that a business derives deemed net income on gifted trading stock.

Option 4.2: Make the temporary relief permanent

4.26 Option 4.2 makes the current temporary emergency relief permanent, meaning that it would also apply in normal, non-emergency times. This would mean making permanent two separate rules:

- A rule that allows a business to have a net deduction for donations of trading stock to approved donee organisations and public authorities (with no deemed income).
- A rule that allows a business to effectively remove trading stock from the tax base with no net deduction nor deemed income margin for donations to recipients that are not approved donee organisations or associated persons. This is achieved by deeming a business to derive income equivalent to the deduction a business would normally take for the trading stock, being either the cost or the value under section EB 3 at the end of the previous income year.

Advantages

4.27 This option has the advantage of relative simplicity, given the legislative regime is already established. The tax rules would not be a disincentive for businesses donating trading stock. It also reduces compliance costs for businesses donating to donee organisations and public authorities because they are no longer required to determine and record the market value of their gifts on disposal.

Disadvantages

4.28 Even if land and forestry remain excluded from the definition of trading stock for the purpose of this relief (as is the case for the temporary relief), there will be a very wide range of trading stock that will qualify for a tax concession. This may not be appropriate and may be detrimental to charities. For example, it may encourage the donation of goods that charities do not wish to receive or do not have the capacity to receive.

4.29 The emergency proposals were developed with a specific COVID-19 context in mind that may not be suitable for broader application. For example:

- The temporary deduction available for gifts of trading stock is not capped. This is an important deviation from the donation framework, where company, Māori authority and individual donations are capped to the net income or taxable income of the donors. Without change, this would mean a greater tax benefit would arise for gifts of trading stock than gifts of money.
- The temporary concession applies to gifts made to public authorities. This was put in place to ensure donations to public authorities, for example donations of hand sanitiser to hospitals, were covered by the relief. A permanent concession for public authorities would not align with the current donation framework, which limits concessions to donations to approved donee organisations.
- Timber and certain disposals of land are excluded from the definition of trading stock, so that section GC 1 still applies. This exception from the relief reflects the nature of the COVID-19 response and aligns the concession with the types of goods being gifted at this time. The same exceptions may be justified on the grounds that these types of trading stock are unlikely to be of use to approved donee organisations in general,

but there may in fact be more types of trading stock that fall into this category.

- 4.30 Although this option does reduce compliance costs for businesses, it does not align with the legislative approach that allows companies and Māori authorities to deduct gifts of money under sections DB 41 and DV 12 respectively. Under these sections, a deduction is specifically allowed, and the Commissioner requires companies and Māori authorities to report this information in their income tax return. The temporary measures do not allow for this because they merely switch-off a deemed income rule. This may reduce the transparency of the concession as well as Inland Revenue's ability to collect important information about uptake, including whether any concession is in fact changing behaviours in line with the policy intent.

Option 4.3: Make the temporary relief permanent, with several limitations

- 4.31 Option 4.3 makes the temporary relief permanent, with several limitations.
- 4.32 In order to align the trading stock concession with the concession for gifts of money, it could be limited to donee organisations (and not public authorities). Further, the total net deduction (of both money and trading stock) could be made subject to a cap so that it does not exceed the net income of the company or Māori authority, or the taxable income of the individual, for that income year.
- 4.33 Alignment could also be achieved if the net deduction was made available through a provision similar to sections DB 41 and DV 12. To achieve this, section GC 1 would remain in place, requiring the donor to return as deemed income the market value of the gift on disposal. However, under a separate provision, a deduction for the market value of the gift would be allowed for the business where the gift was made to a donee organisation. The total deduction available under this provision and sections DB 41 and DV 12 in a tax year could then be made subject to the net income cap.
- 4.34 This concession could operate alongside a separate, more limited, concession for donations made to a person not associated with the business. In this situation, a deduction would be allowed for the difference between the market value and either the cost or opening value under section EB 3 if the trading stock was acquired in a prior year. As with the current temporary version of this rule, this removes the gift from the tax base, with neither a net deduction nor a net income outcome in the year of disposal.

Advantages

- 4.35 The limitations included in this option would ensure the tax rules for gifts of trading stock to donee organisations align with the broad donation framework, and that they do not act as a disincentive for businesses donating trading stock to non-associated parties.
- 4.36 This option would minimise tax avoidance concerns relating to associated party transactions (where the associated person is not an approved donee organisation). These transactions would still be subject to a deemed income provision at market value.
- 4.37 This option also addresses the concerns raised above at paragraph 4.30. It would make the concession transparent and enable the Commissioner to monitor the use of the incentive, as is the case for deductions taken under sections DB 41 and DV 12. It would also support monitoring of the cap on net deductions taken for trading stock and gifts of money in the tax year.

Disadvantages

- 4.38 There may be some complexity applying a cap to trading stock donations.
- 4.39 Compliance costs would arise if the business is still required to determine and return market value for their gifts and then additionally claim a market value deduction. These costs may, however, be proportionate given the importance of monitoring the use of tax concessions.
- 4.40 Similar to option 4.2, there will be a very wide range of trading stock that will qualify for a tax concession under this option. This may not be appropriate and may be detrimental to charities.
- 4.41 Having a separate rule deeming income at cost or opening value for gifts to non-associated parties that are not donee organisations would introduce more complexity to the donated trading stock rules.
- 4.42 In some cases, the full value of deductions claimed in relation to the gifted trading stock (such as deductions taken for overhead costs) will not be reflected in the cost or opening value of the gifted trading stock. In these cases, a deemed income adjustment equal to the cost of the trading stock may not remove all costs from the tax base.

Option 4.4: Deem all donors to derive income at cost or opening value of the donated trading stock

- 4.43 Option 4.4 extends the temporary relief for gifts to non-associates who are not donee organisations or public authorities to all gifts of trading stock outside of emergency times. Under this option, all donors would be required to report deemed income equal to the lower of cost or opening value of the gifted trading stock on disposal. In effect, the deduction and income would cancel out so there is no net tax affect when trading stock is donated.

Advantages

- 4.44 We have included this option because we are aware that adding further concessions comes at a fiscal cost, which this option would minimise.
- 4.45 Compared to the status quo, this option reduces compliance costs for businesses that would no longer be required to determine the market value of their gifts.
- 4.46 Although it is not concessionary, this option may address perceived unfairness with the tax settings as they relate to gifts. In particular, this option would address the concern where a person is required to pay tax when they make a gift due to the market value being greater than the cost of the gift.
- 4.47 This option is also consistent with the requirement that a donation is made in cash to qualify for a deduction.

Disadvantages

- 4.48 Although it removes a disincentive, this option does not incentivise gifting behaviour.
- 4.49 As mentioned above at paragraph 4.42, deductions taken for overhead costs will not be reflected in the opening value of the trading stock therefore the deemed income adjustment may not remove all related costs from the tax base.

- 4.50 In cases where trading stock is gifted but stays within the tax base (because the donee also holds the assets on revenue account) there would need to be a new rule to clarify the value at which donees bring the gift into account.

Option 4.5: Remove the deemed income rule for gifts of food made to approved donee organisations and non-associates

- 4.51 Option 4.5 provides a permanent trading stock concession for gifts of food to approved donee organisations and non-associated parties. This would affect, for example, farmers and other businesses that gift livestock or food to foodbanks or individuals in need.
- 4.52 In addition to incentivising pro-social behaviour, permanently allowing a net deduction for food gifted to approved donee organisations and non-associates may have environmental benefits.
- 4.53 Currently, section GC 1 acts as a disincentive to gifting food with a market value greater than zero (that is, food that is still fit for consumption and is not past its expiry date). This may result in increased food waste, particularly where a business has food surplus to requirements.
- 4.54 If surplus food is not gifted, it may expire and become unfit for consumption. In this case the market value of the trading stock on disposal will be zero, and the business will in effect get a net deduction for the expired stock. If the food was instead gifted ahead of its expiry date, the business would have a tax liability if the market value of the stock was greater than its cost. This tax setting inadvertently encourages food waste.

Advantages

- 4.55 This option would provide relief for a narrow range of trading stock donations, which would help ensure the relief is appropriate and not detrimental to charities.
- 4.56 This option would minimise the fiscal cost of any relief.
- 4.57 This option would also align with the Ministry for the Environment's waste strategy, which envisages New Zealand as a low-waste society by 2050. A guiding principle of that strategy is "enabling businesses to do the right thing", which this option would encourage.⁵

Disadvantages

- 4.58 Targeting a donation concession to one area such as food will raise the question as to why it is not extended to other charitable purposes with equal benefit to the community.
- 4.59 This option could result in boundary issues and disputes if, for example, the definition of food was not clear.

⁵ Ministry for the Environment, 2023. *Te rautaki para / Waste strategy*. Available at <https://environment.govt.nz/assets/publications/Te-rautaki-para-Waste-strategy.pdf>

Questions for submitters

- What are your views on the options outlined in this chapter? What additional advantages or disadvantages of each option should officials consider?
- Are there any other options or issues you believe officials should consider in relation to gifted trading stock?

What are your views on how each option will change trading stock gifting behaviour? To what extent will gifts of money be replaced by gifts of trading stock? Please provide examples and estimates of amounts involved, if possible. (Please be aware that the information you provide could be released publicly. Clearly indicate in your submission if any information should be withheld on the grounds of privacy, or for any other reason.)

CHAPTER 5

Trading stock disposals that are for personal use

- 5.1 Section GC 1 also applies where a person takes trading stock for their own personal use. Inland Revenue has a longstanding policy on this type of transaction.⁶ It also aligns with the commentary above concerning dealings with associated persons.
- 5.2 The application of a rule such as section GC 1 is necessary in this context because of the deduction rules for trading stock. Those rules override the private limitation in section DA 2, so a person would, without a rule such as section GC 1, effectively be allowed a deduction for trading stock they later take for their own private use. To reflect the fact that the trading stock has been removed from the tax base, the person is therefore deemed to derive income at market value on disposal to themselves.
- 5.3 This policy is not proposed to be amended.

⁶ QB 14/01 *Adjustments for trading stock (including raw materials) taken for own use or consumption*, Inland Revenue
[qb1401.pdf \(ird.govt.nz\)](http://ird.govt.nz/qb1401.pdf)

APPENDIX A

Trading stock disposals: Policy options summary

The options outlined in the below table assume that the temporary relief in sections GZ 4 and GZ 5 are still available via Order in Council in times of national emergency (see section 225ABA of the Tax Administration Act 1994).

Purpose of disposal	Policy option	Business impact: Disposal to donee organisations	Business impact: Disposal to non-associated persons (that are not approved donee organisations)	Business impact: Disposal to associated persons (that are not approved donee organisations)
Business purpose	3.1 Status quo	N/A	Deemed income on disposal at market value (but note possible argument that market value consideration is received albeit not in cash so that section GC 1 does not apply).	Deemed income on disposal at market value
	3.2 Temporary relief becomes permanent	N/A	No deemed income on disposal at market value (<i>unless trading stock is forestry or land, which will have a deemed income on disposal at market value</i>).	Deemed income on disposal at market value
	3.3 Permanent relief with explicit deduction for value of business purpose	N/A	Deemed income on disposal at market value but deem the income adjustment to be an expense of the taxpayer. This	Deemed income on disposal at market value

Purpose of disposal	Policy option	Business impact: Disposal to donee organisations	Business impact: Disposal to non-associated persons (that are not approved donee organisations)	Business impact: Disposal to associated persons (that are not approved donee organisations)
	supported by the disposal		expense would be deductible if it met the general permissions (that is, there is a connection to business income).	
Charitable/benevolent purpose	4.1 Status quo	Deemed income on disposal at market value.	Deemed income on disposal at market value	Deemed income on disposal at market value.
	4.2 Temporary relief becomes permanent	No deemed income on disposal (<i>unless trading stock is forestry or land, which will have a deemed income on disposal at market value</i>).	Deemed income on disposal at cost or opening value under section EB 3 (<i>unless trading stock is forestry or land, which will have a deemed income on disposal at market value</i>).	Deemed income on disposal at market value.
	4.3 Temporary relief becomes permanent but with several limitations	Deemed income on disposal at market value, but there is a corresponding deduction that is subject to a donation cap. (<i>If trading stock is forestry or land, there will not be a corresponding deduction.</i>)	Deemed income on disposal at market value, but there is a corresponding deduction for the difference between market value and the cost or opening value under section EB 3 (<i>unless trading stock is forestry or land, which will</i>	Deemed income on disposal at market value.

Purpose of disposal	Policy option	Business impact: Disposal to donee organisations	Business impact: Disposal to non-associated persons (that are not approved donee organisations)	Business impact: Disposal to associated persons (that are not approved donee organisations)
			<i>have a deemed income on disposal at market value).</i>	
	4.4 Deem all donors to derive income at cost or opening value for gifts to non-associates	Deemed income on disposal at cost or opening value under section EB 3 (<i>unless trading stock is forestry or land, which will have a deemed income on disposal at market value).</i>	Deemed income on disposal at cost or opening value under section EB 3 (<i>unless trading stock is forestry or land, which will have a deemed income on disposal at market value).</i>	Deemed income on disposal at market value.
	4.5 Remove the deemed income rule for gifts of food made to donee organisations and non-associates	Deemed income on disposal at market value, but there is a corresponding market value deduction for gifts of food made to donee organisations, which is subject to a donation cap. (<i>If trading stock is not food, there will not be a corresponding deduction.</i>)	Deemed income on disposal at market value, but there is a corresponding market value deduction for gifts of food made to non-associates, which is subject to a donation cap. (<i>If trading stock is not food, there will not be a corresponding deduction.</i>)	Deemed income on disposal at market value.