Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Donated Trading Stock – extension of current income tax concession period and next steps**

Date:	14 December 2022	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2022/554

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	16 January 2023
Minister of Revenue	**Agree** to recommendations	16 January 2023

Contact for telephone discussion (if required)

Name	Position	Telephone
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14 December 2022

Minister of Finance
Minister of Revenue

Donated Trading Stock – extension of current income tax concession and next steps

Purpose

1. We recommend that a COVID-19-related income tax concession to support businesses donating trading stock, due to expire on 31 March 2023, be renewed for a further 12-month period by way of an Order in Council. Alternatively, a 12-month extension could be achieved by way of a Supplementary Order Paper at the Committee of the whole House stage of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill No 2.

2. This report outlines integrity issues and fiscal costs with further extensions and recommends a review of policy settings.

Context and background

3. A trading stock concession was introduced to support the Government's economic response to the COVID-19 outbreak.

4. In 2020, stakeholders from both the charitable and commercial sectors informed the (then) Minister of Revenue about their concerns that an anti-avoidance rule in the Income Tax Act disincentivises businesses from donating goods. At the time a number of businesses were donating goods, such as medical consumables, hand sanitiser and food to assist with the immediate effects of the lockdown response to COVID-19.

5. The tax rule at issue requires businesses to report the disposal of trading stock at market value as part of their taxable income, even if it is donated or sold to unrelated parties at below market value. This means businesses are effectively taxed on a deemed profit margin for the trading stock they donate. This rule is designed to stop the transfer of business assets from the tax base for insufficient consideration. It also supports the policy setting that only gifts of money to certain approved donee organisations will qualify for tax gift concessions.

6. The rule is consistent with the policy setting that requires market value adjustments when other property is transferred out of the tax base. We also note that businesses have the option of reducing the rule's effect if they sell their trading stock on the open market and donate the proceeds to charity.

7. However, we consider that this rule, which was introduced principally as an integrity measure, can overreach in some situations by imposing tax when tax avoidance is not a concern. The overreach is not limited to COVID-19 but has been exacerbated by it because some businesses made more donations of trading stock in response to the COVID-19 outbreak.

8. There was a precedent for temporarily switching off the rule, which occurred for an 18-month period in response to the Canterbury earthquakes in 2010-2012.

9. You agreed to amendments which were included in the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021. The

amendments provided relief for disposals of trading stock, excluding land, forestry and other similar items, to the following classes of person:

9.1 Public authorities and donee organisations (the latter are organisations whose donors can claim a tax benefit, such as the donation tax credit, for monetary donations made to the organisation), and

9.2 Non-associated persons (which are not public authorities or donee organisations) if the business:

9.2.1 can demonstrate the disposal is made for business purposes (in this case a full deduction is permitted and a market-value income adjustment is not required) or

9.2.2 makes a gift (in this case no deduction is permitted and a market-value income adjustment is not required).

10. The amendments also authorised the making of an Order in Council to extend the relief if the Minister of Revenue is satisfied that people in New Zealand are significantly adversely affected by COVID-19 or if there is an emergency event that significantly adversely affects people in New Zealand.

11. Cabinet initially approved relief from the rule for a two-year period from 17 March 2020 to 16 March 2022 (CAB-21-MIN-0013.02 refers). Cabinet then approved relief for a further one-year period from 17 March 2022 to 31 March 2023 (DEV-22-MIN-0015 refers).

12. There is public interest in this issue. We understand that members of the Corporate Taxpayers Group discussed the treatment of donated trading stock with the Minster of Revenue on 8 December 2022. A submitter has also raised the issue with the Finance and Expenditure Select Committee as part of the hearings on the Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Bill (No. 2).

13. s 9(2)(f)(iv) [redacted]

Proposal

14. We recommend extending the temporary relief, for business taxpayers that dispose of trading stock at below market value, for a further 12-month period ending 31 March 2024.

15. The Income Tax Act 2007 allows 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 to be significantly adversely affected by COVID-19 beyond 31 March 2023.

16. Alternatively, a 12-month extension could be achieved through primary legislation, by way of a Supplementary Order Paper at the Committee of the whole House stage of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill No 2.

Rationale for extending the relief

New Zealand's approach to COVID-19 relief measures

17. Under the Epidemic Preparedness Act 2006, the Prime Minister declared by notice that COVID-19 was likely to significantly disrupt essential governmental and business activity in New Zealand. That Epidemic Notice was first issued in March 2020 and was renewed every three months until October 2022. In October, the decision was taken to allow the Epidemic Notice to expire, because significant disruption was no longer likely.

18. The current use of COVID-19 Orders has been authorised under the COVID-19 Public Health Response Act 2020. Some measures such as the seven-day isolation period for cases remain, based on evidence that there is a risk of an outbreak or the spread of COVID-19.

19. In addition, the Government is continuing to provide some financial support. For example, support is provided to people who are required to isolate through the Leave Support Scheme. People affected by COVID can also access support through the Care in the Community welfare response, which includes the provision of food parcels.

20. However, the emergency COVID provisions and almost all economic support schemes have been stopped.

Inland Revenue's approach to COVID-19 relief measures

21. Inland Revenue's current position is that we are unlikely to extend other COVID-19 determinations. For example, for the purpose of remission of interest, the Minister of Revenue can only make an Order in Council to extend the time limit of the COVID-19 concession if the Minister is satisfied that ***the ability of taxpayers to pay tax on time*** is likely to continue to be significantly adversely affected by COVID-19. Inland Revenue has taken the view not to extend the COVID-19 determinations on the basis that the consequences for taxpayers are not as severe as was the case during the lockdowns.

Extending donated trading stock relief

22. The provision for donated trading stock deliberately takes a broader view and requires the Minister of Revenue to be satisfied that ***"people in New Zealand"*** are likely to continue to be significantly adversely affected by COVID-19. The Minister is not required to be satisfied that COVID-19 has impacted on matters directly relevant to their tax behaviour, nor is he required to be satisfied that the recipients of donations are significantly adversely affected by COVID-19.

23. At the time of preparing this report there has been an uptick in cases and hospitalisations (there are currently over 400 people in hospital with/for COVID-19, including 10 in intensive care). While there is no longer a significant adverse impact for people collectively, reflected in the decision to not renew the Epidemic Notice, there will be a significant adverse impact for a number of individuals and families (at any point in time, and over the course of a year).

24. Proportionate measures are still necessary to protect the most vulnerable. On balance, we consider that there are people in New Zealand who are significantly adversely affected by COVID-19 and this could justify an extension of the donated trading stock relief provision.

25. We note that our recommended extension is likely to be the last one that can be permitted under current law, unless there is a further resurgence of COVID-19 or another national emergency occurs after 31 March 2024.

Legislating donated trading stock relief for a 12-month period

26. If the current COVID-19-related Order in Council relief is not extended because the Minister of Revenue may not consider that the threshold (that people in New Zealand are likely to be significantly affected by COVID-19) is met, the Minister could authorise a Supplementary Order Paper to the current bill, extending the relief for a 12-month period. This will allow time for officials to develop, and recommend if appropriate, a permanent solution for donated trading stock.

s 9(2)(f)(iv)

[redacted]

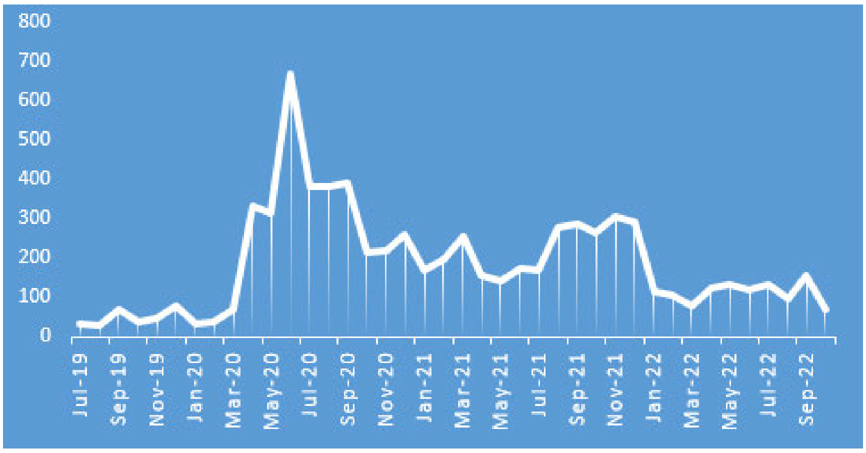
s 9(2)(f)(iv)

Fiscal implications

32. The original fiscal cost of the tax relief provided by the changes enacted in 2021 was estimated to be $10 million, which was spread across the 2020/21 to 2022/23 fiscal years (the relief applied to one tax year, but the impact was spread across multiple fiscal years because taxpayers file at different times). The extension agreed to earlier this year,[1] had an estimated fiscal cost of $5 million spread across the 2022/23 and 2023/24 fiscal years.

33. The fiscal cost of the further extension recommended in this report is expected to have lower fiscal cost of $2.5 million spread over the 2023/24 and 2024/25 fiscal years. This is based on an assumption that gifting is slowly reducing to pre-COVID levels. For example, the Auckland City Mission provided us with the below graph, which shows that upticks in donated goods related primarily to the COVID-19 directed lockdowns (April 2020, August 2021). The volume of donated goods since then has fallen, but as at October 2022 remains about twice that of pre-COVID levels.

Graph: Auckland City Mission – Pallets of donated food and toiletries



34. We recommend that the fiscal cost be charged against the Tax Policy scorecard. We consider the change assists with taxpayer compliance until such time as we complete policy work on whether tax relief on donated trading stock should become a permanent feature of the income tax system.

35. The Treasury has concerns about the accuracy of the costings (although data limitations mean that there may not be a way to improve these) and has not formed a position on the proposal's value for money.

Administrative implications

36. There are no material administrative implications connected with extending the tax relief for donated trading stock to 31 March 2024.

Consultation

37. Officials undertook targeted consulted on this issue in 2020, which was largely focused on a temporary solution at the time. Feedback from stakeholders was incorporated into the temporary solution. We have not formally consulted with

[1] Tax Administration (Extension of Period of Relief for Certain Disposals of Trading Stock) Order 2022, SL 2022/55

stakeholders as part of the preparation of this advice, however we have had discussions with the Auckland City Mission over the last few weeks.

38. We have discussed the issues raised in this report with the Ministry of Health, s 9(2)(f)(iv)
s 9(2)(f)(iv)

39. The Treasury was consulted in the preparation of this report.

Next steps

40. If you agree with the recommendations in this report we will:

40.1 Either prepare a paper to the Cabinet Legislation Committee seeking its approval to an Order in Council that would extend the current relief for donated trading stock to 31 March 2024. We will instruct the Parliamentary Counsel Office to draft an Order in Council, giving effect to the above,

or

40.2 Draft a Supplementary Order Paper to the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill No 2, to be included at the Committee of the whole House stage,

and

s 9(2)(f)(iv)

Recommended action

41. We recommend that you:

(a)(i) EITHER

Agree to use the existing COVID-19-related Order in Council process to extend the exclusion from the deemed income rule for trading stock disposed of at below market value to 31 March 2024, and that officials be directed to prepare a paper to Cabinet Legislation Committee seeking its approval to an Order in Council

Agreed/Not agreed Agreed/Not agreed

(ii) OR

Agree to extend the exclusion from the deemed income rule for trading stock disposed of at below market value until 31 March 2024 by way of a Supplementary Order Paper at the Committee of the whole House stage of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill No 2.

Agreed/Not agreed Agreed/Not agreed

(b) **Note** the following change as a result of the decision in recommendation (a) above, with a corresponding impact on the operating balance and net core Crown debt.

	$m – increase/(decrease)				
Vote Revenue	**2022–23**	**2023–24**	**2024–25**	**2025–26**	**2026–27 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.000)	(1.000)	(1.500)	(0.000)
Total change in Revenue	**0.000**	**0.000**	**1.000**	**1.500**	**0.000**

Noted　　　　　　　　　　　　　　　　Noted

(c) **Agree** that the cost of the reduction in tax revenue shown in recommendation (b) above be charged against the Tax Policy Scorecard.

Agreed/Not agreed　　　　　　　　　　　　Agreed/Not agreed

(d) s 9(2)(f)(iv)

Agreed/Not agreed　　　　　　　　　　　　Agreed/Not agreed

s 9(2)(a)

Stewart Donaldson
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon Grant Robertson
Minister of Finance
/ /

Hon David Parker
Minister of Revenue
/ /