

Hon Barbara Edmonds, Minister of Revenue

Information Release

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

September 2023

Availability

This information release is available on Inland Revenue's tax policy website at <https://taxpolicy.ird.govt.nz/publications/2023/2023-ir-cab-dev-23-sub-0146>

Documents in this information release

#	Reference	Type	Title	Date
1	DEV-23-SUB-0146	Cabinet paper	Disposals of trading stock at below market value: an officials' issues paper	19 July 2023
2	DEV-23-MIN-0146	Minute	Disposals of trading stock at below market value: an officials' issues paper	19 July 2023

Additional information

The Cabinet paper was considered by the Cabinet Economic Development Committee on 19 July 2023 and confirmed by Cabinet on 24 July 2023.

One attachment to the Cabinet paper is not included in this information release as it is publicly available:

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

Information withheld

No information was withheld for this information release.

Accessibility

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In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

DISPOSALS OF TRADING STOCK AT BELOW MARKET VALUE: AN OFFICIALS' ISSUES PAPER

Proposal

- 1 This paper seeks the Cabinet Economic Development Committee's approval to release for consultation an officials' issues paper (the Paper) on the tax treatment of disposals of trading stock at below market value.

Relation to Government Priorities

- 2 The income tax setting relating to disposals of trading stock at below market value contains an overreach, both for disposals made in the ordinary course of business and disposals in the nature of a gift. Developing a permanent solution to this overreach is a priority on the Government's tax policy work programme.
- 3 Public consultation on possible solutions will support the development of tax settings that are fair and sustainable in the longer-term, in line with the Government's revenue strategy.

Background

- 4 In 2020 officials consulted on temporary changes to deemed income rules relating to disposals of trading stock. This was part of the Government's COVID-19 response to concerns that the tax rules disincentivise businesses from donating trading stock. The rules causing this disincentive had been temporarily removed in response to the Canterbury earthquakes in 2010-2011.
- 5 The consultation highlighted a general perception of unfairness amongst tax practitioners and businesses in relation to the rules. Officials agreed that the rules can overreach in relation to some disposals.
- 6 The 2020 consultation led to the enactment of temporary relief from the deemed income rules for both COVID-19 and for potential future emergencies [CAB-23-MIN-0032 refers]. The COVID-19 measures are due to expire on 31 March 2024.
- 7 Although the temporary measures alleviated immediate concerns raised by businesses, a permanent solution is necessary going forward. Further consultation is required, particularly given the emergency provisions were developed under relative urgency. Consultation is also important given the rules in question have been a longstanding aspect of the income tax settings and provide important integrity protections.

- 8 Public consultation through the attached Paper will support the development of a coherent and fair set of permanent rules that maintains these protections.

Current law

- 9 A rule in the Income Tax Act 2007 deems businesses disposing of trading stock to have income equal to the market value of those goods.
- 10 The deemed income rule was introduced in the late 1940s as an anti-avoidance measure intended to counter situations such as when a retiring farmer gifted livestock to a relative who was also a farmer. Income tax was avoided by the retiring farmer on the gift and the succeeding farming business could revalue the stock brought onto its books at market value.
- 11 The rule is important because it protects the revenue base from the artificial reduction of business profits through transfers of trading stock.
- 12 However, the provision was drafted broadly and applies in circumstances when tax avoidance is not a concern. This overreach occurs both for disposals made in the ordinary course of business and disposals in the nature of a gift.
- 13 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 not allowing a net deduction for trading stock disposals when a business purpose exists, and by applying the rule to transactions between non-associated parties.
- 14 For disposals made for charitable purposes, 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.
- 15 As part of the Government's COVID-19 response, relief was provided to turn off the deemed income rule for certain gifts of trading stock as well as for disposals that were made for a business purpose.

Officials' Issues Paper

- 16 Because of the public interest in this matter and the different options which could be adopted for a permanent solution, I recommend that officials undertake consultation with interested stakeholders with a view to developing a permanent solution going forward.
- 17 The Paper consults on various policy options to change the rules permanently as well as retention of the status quo. The options relate to disposals in the nature of a gift for which there is no business purpose and other disposals that may or may not be made for a business purpose.

Disposals of trading stock that are not gifts

- 18 The Paper contains two new options that would in effect make the temporary relief for business disposals permanent, allowing a net deduction for trading stock disposed of to non-associated persons for a business purpose.

Disposals of trading stock that are gifts

- 19 The Paper contains four new options for the tax settings as they relate to gifts. The options include making the temporary relief permanent and making the temporary relief permanent but with certain limitations to align the rules with donations of money.
- 20 One of the options would allow a net deduction for gifts of food. This option was specifically suggested by the Prime Minister's Chief Science Advisor, who is concerned the current tax settings promote food waste.

Risks

- 21 Stakeholders are anticipating this consultation on permanent options, following officials' targeted consultation on the temporary extensions for COVID-19 relief. We expect the Paper to be welcomed by business groups as well as donee organisations, as all the proposed changes address the perceived overreach to some extent.
- 22 Given that the temporary relief ends on 31 March 2024, there will be an expectation from some stakeholders that policy decisions are made and legislation is enacted in a short timeframe.

Financial Implications

- 23 There are no financial implications associated with this Cabinet paper. However, all options included in the Paper (apart from the status quo options) would have a fiscal cost if implemented. If these options progress into final recommendations their costs will be quantified and reported back to Cabinet.

Impact Analysis

Regulatory Impact Assessment

- 24 As requested by the Treasury, the Inland Revenue QA panel has reviewed the discussion document and determined that it contains sufficient impact analysis to support Cabinet's decision to release it. Therefore, a separate regulatory impact statement (RIS) is not required at this stage. A full RIS will be completed at a later stage to inform Cabinet's final decisions on this proposal.

Climate Implications of Policy Assessment

- 25 A Climate Implications of Policy Assessment is not required.

Population Implications

- 26 The options included in this Paper would primarily affect businesses and donee organisations. My officials will consider the exact impacts of the various options in later advice following consultation.

Consultation

- 27 The content of this paper has been informed by targeted consultation by my officials with taxpayer representatives that occurred in 2020 in response to COVID-19.
- 28 The Treasury was consulted in developing the Paper. My officials will consult further with agencies in developing final policy recommendations.
- 29 My officials also engaged with the Chief Science Advisor to the Prime Minister in developing the option relating to disposals of food.

Communications

- 30 If Cabinet agree, the attached consultation paper will be published for consultation on the Inland Revenue website. The consultation will remain open for a period of six weeks.

Proactive Release

- 31 I propose to proactively release this Cabinet paper, associated minutes, and key advice papers with appropriate redactions within 30 working days of Cabinet making final decisions.

Recommendations

The Minister of Revenue recommends that the Committee:

- 1 **note** the contents of the attached officials' issues paper;
- 2 **approve** the release of the attached officials' issues paper for a six-week public consultation period;
- 3 **note** that I will provide a further Cabinet paper seeking final policy approvals if, following consultation, I prefer an option other than the status quo.

Authorised for lodgement

Hon David Parker

Minister of Revenue



Cabinet Economic Development Committee

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Disposals of Trading Stock at Below Market Value: Release of Officials' Issues Paper

Portfolio **Revenue**

On 19 July 2023, the Cabinet Economic Development Committee:

- 1 **noted** that:
 - 1.1 the Tax Administration (Extension of Period of Relief for Certain Disposals of Trading Stock) Order 2023 provides for the temporary relief from deemed profit rules for certain gifts of trading stock as well as for disposals that were made for a business purpose [CAB-23-MIN-0032];
 - 1.2 the Order was part of the government's response to COVID-19 and is due to expire on 31 March 2024;
- 2 **noted** that the officials' issues paper *Disposals of Trading Stock at Below Market Value* (the officials' issues paper), attached to the submission under DEV-23-SUB-0146, considers different options for the tax policy rules that could be adopted as a permanent solution;
- 3 **approved** the release of the officials' issues paper for a six-week public consultation period, subject to any minor or technical amendments that may be required;
- 4 **noted** that the Minister of Revenue will report back to Cabinet seeking final policy approvals if, following the consultation, the Minister prefers an option other than the status quo.

Sam Moffett
Committee Secretary

Present:

Hon Grant Robertson (Chair)
Hon Willie Jackson
Hon Damien O'Connor
Hon Andrew Little
Hon David Parker
Hon Priyanca Radhakrishnan
Hon Kieran McAnulty
Hon Ginny Anderson
Hon Barbara Edmonds
Hon Rino Tirikatene
Hon Rachel Brooking

Officials present from:

Office of the Prime Minister
Officials Committee for DEV