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Deputy Commissioner, Policy and Regulatory
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Our ref Trading stock
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Dear Stewart and Lucy

Disposals of trading stock at below market value

We welcome opportunity to make a submission on the Officials' Issues Paper, *Disposals of trading stock at below market value*.

We are pleased to see that Inland Revenue is considering a permanent solution to the issue of disposals of trading stock at below market value resulting in taxable income, particularly as significant time has been spent in recent years developing a temporary emergency event-based solution, rather than addressing the underlying problem.

We agree that the current rules for the disposals of trading stock at below market value need revision. The application of the deemed market value rule in section GC 1 of the Income Tax Act 2007 is too wide and is a disincentive for taxpayers to donate trading stock. And in some instances, we expect that it may not be being applied at all (either deliberately or more likely inadvertently).

Where a taxpayer disposes of trading stock at less than market value to an unassociated person there will generally be a good commercial reason for the disposal, even if there does not appear to be any direct nexus with the day-to-day business activities of the taxpayers. For example, increasingly, there is a societal expectation that businesses will contribute, in varying ways, to the community in which they operate in. This contribution may take the form of a donation of goods or a contribution of time or services. Although there may not be a direct link that is immediately apparent between a donation of trading stock and the activities of the business, there will be the expectation on businesses that they will support community initiatives as part of their wider "social licence" to operate in a responsible manner. Therefore, any solution that requires an explicit nexus to be established with business activities or deriving ordinary income will result in disproportionate compliance costs for the potential revenue at risk (if any).

This is highlighted in paragraph 3.25 of the officials' paper which note that under option 3.2 the calculation to determine the deemed income would impose compliance costs in situations where there is both a charitable and business component to the disposal of trading stock.

In our view, the "business purpose test" requirement in option 3.2 should be omitted, as in almost all circumstances there will be a wider business imperative as outlined above, even where the disposal could also be considered to have a charitable component. In practice, it would be



extremely difficult to split a donation of trading stock into the separate business and charitable components. And we question for what purpose? Such a split would necessarily be arbitrary and at risk of being subject to challenge by Inland Revenue, further increasing compliance costs to somehow try to “get it right”. The additional costs that would be imposed are not justified, in our view.

KPMG’s is strongly of the view that the tax rules should support the donation of trading stock by businesses in both times of disaster or emergency, and where the donation is to support community initiatives (such as the donation of goods to community groups for fundraising initiatives). But the tax rules also need to be workable.

We therefore submit that any market value override on the disposal of trading stock for less than market value should be restricted to transactions with associated persons or where the trading stock is taken for personal consumption. We believe that section BG 1 can be effectively utilised to deal with the latter, where required.

If you would like to discuss our submission with us, please contact Rachel Piper on 09-363-3525.

Yours sincerely

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