

# Regulatory Impact Statement

## Tax relief for donated goods – Christchurch earthquake

### Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

It provides an analysis of options to provide tax relief for goods donated (or supplied for less than market value) to support the Christchurch earthquake relief.

The analysis has been undertaken in a very constrained timeframe, due to the urgency of the Government decisions that are required. This has severely limited the depth of research and analysis able to be undertaken. Where fiscal cost estimates have been made there is a significant degree of uncertainty involved due to difficulties in accurately estimating the value of donations (or supplies for less than market value) that may be made.

As a result of the urgency of the Government decisions that need to be made in relation in this problem, consultation has been extremely limited but the relief applies for a limited period only. Consideration has been given to correspondence received by Ministers and officials in connection with the issue. Consultation has been undertaken with the Treasury and the Treasury supports Inland Revenue's conclusions and recommendations.

None of the policy options would impose additional costs on businesses, impair private property rights, restrict market competition, reduce the incentives for businesses to innovate and invest, or override fundamental common law principles.



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## **STATUS QUO AND PROBLEM DEFINITION**

### **Background**

1. Following the Christchurch earthquake on 22 February 2011, many individuals and businesses have donated (or supplied for less than market value) goods, as opposed to making cash donations, to those affected by the Christchurch earthquake. Several public calls have been made to Ministers and officials seeking legislation to provide tax relief for donated goods, especially trading stock donated by businesses.

### **Current law**

2. Section LD 1 of the Income Tax Act 2007 ("ITA") allows an individual who makes a charitable or other public benefit gift to claim a tax credit of one-third of total gifts made to donee organisations in a tax year, up to the level of their taxable income. Section DB 41 of the ITA allows a company a deduction for a charitable or other public benefit gift that it makes to a donee organisation. Such deductions are limited to the level of the company's net income in the corresponding tax year (before deducting the donation amount).

3. Section GC 1 of the ITA treats a person who disposes of trading stock for no consideration or for an amount less than market value as having derived an amount equal to the market value of the trading stock at the time of disposal.

4. Under the Estate and Gift Duties Act 1968 ("EGDA"), gift duty is payable on gifts made by a person exceeding an aggregate value of \$27,000 in a 12-month period. For gift duty purposes, a gift is something given, other than by will, where the person making the transfer (the donor) does not receive fully adequate consideration in money or money's worth.

### **The policy problem**

5. Currently, those donating goods in response to the Christchurch earthquake are not eligible for the donations tax credit or the company donation deduction.

6. The effect of section GC 1 of the ITA is that people donating (or supplying for less than market value) trading stock in response to the Christchurch earthquake will have to return as income for tax purposes the full market value of that trading stock.

7. The provision of trading stock for less than market value would also constitute a gift under the EGDA.

8. Officials are aware that donations of trading stock to people affected by the Christchurch earthquake have already occurred and are probably widespread. It can be reasonably assumed that many people making these donations of trading stock lack awareness of the current law.

9. The immediate provision of goods to those in need is of vital importance to the Christchurch earthquake relief effort. The existing tax laws do not encourage the donation (or supply for less than market value) of goods to assist the Christchurch earthquake relief.

10. The existing tax laws are designed to deal with manipulation by businesses. As a result, they do not deal adequately with donations of trading stock, particularly in circumstances such as the Christchurch earthquake. This is an unintended policy outcome due simply to the donation of trading stock by businesses to disaster victims not having been contemplated.

## **OBJECTIVES**

11. The desired Government outcomes are to:

- ensure that the tax treatment of goods donated (or supplied for less than market value) as part of the Christchurch earthquake relief is appropriate;
- ensure that the revenue base remains sufficiently protected; and
- provide certainty to those making or contemplating making donations (or supplies for less than market value) of goods as part of the Christchurch earthquake relief.

12. The desired Government outcomes must be achieved within a short timeframe. This is because they are responding to a devastating event that has already occurred. Ideally, people should have certainty as to what the tax treatment will be in respect of certain things they have done or are contemplating doing as soon as practically possible.

## **REGULATORY IMPACT ANALYSIS**

13. Several different options have been considered to address the problem and achieve the desired Government outcomes. Options 1 and 2 are alternatives to one another. Option 3 is a separate option, which could be used either by itself, or in conjunction with option 2, but not in conjunction with option 1.

### **Option 1: Make all non-monetary donations eligible for tax relief**

14. Currently, non-monetary donations are not eligible for the donations tax credit (for individuals) or the company donation deduction. An option that has been considered is making all non-monetary donations eligible for the donations tax credit (for individuals) and the company donation deduction.

15. This option would be a significant change to the current policy settings for charitable giving. Furthermore, this is a policy change that has previously been considered and rejected by the Government.

16. Such a policy change would be complex and fiscally expensive and there would be real risk to the revenue base. A key problem area is the valuation of non-cash items, especially where there is no easily ascertainable market for those items, such as second-hand goods.

17. If this option were chosen, there would be no gift duty problem as the charitable giving tax incentives are only available for gifts to donee organisations and such gifts are already exempt from gift duty.

### **Option 2: Make donated trading stock eligible for tax relief**

18. Currently, businesses donating (or supplying for less than market value) trading stock in response to the Christchurch earthquake will have to return as income for tax purposes the full market value of that trading stock. The public calls regarding the tax treatment of donations have been principally focused on trading stock. An option that has been considered is a

targeted earthquake related donated trading stock provision. For completeness, this option would cover the 4 September 2010 Canterbury earthquake as well as the 22 February 2011 Christchurch earthquake.

19. Under this option, the disposal of trading stock by businesses would be valued at the actual consideration, if any, received (normally nil). This would apply for trading stock disposed of with the intention of helping to alleviate the impact of the earthquakes. The rule would provide that the trading stock must be:

- of a type the donor or supplier normally deals in;
- donated or supplied for less than market value;
- donated or supplied to non-associated persons; and
- donated or supplied within four months from the applicable earthquake.

20. Implementing a specifically targeted donated trading stock provision would reduce the risk to the revenue base. Also, there is a precedent already existing in current law in respect of transfers of livestock because of self-assessed adverse events.

21. It is difficult to accurately estimate the expected fiscal costs of such a measure due to difficulties in estimating the value of donations (and supplies for less than market value) that may be made. Officials' best estimate is that the fiscal cost of this option and option 3 would be \$3 million in the 2010/11 fiscal year.

22. It is not expected that there would be significant compliance or administration costs as a result of this option.

23. If this option were chosen by itself, there would still be a gift duty problem because the provision of trading stock for less than market value would constitute a gift under the EGDA.

### **Option 3: Make donated trading stock exempt from gift duty**

24. Currently, under the EGDA, the donation (or supply without receiving fully adequate consideration in money or money's worth) of goods made as part of the Christchurch earthquake relief will be subject to gift duty if the donor makes gifts exceeding an aggregate value of \$27,000 in a 12-month period, and those gifts do not fall within one of the current exemptions.

25. An option that has been considered is to exempt from gift duty any gifts of trading stock in the same circumstances covered in option 2 above.

26. This option would result in a reduction in gift duty collected by the Crown but would help to encourage the donation of trading stock for those who seek to support the Christchurch earthquake relief, by removing tax costs which disincentivise gifting.

## **CONSULTATION**

27. The urgency of the Government decisions that need to be made in relation to this problem has meant that consultation has been extremely limited. Consideration has been given to correspondence received by Ministers and officials in connection with the issue. Consultation has been undertaken with the Treasury and the Treasury supports the preferred option.

## **CONCLUSIONS AND RECOMMENDATIONS**

28. Officials have considered the options outlined above. Officials consider that implementing option 2 in conjunction with option 3 would best address the problem in a way that meets the desired Government outcomes. This solution limits the potential cost and risks associated with providing tax relief for donated goods, and removes the disincentives faced by businesses in regard to the donation (or supply for less than market value) of trading stock in aid of the Christchurch earthquake relief. It provides appropriate tax relief for businesses that are supporting the earthquake relief effort, whilst providing the necessary degree of protection to the revenue base and avoiding the major problems that would be created by widening the charitable giving tax incentive provisions to include non-monetary donations.

## **IMPLEMENTATION**

29. The proposed options would be given effect by amendments to the ITA and the EGDA. The amendments would apply retrospectively. The legislative vehicle for these amendments is a special omnibus earthquake related tax bill expected to be introduced and enacted in May 2011.

30. Officials do not foresee any systems issues arising in connection with the implementation of the proposed options.

## **MONITORING, EVALUATION AND REVIEW**

31. In general, Inland Revenue monitoring, evaluation and review of new legislation takes place under the Generic Tax Policy Process ("GTPP"). The GTPP is a multi-stage tax policy process that has been used to design tax policy in New Zealand since 1995. The final stage in the GTPP is the implementation and review stage, which involves post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external consultation are also built into this stage. In practice, any changes identified as necessary for the new legislation to have its intended effect would generally be added to the Tax Policy Work Programme, and proposals would go through the GTPP.