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Purchase price allocation
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
Wellington

By email: webmaster@ird.govt.nz

Tax policy consultation – Purchase price allocation – Issues Paper

1. The New Zealand Law Society (the Law Society) welcomes the opportunity to comment on the proposals in the tax policy Issues Paper on *Purchase Price Allocation, December 2019* (Paper).

The problems

2. According to the Paper, the current law on purchase price allocation is problematic in two main respects.

3. First, whilst the Income Tax Act 2007 (the Act) generally requires the parties to the sale of a business to allocate to the assets the subject of the sale their market value, it does not always require them to adopt the same value. That is, they might adopt different values, while both asserting that the value they have adopted is within the range of market values.

4. Secondly, the Act arguably leaves scope for the parties to an arm's length transaction to assert that whatever value they agree to allocate to an asset must be market value (because they are dealing at arm's length), and that it is therefore immune to challenge by the Commissioner.

5. The Law Society acknowledges that these issues can arise under the current law.

The proposed solutions

6. Inland Revenue propose that the Act should be amended so that the parties to a transaction are required to adopt the same allocation.

7. Inland Revenue further proposes that the allocation should be based on market values; and that the Commissioner should be empowered to challenge any allocation that she considers not to be at market value, even if it has been adopted by both parties.

Vendor setting values

8. The Law Society has reservations as to the proposal that in various circumstances the vendor should set the values allocated to the assets, and that the purchaser should be required to use the values determined by the vendor.

9. This proposal would seem to put too much power in the hands of the vendor, and to leave the purchaser at risk of being unable to determine its tax position on completion of the transaction. The proposal assumes that a purchaser who objects to the vendor's allocation will be able to renegotiate the price, or to postpone entering into an agreement until the allocation is resolved. However, in practice these assumptions may be unrealistic.

10. Officials should consider whether the proposed procedure for resolving disputes will be unduly time-consuming and unpredictable.

Defaults

11. It would be desirable for the law to provide for a series of default rules for allocating values, and the Law Society proposes as follows.

12. First, for trading stock the default should be the vendor's carrying value. That is commonly how the allocation is effected under the current law.

13. Secondly, for depreciable property, the default should be the vendor's tax written down value. Again, that is commonly how the allocation is effected under the current law. A rule to this effect is also suggested as a possibility in the Issues Paper at [5.7] and [5.15]-[5.19]. It may be, however, that this rule produces inappropriate results in some circumstances, such as where the vendor has constructed or developed the asset (and, more particularly, where the asset is software or some other fixed-life intangible property). It might be prudent to provide for an exception for such property. If there were to be such an exception, it would be important to consider what its scope should be, and how the price to be allocated to such property should be determined. These issues would benefit from further consideration.

14. Thirdly, for other revenue account property, there is commonly no conveniently available default figure. The rule should therefore be that both parties must use the same figure, and that that figure should be market value at the time of completion. If the parties fail to agree, the rule should perhaps be that the purchaser must obtain a valuation, and that both parties must use it.

15. Fourthly, if there is to be a series of default rules, it would be helpful to have one for non-depreciable capital property (in particular, land and buildings). This is because it might seem anomalous to have a rule for all classes of property other than non-depreciable capital assets (leaving aside goodwill, which is usually a residual), and) the legislation would be cleaner if it were simply to require the parties to use the same allocation for *all* assets covered by the transaction. Should there be a default rule for land and buildings, one possibility would be to use the valuations local bodies use for rating purposes.

16. These four rules should be merely defaults. That is, the parties should remain free to agree other figures, as long as they both use the same figures and whatever figures they use are within the range of market values.

17. It is possible that default rules (or any rules) would in some circumstances produce results not in accordance with market. It seems unlikely, however, that that would be problematic because (a) such results would usually operate to the Revenue's

advantage and (b) the parties would usually therefore elect to agree upon some other figure in accordance with market, rather than fall back on the default rule.

The total price of the transaction

18. Whatever rules are adopted (whether default rules as suggested here, or any other rules), they might sometimes produce prices that add up to more than the total price of the transaction, as, for instance, in a fire sale. As indicated in the Paper, the appropriate solution to this problem would be a proportionate reduction in the allocated market prices. It would be helpful if the Paper set out how such calculations are to be carried out.

The de minimis rule

19. It would be appropriate, as proposed, that the price allocation rules should be subject to some *de minimis* exception. It may simplify compliance and administration if the *de minimis* were to relate to the total consideration for the transaction, rather than to the amount deductible or depreciable. On that basis, an appropriate *de minimis* might be, for instance, $500,000 or $1,000,000. Many small business sale and purchase transactions will occur without the benefit of advisers, and a suitable *de minimis* should assist those transactions.

Timing

20. The proposed changes will require law firms and others to amend the precedent documents they use in connection with sales of businesses, so it would be helpful if practicioners were given sufficient time to update their operational documents to incorporate the changes. For example, if the new rules are to take effect from 1 April 2021, it would be helpful if they could be finalised by 31 March 2020.

Further assistance

21. We trust Inland Revenue will find these comments helpful. If you wish to discuss them, please do not hesitate to contact the Tax Law Committee convenor Neil Russ, through the Law Society's Law Reform Adviser, Emily Sutton (Emily.Sutton@lawsociety.org.nz).

Yours faithfully

Herman Visagie
Vice President