Purchase price allocation

An officials' issues paper

17 February 2020

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Purchase Price Allocation
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Inland Revenue Department
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By email: policy.webmaster@ird.govt.nz

Dear Emma

Purchase price allocation

Chartered Accountants Australia and New Zealand (CA ANZ) appreciates the opportunity to provide feedback on the issues paper "Purchase price allocation".

The issues paper highlights a problem that arises with some business or property sales because the tax rules (excluding trading stock) do not explicitly require a buyer and seller to adopt the same allocation. Some vendors and purchasers are maximising their tax positions by adopting different allocations. The vendor's allocation may result in less taxable income. The purchaser's allocation may result in a higher depreciation base or deductions.

To put a stop to this practice Officials have proposed that:

1 Where the vendor and purchaser agree on an allocation in the sale and purchase agreement (SPA), both parties must file their tax returns using the agreed values.

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2 If the parties do not agree, the allocation will be determined by the seller who must notify the purchaser and Inland Revenue within a specified time frame, for example 3 months.

3 If the vendor does not provide an allocation within the specified time period, then the purchaser must request an allocation. If no allocation is provided by the vendor within a defined time frame, for example one month, the purchaser may allocate the purchase price and notify Inland Revenue and the seller (who is required to use it).

Conclusion

CA ANZ does not support the proposals as they are outlined in the issues paper.

As we have previously submitted, we believe that the Commissioner has existing tools to combat a situation where taxpayers are failing to follow agreed allocations in a sale and purchase agreement. Further the Commissioner could take a more compliance focused approach to resolving issues where parties fail to agree. However, we acknowledge there could be situations where complications arise where no agreement is made between the parties and the Commissioner may need a mechanism to arbitrate where this occurs.

We however have significant concerns with the proposals set out in the issues paper for situations where the parties to a transaction have not agreed an allocation of the purchase price as they are not practical, do not reflect the intricacies of commercial negotiations, and do not appropriately accommodate situations where the parties do not or cannot agree on an allocation within the timeframe for a transaction.

In particular we have real concerns with allowing a vendor (or for that matter, the purchaser) any control over the allocation as this will impact on the relative balance in a third-party negotiation.

The proposal to adopt the trading stock approach in section EB 24 of the Income Tax Act 2007 does not appropriately recognise the different nature of trading stock from other assets commonly involved in property or business sale transactions.

We have therefore proposed an alternative approach that we consider should be sufficient to address the concerns raised in the issues paper and ensure consistent tax positions are taken by both parties. This approach would also ensure that a number of the proposals canvassed in the issues paper relating to revenue account property holders and the denial of a deduction for purchasers unless the amount had been correctly determined, are not required.

Proposed alternative approach:

By way of an alternative approach CA ANZ proposes:

1 the allocation for the purchaser be deemed to be based on market value (like the existing legislation for the vendor);

2 to require both parties to follow an agreed allocation by asset or asset category in a SPA (or a separate agreement entered into between the parties) in filing their tax returns [as proposed in the issues paper];

In many cases the purchase price is allocated in the SPA by asset category as it is simply not practical to allocate the purchase price to every individual asset (refer to paragraph 6 below);

3 in the event the parties have agreed an allocation in a SPA the Commissioner can challenge the agreed allocation only in the event that:

- the allocation is a sham;
- a tax avoidance arrangement exists; or
- the Commissioner considers the fair market value to be materially different;

4 taxpayers should be required to file an Electronic Transaction Disclosure (similar to a BEPS Disclosure) along with the relevant tax return for transactions where there is an allocation to depreciable property above a de minimis level of $1m or a total transaction value of more than $5m. This disclosure would include:

- the parties to the transaction (including IR numbers);
- whether the parties have agreed an allocation;
- whether the agreed allocation has been followed in the party's tax return; and
- the aggregate amounts allocated to particular categories of property (i.e. goodwill, depreciable intangible property (including software), buildings, other depreciable property, trading stock, financial arrangements, other assets).

5 in the event that the parties have not agreed an allocation the Commissioner would have the ability to determine a reasonable allocation of market value and require both parties to adopt the Commissioner's determination (i.e. the Commissioner could decide to accept either of the parties allocations or determine a more appropriate allocation such as the average of the two allocations or somewhere in between).

6 subject to the above situations where the Commissioner is able to challenge an agreed allocation, where the parties have allocated the purchase price to a specified list of categories of assets (i.e. goodwill, depreciable intangible property (including software), buildings, other depreciable property, trading stock, financial arrangements, other assets) but have determined the allocations based on a global market value for each category, an allocation of the agreed value to each asset in that category based on the vendor's tax net book value should be deemed to be market value for the individual depreciable assets.

7 safe harbour rules for market value for certain types of assets would also assist (so that valuations and agreement would only be required for material assets.) For example, for office equipment, tax or accounting book value is often used as a proxy for market. Agreements to that effect should be allowed. This could be done by way of regulation to allow the Commissioner to determine asset

types and amounts which have a low risk of mis-valuation to be attributed objectively determined values.

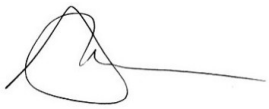
8 there are different levels of complexity as well as, we assume, different levels of risk of a mis-match between vendor and purchaser allocations. The Cabinet paper[1] specifically identifies commercial property transactions as being one area where such risk is considered to exist. A phased application of allocation rules would be reasonable. This would allow the effect and efficacy of the rules to be tested before applying to all property transactions. For example, application to commercial property only would have a restricted application so that problems could be identified and corrected before the rules apply to business sales.

Education

If the proposed changes are enacted, the desire to have the parties reach agreement, is likely to be more successful if Inland Revenue take a proactive approach educating taxpayers and tax agents. We believe an education campaign is essential because not all taxpayers seek advice from an accountant or tax agent before entering into a transaction.

Please contact us if you wish to discuss our submission.

John Cuthbertson CA
CA ANZ NZ Tax Leader



Greg Haddon FCA
Tax Advisory Group Chair

[1] http://taxpolicy.ird.govt.nz/publications/2020-ir-cab-dev-19-sub-0336/overview paragraph 21