

Recent changes to tax and purchase price allocation under the Income Tax Act 2007

The Income Tax Act 2007 now includes a standard mechanism to allocate the values of assets in certain transactions

The Income Tax Act 2007 was recently amended pursuant to the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 to insert a process for determining the allocation of the purchase price for agreements entered into on or after 1 July 2021. The changes affect the allocation of the sale price between taxable, depreciable and non-taxable assets, where two or more assets are sold. This affects the sale and purchase of the following types of assets: taxable assets like stock or personal property, depreciable assets like plant or machinery and non-taxable assets like business goodwill.

These amendments have been introduced in order to better capture taxable assets and ensure that the tax records of vendors and purchasers align with one another. Previously, both vendors and purchasers have been able to allocate different values to assets being bought and sold in order to obtain a better tax position for themselves. This can create tax discrepancies and usually results in the IRD receiving less tax than it otherwise should. The amendments seek to better align the tax position of both the vendor and purchaser in future asset sales, and remove any ambiguity around the allocation of the purchase prices of assets.

These new rules are applicable to the sale and purchase of assets where the total purchase price is \$1 million or more, or in the case of residential land (including buildings and chattels), where the total purchase price is \$7.5 million or more.

Any transaction that meets or exceeds these thresholds is subject to the following purchase price allocation process:

- where the vendor and the purchaser agree on an allocation of the purchase price, the parties must each adopt the same allocation in their respective tax returns. The agreement should be made and documented before either party file their tax returns; or
- where the vendor and the purchaser do not agree on the allocation of the purchase price:
 - at any time within the three months following the settlement date for the transaction the vendor is entitled to determine the allocation within the first three months post settlement and must notify the purchaser and the Commissioner of IRD of the allocated amounts. The amounts cannot be less than the greater of the market value or the vendor's tax book value for the relevant assets;
 - if the vendor does not make an allocation within the relevant timeframe above, the purchaser is entitled to determine the allocation within the following three-month period (i.e. within six months of settlement of the sale), and must notify the vendor and the Commissioner of IRD. Once again, the amounts cannot be less than the market value for the assets; and
 - if neither party make a notification, IRD may allocate the amounts to each asset and any tax deduction that the purchaser is entitled to may be denied by IRD until the following year's tax return.

At any time during this process (whether or not both parties agree on the assigned values), the Commissioner of IRD may challenge an allocation if he or she considers the amounts allocated do not reflect the market value. The Income Tax Act 2007 states that the allocated amount must reflect the greater of the relative market value of the class of asset proportional

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to the other classes of assets and the tax book value of the asset.

The process as a whole is favourable towards the vendor and we strongly recommend that the parties agree upon the allocation in the sale and purchase agreement (and file their tax returns accordingly). If it is not possible to agree on the allocations, then the parties should ensure the agreement includes an agreed process for determining the allocations.

The new tax rules came into effect on 1 July 2021 and apply to agreements entered into (conditional or unconditional) on or after 1 July 2021.

ADLS has created standardised addenda for real estate, business and tender agreements which provide a mechanism for the parties to deal with the allocation of the purchase price. The starting position of the purchase price allocation clauses suggested by the addenda is that the parties have already agreed on the allocation prior to entering into the agreement and as such, the parties need to input the details of the allocation at Schedule 4 attached to the agreement. If this has not been done, the allocation will be agreed by the parties or determined by a suitably qualified third-party expert appointed by the parties (or the president of the New Zealand Law Society where the parties cannot agree on the expert). The addenda also prescribes time frames for the parties to propose the allocation and to appoint an expert.

The addenda is detailed and will need to be reviewed on a case by case basis to determine whether the provisions are appropriate for the specific transaction.

Want to know more?

Our [Commercial Property](#) and [Residential Property](#) Teams can assist you in preparing / negotiating a sale and purchase agreement to ensure that your position is protected against a disadvantageous purchase price allocation.