EXPOSURE DRAFT – FOR COMMENT AND DISCUSSION ONLY

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OPERATIONAL STATEMENT

The valuation of livestock

Issued: XX XXXX 20XX

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Operational statements set out the Commissioner of Inland Revenue's view of the law in respect of the matter discussed and deal with practical issues arising out of the administration of the Inland Revenue Acts.

This statement describes the options available for taxpayers who are in the business of farming to value the livestock that they have on hand at balance date.

All legislative references in this statement are to the Income Tax Act 2007, unless stated otherwise.

START DATE
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REPLACES

- Access to herd scheme *Tax Information Bulletin* Vol 5, No 10 (March 1994): 9
- Livestock valuation at farmer's death *Tax Information Bulletin* Vol 6, No 14 (June 1995): 26
- Livestock valuation – election of method *Tax Information Bulletin* Vol 16, No 5 (June 2004): 41
- Livestock valuation – previous years' invalid elections *Tax Information Bulletin* Vol 16, No 5 (June 2004): 45
- Values placed on exotic livestock *Tax Information Bulletin* Vol 7, No 2 (August 1995): 30
- Valuing livestock when estate continues farming activity previously carried on by deceased *Tax Information Bulletin* Vol 7, No 2 (August 1995): 30

Introduction

Historically, for tax purposes "livestock" was included in the definition of "trading stock". As a result, any business taxpayer that held livestock for sale or exchange as part of their business was required to:

- include as income, an amount equal to the value of the livestock that they had on hand at balance date;[1] and
- value that livestock using one of the valuation options available to all business taxpayers to value their trading stock, or at a standard value issued by the Commissioner of Inland Revenue (CIR).

Standard values were generally set when a farming business began and they remained at that set level for the life of the farming operation.[2]

In its report of 9 May 1986, the Consultative Committee on Primary Sector Taxation made a recommendation to the government to allow livestock to be valued using methodologies specific to livestock.[3] The government accepted this recommendation, with effect from the 1987 income year.

[1] See, for instance, s OB 1 of the Income Tax Act 1994.

[2] See, for instance, s 86 of the Income Tax Act 1976.

[3] See, for instance, ss EE 4 and EL 1 of the Income Tax Act 1994.

The enactment of the Income Tax Act 2004 saw the removal of livestock from the definition of "trading stock". What remains is the requirement to value livestock used in a business at the end of each income year using one of the available livestock valuation methods.[4]

The options currently available to taxpayers to value livestock on hand at the end of an income year are:[5]

- **for specified livestock**, one of the following methods:[6]
  - the national standard cost scheme (discussed from [12]);
  - the herd scheme (discussed from [25]);
  - another valuation method – cost price, replacement price or market value (discussed from [63]); or
  - a formula available to the bailee of bailed livestock (bailed livestock is discussed from [89]);
- **for non-specified livestock**, one of the following methods (discussed from [77]):[7]
  - cost price;
  - replacement price;
  - market value; or
  - (with the CIR's consent) its standard value;
- **for high-priced livestock**,[8] the livestock's cost price, less a depreciation percentage determined by the CIR (discussed from [59]); and
- **for bloodstock**,[9] generally its cost price (discussed from [84]).

Key terms

A **taxpayer** or a **farmer** means, solely for the purposes of this statement, a taxpayer or a farmer that is in the business of farming livestock.

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[4] Section EC 2(1).

[5] Introduced by s 20 of the Income Tax Amendment Act (No 2) 1993 and ss 20 – 26 of the Income Tax Amendment Act (No 3) 1993.

[6] Section EC 7.

[7] Section EC 30.

[8] Sections EC 33 and 34.

[9] Sections EC 38 to EC 48.

Class of livestock means one of the categories for a type of livestock listed in column 2 of sch 17 ("Types and classes of livestock"). For instance, the classes of sheep are ewe hoggets, ram and wether hoggets, two-tooth ewes, mixed-age ewes, rising 5-year and older ewes, mixed-age wethers and breeding rams.

Non-specified livestock means livestock other than bloodstock, high-priced livestock and specified livestock.

Specified livestock means an animal of a type specified in column 1 of sch 17 ("Types and classes of livestock"); for example, beef cattle, dairy cattle, deer and pigs. It generally does not include an animal that is high-priced livestock.[10]

Type of livestock means a category of livestock listed in column 1 of sch 17 ("Types and classes of livestock"). These types are beef cattle, dairy cattle, deer, goats, pigs and sheep.

[10] Except as provided for in s EC 37 (Bailments).

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Discussion

Specified livestock

Electing a valuation method

1. In their first year of business, a taxpayer must decide which valuation method they will use to value their specified livestock; the taxpayer "elects" to use a certain option (or options). They do this simply by using the chosen method in their return of income for the income year.[11] They can choose to use more than one method.
2. However, owners of specified livestock that are also high-priced livestock or bailed livestock, do not have a choice on what valuation method they use. The methods are set by legislation and are discussed in later paragraphs.
3. When a taxpayer chooses a valuation method, that method continues to apply in each of the following income years unless they choose another method that is available to them.[12]

Types of election

4. How a taxpayer makes an election varies depending on what the taxpayer is electing to do. For instance, some elections allow taxpayers to "choose" what they wish to do and to then advise the CIR of this choice by taking the relevant position in their income tax return.
5. Unless legislation specifically requires a taxpayer to provide an election to the CIR in writing, the CIR accepts that such notification is not required.
6. Examples of situations that do not require the CIR to be notified in writing are where the taxpayer:
   - is electing which valuation method(s) to use in their first year of farming specified livestock, as stated at [1];
   - is recalculating a herd value ratio;
   - has adopted the herd scheme and is using an alternative valuation option to value livestock of a class; or

[11] Section EC 7(2).

[12] Section EC 7(3).

- is moving between the cost price, market value and replacement price methods.

7. Some elections require the taxpayer to "notify" the CIR in the same year that the taxpayer wishes their election of method to be effective. Where this requirement exists, a taxpayer must notify the CIR by the date of filing their return of income for the income year in which the election is first to apply.

8. Taxpayers may "notify" the CIR either electronically (by email or myIR) or in writing.[13] Merely taking the relevant position in their income tax return is not sufficient.

9. Taxpayers must provide notification in one of these ways when they are electing to:

   - leave another valuation option and use the herd scheme for a type of livestock;[14]
   - use a herd value ratio or Chatham Islands adjustment in the first year that they elect to value livestock using the herd scheme[15] (see more on the **Herd value ratio (and recalculated ratio)** from [37] and the **Herd value ratio – Chatham Islands adjustment** from [44]); and
   - after adopting the herd scheme, use an alternative valuation option in circumstances where all female breeding stock are to be used in a fattening business[16] (see further discussion from [35]).

10. Some elections require the taxpayer to "notify" the CIR 2 years prior to the income year in which the election is to become effective.[17] As with same-year elections that are discussed from [7], the taxpayer must notify the CIR either electronically or in writing. However, in these cases they must notify the CIR by the date of filing their return of income for an income year that is at least 2 income years before the income year in which the election is to first apply. A taxpayer must provide this notification in this way when they are electing to:

    - stop valuing livestock under the herd scheme (except when an alternative valuation method is allowed);[18]
    - adopt a herd value ratio or a Chatham Islands adjustment, after adopting the herd scheme;[19] or

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[13] Section 14C(2) of the Tax Administration Act 1994.

[14] Section EC 11(2)(a).

[15] Section EC 11(2)(b).

[16] Section EC 11(2)(c).

[17] Section EC 11(3).

[18] Section EC 11(3)(a).

[19] Section EC 11(3)(b).

- change between the cost price and national standard cost methods.[20]

Information requirements for notices of election

11. All notices of election must provide the following information:[21]

    - the first income year in which the election is to apply;
    - the type, class or other description of the applicable livestock; and
    - the existing and proposed methods of valuing the applicable livestock.

    For an election to use a herd value ratio or recalculated herd value ratio, the notice of election must provide the following additional information:

    - the assessed value of an average animal of each applicable class of livestock;[22]
    - the date on which the valuation of each animal was made; and
    - the name and address of the valuer.

The national standard cost scheme

12. In its final report to the Ministers of Finance, Agriculture and Forests, the Consultative Committee on Primary Sector Taxation described the cost options that should be available for farmers to value their livestock:[23]

    > Our suggestion is that taxpayers who wish to adopt the cost option be entitled to use one of the following methods of arriving at the cost of **farm bred stock only**:
    >
    > actual cost, based on specified costing systems and records,
    >
    > …
    >
    > Purchased stock, whether high-priced or other, would be brought in at actual cost.

[20] Section EC 11(3)(c) and (d).

[21] Section EC 11(4).

[22] Section EC 17(4).

[23] Consultative Committee on Primary Sector Taxation *Report of the Consultative Committee on Primary Sector Taxation* (9 May 1986): 25, 26.

The committee added:

> The Consultative Committee has been advised that the greatest part of the cost of "growing" an animal (as distinct from maintaining it) occurs during its first two years of life (first year for pigs).
>
> …
>
> Any rule about cost accumulation can only be arbitrary. As an arbitrary rule, therefore, we suggest that for farm-bred animals, cost should be accumulated to the point of maturity, set at first balance date after birth for pigs, second balance date after birth for all other species.

13. In 1986 this consultative committee was describing what is now the cost price method (which is further discussed from [63]). However, the subsequent Consultative Committee on Livestock Valuation adopted these same requirements for a new national standard cost (NSC) scheme that was introduced with effect from the 1993 income year.[24]

14. The two cost schemes have one main difference. Namely, the farmer self-assesses the cost price method and that assessment reflects their own farm costs of production, whereas the CIR determines the values used in the NSC scheme and they reflect national average costs of production.

NSC values

15. The CIR determines NSC values and generally publishes them in February each year. The values determine the national average cost of producing livestock to a mature state – that is, the costs of production. Schedule 18 to the Act sets out the livestock for which the CIR must determine NSC values.

16. For most types of specified livestock, the CIR determines two costs:[25]

    - the national average cost of breeding, rearing and growing rising 1-year old stock of each type (BRG costs); and
    - the national average cost of rearing and growing rising 2-year old stock of each type (RG costs).

[24] Consultative Committee on Livestock Valuation *Report of the Consultative Committee on Livestock Valuation* (2 September 1992).

[25] The exceptions are beef cattle and dairy cattle, for which the CIR determines three costs.

17. Separate cost figures are determined for: purchased bobby calves; 3-year old male, non-breeding cattle; weaner pigs up to 10 weeks of age; and growing pigs aged between 10 and 17 weeks.[26]

18. The NSC values that the CIR determines reflect the national average costs of production of the various types and classes of immature livestock at each stage of their growth. Farmers using the scheme apply the BRG costs to rising 1-year stock bred on the farm during the year and the RG costs to immature animals on hand at the beginning of the year (rising 2-year). The actual cost of acquisition is used to value any immature livestock purchased during the year.

19. The average of these two costs (the various costs determined for the year for homebred livestock and the purchase price of purchased immature livestock) is used to calculate the closing value of immature livestock on hand. Once livestock has reached maturity, the animal holds that cost until disposal. No further RG costs are allocated to them.

20. When the NSC scheme was introduced, consultation between Inland Revenue and (as it was then) the New Zealand Institute of Chartered Accountants produced the methodology to be used to calculate the national average cost of production for each type of immature livestock (the BRG and RG costs).

21. The NSC values determined include only the **direct** costs of breeding, rearing and growing rising 1- and 2-year livestock. The costs determined therefore exclude costs incurred in owning (or leasing) and operating the farm business. They also exclude the costs of operating non-livestock enterprises (such as cropping) and direct costs associated with producing and harvesting any of the livestock's dual products (depending on the type of animal, the production of meat, wool, fibre, milk or velvet).

22. Because the costs included in the NSC calculations are generally tax deductible, the scheme is largely tax neutral. While amounts included as the value of livestock are taxable, this is offset by the deductible nature of most of the costs of production.

Elections to enter and exit the NSC scheme

Restrictions on entering the NSC scheme

23. Taxpayers may choose (without providing a written election to the CIR) to value specified livestock under the NSC scheme unless:

[26] Suckling pigs are valued at nil for tax purposes.

- the taxpayer is using the cost price method to value any livestock in the same income year;[27]
- the taxpayer used the cost price method to value any livestock in the preceding year and has not given at least 2 years' written notice of their intention to value specified livestock under the NSC scheme;[28]
- specified livestock has been made available to another person under a profit-sharing arrangement and, in the income year, the other person values any livestock of that type under the cost price method;[29]
- the taxpayer has bailed or leased livestock to another person under a long-term bailment (that is not a profit-sharing arrangement);[30]
- the livestock is of a type or class that is not included in sch 18 (Categories of livestock for which national standard costs to be declared);[31] or
- the livestock is male breeding stock, where livestock of the same type is valued under the herd scheme in an income year. This is so even where some livestock of that same type has been valued using the NSC scheme.[32]

Exiting the NSC scheme

24. Taxpayers may exit the NSC scheme without providing written notice, except that they must give:

- written notice in the same year to move livestock of a particular type from the NSC scheme to the herd scheme;[33] and
- 2-years' written notice to move from the NSC scheme to the cost price method.[34]

[27] Section EC 9(1).
[28] Section EC 9(2).
[29] Section EC 9(3).
[30] Section EC 9(4).
[31] Section EC 9(5).
[32] Section EC 8(6).
[33] Section EC 11(2)(a).
[34] Section EC 11(3)(d).

The herd scheme

25. In its final report to the Ministers of Finance, Agriculture and Forests, the Consultative Committee on Primary Sector Taxation described the herd scheme as follows:[35]

> The herd scheme is intended to reflect the fact that in some respects a herd or flock can be likened to a "machine". The "machine" is a relatively fixed asset, owned and maintained for the sale value of what it produces, rather than for its own inherent sales value. The herd scheme exempts from tax any inflationary gains on the realisation of the "machine" over and above its "cost", but rather than permitting annual depreciation, the scheme gives tax deductions for the annual cost of "repairs and maintenance" i.e. the difference between the replacement animals and the proceeds from the sale of the stock replaced.

26. The means of excluding these "inflationary gains" for tax purposes is to attribute the same value to the specified livestock on hand at both the opening and closing balance dates of the farmer. In this way, it is only an increase or decrease in the value of livestock numbers over the income year that affects a taxpayer's taxable profit (or loss).

Herd scheme values

27. Each year the CIR must determine the national average market values (NAMVs) of all types and classes of specified livestock that are to be valued under the herd scheme for an income year.[36]

28. To ascertain the NAMV of the various classes of livestock, the CIR contracts with a number of highly experienced livestock valuers situated throughout the country.[37] Each valuer is asked to provide the market value of the various livestock classes located in a specified region. Generally, more than one valuer is contracted for each region. The market valuations required are for good-quality, on-farm animals (capital stock) as at 30 April.

29. From these valuations, the CIR calculates the NAMV for each livestock class. In the case of the sheep, beef, dairy cattle and deer (red, wapiti and elk) classes, a weighted average is used against the values each valuer produces (the weighted average is calculated based on total livestock numbers for a type of livestock in a particular region compared with the national herd numbers for that type of livestock[38]). Because

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[35] Consultative Committee on Primary Sector Taxation (9 May 1986): 17.

[36] Section EC 15(1).

[37] Usually this involves gaining valuations from 38 valuers.

[38] Stats NZ collates livestock numbers.

of their comparatively low numbers, a straight average is used for the remaining livestock types, except "other deer". The value of "other deer" is taken as the mid-point between the trophy and meat market values.

30. The NAMVs that are determined are published (generally in May each year) and apply to the income year for which they are determined, irrespective of whether that income year started before, on or after the date on which the CIR made the determination.[39]

Elections to enter and exit the herd scheme

Entering the herd scheme

31. In the first year of business, a taxpayer is free to choose the herd scheme to value their specified livestock (or some of their livestock). However, if a taxpayer has already used a method other than the herd scheme to value livestock, then they must give 1 year's written notice to use the herd scheme.[40] For a discussion of the contents of a notice of election, see [11]. Once made, the election is irrevocable and remains in place until the taxpayer chooses another method that is available to them.[41]

Exiting the herd scheme

32. A taxpayer can only exit the herd scheme if: [42]

- they are going to stop using all female livestock for breeding and will, instead, use them in a fattening operation (in which case the taxpayer must give 1 year's written notice); or
- the number of animals in a class has increased in an income year. To the extent of that increase, the taxpayer may use an alternative valuation option.

33. Even if a taxpayer meets one of these criteria, if livestock of a particular type is valued under the herd scheme, all male breeding stock of that type must be valued under the herd scheme if any livestock of the same type is valued under the national standard cost scheme or the cost price method.

34. Despite these restrictions, a taxpayer may still elect to adopt a herd value ratio or recalculated herd value ratio or the Chatham Islands adjustment for any livestock type.

[39] Section EC 15(2).
[40] Section EC 11(2).
[41] Section EC 7(3).
[42] Section EC 8(1).

An election to use one of these valuation options must be made 2 years before the income year in which the valuation method is to become effective.[43]

Use of an alternative valuation option (AVO)

35. As stated at [32], where a taxpayer is valuing livestock under the herd scheme and the number of livestock in a class has increased in an income year, then, to the extent of that increase, a taxpayer may use an alternative valuation option to value that increase. They follow a formula to calculate whether the number of livestock has increased. This formula looks to account for livestock subject to associated party transactions (the formula is reproduced in the Appendix).

36. If a taxpayer meets the requirements to use an AVO, the CIR is not required to be notified of the election to use one.

Herd value ratio (and recalculated ratio)

37. As described from [27], NAMVs provide the **national** average market value for the specified livestock types and classes. Because of this, they may not always reflect the market value of the livestock of a particular taxpayer, or even of a particular region. Where a farmer believes that the market value for their type of livestock regularly differs markedly from the NAMVs determined by the CIR, they can elect to use a herd value ratio to reflect more accurately the market value of their livestock. They can only apply a ratio to an entire type of livestock, rather than to individual classes within that type.[44]

38. A farmer may recalculate the herd value ratio if they believe their current ratio no longer reflects market value. The CIR may also require a ratio to be recalculated for the same reason.[45]

39. The ratios that can be used are 0.9 (90%), 1.0 (100%), 1.1 (110%), 1.2 (120%) and 1.3 (130%) of the NAMVs determined in that income year.[46] See the Appendix for the formula for calculating a herd value ratio. The herd value ratio that can be used is the one that is the closest match to the market value of the applicable livestock.

40. The farmer will need to obtain a valuation from a recognised livestock valuer. The valuation must be that of an **average animal** for each class, of each type of specified

[43] Section EC 11(3)(b).

[44] Section EC 17(1).

[45] Section EC 18.

[46] Section EC 17(5).

livestock for which a herd value ratio is intended to apply. It cannot be the average of all the livestock of that class owned by the taxpayer.[47]

41. As with the values the CIR obtains to calculate that year's NAMVs, the taxpayer must carry out their herd value ratio valuation on 30 April **in the year that they elect to adopt a herd value ratio**.[48]

Elections to use or recalculate a herd value ratio

42. Where a taxpayer makes an election to use a herd value ratio before adopting the herd scheme, written notice is required in the same year that the herd value ratio is first used.[49] Once a taxpayer has adopted the herd scheme, they must give 2 years' written notice to either adopt or recalculate a herd value ratio.[50] For a discussion of the contents of elections, see [11].

43. A taxpayer currently using the herd scheme to value a type of livestock must obtain a valuation at the time that they make an election to use a herd value ratio for that type of livestock. Effectively, this means that the valuation must be obtained 2 years before the taxpayer uses that herd value ratio. Example 1 illustrates these different factors that farmers must weigh up in using a herd value ratio.

Example 1 – Use of a herd value ratio

Mary and Tony are King Country sheep farmers. Their livestock is valued under the herd scheme. They believe that, historically, the NAMVs for sheep that the CIR has determined have been higher than the market value of their livestock. The reason for the difference may be that their farm is located on rough hill country.

They are aware that before they can elect to use any of the available herd value ratios, they must obtain a valuation from a recognised livestock valuer that justifies their use of a particular ratio. In discussing herd value ratios with them, their agent emphasises that they must make it clear to the valuer that the valuation they wish to obtain is **not** one that provides the average value of each of their livestock classes. Rather, the valuation must of an average animal in each class on 30 April of that year.

[47] Section EC 17(4).

[48] Section EC 17(4).

[49] Section EC 11(2)(b).

[50] Section EC 11(3)(b).

The valuations Mary and Tony obtained showed that, while the average animal value in all classes of their livestock was below the NAMVs the CIR determined for that year, most were only marginally so. Only the value of their two-tooth ewes and mixed-age ewes are sufficiently lower to justify a herd value ratio of 0.9. A ratio of 0.9 (or 90%) is the only available ratio that is less than the declared NAMVs.

Because Mary and Tony are already using the herd scheme to value their livestock, their agent advises them that if they wish to use this ratio, they must elect to do so 2 years before they apply the ratio. As Mary and Tony believe that the ratio is historically accurate (and will remain so), they decide to go ahead with their election.

In discussing this matter with the farmers, their agent also points out that if the reduced values were of short duration (because of the effect of an adverse event on their livestock for instance), using a ratio would not have been useful. This is because the livestock values would be expected to return to normal within the 2-year election period.

Herd value ratio – Chatham Islands adjustment

44. Due to their low values, specified livestock that are on the Chatham Islands at the end of an income year may be subject to a Chatham Islands adjustment.[51] The Chatham Islands adjustment is an extension to the herd value ratios that may otherwise apply and that the CIR determines from time to time. Currently the Chatham Islands adjustment to the herd value ratio is 0.3 (30% of the NAMV for specified livestock set each year). This adjustment applies to sheep and beef cattle only.[52]

45. The election requirements for the Chatham Islands adjustment are the same as those for a herd value ratio (stated at [42]).

Sales to associated parties

46. Where a transfer of specified livestock occurs between associated parties, and that livestock has previously been valued using the herd scheme, the associated party acquiring the livestock must continue to use the herd scheme to value that stock.[53] The party acquiring the livestock also assumes the same position as the original owner

[51] Section EC 19.

[52] Livestock values – Chatham Islands, Appendix of *Tax Information Bulletin* Vol 5, No 2 (August 1993): 22.

[53] Section EC 4B(1).

in relation to the previous herd scheme election, herd scheme base number and herd scheme values. This rule applies even where the transfer is made under the Property (Relationships) Act 1976.[54]

This general rule has three exceptions: sales made in the ordinary course of business; intergenerational transfers; and deceased estates.

Sales made in the ordinary course of business[55]

47. The CIR acknowledges that associated parties may trade among themselves in the ordinary course of their businesses. These sales are not affected by this rule.

48. Given the large number of potential scenarios that could exist in this area, what constitutes "the ordinary course of business" has been left to the judgement of the parties to the transactions, rather than being defined by legislation. Common sense should be applied.

Intergenerational transfers[56]

49. The intergenerational transfer exception applies when livestock is transferred to the son, daughter or grandchild of the original owner and:
    - the recipient did not have an interest in the livestock before transfer;
    - the transfer is at market value on commercial terms and conditions (other than financing); and
    - the original owner has disposed of all specified livestock, and they do not derive income from specified livestock for the following 4 years.

50. To make this work, there is a complicated application of the associated person rules. Essentially, where the **only** connection between the parties is this blood relationship, then the exception can apply. The recipients of the livestock cannot have an interest in the livestock before transfer.

51. **Condition of not deriving income from specified livestock:** As indicated in the final bullet point at [49], the original owner of the livestock must stop deriving income directly or indirectly from the disposal of specified livestock, that is part of a business,

[54] Section FB 15.
[55] Section EC 4B(1).
[56] Section EC 4B(2).

for the next 4 years. This doesn't mean that they must dispose of all of their livestock; rather, they must not use any remaining livestock in a business.

52. For instance, the vendor could graze a few animals on a lifestyle block for personal consumption. They could retain only the land and enter into a 50:50 sharemilking arrangement, or start farming non-specified livestock, all without disturbing the exception.

53. The word "indirectly" refers to the situation where the livestock are owned by a trust or company that the vendor is associated with.

54. The 4-year period was chosen because it should be long enough to confirm there was a genuine intention to cease deriving income from specified livestock.

Deceased estates[57]

55. The third exception relates to deceased estates. The rule here is that the **intergenerational transfers** exception applies unless the will creates a life interest in the relevant livestock.

56. Examples 2 and 3 illustrate two different scenarios involving sales to an associated party. For more For information on the topic of sales to associated parties, see Associated party transfers of herd scheme livestock *Tax Information Bulletin* Vol 25, No 9 (October 2013): 4.

Example 2 – Sales to an associated party in the ordinary course of business

George is a dairy farmer while his son Peter has recently acquired a block of land near the family farm on which he is establishing a beef fattening operation. Peter values his livestock using the NSC valuation option, while his father values the dairy herd using the herd scheme option.

One of the ways in which Peter acquires stock is by purchasing his father's unwanted rising 1-year steers. Peter acquires this stock at market value, while George provides loan finance to ensure that his son is in a position to acquire the livestock.

In this circumstance, as Peter is acquiring the livestock to further his usual business operation and acquired the livestock at market value, the CIR would accept that the transfer of livestock has occurred in the ordinary course of business. The fact the

[57] Section EC 4B(3).

acquisition has been funded with finance George has provided is not relevant to this outcome.

Peter is therefore free to value the acquired livestock using a valuation option other than the herd scheme (that they had previously been valued under).

Example 3 – Sales to associated party by intergenerational transfer

Some years have passed since the scenario in Example 2 occurred. While Peter's fattening operation is now well established, George has decided it is time he retired.

As he would like the farm to remain in family hands, he approaches Peter with the proposition that Peter takes over the family dairy farm on normal commercial terms with financial assistance from George. Peter agrees to do this.

Peter remembers their previous discussion about acquiring livestock from an associated person. In discussing the proposed change of ownership with their agent, he asks if he will have to use the herd scheme to value the dairy herd that he will be acquiring in this new scenario. The agent first asks George and Peter whether the transfer will be at market value on usual commercial terms. After they confirm it will be, the agent advises Peter that if George gives up any business of farming specified livestock for at least 4 years, Peter will be able to use a valuation option other than the herd scheme to value the dairy herd.

Farmer disposes of livestock before CIR determines NAMVs

57. Where, in an income year, a farmer ceases to derive income from the sale of specified livestock and disposes of that livestock before 1 November that precedes the determination of the NAMVs for that income year, the opening value of that specified livestock is:[58]

- the opening value of the livestock for the previous income year; or
- if a herd value ratio has been adopted, the herd value multiplied by the herd value ratio applying in the previous income year.

58. Note that this treatment may not apply if the disposal is to an associated person.

[58] Section EC 20(1) and (2).

High-priced livestock

59. High-priced livestock are specified livestock that are purchased for at least $500 per head **and** cost at least five times the national average market value that the CIR determined for that class of specified livestock in the year of acquisition. Further, on acquisition, the animal must be capable of being used for breeding or, if it is immature livestock, it must be expected to be capable of being used for breeding when it reaches maturity.[59]

60. High-priced livestock must be valued at its cost price. Mature, high-priced livestock are valued at cost less an amount of depreciation, for which the CIR sets the rate.[60] Immature high-priced livestock are valued at cost price and may not be depreciated. For the current depreciation rates, see Assigned percentages of high-priced livestock *Tax Information Bulletin* Vol 9, No 6 (June 1997): 5.

61. Taxpayers must choose either the straight-line method or the diminishing value method of depreciation.[61] If a taxpayer chooses the diminishing value method, they must notify the CIR of this (either by email or myIR, or in writing[62]) at the time of filing the first income tax return of income that uses the high-priced scheme.[63]

62. Each head of stock remains high-priced livestock until either:

    - the year in which the depreciated value for that livestock falls below the level of the NAMVs the CIR determines for that class of livestock;[64] or
    - the taxpayer no longer expects to use that livestock for breeding.[65]

    At either such time, the high-priced livestock reverts to being ordinary specified livestock.[66]

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[59] Section YA 1.

[60] Section EC 34(1).

[61] Section EC 32(2).

[62] Section 14C of the Tax Administration Act 1994.

[63] Section EC 32(3).

[64] Section EC 35(1).

[65] Section EC 35(2).

[66] Section EC 35(4).

Other valuation options – cost price, market value or replacement price

The cost price method

63. As discussed at [12], in its final report to the Ministers of Finance, Agriculture and Forests, the Consultative Committee on Primary Sector Taxation described the cost options that should be available to value livestock. As a result of that and later advice from the Committee, the cost price and NSC methods were implemented. Both methods seek to determine the costs of production to bring livestock to a mature state; the breeding, rearing and growing costs.

64. The cost method works similarly to the NSC method, except that rather than the CIR determining the costs of production at a national level, a farmer uses their own, self-assessed costs of production.

65. The guidelines for calculating a self-assessed cost for specified livestock were developed for introduction in the 1991/92 income year. These guidelines are complex and rely on the farmer having an inventory system capable of tracking individual livestock units over their life on the farm.

66. Calculating the production costs of specified livestock (other than pigs, for which different steps apply) involves the following six main steps:

- **Step 1** – Identify and specify the direct costs of livestock production and assign identifiable costs to each livestock type.
- **Step 2** – Calculate the total farm livestock units (LSUs).
- **Step 3** – Apportion the undivided direct costs of livestock production between the livestock types. Do this based on the proportion of LSUs associated with each type and class of livestock.
- **Step 4** – Use dual product multipliers to allocate some of the costs to the production of meat, wool, fibre, milk or velvet, as appropriate.
- **Step 5** – Include the costs of livestock purchased.
- **Step 6** – Calculate an average cost per head and use it to value that year's intake of stock in each age grouping on hand at the end of the income year. Where mature livestock of mixed ages and intake years are valued at cost, you will need an inventory system to account for livestock over their lifetime on the farm.

67. If a taxpayer uses the self-assessed cost method, they should take care to establish sufficient documentation to support the values used.

68. The CIR recommends that a taxpayer seeks professional advice before endeavouring to use this method.

69. For more information on calculating costs for specified livestock, see [Livestock production – establishing a self-assessed cost](), Appendix A of *Tax Information Bulletin* Vol 4, No 7 (March 1993): 2.

The market value and replacement price methods

70. The valuation options of market value and replacement price are sufficiently similar to discuss together.

71. The concept of market value appears throughout the Act. It is regarded as the current selling value in the relevant selling market of the taxpayer's business.[67]

72. Replacement price is the market value of the livestock at balance date or, if there is no market value at that date, the last price that the taxpayer paid during the income year to acquire equivalent livestock. In establishing replacement price, any amount of GST input tax is disregarded.[68]

73. Although it is not a legislative requirement to obtain an independent market valuation to support the values used, there is an expectation that a taxpayer using market value or replacement price is able to substantiate the value used if the CIR requires them to. In view of this, many taxpayers find obtaining a valuation from a recognised livestock valuer the easiest (and most accurate) way of supporting the valuations that they have used. Any valuation must be accurate as at a taxpayer's balance date.

Non-specified livestock

74. The term "non-specified livestock" means livestock other than bloodstock, high-priced livestock and specified livestock.[69] Effectively, the term is a catch-all phrase for all other animals that are commercially farmed.

75. "Livestock" is not defined in the Act, but ordinarily is often used in contrast with "deadstock". In farming terms, livestock are the animals on the farm and deadstock the implements.[70] If all animals are livestock, then "non-specified livestock" are all

[67] *Australasian Jam Co Pty Ltd v FC of T* [1953] HCA 52, (1953) 88 CLR 23, (1953) 10 ATD 217, [1953] ALR 855, 27 ALJ 408, 1953 WL 39957.

[68] Section EB 10.

[69] Section YA 1.

[70] *Wardhaugh (AF) Ltd v Mace* [1952] 2 All ER 28: 31

animals **except** bloodstock, high-priced livestock and specified livestock. They would include for instance, chickens, emus, ostriches, rabbits, alpacas, farmed fish and shellfish.

76. As stated in the introduction to this statement, the requirement to value livestock (including non-specified livestock) at a taxpayer's balance date affects any taxpayer who carries on a farming business.

Valuation options

77. The owners of non-specified livestock can choose to value that livestock using:[71]

- the (self-assessed) cost price method;
- the market value method;
- the replacement price method; or
- if the CIR agrees, a standard value.

78. A taxpayer is able to move freely between these options without providing written notice to the CIR. So, for instance, they could choose to value their non-specified livestock using the cost price method one year, and then the next year choose to value that stock using the market value method.

79. While the legislation provides for a standard value as a legitimate valuation option, this option is only available if the CIR agrees to such a value. To date, the CIR has not approved any standard value.[72]

The (self-assessed) cost price method

80. As it relates to specified livestock, the cost price method has been discussed at [63] to [69]. The matters covered in those paragraphs apply equally to the owners of non-specified livestock, except that the CIR has not published generic guidelines for calculating a self-assessed cost for all non-specified livestock.

81. To date, the only published guidelines that involve non-specified livestock relate to Ostriches and emus – valuation for income tax purposes *Tax Information Bulletin* Vol 9, No 8 (August 1997): 11. These guidelines are based on those developed for specified livestock, with variations to account for the unique nature of farming birds, such as a methodology for valuing the bird's eggs at the end of the year.

[71] Section EC 30.

[72] As required by s EC 29.

82. These guidelines, and the guidelines developed for specified livestock may be of use to owners of non-specified livestock (depending on the type of livestock they are valuing). However, it is important that any methodology taxpayers develop to value their livestock is based on accurate, verifiable data that realistically capture the costs of production for that livestock type.

The market value and replacement price methods

83. As they relate to specified livestock, the market value and replacement price valuation methods have been previously discussed at [70] to [73]. The matters covered in those paragraphs apply equally to the owners of non-specified livestock.

Bloodstock

84. For the purposes of the livestock valuation rules, "bloodstock" means a horse that is a member of the standardbred or thoroughbred breed of horses. It also includes a share or interest in such a horse.[73]

85. At the end of each year, bloodstock that is used or intended to be used for breeding must be valued at its cost price. From maturity, that cost price must be reduced by an amount that varies based on whether the bloodstock is a stallion or mare, and whether a previous owner has used the horse for breeding.[74]

86. Even where the actual cost cannot be calculated (with certainty), such as with home-bred progeny, a bloodstock breeder is still required to establish the cost price of that progeny. The CIR has published guidance on how to calculate that cost price: see QB 21/09: *How to determine the cost price of bloodstock*.

Other matters

Transfers of livestock between a wholly owned group of companies

87. Livestock transferred between members of a wholly owned group of companies during the income year may be valued at year-end at the cost of that livestock to the company that originally owned it. This can occur when:

- the group members that have owned the livestock are all resident in New Zealand;

[73] Section YA 1.

[74] Sections EC 39, EC 41, EC 42, EZ 5 and EZ 6.

- both the company that owned the livestock at the beginning of the income year and the company owning the livestock at the end of that year are still members of the group at the end of the income year; and
- both companies share the same balance date or, if they do not, the CIR has approved their adoption of different balance dates because those dates correspond to the end of a business cycle and are necessary to avoid material distortions in net income.

88. If the companies stop being part of the same wholly owned group, then the company that owns the livestock at the end of the income year is treated as disposing of and reacquiring the livestock for its market value at the time the group membership ends. If the market value of the livestock cannot be determined separately from other property, the market value of the livestock at the time that company acquired it is treated as its value.

Bailed livestock

89. A bailment of livestock occurs when the owner of livestock (the bailor) bails or leases that livestock to another person (the bailee). There are two forms of bailment agreement.[75] A "long-term bailment" exists where the bailor does not expect the same livestock that are subject to the bailment agreement to be delivered back to them. This contrasts with a "short-term bailment", where the bailor would expect, among other things, to have the same livestock returned to them.

90. Most bailments meet the definition of a long-term bailment. In this circumstance, both the bailor and bailee must account for the bailed livestock at year end; the bailor as owner and the bailee because they have an interest in the livestock.

91. While the bailor accounts for this livestock in the ordinary way, the bailee can "back out" the bailed livestock from their accounts. They do this by calculating the number of total livestock in a class (the number they own plus the number of bailed livestock in that class) and deducting from that total the number of bailed livestock in that class. They then value the number left.

92. Where the bailment is a long-term bailment, the bailor cannot use either the NSC[76] or cost price[77] option to value their bailed livestock.

[75] Section EC 27.
[76] Section EC 9(4).
[77] Section EC 10(4).

Livestock gifted because of an adverse event

93. Sometimes, where a farmer has lost stock because of an adverse event, they may receive replacement livestock from other farmers. Often the other farmers gift this livestock for consideration that is less than market value or may even donate it for no consideration. Where either of these situations occurs and the recipient and supplier are not associated, both parties treat the acquisition and disposal of the livestock as being disposed of and acquired at the greater of nil or the actual consideration paid.[78]

94. Where the parties are associated, then both parties to the transaction are required to treat the transaction as having occurred at the market value of the livestock transferred.[79]

Joint interests – partnerships, joint ownership and look-through companies

95. For any election to be effective, where livestock is owned by 2 or more persons all the owners must jointly elect the valuation method to be used.[80]

96. Where no effective election is made, then:

- where the owners bail or lease livestock, or enter a profit-sharing arrangement, the market value method will apply; and
- in any other case, the national standard cost scheme applies.[81]

97. Where owners have a profit-sharing arrangement and livestock under the arrangement is valued using either the cost price method or the NSC method, all parties to the arrangement are treated as the single owner of the livestock.[82]

98. Where a taxpayer has an interest in livestock in a partnership or a look-through company, they must treat these interests separately to any other livestock interests that they have. While separate elections are required for the different interests, the taxpayer does not have to choose the same valuation method for each interest.[83]

[78] Section EC 5.

[79] Section GC 1.

[80] Section EC 12(1).

[81] Section EC 12(2).

[82] Section EC 12(3).

[83] Section EC 12(4) and (5).

Changes in partnership interests

99. Where a change in partnership interests occurs (and therefore a new partnership is created) and more than 50% of the property is the same between the two partnerships, the new partnership is required to value specified livestock in the same manner as the old partnership.[84] A change in partnership interests can occur not only when a partner leaves or joins a partnership but also when a partner retires or dies.

100. Where any partner enters a partnership and acquires specified livestock interests that include female breeding stock that have been valued using the cost price or NSC method, that new partner is treated as using the same cost base and valuation method as the exiting partner. A spreading calculation is available to account for the addition to the cost base where the partners continue to use the cost price or NSC method. See the Appendix for this calculation.[85]

Valuation of livestock on the death of the farmer

101. When a farmer dies and the estate is transferred to an executor or administrator, the estate (including any livestock) is deemed to have been disposed of by the farmer and acquired by the executor or administrator immediately before the farmer's death.[86]

102. Because they effectively step into the shoes of the deceased as their personal representative, executors and administrators are bound by any valuation elections the deceased has made.

103. Exceptions to this approach apply where the property is transferred to the deceased's surviving spouse, civil union partner, de facto partner, a person who is within the second degree of relationship to the deceased person (their children), or a charity.[87] In these circumstances, the livestock will be treated as a transfer of property on the settlement of relationship property as long as certain other legislative requirements are met.[88] For details of these requirements, as set out in s FC 4 (Property transferred to charities or to close relatives and others), see the Appendix.

[84] Section EC 13.

[85] Section EC 26B.

[86] Section FC 2(1) and (2).

[87] Sections FC 3 and 4.

[88] Sections FC 3(1) and FC 4(1), (3).

Where the deceased used the herd scheme to value specified livestock

104. Where, before their death, the farmer had used the herd scheme to value a type or class of specified livestock, the herd scheme must continue to be used for that livestock when:

- the will creates a life interest in the relevant livestock; or
- the livestock is transferred to the executor or administrator (because the executor or administrator "stands in the shoes" of the deceased).

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Income Tax Act 1994, ss EE 4, EL 1, OB 1 ("trading stock")

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Income Tax Amendment Act (No 2) 1993, s 21

Income Tax Amendment Act (No 3) 1993, ss 20–26

Tax Administration Act 1994, s 14C

Case references

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Appendix

To calculate the number of livestock able to use an alternative valuation option other than the herd scheme (from [35])

EC 8 Restrictions arising from use of herd scheme

…

Second exception: increase in a class

(3) Despite subsection (1), a valuation method other than the herd scheme is available to a person in an income year, to the extent of a person's animals of a class, in an income year (the **current year**), that are in excess of the person's class closing animal balance.

A definition and a formula

(4) **Class closing animal balance** means the number of animals of a class calculated using the formula—

last year's class amount + associated class transfers.

Definition of items in formula

(5) In the formula,—

(a) **last year's class amount** is the animals of the relevant class that the person valued under the herd scheme at the end of the year before the current year:

(b) **associated class transfers** is the amount, if positive, calculated under section EC 4B(5), for the relevant class, that are transferred in the current year to the person to the extent to which section EC 4B(4) applies to the type of animals transferred.

To calculate herd value ratio (from [39])

EC 17 Herd value ratio

…

Calculation of herd value ratio

(5) The herd value ratio for livestock of a particular type is calculated by using the formula in subsection (6) and rounding the result of the calculation to the nearest of the following figures: 0.9, 1.0, 1.1, 1.2, 1.3.

Formula

(6) The formula is—

$$\Sigma(\text{average value} \times \text{number}) \div \Sigma(\text{herd value} \times \text{number}).$$

Definition of items in formula

(7) In the formula,—

(a) **Σ** is the total of the individual calculations for all applicable classes of livestock type valued under the herd scheme:

(b) **average value** is the average value of an animal in a class as described in subsection (4):

(c) **number** is the number of all livestock of that class on hand at the end of the income year, including livestock that are not in the herd scheme, but not including high-priced livestock:

(d) **herd value** is the herd value of livestock for a class.

To calculate partner's cost base (from [101])

EC 26B Entering partners' cost base

…

Addition to cost base

(3) For the purposes of determining the value of the specified livestock at the end of an income year for the purposes of section EC 2, the entering partner must add to the existing cost base, described in subsection (2), the amount for the income year (the **current year**) calculated using the following formula:

livestock cost base difference × current year count ÷ allowed years.

Definition of items in formula

(4) In the formula,—

(a) **livestock cost base difference** is the cost base that the entering partner would have for the specified livestock at the end of the income year in which the acquisition of the specified livestock occurred, ignoring subsection (2) reduced by the entering partner's existing cost base for the specified livestock at the end of that year, described in subsection (2). It must be a positive number:

(b) **current year count**,—

(i) is the allowed years reduced by the number of years between the current year and the income year in which the entering partner's acquisition of the specified livestock occurred, ignoring years in which the partners do not use the cost price method or national standard cost scheme (for example: **current year count** is **1**, if the allowed years is **4**, and the acquisition of the specified livestock occurred in the 2010–11 income year, and the current year is the 2013–14 income year, and the relevant method or scheme was used for all relevant income years):

(ii) may equal the allowed years (for example: the current year is the same year as the income year in which the entering partner's acquisition of the specified livestock occurred), but must not be a negative number:

(c) **allowed years** is—
  (i) 4, if the partners acquire or dispose of any partnership interests that include any livestock after the entering partner's acquisition of the specified livestock and before the end of the income year in which that acquisition occurred; or
  (ii) 5, if the partners do not acquire or dispose of any partnership interests that include any livestock after the entering partner's acquisition of the specified livestock and before the end of the income year in which that acquisition occurred.

For the transfer of property upon death (at [104])

FC 4 Property transferred to charities or to close relatives and others

When this section applies

(1) This section applies in the circumstances described in section FC 1(1)(b) when tax-base property is transferred on a person's death if—
  (a) each beneficiary of the deceased person is described in subsection (2); and
  (b) no life interest in the property is created; and
  (c) no trust over the property is created, other than a trust to execute the will and administer the estate; and
  (d) the net income of the estate is distributed as described in subsection (3).

Beneficiaries of deceased

(2) A beneficiary of the deceased person must be—
  (a) a close relative of the deceased person:
  (b) a person exempt under section CW 41, CW 42, or CW 43 (which relate to exempt income of charities).

Income from estate must be distributed

(3) While the administration of the estate is continuing, the net income of the estate is distributed to the extent allowed—
  (a) under the will or the rules governing intestacy; and
  (b) by the trustee's legal obligations.

Transfer subject to subpart FB

(4) The transfer is treated as a transfer of property on a settlement of relationship property under subpart FB (Transfers of relationship).