IN THE TAX COURT OF SOUTH AFRICA

(HELD AT MEGAWATT PARK)

(1)	REPORTABLE: YES / NO
(2)	OF INTEREST TO OTHER JUDGES: YES/NO
(3)	REVISED.

DATE SIGNATURE

CASE NO: 13626

In the matter between:

XYZ (PTY) LTD **Appellant**

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **Respondent**

JUDGMENT

INGRID OPPERMAN J

(Accountant Member and Commercial Member concurring)

INTRODUCTION

[1] To the extent that this appeal involves matters of law, this judgment and the order is my own. To the extent that issues of fact were considered and decided, the learned accountant member and commercial member concur with the findings of this court.

[2] The years of assessment relevant to this appeal are the appellant's ('*XYZ*') 2008 and 2009 tax years ('*the relevant years*').

[3] XYZ is a member of the XYZ Group with its parent company in Sweden ('*the XYZ Group*'). XYZ's main business is to sell machinery and equipment (including spare parts and consumables) imported mainly from Sweden and which is used in the mining industry and other industries in South Africa. It comprises a number of business areas. It is common cause that at the end of each relevant year, XYZ held many thousands of items of equipment, equipment spare parts and consumables which were '*trading stock held and not disposed of*' for the purposes of section 22 of the Income Tax Act[1] *('the Closing Stock').* The trading stock is referred to as inventory in XYZ's annual financial statements.

[4] In terms of section 22(1) of the Income Tax Act, XYZ had to include in its taxable income for each relevant year, the '*value*' of the Closing Stock. The '*value*' for these purposes is specified in section 22(1)(*a*). It provides that the '*value*' is '*the cost price*' of the trading stock '*less such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock … has been diminished by reason of damage, deterioration, change of fashion, decrease in the market value …*' ('*the Diminution Amount').* Therefore, any Diminution Amount reduced the value of the Closing Stock included in the taxable income of XYZ for a relevant year and, consequently, reduced XYZ's taxable income. XYZ contends there was a Diminution Amount of R30 191 000[2] in respect of the 2008 Closing Stock and a Diminution Amount of R33 402 000 in respect of the

[1] Income Tax Act, 1962, applicable at the relevant time.
[2] All amounts stated in the audited financial statements are rounded off to the nearest thousand.

2009 Closing Stock. SARS[3] contends there was factually no diminution of value and hence the cost price should apply.

[5] The value of XYZ's Closing Stock is stated in its financial statements for the relevant years, namely R592 082 000 (for 2008) and R435 681 000 (for 2009). As is shown in Note 11 of the annual financial statements, each '*value*' is less than the cost of that stock (R622 273 000 for 2008 and R469 083 000 for 2009) by R30 191 000 for the 2008 relevant year and by R33 402 000 for the 2009 relevant year. These are the Diminution Amounts in dispute ('*the Disputed Amounts'*).

[6] The Commissioner issued to XYZ additional assessments for the 2008 and 2009 tax years ('*Additional Assessments'*). In the Additional Assessments, in the context of section 22(1), the Commissioner stated his view that '*there was no diminishing (sic) in value at year end for a deduction to be claimed as a result of damage, deterioration, change of fashion, decrease in the market value in respect of trading stock*' and that he had consequently *'added back'* the Disputed Amounts. SARS also levied interest in terms of section 89*quat* of the Income Tax Act in respect of the Disputed Amounts.

[7] XYZ objected to the Additional Assessments. The Commissioner disallowed XYZ's objections to the adding back of the Disputed Amounts and to the section 89*quat* interest. XYZ appealed against that disallowance.

[8] XYZ sought to persuade the Commissioner that it was entitled to invoke the provisions of section 22(1)(*a*) of the Income Tax Act because it implemented a fixed policy, known as the '*Finance Controlling and Accounting Manual'* ('*FAM*') or '*The Way We do Things*' ('*The Way Policy'*), (collectively '*the policy*') determined by the XYZ Group that permits it to write down the value of its closing stock by 50% if such closing stock has not been sold in the previous 12 months and 100% if it has not been sold in 24 months. The policy also permits it to write down any overstock by 50%. The Commissioner contended that the utilisation of 50% or 100% is arbitrary and no different to any other percentage. It

[3] In this judgment the respondent will be referred to as the Commissioner or SARS.

argued that XYZ has not been able to demonstrate why 50% as opposed to any other percentage such as 20% is appropriate. It argued that the use of such a fixed percentage has not been justified and is inconsistent with the requirements of section 22(1)(*a*) of the Income Tax Act.

[9] XYZ contended that it is entitled to estimate the diminution of the value of its stock and that it does so in terms of its policy. The policy, it argues, is in line with International Accounting Standards 2 ('*IAS2*') and Inventories Financial Reporting Accounting Standard ('*IFRS*') and accordingly constitutes a just and reasonable basis for valuing its closing trading stock in terms of section 22(1)(*a*) of the Income Tax Act.

ISSUES

[10] The issues as defined in the Rule 31 and Rule 32 Statements (in respect of each relevant year) are: (i) Was there a Diminution Amount in respect of XYZ's Closing Stock for that year? (ii) If so, was the Diminution Amount a '*just and reasonable*' representation of that Diminution Amount? (iii) Did the Diminution amount have to be '*added back to taxable income in terms of section 23(e) of the Income Tax Act'* ? (iv) Was XYZ liable for interest in terms of section 89*quat* of the Income Tax Act?

BIRDS EYE VIEW OF EVIDENCE PRESENTED

[11] XYZ called 3 witnesses to testify on its behalf, two employees, Messrs A and B and Ms C from V Auditors, its auditor who was involved during the relevant years. SARS adduced no evidence. The evidence received was largely uncontested and no purpose will be served to summarise it. I intend drawing from such evidence in this judgment when appropriate. It will however, be useful to give a birds eye view of the structure of XYZ to understand how the evidence received fits into this framework.

[12] XYZ comprises various operating units which all carry trading stock. Three business areas were identified, one of which has 4 divisions. The business area of '*Construction and Mining'* has 4 divisions identified internally, as AM, AN, AC and AS. The business area

'*Compressor*' is identified internally by the letters AA and the '*Industrial Business*' area by the letters AI.

[13] The total net value of the closing stock for 2008 inclusive of the Disputed Amount of R 30 191 000, was R 592 082 000. Of this the AM division comprised 54%, AC – 15%, AA – 15%, AS – 12%, AN – 4% and AI – 0%. The Disputed Amount for 2008 of R30 191 000 comprised of AM – 34%, AC – 16%, AA – 19%, AS – 26%, AN – 0% and AI – 7%.

[14] The Disputed Amount of R30 191 000 represents 5,1% of the 2008 net stock value of R592 082 000 or 4,9% of the overall stock value of R622 273 000, before its deduction. The Disputed Amount of R33 402 000 represents 7,7% of the 2009 net stock value of R435 681 000 or 7,1% of the overall stock value of R469 083 000, before its deduction. The net effect of the Diminution Amounts (Disputed Amounts) on the 2009 taxable income is therefore R 3 211 000 (comprised of the difference between the 2009 and 2008 Diminution Amounts).

[15] By comparison, the Diminution Amount of R14 470 000 for 2007 represents 3,5% of the 2007 net stock value of R417 207 000 or 3,4% of the overall stock value of R431 677 000, before its deduction. The net effect of the Diminution Amounts on the 2008 taxable income is therefore R15 721 000 (comprised of the difference between the 2008 and 2007 Diminution Amounts).

[16] Mr A's evidence was focused almost exclusively on AM. It would appear that XYZ adopted this approach as, during 2008, AM was the largest division in terms of inventory value and the largest contributor to the Disputed Amount.

[17] In the 2008 year and within the AM division, provision was made for various categories of closing stock. They are: slow-moving stock, over-stocked stock, demonstration stock, in transit stock, standard cost stock and the stock of a company called D Co. acquired shortly before the 2008 year-end. These '*provisions*' represent the diminution of closing stock balances totalling R9 551 590, or 32% of the total R30 192 000 disputed amount for 2008. The amount of R9 551 000 together with an amount of R604 000 for provisions for

'*Changes in Standard Cost*', comprises the total amount of R10 155 000 provided for in 2008 for the AM division, made up as follows:

- 35% representing slow-moving stock – R3 307 669
- 34% representing over-stocked stock –- R3 369 841
- Stock in transit to product companies ('*PCs*') of R4 075 706, less credit notes due from PCs – R2 947 980 (a net amount of R1 127 726 being 12%)
- 2% representing demonstration stock of R202 320

[18] The same categories of diminution stock, were also provided within the AM division for the 2009 year, without the D Co. stock which was by then subjected to the same accounting policies in relation to slow-moving stock and over-stocked stock as the rest of the stock items together with a new category, '*returns to be scrapped'*, only provided for in 2009. '*Provisions*' representing the Diminution Amount of closing stock balances totalling R10 515 000 of the total R33 402 000 Disputed Amount for 2009, were explained by the auditor to be made up as follows:

- 44% represented slow-moving stock being R4 603 122
- 34% represented over-stocked stock being R3 532 708
- 18% represented stock in transit to PCs of R2 401 192, less credit notes due from such PCs of R479 810 yielding R1 921 381
- 2% represented demonstration stock of R243 130
- 2% represented returns to be scrapped of R214 374.

[19] No evidence was led on the composition of the balance of R22 886 825 of the disputed amount i.e. R33 402 000 – R10 514 715, other than that the policy was applied within all XYZ divisions on a consistent basis and that the financial statements for 2009 were compiled in accordance with, amongst other principles, IFRS and IAS2.

[20] Fundamental to the entire dispute, is the interpretation and application of section 22(1)(*a*) of the Income Tax Act.

THE CONTEXT AND PURPOSE OF SEC 22(1)(*a*)

[21] The Commissioner does not contest the existence of the policy nor that XYZ had applied the policy during the relevant years. The departure point is whether there was a diminution in value for any of the reasons specified in section 22(1) of the Income Tax Act and if so, whether the use of a fixed percentage in the policy can be regarded as just and reasonable as representing the diminution in value of the trading stock by XYZ in the relevant years.

[22] The crisp legal dispute between the parties is thus whether the nett realisable value (‘*NRV*’) of the XYZ’s closing stock, calculated in accordance with IAS2, IFRS, South African statements of Generally Accepted Accounting Practice (‘*SA GAAP*’) and the policy, may and should, where it is lower than the cost price of such trading stock,[4] be accepted as representing the value of trading stock held and not disposed of at the end of the relevant years for purposes of section 22(1)(*a*) of the Income Tax Act.

[23] It is accordingly necessary to interpret and apply, the provisions of section 22(1)(*a*) of the Income Tax Act and in particular the words:

> “the cost price … less such amount as the Commissioner may think just and reasonable as representing the amount by which **the value of such trading stock** … **has been diminished** by reason of damage, deterioration, change of fashion, **decrease in the market value** or for any other reason satisfactory to the Commissioner;….”.

(emphasis provided)

[24] Section 22(1)(*a*) must be interpreted in the context of the Income Tax Act as a whole, and in the context of the relevant provisions of section 22.[5] In the event of ambiguity, explanatory memoranda issued when the relevant legislation was enacted may be looked at

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4 The cost price of the trading stock should be determined in accordance with section 22(3) of the Income Tax Act. In this case neither the correctness of the calculation of the cost price nor whether it had been calculated in accordance with section 22(3), was disputed.

5 The current approach to interpretation encapsulating the principles stated by Wallis JA in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) at [18] and refined in the numerous authorities since then is to be found in *Novartis v Maphil*, [2015] ZASCA 111. Those principles apply to tax statutes - see *CSARS v Bosch & Anor* 2015 (2) SA 174 (SCA) at [9] & *XO Africa Safaris CC v CSARS* 79 SATC 1 (SCA) at [20].

[6] and the court should attempt to determine and give effect to the "*statutory purpose underlying"* the relevant section.[7] Reference can also be had to academics' views and statements by Ministers responsible for legislation.[8]

[25] Section 22(1) deals with trading stock held and not disposed of by a taxpayer "*at the end of [the relevant] year of assessment"* (closing stock). The relevant provisions are as follows:

> **"**The amount which shall, in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade … be taken into account in respect of **the value** of any trading stock held and not disposed of by him **at the end of such year of assessment**, shall be – (a)……"

(emphasis provided)

[26] Section 22(1) requires the '*value*' of closing stock to be taken into account by a taxpayer. Section 22(2) deals with trading stock held and not disposed of by a taxpayer '*at the beginning of [a relevant] year of assessment' (*opening stock*).* The relevant provisions are as follows:

> **"**The amount which shall in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade … be taken into account in respect of **the value** of any trading stock held and not disposed of by him **at the beginning of any year of assessment**, shall –(a)………"

(emphasis provided)

[27] Therefore, section 22(2) requires the '*value*' of opening stock to be taken into account by a taxpayer. That '*value*' is the same amount '*taken into account in respect of the value of such trading stock at the end of [the] preceding year of assessment'*. Therefore, if the

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6 See *Minister of Health & Anor v New Clicks (Pty) Ltd* 2006 (2) SA 311 (CC) at paras [199] – [201]; *Westinghouse Brake & Equipment v Bilger Engineering* 1986 (2) SA 555 (A) at 562H-563A; *Attorney General Eastern Cape v Blom & Others* 1988 (4) SA 645 (A) at 668H-669D; *S v Makwanyane* 1995 (3) SA 391 (CC) at paras [14] - [16] & [19] and *Master Currency (Pty) Ltd v CSARS* 2014 (6) SA 66 (SCA) at 70-1.

7 See *XO Africa Safaris CC v Comm, SARS supra* where, having regard to the history of s 11(2)(*l*) of the Value-Added Tax Act, 1991, the SCA (at [30] & [31]) identified "*the statutory purpose underlying [that section]*" and interpreted that section in a manner which accorded with that purpose.

8 See *De Reuck v Director of Public Prosecutions, WLD & Others* 2003 (3) SA 389 (W) at [14]; *S v Makwanyane supra* at para [14]. The Minister responsible for fiscal legislation is the Minister of Finance.

section 22(1) closing stock value for Tax Year 1 was R100, the section 22(2) opening stock value for Tax Year 2 will also be R100. This implies that the net movement in stock values, comprising of the difference in values between the closing stock and the opening stock would affect the taxpayer's taxable income and not only the closing stock value.

[28] The rationale and objectives of section 22 were described in the following extract from *Richards Bay Iron & Titanium (Pty) Ltd v CIR* [9]**,** quoted with approval in the more recent case of *SARS v South African Custodial Services (Pty) Ltd)*:[10]

> "The rationale for the existence of these provisions is neither far to seek nor difficult to comprehend. The South African system of taxation of income entails determining what the taxpayer's gross income was, subtracting from it any income which is exempt from tax, subtracting from the resultant income any deductions allowed by the Act, and thereby arriving at the taxable income … Where a taxpayer is carrying on a trade, any expenditure incurred by him in the acquisition of trading stock is deductible in terms of s 11(*a*) of the Act because it is expenditure incurred in the production of income, and it is not of a capital nature. Income generated by the sale of such stock is of course part of the trader's gross income. Where in his first year of trading a trader has bought, and thereafter sold, all the stock which he acquired during that year, no problem arises. There will be a perfect correlation between the trading income earned and the expenditure incurred in that particular year in purchasing and selling the stocks sold, and the difference between the two sums will give a true picture of the result of the year's trading. There will be no stock on hand at the close of the year of which account need be taken. Contrast with that situation a situation in which the trader, having sold all the stock acquired earlier during that year at a substantial profit, purchases large quantities of stock just prior to the close of his tax and trading year. **If he were permitted to deduct the cost of purchasing that stock from the income generated by his sales, without acknowledging the benefit of the stock acquired, he would be escaping taxation in that year on income which otherwise would have been taxable by the simple expedient of converting it into trading stock of the same value** … ."

(emphasis provided)

The judge went on to state:[11]

> "There is no reason to doubt that it was for these reasons that the South African legislation too requires opening and closing trading stock to be taken into account when

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9 1996 (1) SA 311 (A) at 316-7.

10 2012 (1) SA 522 (SCA) at para [39].

11 At 318.

> determining taxable income derived from carrying on any trade in any year of assessment."

[29] It is clear therefore that section 22 works in conjunction with the deduction provision in section 11(*a*) of the Income Tax Act. In terms of section 11(*a*), in determining its taxable income, a taxpayer deducts expenditure incurred by it in acquiring trading stock (i.e. the cost of such stock) in the year such expenditure is incurred. However (in terms of the "*gross income*" definition in section 1 of the Income Tax Act) the taxpayer only includes the sale proceeds of that stock in its gross income in the year such stock is sold. Where the stock is bought and sold in the same year, in determining its taxable income the taxpayer will: (i) deduct the cost of the stock of say, R100 (under section 11(*a*)); and (ii) include the sale proceeds of the stock of say R300 in gross income. The effect will be that it is taxed on its profit (R200). In such a case, the provisions of section 22 do not apply as there is no stock "*held and not disposed of*" at either the beginning or end of that year and therefore no opening stock or closing stock.

[30] However, the stock may be bought and sold in different years. In that case, the taxpayer is still entitled to deduct the cost of the stock (R100) under section 11(*a*) in the year such expenditure is incurred. However, the provisions of section 22 apply in such circumstances and those provisions effectively defer the deduction of that cost (or part of that cost) to the year such sale occurs. Therefore, section 22 is a timing provision - it is not a deduction provision and does not provide for any deduction.

[31] This is best illustrated by the following examples:

Example 1

[32] In Tax Year 1 a car dealer buys a car with a cost of R100. The car is sold by him in Tax Year 3 for R300.

[33] The income tax consequences for the dealer in Tax Year 1 are as follows: The R100 cost is deducted in determining the dealer's taxable income (in terms of s 11(*a*)). As the car is "*held and not disposed of*" by the dealer at the end of Tax Year 1, it is closing stock and (in terms of s 22(1)) the cost (R100) is added in determining the dealer's taxable income. Therefore, there is a nil net effect on the dealer's taxable income in Tax Year 1.

[34] The income tax consequences for the dealer in the next year Tax Year 2 are as follows: As the car is '*held and not disposed of*' by the dealer at the beginning of Tax Year 2, it is opening stock and (in terms of s 22(2)) the Tax Year 1 closing stock amount (R100) is subtracted. As the car is '*held and not disposed of*' by the dealer at the end of Tax Year 2, it is closing stock and (in terms of s 22(1)) the cost (R100) is added. Therefore, there is again a nil net effect on the dealer's taxable income in Tax Year 2.

[35] The consequences for the dealer in Tax Year 3 (the year it sells the car) are as follows: As the car was opening stock at the beginning of Tax Year 3 the Tax Year 2 closing stock amount (R100) is subtracted (in terms of s 22(2)). The sale proceeds (R300) are included in the dealer's gross income and are therefore added. Therefore, in Tax Year 3, the dealer has a net taxable income of R200 (which is equal to its profit from the trading stock).

[36] In this example, the determination of the dealer's taxable income by adding R100 as the closing stock '*value'* (in terms of section 22(1)) creates an equitable balance and achieves the objectives referred to in the *Richards Bay* case. This is because at all relevant times the dealer expects to sell the car at a profit and thus to recover its cost. The realisable value of the car is more than its cost as at the ends of Tax Years 1 and 2. Section 22 simply defers that cost deduction until the year the cost is recovered which occurs in Tax Year 3. That expectation i.e. that the dealer will sell the car at a profit and thus recover its cost, does not exist in example 2.

Example 2

[37] The facts are assumed to be the same as in Example 1 in Tax Year 1, but as at the end of Tax Year 2 the dealer reasonably estimates the realisable value of the car to have gone down to R80, because, for instance, parts for that kind of car are no longer produced and the selling price of the car listed in the most recent issue of the auto dealer's digest is R80. As that realisable value is less than the car's cost being R100, as at the end of Tax

Year 2, the dealer does not expect to recover R20 of its cost at that time i.e. at that time it expects to sell the car at a R20 loss.

[38] The income tax consequences for the dealer in Tax Year 1 are the same as in example 1. However, in determining its Tax Year 2 taxable income, the dealer is not required to add the cost of R100 in terms of section 22(1). That is because section 22(1)(*a*) provides that the '*value*' of closing stock is cost less '*such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock … has been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason satisfactory to the Commissioner'*. Therefore, any Diminution Amount is required to be subtracted from the cost in determining the '*value*'. Put differently, the '*value*' of the car to be added (in terms of section 22(1)) is the lesser of cost and realisable value.

[39] The income tax consequences for the dealer in Tax Year 2 are consequently as follows: As the car is '*held and not disposed of*' by the dealer at the beginning of Tax Year 2, it is opening stock and in terms of s 22(2), the Tax Year 1 closing stock amount of R100 is subtracted. As the car is '*held and not disposed of*' by the dealer at the end of Tax Year 2, it is closing stock and in terms s 22(1)(*a*) the lesser of cost being R100 and realisable value being R80, is added. Therefore, R80 is added. It follows that in Tax Year 2, of the total cost deduction, R20 representing the expected loss, is no longer deferred but only the remaining R80 that the dealer still expects to recover. This is because the trader is in terms of section 22(1)(*a*) required to subtract from the cost of R100 the amount which is a '*just and reasonable*' representation of the Diminution Amount in this example being R20.

Example 3

[40] Now assume the facts are the same as in example 1 but that already as at the end of Tax Year 1, the dealer reasonably estimates the realisable value of the car to have gone down to R80 for the same reasons given in example 2. The income tax consequences for the dealer in Tax Year 1 will then be as follows: The R100 cost is deducted in determining the dealer's taxable income in terms of s 11(*a*). As the car is '*held and not disposed of'* by the dealer at the end of Tax Year 1, it is closing stock and in terms of s 22(1)(*a*) the lesser of cost being R100 and the realisable value being R80, is added. Therefore, R80 is added. It follows that in Tax Year 1, of the total cost deduction, R20 being the expected loss, is no longer deferred but only the remaining R80 that the dealer still expects to recover is deferred.

[41] Suppose at the end of Tax Year 2 the car has still not been sold. However, due to an excellent review on a popular website during that year, interest in buying the car has increased significantly and the taxpayer expects to realise the car at a profit at that time i.e. as at the end of Tax Year 2, the car's realisable value is no longer less than its cost of R100. The income tax consequences for the dealer in Tax Year 2 will then be as follows: As the car is *'held and not disposed of'* by the dealer at the beginning of Tax Year 2, it is opening stock and the closing stock value for Tax Year 1 being R80 is subtracted in terms of s 22(2). As the car is '*held and not disposed of*' by the dealer at the end of Tax Year 2, it is closing stock and in terms of s 22(1)(*a*) the lesser of cost being R100 and realisable value is added. As there is no Diminution Amount because the realisable value is not less than cost, the cost being R100 is added. Therefore, in Tax Year 2, the dealer has a net taxable income of R20, which reverses the R20 loss in Tax Year 1.

[42] These examples demonstrate that any subtraction from cost in terms of section 22(1)(*a*) is, where appropriate, reversed in a subsequent year so that a trader is always taxed on its profit.

[43] As is demonstrated in Example 2, section 22(1)(*a*) limits the cost deduction deferred, to that amount which the dealer can reasonably expect to recover as at the end of the relevant tax year by providing for any Diminution Amount existing at that time to be subtracted from cost in determining the '*value'* of closing stock. This is clearly the purpose of section 22(1)(*a*).

[44] The most recent authority which has held that the correct legal interpretation of the description in section 22(1)(*a*) of the '*value*' of closing stock to be taken into account, accords with the value of closing stock to be taken into account under the relevant accounting principles, is Tax Court Case No. 13539/13673 ('*Case 13539*').[12]

[45] That case also concerned the '*value*' of closing stock to be taken into account by the taxpayer in terms of section 22(1). The taxpayer (a car dealer) had determined the cost and the NRV (net realisable value) of its closing stock on the basis set out in IAS2. It had then, in respect of each car included in its closing stock, compared the cost to the NRV and included in taxable income (in terms of section 22(1)) the lesser of cost and NRV. The dispute was whether in applying the provisions of section 22(1)(*a*) the NRV, which had been calculated by the taxpayer in accordance with IAS2 *(*and which took into account various costs which the taxpayer anticipated incurring in respect of the closing stock*)*, was the amount which had to be compared to the cost. SARS contended that *'the concept of NRV as provided for and recognized in the IAS2 for accounting purposes … finds no direct application for the purposes of section 22(1) …'.*

[46] In rejecting SARS' contentions, Eksteen J stated the following:[13]

> "… the NRV as determined in accordance with IAS2 provides an **appropriate method** for purposes of section 22(1) for the determination of the actual value of trading stock at the end of the year of assessment. It follows that where this value is less than the cost price (as defined) a **diminution in value has in fact occurred**. There is widespread support for this method of valuation and the Commissioner ought to have recognised the diminution in value. **The reason for the diminution is to be found in the reduction in the reasonably anticipated taxable income that will be derived from the disposal of the trading stock.** For the reasons set out earlier this is a satisfactory reason in the context of section 22(1). Once it is accepted that the calculation by the appellant of the NRV of the trading stock in issue accords with IAS2, and it was common cause at the hearing that it did, it seems to me that it would be just and reasonable to recognise the difference between the cost price and the NRV as representing the amount by which the value of such trading stock has been diminished."

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[12] Not yet reported and leave to appeal was granted.

[13] See para [47]. Emphasis added.

[47] Earlier on in the judgment the court reiterated that '*the NRV as set out in IAS2 is an appropriate method by which to determine the actual value of trading stock in the hands of the taxpayer at the end of the year of assessment*' and concluded that *'[t]he NRV, determined in this manner must be compared to the cost price … in order to determine whether a diminution in value has in fact occurred'*.[14]

[48] The reasons for the above conclusions were based on a long line of authority (referred to in the judgment). The reasons can be summarised as follows:

48.1 The principles which must be applied in interpreting section 22(1)(*a*) are as stated in the dictum of Wallis JA in *Natal Joint Municipal Pension Fund v Endumeni Municipality*.[15]

48.2 Even prior to there being a legislative provision in South Africa which was the '*equivalent of section 22*', there was a '*well established accounting and business principle that trading stock held and not disposed of at the end of a period of assessment should be brought into account by reflecting it at the lower of market value or cost [which] was accepted in the courts'.*[16] Authority for such finding being *CIR v Jacobshon.*[17]

48.3 The circumstances giving rise to the introduction of the provisions now contained in section 22 were described in the following *dictum* of Corbett JA in *CIR v Nemojim (Pty) Ltd:*[18]

> "The statutory provisions now to be found in s 22(1) and (2) were first introduced into our income tax legislation by s 6(*f*) of the Income Tax Act 55 of 1956 … It would seem that prior to this amendment the scheme of the Act for ascertaining a person's taxable income did not, in the case of a trader, fall completely into line with normal accounting methods for determining a trading profit and drawing a trader's trading account. This was particularly so in regard to the bringing into account

14 Para [37].
15 2012 (4) SA 593 (SCA) at para [18].
16 Para [21] of Case 13539.
17 1923 CPD 221 at 230
18 1983 (4) SA 935 (A) at 956H-957A.

> of opening and closing stocks. Nor did the Act indicate, when such stocks were brought into account, whether they should be reflected at cost or market value or whichever of these was the lower. … Section 22(1) and (2) of the Act … enact how, in the determination of a trader's taxable income, such stocks should be valued. The section appears to assume that the value of such stocks will be taken into account and in this way to recognise what had been accepted in practice over a number of years."

Eksteen J. went on to state that:

> "the accounting methods which are indicated by s 22 … can be applied without difficulty in the case of normal trading operations".[19] Therefore, Corbett JA "appeared to postulate, all-be-it obiter, that normal accounting methods are indicated by section 22."[20]

48.4 A comparison of NRV ('*as set out in IAS*') to the cost price "*in order to determine whether a diminution in value has in fact occurred … is consistent with the purpose of section 22".*[21] In this regard '*what is to be added back to taxable income is no more than the reasonably anticipated taxable income that may arise from the disposal of the trading stock in the* future".[22] Such "*approach provides an equitable balance which avoids hardship by insuring that the taxpayer need not pay tax in the current year of assessment on more than what the stock can be expected to realise for him*".[23] ('*the equitable balance*')

19 The above extracts were quoted with approval in para [22] of Case 13539.
20 Para [24] of Case 13539.
21 See paras [37] and [38] of Case 13539.
22 See para [38] of Case 13539.
23 See para [38] of Case 13539.

48.5 The approach also accords with the following extract from the *'Explanatory Memorandum on the Income Tax Bill, 1984'* (which introduced section 22(3)):[24]

> **"**A statement of generally accepted accounting practice, known as AC108[25] approved by the Accounting Practices Board, states the methods of valuation more fully and, with the exception of the references to the LIFO method of valuation, is acceptable as a practical guide for the valuation of trading stock for purposes of the Income Tax Act."

48.6 *Silke on South African Income Tax* in relation to the Explanatory Memorandum[26] states the following:

> "According to the 'Explanatory Memorandum on the Income Tax Bill, 1984', Statement AC 108, a statement of generally accepted accounting practice published by the South African Institute of Chartered Accountants… has been approved by the Commissioner 'as a practical guide for the valuation of trading stock for the purposes of the Income Tax Act'.…
>
> Since Statement AC 108 encourages the use of the 'first in first out (FIFO)', 'weighted average cost', 'specific cost', 'standard cost', 'retail method' or **'net realizable value'** bases of valuation in appropriate circumstances, it seems that in practice all of these bases may be adopted by taxpayers for the purposes of s 22."[27]

(emphasis provided)

48.7 Section 22(1) '*is silent as to the manner of valuation of trading stock at the conclusion of a year of assessment'.* In determining *'whether a diminution in value [of such stock] has* ***occurred the adoption of the NRV as a method of the assessment of value provides a sensible, businesslike result***

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24 There is numerous authority to the effect that in the event of ambiguity, explanatory memoranda issued at the time when the relevant legislation was enacted may be looked at to, for instance, identify "*the statutory purpose underlying [that section]*" see *XO Africa Safaris CC v Comm, SARS* 79 SATC 1; *Minister of Health & Anor v New Clicks (Pty) Ltd* 2006 (2) SA 311 (CC) at paras [199] – [201]; *Westinghouse Brake & Equipment v Bilger Engineering* 1986 (2) SA 555 (A) at 562H-563A; *Attorney General Eastern Cape v Blom & Others* 1988 (4) SA 645 (A) at 668H-669D; *S v Makwanyane* 1995 (3) SA 391 (CC) at paras [14] - [16] & [19] and *Master Currency (Pty) Ltd v CSARS* 2014 (6) SA 66 (SCA) at 70-1 and that the court should attempt to determine and give effect to the "*statutory purpose underlying"* the relevant section.

25 IAS2 is headed "*IAS2 (AC108) Inventories".*

26 At para 8.111.

27 Referred to in para [40] of Case 13539.

> ***which accords … with the purpose of section 22(1) in the context of the Act and with the weight of authority*”**.[28]

(emphasis provided)

[49] I accept and approach this task of interpreting this section from the premise that it is a question of law for the court to decide. Any opinion of an accountant or other expert as to the correct interpretation or application of a provision of the Income Tax Act would clearly be inadmissible. In addition, the fact that accountants treat amounts in a certain manner cannot override the provisions of the Income Tax Act.[29]

[50] The background to the enactment of section 22 of the Income Tax Act, as summarized by Eksteen J, is uncontroversial.

[51] XYZ argued that it was not the intention of the legislature that a trader, who had thousands of trading stock items, was required to determine with exact accuracy the realisable value, nor was it required of a trader who had thousands of trading stock items to assess each individual item annually, individually.

[52] In support hereof it referred to *ITC 1489,*[30] where Conradie J accepted that '*a method of reducing the cost of stock by a percentage*' could be adopted '*because, for example, it is impractical to value individual items of stock'*. We were also referred to SARS' Practice Note No. 36 (13 January 1995) which accepts that '*a method of reducing the cost of stock by a percentage'* may be adopted. Although not binding, Wunsh J warned, it may '*safely be assumed that [the Commissioner] will consider himself bound by his own practice notes*'.[31]

[53] In my view, the NRV as set out in IAS2 is an appropriate method by which to determine the actual value of trading stock in the hands of the taxpayer at the end of the

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28 See para [44] of Case 13539. Additional authorities referred to included the following statement in *ITC 1881* 78 SATC 132 at para [73]: "*In terms of section 22 of the IT Act trading stock is valued in terms of s 22(1)(a) which is in essence the lower of cost or net realisable value"*. *ITC 1881* in turn referred to *Meyerowitz on Income Tax 2007-2008* at para 9.9.6 that: *"In practice, the taxpayer takes his trading stock either at cost or at what he considers net realisable value"*.

29 See *Sub-Nigel v CIR*, 1948 (4) SA 580 (A) at 588.

30 53 SATC 99 at 104.

31 ITC 1675 62 SATC 219 at 218-9.

year of assessment. It provides a sensible and businesslike result which accords with the purpose of section 22(1) being that the cost deduction deferred should be limited to what the taxpayer can reasonably expect to recover as at the end of the relevant tax year. The legislature could, in my view, not have intended that a requirement for a trader to subtract a Diminution Amount from cost is that the trader assess each individual item of closing stock. Such a requirement would mean the equitable balance which section 22 is aimed at achieving would only be achieved in respect of traders with a small number of trading stock items; it would not be achieved in respect of traders (such as XYZ) which, due to the fact that they hold thousands of trading stock items, cannot feasibly assess each item individually on an annual basis. The fact that such a requirement does not exist has been recognised in the case law and in SARS' own practice note.

[54] The legislature could also not have intended that a requirement for a trader to subtract a Diminution Amount from cost under section 22(1)(*a*) be, that the trader determine with accuracy what the realisable value of the relevant trading stock is (by reference to, for instance, a car dealer's digest in the case of a car dealer). Such a requirement would mean the equitable balance which section 22 is aimed at achieving would only be achieved in respect of traders whose businesses and trading stock are of such a nature that they are able to make such accurate determinations (such as car dealers); it would not be achieved in respect of traders (such as XYZ) which, due to the fact that they operate in a highly specialised industry with little competition in the South African market and with a limited number of key customers, cannot determine the realisable value of their trading stock with accuracy.

[55] The fact that such a requirement does not exist is recognised in the reference in section 22(1)(*a*) to the amount which is a '*just and reasonable [representation of] the amount by which the value of [the] trading stock … has been diminished.*' It does not refer to the amount which is the amount by which the value of the trading stock has diminished. At the time when the value of Closing Stock has to be included in terms of section 22(1) of the Income Tax Act, such stock is '*held and not disposed of'* by the taxpayer. Therefore, at that time the taxpayer does not know what the selling price of the stock will be and, indeed, whether the stock will even be sold. It follows that the value of Closing Stock is not a definitely ascertainable amount; it is an estimated amount. If and when such stock is ultimately sold, its value becomes a definitely ascertainable amount (namely, the amount of the sale proceeds if sold, or zero if scrapped). However, in the year in which the sale or scrapping occurs, the stock no longer comprises Closing Stock and therefore, although any sale proceeds are included in the trader's gross income, they are not the '*value*' referred to in section 22(1)(*a*).

[56] As was pointed out by Van Zyl J in the *Jacobsohn* case,[32] the '*underlying principle upon which income is assessed is value'*. However, that principle is of little use '*unless on either side of the account value is represented by what is true, or under the circumstances as near as possible true for that side*'. Thus, said the Judge:

> "… on the one side the true value of the capital employed can be ascertained from the cost price and on the other side the nearest you can get to the true value of the receipts and accruals and the prospective receipts and accruals is to take the sale price of the wool actually sold and the likely price (determined by the market value) for which the wool on hand can be sold. The real difficulty in the case arises from the fact that on the one side of the account you are dealing with a definitely ascertainable amount, whereas on the other side of the account you are dealing with an amount which can only in part be definitely ascertained, the rest being dependent upon the value to be placed on the wool on hand, and that value to make it consistent with the ascertainable portion of the amount, should in my opinion, be **based upon an estimate which approximates to the procurable sale price** and not to the cost price. This method seems to me to be not only consistent with the provisions of the Act, but also a fair and equitable way of dealing with the matter. It on the one hand avoids the injustice of making the respondent pay a large sum as income and super tax, when from a commonsense and commercial point of view he has in fact had no income; while on the other hand it leaves the Crown's right intact to tax him under the Act in respect of any income he makes out of any subsequent sale of the wool on hand."

(emphasis provided)

[57] There is also nothing in section 22 which could be interpreted as imposing, as a requirement for a trader to subtract a Diminution Amount from cost under para (a), that the

[32] *Supra* at 229-230.

relevant trading stock can no longer be used. What is required is that there has been a diminution in the value of the relevant trading stock '*by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason which [should] be satisfactory to the Commissioner'*. Although stock, which can no longer be used, may satisfy this requirement, it is not the only type of stock in respect of which there may, for instance, be a '*deterioration*' or a '*decrease in the market value*'. This is demonstrated by the fact that stock, which is no longer produced or is out of date *(and which is consequently 'obsolete')*[33] may, despite the fact that it can still be used, result in a '*decrease in the market value*'.

[58] Lastly, there is also nothing in section 22 which could be interpreted as imposing, as a requirement for a trader to value its closing stock at the lesser of cost and realisable value in a particular tax year, that the relevant stock is ultimately disposed of for that realisable value.

THE FIRST ISSUE: WAS THERE A DIMINUTION AMOUNT IN RESPECT OF XYZ CLOSING STOCK?

[59] SARS admitted that:

> "the statement in the 2009 audited financial statements of 'Inventories' for the relevant tax years (under the heading 'Current Assets' at TB1/291, read with Note 11 at TB1/314) 'presented fairly, in all material respects, the financial position' of XYZ 'in accordance with South African Statements of Generally Accepted Accounting Practice' (as stated by KPMG in the relevant audited financial statements at TB1/287)."

[60] As confirmed by Ms C's undisputed evidence, the '*value*' of the Closing Stock for each Relevant Year presented in those audited financial statements was R592 082 000 (2008) and R435 681 000 (2009) which value was less than the cost of such Closing Stock of R622 273 000 (2008) and R469 083 000 (2009) by the amounts labelled '*Provision for Inventory Obsolescence*' (i.e. the Disputed Amounts).

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[33] In this regard, the word "*obsolete*" is defined in the Oxford English Dictionary (online) as "*no longer produced or used; out of date".*

[61] The deduction from the cost values (i.e. the Disputed Amounts) was done in accordance with the policy. The policy refers to IAS2 and in its '*audit instructions*' the global auditor of the XYZ Group for 2006-2009 (V Auditors) stated that:

> "The application of IFRS for the XYZ Group is defined and interpreted in a database called 'The Way We Do Things'. This should be local auditors first source of guidance when interpreting accounting issues."
>
> "Our responsibilities to XYZ as auditor require us to provide an audit opinion in accordance with auditing standards generally accepted in Sweden (equivalent to International Standards on Auditing) … As a listed company within the European Union, XYZ is required to report in accordance with IFRS."
>
> "The XYZ Group has included all group-wide instructions, principles and guidelines in a database called 'The Way We Do Things'. This also includes a section called Finance, Controlling, Accounting manual, which is referred to as FAM … which contains accounting instructions that are based on [IFRS]. All reporting from subsidiaries must be compliant with FAM in order to ascertain that the Group's official reporting complies with IFRS."

[62] Ms C's evidence (undisputed) was that the audit instructions of the global auditors were communicated to her (as manager of V Auditor's local auditing team) and this is what was applied.

[63] IAS 2 is part of SA GAAP/IFRS and it includes the requirement that where the cost of inventories may not be recovered because, for instance, *'they have become wholly or partially obsolete'* or *'their selling prices have declined'* they must be written down below cost. *'Obsolete'* is not defined in IAS2 and in addition to describing stock which is no longer used, its ordinary meaning includes stock which is *'no longer produced'* or is *'out of date'*.[34]

[64] XYZ argued that because of the admission made by SARS and because the audited financial statements reveal that the NRV of the closing stock for the relevant years is less than the cost of such stock, it has been established that '*the value of [the relevant] trading stock … had been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason [which should have been] satisfactory*

[34] Oxford English Dictionary (online).

to the Commissioner' as contemplated in section 22(1)(*a*) (i.e. that there was a Diminution Amount in each relevant year).

[65] It therefore followed, so the argument ran, that there was no need to have regard to any further evidence of XYZ in order to conclude that such Diminution Amounts exist. Mr T SC, representing the Commissioner, argued that the admission of fact document[35] should be read as a whole and that it was evidently not the intention to admit what was at the very core of the dispute between the parties.

[66] He submitted further that what was sought to be admitted, was that the auditors had correctly and accurately executed what they set out to do. In my view, it does seem unlikely that SARS would admit the very issues which lie at the heart of this appeal. I will accordingly adjudicate this matter on the basis that the admission relied upon by XYZ is not to be construed in the manner argued by it.

[67] Mr A and Mr B, who both had extensive knowledge and experience regarding the specialised business of XYZ, its limited customer base, and the specialised nature of much of its trading stock, testified that during the relevant years, the trading stock of XYZ always included some items which had no realisable value at all and had to be scrapped and some items which had a realisable value which was less than their cost. In particular, Mr B testified that XYZ works in a niche and innovative industry, primarily supplying costly mining equipment to a specialised market of mining companies.

[68] He added that there is generally no generic market for the equipment and parts sold by it. He explained that technology in the mining industry develops at a rapid pace and XYZ needs to constantly innovate and develop better products and parts. Therefore, many products held by XYZ cease to be produced and become outdated (obsolete) within a short time period. In order to retain clients, XYZ needs to provide excellent maintenance services and ensure that the costly primary production machines which it sells are able to operate.

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35 Received into evidence as exhibit 'B'.

[69] This is because a mine (for instance) may be unable to perform mining operations until a part in its machine that has broken down or been damaged has been replaced. Were it not to provide that excellent support service, XYZ would not be able to sell the primary production equipment which it produces and distributes. Therefore, due to the unique nature of the industry in which XYZ operates, it always holds large volumes of trading stock that have not been sold for a significant period of time, and there is a high risk that such stock will never be sold due to deterioration and/or obsolescence.

[70] Both Mr A and Mr B testified that as at the end of each relevant year, it would not have been possible for XYZ to sell all XYZ's Closing Stock items and that XYZ would also have to sell some Closing Stock items at prices below cost. The reasons given by them included that stock items may no longer be used in the industry, stock items may have also become damaged due to wear and tear (for instance, some items have a limited shelf life), stock items may have been ordered specifically for a client, but the client does not then take that stock *(*referred to as *'non-stock articles')*. Due to the specialised environment in which XYZ operates where it has to be able to supply spare parts required by its customers within a short time period and often on an urgent basis and its customer base is limited, it knows that it will not be able to sell all trading stock acquired by it; items might be capable of being returned to the Product Company but only at a reduced price (i.e. a price below cost), or XYZ might be able to only sell such stock in a fire sale at a reduced price below cost; the circumstances in which an XYZ Group company will be prepared to purchase trading stock from XYZ are limited (it will not accept any damaged or non-stock items for instance) and the XYZ Closing Stock included demonstration items, which are items which were used for customer demonstrations and which had therefore been worn out to some degree.

[71] From the aforegoing facts there can be very little doubt that the '*value of [the relevant] trading stock … had been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason….'* as contemplated in section 22(1)(*a*) i.e. there was a Diminution Amount in each Relevant Year.

Extent of appeal court's powers

[72] If *(as contended by XYZ)* there was a diminution in value of the Closing Stock for a reason contemplated in section 22(1), the Commissioner was required to *'exercise a discretion as to the amount which he consider[ed] to be just and reasonable as representing the amount by which the value of such trading stock ha[d] been diminished';* and he has failed to do what is required of him in terms of the Income Tax Act.

[73] Where, as in the current matter, an appeal concerns a discretion which the Commissioner was required to exercise, the required approach of the Court was stated by van Heerden JA in *CIR v Da Costa*[36] to be a re-hearing of the whole matter by this court and that this court could substitute its own decision for that of the Commissioner.

[74] The application of the above principles to a matter (such as the present), where the Commissioner had completely failed to exercise the discretion vested in him in terms of section 22(1), is summarised in the judgment handed down in *Case 13539* as follows:

> "*The discretion*
>
> [45] Section 22(1)(*a*) provides for the Commissioner to exercise a discretion as to whether the reason for the diminution in value is satisfactory. In the event that it is, then, as recorded earlier, a further discretion arises as to the amount which ought to be permitted as a reduction to the cost price of the trading stock as being a just and reasonable reflection of the diminution in value.
>
> [46] In the present instance the Commissioner did not recognise that a diminution in value had occurred at all in consequence of the further costs which the appellant had taken into account in determining the NRV … For the reasons set out earlier herein I consider that he erred in this regard. By virtue of the error he did not exercise his discretion. In an appeal in terms of the Act the tax court is required to make the same decision, *de novo*, as the Commissioner was required to make. Where the Commissioner was required to exercise a discretion the court of appeal is called upon to exercise its own original discretion in that regard. (See *CIR v De Costa* 1985 (3) SA 768 (A) at 774I-J)."

[75] Therefore, if *(as contended by XYZ)* there was a diminution in value of the XYZ Closing Stock for a reason contemplated in section 22(1) (i.e. there was a Diminution

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[36] 1985 (3) SA 768 (A) at 774.

Amount), it is necessary for this Court to decide the amount which is a '*just and reasonable*' representation of that Diminution Amount.

THE SECOND ISSUE: WAS THE DISPUTED AMOUNT A *'JUST AND REASONABLE'* REPRESENTATION OF THE DIMINUTION AMOUNT?

[76] The Diminution Amounts are the difference between cost and NRV. Ms C testified that during the relevant years, SA GAAP were identical to IFRS and that '*International Accounting Standards*' ('*IAS*') are part of SA GAAP/IFRS. Her evidence was that the standards which had to be applied in respect of the value to be reflected in accounts in respect of trading stock '*inventories'* were: *'International Accounting Standard IAS2 (AC108) Inventories'*('*IAS2*'); *'International Accounting Standard IAS8 (AC 103) Accounting Policies, Changes in Accounting Estimates and Errors'* ('*IAS8*'); and *'International Accounting Standard IAS10 (AC107) Events after the Balance Sheet Date'* ('*IAS10*').

[77] Para 1 of IAS2 states that '*[t]he objective of this Standard is to prescribe the accounting treatment for inventories*' and that *'[a] primary issue'* in *'accounting for inventories is the amount of cost to be … carried forward until the related revenue are recognised'*. Therefore, as in section 22(1)(*a*), there is a recognition that it is not always appropriate to *'carry forward'* the full cost of trading stock (inventories) to the year that the stock is sold (i.e. the year that '*the related revenue are recognised'*). The amount which must be *'carried forward'* is stated in para 9 of IAS2. It requires closing stock to be '*measured at the lower of cost'* and *'net realisable value'* (as defined in IAS2). NRV is defined in para 6 of IAS 2 as '…*the estimated selling price in the ordinary course of business* …'.

[78] It is therefore accounting practice to value closing stock '*at the lower of cost'* and NRV. The reason for this is given in para 28 of IAS2 being that the '*cost of inventories may not be recoverable'* if they *'are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined'*. As stated in para 28 of IAS2, the practice of valuing trading stock '*at the lower of cost'* and NRV is '*consistent with the view that assets should not be carried in excess of amounts expected to be realised for their sale…'.*

[79] In terms of para 30 of IAS2:

> "Estimates of [NRV] are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise …"

[80] Section 22(1) requires the value of trading stock '*held and not disposed*' of at the end of a year to be included in determining taxable income in each year that such stock continues to be '*held and not disposed of*'. The '*evidence available*' at the time an *estimate* of the NRV of such stock is required to be made in respect of the first year may change by the time that a subsequent estimate (or estimates) of that stock is required to be made. Due to the fact that each estimate can only be based on the *'most reliable evidence available at the time [it is] made'*, the NRV of stock cannot be expected to remain constant.[37]

[81] This is recognised in para 33 of IAS2, which reads as follows:

> "A new assessment is made of [NRV] in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in [NRV] because of changed economic circumstances, the amount of the write-down is reversed (i.e. the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of the cost and the revised [NRV]. This occurs, for example, when an item of inventory that is carried at [NRV], because it's selling price has declined, is still on hand in a subsequent period and its selling price has increased."

[82] Where a change in NRV occurs in the circumstances contemplated in para 33 of IAS2, this would not of course mean that the original NRV was incorrect or unreasonable.[38] As is apparent from XYZ's financial statements, it can take many months after the close of an accounting period (the *'balance sheet date'*) until relevant financial information is assembled into a financial statement and the value of closing stock, (based on the lower of cost and (estimated) NRV), is approved by the directors of the relevant trader. During that time evidence relevant to the NRV may become available. Such evidence was referred to in *ITC 1489*[39] as '*post balance sheet experience'*.

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[37] This was confirmed by Ms C in her evidence.

[38] This was confirmed by Ms C in her evidence.

[39] 53 SATC 99 at 104.

[83] The position in *ITC 1489* was that the taxpayer had valued its Closing Stock '*as though it might have to be liquidated at a forced sale*' (referred to by the court as being '*on a calamity basis*'. However, the Court pointed out that:

> "By the time the accountants came to compile the accounts they knew that the appellant had managed to dispose of most of its stock without losing its managing director to the grim reaper or going into liquidation or suffering some other disaster. Moreover, by the time the appellant's accounts came to be drawn up most of the motor cars making up the year's opening stock had been sold and it was possible to determine which had been sold at a loss. Those which were not, could be taken in at cost and those on which losses were made could be taken in at the price realised. This left only a small number of cars in respect of which an estimate had to be made and this could be made fairly accurately on the basis of what had happened to the rest. We find this an attractive line of reasoning. There would appear to be no reason to speculate when the march of events has made uncertain things certain. There is no need to value stock on a calamity basis, if, through the benefit of hindsight, there is no need to do so. This is also good accountancy practice. Paragraph 34 of *AC 108*, a statement of generally accepted accounting practice in South Africa, states that –
>
> > 'estimates of net realisable value should be based on most reliable evidence available at the time the estimates are made as to what the stock is expected to realise.'
> >
> > Everingham and Hopkins in the second edition of their work *Generally Accepted Accounting Practice in South Africa* define 'net realisable value' as –
> >
> > > 'the estimated selling price in the ordinary course of business less costs of completion and less costs necessarily to be incurred in order to make the sale'."[40]

[40] At 104.

[84] Similarly, para 30 of IAS2 requires estimates of NRV to be based on the '*most reliable evidence available at the time the estimates are made'* and states that *'these estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent such events confirm conditions existing at the end of the period'*. Therefore, para 30 requires '*post balance sheet experience*' to be considered in estimating NRV.[41]

[85] Ms C's undisputed evidence was that the calculation of the '*value*' of the Closing Stock set out in Note 11 of its financial statements '*accords with IAS 2*'. Therefore it would, in my view, be just and reasonable to recognise the difference between the cost price and the NRV as representing the amount by which the value of such trading stock has been diminished. Such difference is the Disputed Amounts, as set out in Note 11. Compliance by XYZ with the principles in IAS2 and the policy (which embodies compliance with IAS2), was subjected to both internal and external audits. The effect of this is that the reasonableness of the Diminution Amounts was subjected to external audit.

[86] The dicta in *ITC 1489*[42] at 104 was mirrored in Practice Note: No 36[43] which states that if a method of reducing the cost of stock by a percentage is used, the percentage reduction should be supported by trading history. In assessing the reasonability of the Diminution Amounts, the evidence of Ms C was that (as required by SA GAAP/IAS2) *'where appropriate, post balance sheet experience'* was taken into account and also that the *'trading history'* of XYZ was taken into account. As examples of where the '*trading history'* of XYZ was taken into account, Ms C referred to the substantive analytical procedures performed by V Auditors. Those procedures included:

86.1 That, for the period ending 31 December 2008, the reasonableness of the Diminution Amount, based upon the inventory balance, the expected

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41 This was confirmed by Ms C in her evidence. In this context, she referred to IAS 10, which requires post balance sheets events to be considered. She said that para 3 of IAS 10 requires *"adjusting"* events (i.e. events that provide evidence of conditions that existed at the end of the reporting period) to be taken into account in valuing inventory. In contrast, *"non-adjusting"* events are not taken into account.

42 Footnote 30.

43 Footnotes 30 and 31.

percentage of the Diminution Amount and the Diminution Amount from a historical perspective, was tested. A difference of less than 5% was expected and achieved. The conclusion reached by KPMG based on this testing, was that the Diminution Amount was reasonable. This opinion based on such facts, I accept.

86.2 That, for the purpose of assessing the reasonableness of the Diminution Amount, a comparison of the amount of the Diminution Amount (as a percentage of inventories) to the percentage in the previous year, was done. The conclusion reached by KPMG based on this testing was that the Diminution Amount was reasonable as the provision was 4% of total stockholding and had remained consistent year on year. This reasoning and conclusion too I accept.

86.3 That a comparison was made between the average number of days that inventory was held, with the average number of days it had been held in previous years. That comparison also resulted in the Diminution Amount being found to be reasonable. This conclusion too, seems correct.

[87] The policy refers to IAS2 and the fact that it incorporates the IAS2 principles was undisputed. In this regard IAS2 provides the following: *'[NRV] is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale'*.[44] In particular, under the heading *'Lower of Cost or Net Realizable value',* the policy records that *'inventory shall be valued at the lowest of the following two amounts: Historical cost [and] Net realizable value'*. IAS2 provides further '*[NRV] refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business*'. This principle is also in the policy. In particular, NRV is stated in the policy to be *'the estimated net selling price in the ordinary course of business'*. The policy provides under the rubric '*Scrappings, Returns and Provision for Obsolescence*' amongst other things, the following:

> **b) Slow-moving items**
>
> Products and parts in assembly as well as in sales stock, still being produced, but not moved during the last 12 months.
>
> To be written down by at least 50%, if there is no special reason to keep them at higher value.
>
> Products and parts which have not moved during the last 24 months should be written off completely, if there is no special reason to keep a value for them.
>
> Slow-moving items should be returned to suppliers, be sold out at discount or be scrapped.
>
> **c) Overstock**
>
> Items with stock volume above 12 months' consumption.
>
> To be written down by at least 50%, if there is no special reason to keep them at a higher value.
>
> To be returned to suppliers or sold out at discount.
>
> Specific guidelines for the physical actions to be taken regarding machines unless otherwise instructed by the Divisions.

[88] Evidence was led in respect of a report on inventory dealing with slow moving stock ('*Inventory 33*'). All this stock emanated from the Construction and Mining unit known as ZAM. Inventory 33 reflected the age of the particular item by arranging the cost of the items in separate columns, depending on how long they had been on XYZ's shelves.

[89] The items were aged 6, 11, 12, 23 and 24 months. After 12 months of not recording any sales prior to compiling the inventory, provision was made for a 50% write-off in

[44] Para 6 of IAS2.

accordance with the policy, and, if no sales were recorded for a further 12 months, for another 50%. Mr A explained that this inventory was generated by their computer system on a monthly basis and that the purpose was to assist management to assess its level of efficiency. He explained that ideally, stock should be sold within 6 months of acquisition.

[90] Mr A also testified, with reference to examples of stock line items on Inventory 33, that items with larger values had been removed from the automated system of slow moving items and recorded in a special column titled 'REMOVED'. The market value of these items were assessed individually and accounted for outside the automated system process. This implied that the stock to which the policy was applied, was, generally, spare parts and consumables.

[91] Evidence was also led in respect of an inventory dealing with over-stocked items ('*Inventory 16*'). All this stock emanated from the Construction and Mining unit known as AM. The dispute relates to 2 999 line items (stock types) for the AM division, 1 012 for the AS division and 563 for the AA division yielding a total of 4 573 line items for the three divisions. Each line item (stock types) could consist of many individual items. Counsel for XYZ calculated that the 2 999 line items for the AM division represented 14 159 individual stock items. Inventory 16 reflected the quantity of the particular item on hand ("*QOH*"), the amount of items sold (referred to as the transactional quantity "*TTQTY*") and the overstocked quantity ("*OSQTY*").

[92] The policy requires that items with stock volume above 12 months' consumption are to be written down by at least 50% subject to certain conditions. Inventory 16 was not quite clear as to how this was established or what the word '*consumption*' in the policy meant within the context of a trading organisation (other than of course the fact that Mr A testified that that was what Inventory 16 established).

[93] The accountant member, prepared a schedule[45] utilising the information from Inventory 16. This analysis clarified that the word '*consumption*' in the policy meant sales exceeding an average stock holding period of 12 months from when Inventory 16 had been generated. The schedule revealed quite clearly that the goods reflected in Inventory 16 had been on the shelves for a period exceeding 12 months. The item with the longest projected shelf life was to remain in stock for a period of 1728 months, and the shortest shelf life was to remain in stock for 13 months.

[94] The evidence revealed that, in respect of each relevant year, XYZ complied with the policy and valued its closing stock in accordance with the policy (IAS2). In this regard: Mr A testified that XYZ complied with the policy and that such compliance was verified by internal auditors and, on an annual basis, by XYZ's external auditors (V Auditors); Ms C confirmed that the Closing Stock was valued in accordance with the policy and, in particular, that the Disputed Amounts were calculated in accordance with the policy. The undisputed evidence of Ms C was that a thorough and extensive audit was done.

[95] XYZ's report to give effect to its policy on Slow Moving stock (Inventory 33), is not based on the date of acquisition of the stock items listed. The stock items listed relates to items which had not been sold within 12 or 24 months prior to the generation of Inventory 33. Mr A's evidence was that some stock items could have been held for up to 5 years from the date of acquisition of such item.

[96] In my view, the inability to sell any unit of a particular stock line item for a period of 12 or 24 months as identified in Inventory 33 constitutes sufficient evidence that it can probably not be sold in the ordinary course of business. This is particularly so since there is an expectation to sell stock within a period of 6 months from date of acquisition. This is a clear indicator that the value of the stock has probably diminished. The slow-moving and over-

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[45] It was received as evidence without objection as its workings were based on evidence already received.

stocked stock categories, comprise the majority, 70% of the listed items provided for in 2008 and 77% in 2009, of the diminution amounts.[46]

[97] The diminution in value for stock in transit to product companies and credit notes due for such return purchases together represents 12% of the listed items provided for in 2008 and 18% in 2009.[47] Returns to the product companies is subject to approval by the product company of the pricing determined prior to the return of such stock. This ensures a diminution of value which relates to the stock's known net realizable value.

[98] The diminution in value for demonstration stock represents 2% of the listed items provided for in 2008 as well as in 2009.[48] The demonstration stock cannot be returned to the product company as such stock is regarded as used. A diminution in value of 50% is provided for items not already on the slow-moving inventory (Inventory 33). 100% diminution of value is provided for items which cannot be located or are missing.

[99] The diminution in value for the acquisition of D Co. stock represents 16% of the listed items provided for in 2008. This stock was integrated, reviewed and subjected to the same policies in 2009. The net amount provided was R1 544 036 in 2008. D Co.'s stock was acquired shortly before the 2008 year-end and the cost prices and provisions made by D Co. were maintained for XYZ's 2008-year end. Whilst this approach differs from the policy, the transaction should be tax-neutral if the same amounts were recognised by the Commissioner for D Co.'s tax returns.

[100] The diminution in value for returns to be scrapped of R214 374 represents 2% of the listed items provided for in 2009. This relates to obsolete stock from a previous acquisition

46 In 2008 the total provided was R6 677 509, (comprising of R3 307 669 for Slow Moving items and R3 369 841 for Overstocked items). In 2009 the total provided was R8 135 830, (comprising of R4 603 122 for Slow Moving items and R3 532 708 for Overstocked items).

47 In 2008 the net amount provided was R1 127 726, (comprising of R4 075 706 for transit stock sent to product companies less R2 947 980 for Credit notes due in 2008). In 2009 the net amount provided was R1 921 381 (comprising of R2 401 192 for transit stock sent to product companies less R479 810 for Credit notes due in 2009).

48 In 2008 the amount provided was R202 320. In 2009 the net amount provided was R243 130.

which is due to be scrapped (isolated from normal warehouses and sold to steel dealers or smelters as scrap) with no normal commercial value.

[101] In SARS' Rule 31 Statement[49] SARS states that '*[t]he assertion that slow moving stock was deemed obsolete and written off was misplaced'* and that '*[i]t was inappropriate, having regard to section 22(1) … to deem stock that 'moves slow' to be obsolete*'*.*

[102] I have very little hesitation in concluding that stock items of the nature held by the AM division of XYZ which have for a period of 12 months not had any sales, have diminished in value. Such conclusion is reinforced if regard is had to the fact that not all stock can be returned to the parent company in Sweden and a special return price is negotiated less a further 15%, administration fee. In addition, the parent company does not re-imburse used goods or goods damaged en route, the only other options available to dispose of such items is to sell them at a discounted price at scrap values based on requests for offers.

[103] SARS also states[50] in its Rule 31 Statement that '*the determination of the diminution of trading stock … must represent* ***the actual value*** *by which such stock has been diminished and not merely* ***the possibility of diminution of value*** *and as such requires an actual event to take place resulting in such a loss.'* (emphasis provided)

[104] A trader such as XYZ cannot know the *'actual value'* of closing stock at the time it is required to determine the Diminution Amount in respect of such stock (in terms of section 22(1)). That is because, by definition, such stock is '*held and not disposed of*' by XYZ at that time. An *'actual event … resulting in such a loss'* will only occur in the year when stock is sold at below cost or scrapped. However, in that year such stock is not '*held and not disposed of'* and consequently section 22(1) does not apply in that year. Therefore, the issue is not what the '*actual value*' of the XYZ Closing Stock was for a relevant year, but whether each Diminution Amount (which was based on estimates of NRV in accordance with the

49 Paras 9.1.2 and 9.1.3.
50 Para 21.

policy and IAS2*) justly and reasonably represented the Diminution Amount for that Year at the relevant time* (i.e. at the end of the relevant year).

[105] In para 22 of its Rule 31 Statement SARS states that *'[t]he method of valuing the written down stock should ... at least comply with generally accepted accounting practice, which requires that only events that exist at year end be taken into account in calculating the value of trading stock.'*

[106] The SARS contention that SA GAAP requires *'only events that exist at year end [to be] taken into account in calculating the value of trading stock'* is contrary to SA GAAP, IFRS and the authorities which require post balance sheet events/experience to be taken into account in determining NRV where appropriate.[51] It is also contrary to Ms C's undisputed evidence in this regard.[52]

[107] As confirmed by Ms C and Mr A, post-balance sheet events/experience (as required by SA GAAP and where appropriate) were taken into account in order to make the most accurate estimate possible of the value of the relevant XYZ Closing Stock as at year end (31 December). In addition, the evidence has shown that the method used by XYZ of valuing its closing stock complied with SA GAAP, IFRS and IAS2.

[108] In para 23 of its Rule 31 Statement SARS states that *'[t]he methodology used by [XYZ] … does not comply with the provisions of section 22(1)(a) … as it only identifies slow-moving inventory that can still be used after year end.'* There is nothing in section 22 which excludes trading stock that can no longer be used from consideration. What is required is that there has been a diminution in value '*by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason which [should] be satisfactory to the Commissioner'.* Although stock which can no longer be used may satisfy this

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[51] Although not binding, SARS Practice Note No. 36 (13 January 1995) also accepts that "*where appropriate, post balance sheet experience*" must be taken into account.

[52] Ms C referred to *IAS 10*, which requires post balance sheets events to be considered. She said that para 3 of *IAS 10* requires *"adjusting"* events (i.e. events that provide evidence of conditions that existed at the end of the reporting period) to be taken into account in valuing inventory. In contrast, *"non-adjusting"* events are not taken into account.

requirement, it is not the only type of stock in respect of which there may, for instance, be a '*deterioration*' or a '*decrease in the market value*'. This is demonstrated by the fact that stock which is no longer produced or is out of date *(*and which is consequently '*obsolete*') may, despite the fact that it can still be used, result in a '*decrease in the market value*'.

[109] In any event, the evidence has shown that SARS' contention that the method used by XYZ '*only'* identifies slow-moving inventory is incorrect. It identifies stock which has not sold for either 12 or 24 months as slow-moving or stock levels in excess of 12 months as excess stock. In particular, Mr A's testimony was that the management of XYZ identified high value items (capital stock items) separately in relation to NRV and applied suitable methods to stock returns, demonstration stock, D Co. Stock and stock items to be scrapped.

[110] In my view, the NRV as determined in accordance with IAS2 provides an appropriate method for purposes of section 22(1) for the determination of the actual value of trading stock at the end of the relevant years. Where this value is less than the cost price, a diminution of value has occurred. The reason for the diminution is to be found in the reduction in the reasonably anticipated taxable income that will be derived from the disposal of the trading stock. For the reasons set out earlier this is a satisfactory reason in the context of section 22(1). It was accepted by SARS that the calculation by XYZ of the NRV of the trading stock accords with IAS2. That being so, in my view, it would be just and reasonable to recognise the difference between the cost price and the NRV as representing the Diminution amount. The safeguards are found in compliance with SA GAAP/IFRS and thus IAS2. It should be remembered that section 22 of the Income Tax Act permits a deferral and does not authorize or deal with, deductions. The trader will, ultimately, be taxed on its profits. In my view, the Diminution Amounts of the relevant years were both just and reasonable having regard to all the facts and circumstances elaborated upon herein.

THE THIRD ISSUE: DID THE DIMINUTION AMOUNT HAVE TO BE '*ADDED BACK*' IN TERMS OF SECTION 23(*e*)?

[111] By virtue of my findings herein, this question has become redundant. I nonetheless address it should I be found to be wrong in relation to the previous findings made herein.

[112] This issue involves the interpretation of section 23(*e*) and is consequently a question of law. As Centlivres JA stated in *Sub-Nigel Ltd v CIR*:[53] '*Regard, therefore, must be had to the Act and the Act alone*' and, in order to ascertain what the correct position is, the fact that accountants treat amounts in a certain manner cannot override the provisions of the Income Tax Act. Section 23(*e*) must be interpreted in the context of the Income Tax Act, as a whole, and in the context of the relevant provisions of section 23.[54]

[113] The context of the provisions of section 23 is stated in the following passage from the judgment handed down by Corbett JA in *CIR v Nemojim (Pty) Ltd*:[55]

> **"**Section 11(*a*) provides positively and in general terms, in the case of a person deriving income from the carrying on of a trade within the Republic, what expenditure and losses shall be allowed as deductions from income so derived in order to determine his taxable income. The subsection limits the deductions to expenditure and losses incurred in the Republic in the production of the income, other than those of a capital nature.
>
> Taxable income is the basis upon which normal tax is levied …. Taxable income is arrived at by first determining the taxpayer's gross income and then deducting therefrom any amounts exempt from normal tax in order to arrive at the taxpayer's income. Taxable income is then determined by deducting from income the various amounts which the Act allows by way of deduction from income, including those covered by s 11(*a*): see the definitions of "gross income", "income" and "taxable income" contained in s 1 of the Act.
>
> Section 23 prescribes what deductions may not be made in the determination of taxable income."

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53 1948 (4) SA 580 (A) at 588.

54 The current approach to interpretation encapsulating the principles stated by Wallis JA in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) at [18] and refined in the numerous authorities since then is to be found in *Novartis v Maphil*, [2015] ZASCA 111. Those principles apply to tax statutes - see *CSARS v Bosch & Anor* 2015 (2) SA 174 (SCA) at [9] & *XO Africa Safaris CC v CSARS* 79 SATC 1 (SCA) at [20].

55 1983 (4) SA 935 (A) at 946. Emphasis added. This passage was quoted with approval in *CSARS v Pretoria East Motors (Pty) Ltd* 2014 (5) SA 231 (SCA) at para [3].

[114] The Court went on to hold that para (f) of section 23 is '*in a general sense, the negative counterpart*' of the '*in the production of income*' requirement of s 11(*a*).[56]

[115] Similarly, while section 11(*a*) provides positively that expenditure '*actually incurred*' shall be allowed as a deduction *(assuming the other requirements of section 11(a) are satisfied)* section 23(*e*) is '*in a general sense, the negative counterpart*' of that requirement. The relevant part of para (e) reads as follows:

> **"<u>Deductions not allowed in determination of taxable income</u>**
>
> <u>No deductions</u> shall in any case be made in respect of the following matters, namely …
>
> (e) income carried to any reserve fund or capitalized in any way."

(emphasis added)

[116] The Diminution Amount is the difference between the cost price of the relevant XYZ trading stock and its NRV. The Diminution Amount is not a '*deduction*' claimed under section 11(*a*) (or under any other section of the Income Tax Act) and it would completely defeat the rationale and purpose of section 22 were the Diminution Amount to be *'added back'*.

[117] If an amount determined to be the Diminution Amount is required to be *'added back'* under para (e), that part of para (a) describing the Diminution Amount would serve no apparent purpose and would be superfluous which is contrary to the rules of statutory interpretation[57].

[118] There is nothing in section 22 which could be interpreted as requiring the trader and/or its auditors to give the Diminution Amount a particular label in documents and/or financial statements. Therefore, the fact that the Diminution Amount was labelled a *'provision'* in XYZ's documents is irrelevant.

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[56] At 946-7.

[57] See, for instance, the statement in *Wellworths Bazaars Ltd v Chandler's & Anor* 1947 (2) SA 37 (A) at 43 and *National Credit Regulator v Opperman* 2013 (2) SA 1 (CC) at [99] that: "*A court must be slow to come to the conclusion in interpreting these sections that the words used are tautologous or superfluous and should rather be inclined to suppose that "every word intended to have some effect or be of some use".*

[119] A finding in favour of SARS that the Diminution Amount is not reasonable would simply result in the closing stock for the years of 2008 and 2009 being reflected at cost. Section 23(*e*) has no application.

[120] The net impact of closing stock value in terms of section 22(1) and the opening stock value in terms of section 22(2) of the Income Tax Act, implies that both closing and opening stock values are taken into account in the calculation of taxable income. Any adjustment to the Diminution Amount of closing stock, would have to be accompanied by a likewise appropriate adjustment to opening stock, to determine the net impact (value movement) which affects the taxable income for a particular year.

[121] In this way the provisions of section 22(1) and section 22(2) also differ from a deduction, in that such a diminished amount, affects two years of taxable income and not only one year as in the case of an allowance deduction. For any adjustment to the Diminution Amount in closing stock there must be a likewise and appropriate adjustment to opening stock for the following tax year. Such adjustments should also have to be adjusted the previous tax year, and the year prior to that, etc. to ensure a consistent method of determination of values for taxation purposes as it is not only the closing stock values that affect taxable income, but the net value movement derived from both closing and opening stock values. These amounts are not similar to expenses which are not allowed for deduction and added back into taxable income.

[122] Hence, in the event where the 2008 closing stock is adjusted by an adjustment of the Diminution Amount, a likewise and appropriate adjustment to opening stock would have to be made to determine the net impact (movement) which would affect the 2008 taxable income. The same would be applicable for the 2009 year where the net difference between the adjustments in closing values and the opening values should be taken into account.

THE FOURTH ISSUE: WAS XYZ LIABLE FOR INTEREST IN TERMS OF SECTION 89*QUAT*?

[123] At the relevant times, the relevant parts of section 89*quat* read as follows:

> "(2) If the taxable income of any provisional taxpayer as finally determined for any year of assessment exceeds—
>
> (*a*) ....
>
> (*b*) R50 000 in the case of any person other than a company,
>
> and the normal tax payable by him in respect of such taxable income exceeds the credit amount in relation to such year, interest shall, subject to the provisions of subsection (3), be payable by the taxpayer at the prescribed rate on the amount by which such normal tax exceeds the credit amount …
>
> (3) Where the Commissioner having regard to the circumstances of the case is satisfied that any amount has been included in the taxpayer's taxable income or that any deduction, allowance, disregarding or exclusion claimed by the taxpayer has not been allowed, **and the taxpayer has on reasonable grounds contended that such amount should not have been so included or that such deduction, allowance, disregarding or exclusion should have been allowed, the Commissioner may,** subject to the provisions of section 103(6), **direct that interest shall not be paid by the taxpayer** on so much of the said normal tax as is attributable to the inclusion of such amount or the disallowance of such deduction, allowance, disregarding or exclusion.
>
> …
>
> (5) Any decision of the Commissioner in the exercise of his discretion under subsection (3) or (3A) shall be subject to objection and appeal."

(emphasis added)

[124] If XYZ was not liable for the tax in dispute, then the normal tax payable by it in respect of its taxable income for the 2008 and 2009 year of assessment (as the case may be) did not exceed '*the credit amount in relation to such year'* and, consequently, XYZ would not be liable for section 89*quat*(2) interest. However, if XYZ were liable for the tax in issue, it was argued that XYZ '*has on reasonable grounds*' contended it was not liable for that tax and that this is a classic situation in which the interest should be remitted in terms of section 89*quat*(3). In this regard, it was argued that the issues involved were complex and that an intricate analysis of facts had to be undertaken. It was also contended that there has been no suggestion that XYZ had not acted in a *bona fide* manner in relation to the matters in issue. By virtue of our findings herein, this issue too has become moot.

CONCLUSION

[125] Section 22(1)(*a*) of the Income Tax Act is a timing provision – it is not a deduction provision and does not provide for any deduction.

[126] Any subtraction from cost in terms of section 22(1)(*a*) of the Income Tax Act is, where appropriate, reversed in a subsequent year so that a trader is always taxed on its profit.

[127] The purpose of section 22(1)(*a*) of the Act is to provide an equitable balance which ensures that a taxpayer need not pay tax in the year of assessment on more than what the stock can be expected to realise for him.

[128] The NRV of XYZ's closing stock for 2208 and 2009, calculated in accordance with IAS2, IFRS, SA GAAP and the policy (which policy is in line with IAS2 and IFRS), may and should, where it is lower than the cost price of such trading stock, be accepted as representing the value of trading stock held and not disposed of at the end of the relevant years for purposes of section 22(1)(*a*) of the Income Tax Act.

[129] The NRV as determined in accordance with IAS2, IFRS and SA GAAP and the policy, provides an acceptable and appropriate method for purposes of section 22(1)(*a*) for the determination of the actual value of trading stock at the end of the year of assessment, the application of which leads to a sensible and businesslike result. It constitutes a just and reasonable basis for valuing XYZ's closing stock for 2008 and 2009, as contemplated in such section.

[130] Even though evidence was primarily presented in respect of the AM division of XYZ, the evidence presented was sufficiently representative of the principle to enable this court to evaluate whether the Disputed Amounts for the relevant years were just and reasonable representations of the Diminution Amounts for such years.

ORDER

[131] In the result, the following order is made:

1. The appeal succeeds.

2. The Commissioner's additional assessments for the 2008 and 2009 tax years are set aside.

Ingrid Opperman

Judge of the High Court

Gauteng Local Division, Johannesburg

Heard: 19 – 22 February 2018, 26 – 27 February 2018.

Judgment delivered: 17 May 2018