

Practice Note: No 36 – Date: 13 January 1995
Income Tax: Valuation of trading stock

It is evident that a variety of questionable methods are used by taxpayers to write-off slow-moving and obsolete stock, without reference to its actual net realisable value. It has, therefore, become necessary to explain Inland Revenue's standpoint in this regard.

Amounts written off, for instance on a fixed percentage basis, which cannot reasonably be justified will not be allowed to be deducted from the cost price of such stock held and not disposed of at the end of the year of assessment in terms of section 22 (1) of the Income Tax Act (the Act).

In Income Tax Case No. 1489 ([53 SATC 99](#)) it was held, *inter alia*:

- (a) That if a method of reducing the cost of stock by a percentage is adopted, the percentage reduction should not only be supported by trading history and, where appropriate, post-balance sheet experience, but the Receiver of Revenue should be told how that percentage is arrived at.
- (b) That the Commissioner for Inland Revenue has to exercise a discretion with regard to the amount by which the value of trading stock had been diminished and cannot exercise that discretion if he is not told on what basis the accounts submitted to him have been prepared; hence the Act, by implication, requires such a disclosure.

Taxpayers are, therefore, required to disclose the basis on which stock is valued, which disclosure must be made in the annual return of income.

Where stock has not been valued at cost, but at a lower value, the taxpayer is also required to reveal this to the Receiver of Revenue, submit reasons therefor and indicate how the lower value was arrived at. If stock has been written off on a fixed, variable or any other basis, not representing the actual value by which it has been diminished, the write-off will not be accepted without reasonable justification for such basis.

Where it is found that a taxpayer has undervalued his stock and has not revealed this fact to the Receiver of Revenue, such concealment will be viewed in a serious light and the imposition of additional tax in terms of section 76 of the Act will be considered.