IT 2001 - Winemakers - valuation of winestocks.

This cover sheet is provided for information only. It does not form part of *IT 2001 - Winemakers - valuation of winestocks.*

This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

TAXATION RULING NO. IT 2001

WINEMAKERS - VALUATION OF WINESTOCKS.

F.O.I. EMBARGO: May be released

REF H.O. REF: 4 J96/1 Pt8 DATE OF EFFECT:

B.O. REF:

Sydney: 27/B2/AF 1931 Pt2 dated 6 May 1982
Parramatta: K-T 31A/1/1, T31/1/1 dated 28 April 1982
Melbourne: 86704810 dated 9 December 1981, 13 and 26 August 1982
Perth: J27/3 dated 28 April 1982
Adelaide C31/1/1 Pt 3 dated 27 April 1982

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1102915	WINESTOCKS - VALUATION OF TRADING STOCK	31(1)
	WINEMAKERS	31(2)

OTHER RULINGS ON TOPIC:

PREAMBLE This office has recently considered, in the case of a winemaker who grows his own grapes, whether any amount should be taken into account in arriving at the cost price of stocks on hand at the end of a year for the cost of growing the grapes.

In the particular case, the taxpayer claimed that, in terms of "cost price" stock valuation, fermenting wine at balance date should be valued at the total of the costs applied to the grapes (and wine) from the point of harvesting onwards given that grapes are taken into account as trading stock only at the time they are harvested. On this basis, the taxpayer contended that all vineyard expenses attributable to grapes of a winemaker's own growing should be excluded from the cost of trading stock on hand at balance date.

RULING The taxpayer's basic contention has been rejected. At the same time, however, it is still accepted that plants growing in the ground do not represent trading stock. Crops, fruit, wool etc. come into existence as chattels or goods and are to be taken into account as trading stock only at the time they are harvested, or are shorn, as the case may be.

Where a winemaker elects to value wine stocks on hand at cost price, the cost of materials, labour and a proportion of overheads must be taken into account in determining cost price for tax purposes. Where a winemaker grows his own grapes, absorption cost principles require that the cost of the winemaker's trading stock include some part of the cost to the winemaker of growing the grapes. It is not realistic to say that there is no cost price

that can be attributed to grapes of a winemaker's own growing when labour and materials have gone into raising the crop to the stage it has reached once harvested.

By the same token, costs associated with the establishment of the vineyard, for example, land preparation, propagation and planting costs would not be required to be included in the valuation. Also excluded from the valuation would be costs not normally classified as manufacturing costs even though the costs have some connection with the production of the trading stock. Expenses relating to administration, selling, finance and, generally speaking, to storage are not regarded as costs of production and need not be brought into the valuation. Although absorption cost principles require that a share of overhead costs, as well as direct costs, be brought into the valuation, it is not generally required for practical purposes that overhead costs be dissected in any great detail.

In the light of this approach, expenses which may require apportionment between the manufacturing and other operations of a business are -

Salaries
Payroll tax
Rates and taxes
Motor vehicle expenses
Depreciation
Superannuation contributions for employees

Expenses which do not call for apportionment either because they are remote from the manufacturing process or, in the main, are too small in relation to the cost of goods produced would, in most instances, include -

Interest
Insurance
Bank Charges
Office supplies and stationery
Postage
Telephone
Subscriptions
Licenses and registrations
All selling expenses

Rent paid, unless there are special circumstances indicating the contrary, would be regarded as a financial rather than as a manufacturing charge. Generally speaking, therefore, it may also be disregarded in ascertaining the cost of trading stock.

The cost of storage of completed stock is also, prima facie, not a part of the cost of stocks. However, as in the case of the manufacture of some types of wine and brandy, it is evident that storage and handling charges to some degree play a part in obtaining the finished product. In these instances it would be expected that an apportionment of storage charges should be made. The basis of apportionment is a matter of fact and any fair and reasonable basis would be acceptable.

As you will recall, the former section 31A, which operated from 1953 until its repeal in 1973, permitted winemakers to bring trading stocks of wine, brandy and grape spirit on hand at the end of an income year to account for income tax purposes at certain prescribed minimum values. Following the repeal of that section, representatives from this office discussed the question of the valuation of wine stocks at some length with representatives of the Federal Wine and Brandy Producers' Council of Australia Incorporated. In 1974 the representatives were advised that, in ascertaining "cost price" for section 31 purposes, absorption cost, including pre-harvesting costs, was the correct basis to use. In a manual designed to assist winemakers in establishing product costs for stock valuation purposes the Council acknowledges that this is the basis advised to the wine industry by this office.

It is evident that a number of taxpayers in the winemaking industry are presently bringing trading stock to account, for income tax purposes, on the correct basis. Moreover, some winemakers previously not utilising a pre-harvesting absorption cost basis have readily accepted amendments to assessments bringing to account necessary adjustments to stock valuations over a six year period.

Given the obvious need for uniformity of tax treatment in this area and the fact that, since 1974, the wine industry as a whole has been familiar with our stock valuation requirements, adjustments to increase the valuation of stock to reflect the application of absorption cost should not be confined to the 1982 financial year. Accordingly, where past returns evidence incorrect stock accounting by winemakers, assessments of previous years may be re-opened to the extent permitted by section 170 and the values of both opening and closing stock adjusted. Such amendments should, of course, be made only where it appears that there has been an understatement of income. Additional tax in terms of section 226(2) should not be imposed on understatements of income that have resulted from the omission to take pre-harvesting costs into account.

In the event of an adverse season where, because of a partial failure of the grape harvest, the cost of production of a vintage may reach an uneconomic level and the three alternatives covered by sub-section 31(1) do not provide a reasonable basis of stock valuation, recourse may be had to the provisions of section 31(2). As you know, this section provides a discretion to reduce the value of trading stock, calculated in accordance with the law, where special circumstances relating to that stock exist. For this purpose special circumstances would exist in respect of a winemaker who grew his own grapes or purchased grapes where the cost of those grapes, having regard to the usual conduct of his business must be regarded as uneconomic and, because of a partial failure of the harvest on a broad front, adoption of current market or replacement values would produce an illogical result. The anticipated sale price of the finished product, after taking into account the costs of storage and selling expenses, would be a factor to be taken into

account in the exercise of the discretion given in section 31(2).

In effect sub-section 31(2) should be applied in appropriate cases in such a way so as to ensure that a year of uneconomic production bears a reasonable part of any anticipated loss rather than that this loss be reflected only in the accounts of the year of sale of the product. Nevertheless, the actual effect of the sub-section must substantially depend upon the facts of each case as they emerge.

As a general guideline, where a winemaker seeks to have a special value of stock on hand determined under section 31(2) it would appear that the following bases of valuation may yield fair and reasonable results:

(a) where the winemaker has grown his own grapes and there has been a partial failure of his crop, a conservative estimate of the yield had there not been a partial failure may be taken as a basis for determining an hypothetical value. The stock may then be valued on the basis that the cost of grapes used was

$$\frac{\text{actual yield}}{\text{estimated normal yield}} \times \text{cost of production of grapes}$$

(b) where grapes have been purchased at a price which makes it evident that the resultant production of wine would be uneconomic, the cost of these grapes may be reduced by the proportion by which the anticipated sale price of the wine falls short of an hypothetical sale price which would be necessary, when based on actual costs, to yield a rate of profit equal to the average rate for the three preceding years.

These methods of valuation are given by way of illustration only and, if the application of section 31(2) is considered to be warranted in a given case, any method of valuation advanced by the taxpayer may be accepted so long as it yields a reasonable result.

COMMISSIONER OF TAXATION
6 DECEMBER 1982