PS LA 2003/13 - Valuing trading stock for retailers and wholesalers

PS LA 2003/13

Valuing trading stock for retailers and wholesalers

This Law Administration Practice Statement explains how to value trading stock on hand for retailers and wholesalers.

This practice statement is an internal ATO document, and is an instruction to ATO staff.

Taxpayers can rely on this practice statement to provide them with protection from interest and penalties in the following way. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty. Nor will they have to pay interest on the underpayment provided they reasonably relied on this practice statement in good faith. However, even if they don't have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.

---

1. What is this practice statement about?

This practice statement only applies in relation to those retailers or wholesalers (including consolidated groups) whose consolidated gross operating turnover for the financial year is greater than $10 million.

It provides guidance on:

- What costs to include in valuing trading stock on hand.
- The valuation approach you can take when valuing a taxpayers' trading stock on hand for the 2004 year income tax return.
- The valuation approach you should take when valuing a taxpayer's trading stock on hand in subsequent (2005 and later) year income tax returns, where the taxpayer has not used cost basis valuation previously.

Note: If a taxpayer has a consolidated gross operating turnover for the financial year of less than $10 million, you should accept their calculations where they are made in accordance with this practice statement. However, such a taxpayer may use any other method that is fair, reasonable and in full accordance with the law.

2. Full absorption costing to be used

Valuations of trading stock on hand for these taxpayers must be done using the full absorption costing method.

You can accept the taxpayer's calculations where the cost of their trading stock on hand is determined in accordance with Accounting Standard AASB 102 *Inventories* where all costs incurred in bringing the trading stock to its present location and condition are appropriately captured.

3. Examples of costs that should be absorbed

Examples of costs which are to be included in full absorption costing are:

- the purchasing function
- operating distribution centres
- operating on-or-off-site warehouses or storage areas
- freight from the supplier's premises to the retailer's warehouse or distribution centre
- freight from the retailer's warehouse or distribution centre to the retail outlet.

The costs of operating a warehouse or distribution centre typically include:

- salary and wages
- light and power
- cleaning
- security
- repairs and maintenance
- freight
- insurance
- rent
- rates and taxes
- lease costs
- depreciation
- damaged stock
- telephone
- workcare premiums
- superannuation
- other administration costs.

4. Costs that should not be absorbed

When applying the absorption method, the following costs need not be absorbed.

- General administrative costs unrelated to the operation of the warehouse or distribution centre.
- Costs connected with the selling function.
- Costs incurred outside the normal operations of the warehouse or distribution centre.
- Costs of carrying obsolete stock.
- Cost of displaying goods in the retail outlet.
- Cost of transporting goods from the selling location to the customer's premises.
- Interest.
- Advertising.

You should also accept that incidental costs of a minor nature and which may be time-consuming to record and which would not result in a material difference to value, need not be absorbed. For example, the cost of moving stock from the on-site storage location to the display setting.

5. Accounting costs v. absorption costs

The costs that are being included under absorption costing may include costs which the taxpayer does not include for inventory costing purposes under the relevant accounting standards.

If a taxpayer has not used the full absorption cost method for calculating the cost valuation of their trading stock on hand in a given income tax return year then you may accept a taxpayer's use of calculation methods permitted under the relevant accounting standards for valuing the cost of their trading stock on hand, provided the methods used are consistent with their financial statement accounting calculations and financial statement disclosures over the same period.

Note: Where a taxpayer includes a particular cost amount in their trading stock calculations for calculating the cost of their trading stock on hand for income tax purposes, you may not accept the inclusion of that particular cost amount again at any other assessable income or allowable deduction item, irrespective of which method is used.

6. 2004 financial year

Where taxpayers have not previously used full absorption costing, we will allow those taxpayers to include the appropriate figure in their return for the year ended 30 June 2004. Those taxpayers are not required to adjust their closing stock on hand in earlier year returns.

The rules outlined in this practice statement will apply for the 2005 and subsequent years however.

7. More information

For more information, refer to:

- Legislative principles
  - Section 70-45 of the *Income Tax Assessment Act 1997*
- On judicial interpretation of valuation principles
  - *Phillip Morris v. Federal Commissioner of Taxation* (1979) 38 FLR 383; 79 ATC 4352; (1979) 10 ATR 44
  - *Commissioner of Taxation v. Kurts Development Ltd* (1998) 86 FCR 337; 98 ATC 4877; (1988) 39 ATR 493
- Accounting Standard AASB 102 *Inventories*
- Rulings
  - Taxation Ruling TR 2006/8 *Income tax: the cost basis of valuing trading stock for taxpayers in the retail and wholesale industries*
  - Taxation Ruling IT 2289 *Income tax: valuation of trading stock – average cost or actual cost*
  - Taxation Ruling TR 2009/5 *Income tax: trading stock – treatment of discounts, rebates and other trade incentives offered by sellers to buyers*

Date issued	30 June 2004
Date of effect	30 June 2004