

"The value of an idea lies in the using of it" –

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Thomas Edison

TAX LIABILITIES HIDDEN IN THE SALE OF BUSINESS: VALUATION OF STOCK

In the case of CIR v Nico, the court found that the trading stock, which formed part of the purchase price when the owner sold his business as going concern, would form part of gross income. This case highlighted the necessity for the asking price of a business sold as a going concern, not to be reflected as a lump sum. The selling price must be allocated to various items such as fixed assets, goodwill, stock and accounts receivable. This article focusses on the valuation of slow-moving and obsolete stock when selling a business as going concern.

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. According to Practice Note 36 (1995) issued by the Commissioner, taxpayers must disclose the basis on which they have valued their stock if it has not been valued at cost.

In Income Tax Case No. 1489 it was held 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 SARS should be told how that percentage is arrived at.

The Commissioner 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.

Often business owners under value their stock. This allows for reduced profit margins which results in smaller tax burdens on an annual basis. Once the hugely undervalued stock is recorded in a sale agreement, both the seller and the purchaser is bound thereto. This puts the purchaser in a disadvantaged position, as in his books the stock is now reflected at such lower value, indirectly lowering his cost of sales and increasing his profit margins, creating a greater than true tax burden for the purchaser.

Law & Laughter

Joke: How do you get a group of lawyers to smile for a photo?
Answer: Just say, "fees!"