TR 93/23 - Income tax: valuation of trading stock subject to obsolescence or other special circumstances

This ruling contains references to repealed provisions, some of which may have been rewritten.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32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

This document has changed over time. This is a consolidated version of the ruling which was published on *29 November 2006*

Australian Taxation Office

Taxation Ruling
Income tax: valuation of trading stock subject to obsolescence or other special circumstances

This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the ***Taxation Administration Act 1953****, is a public ruling for the purposes of that Part . Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

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What this Ruling is about

1. Subsection 31(1) of the *Income Tax Assessment Act 1936* sets out the valuation methods available to a taxpayer when valuing trading stock on hand at the end of an income year. Subsection 31(2) gives the Commissioner a discretion to determine a fair and reasonable value of trading stock that, by reason of obsolescence of, or any other special circumstances relating to, the trading stock, is less than the lowest value that could be applicable under subsection 31(1).

2. This Ruling provides guidance on:

(a) the meaning of 'obsolescence';

(b) how to value stock which by reason of obsolescence requires an alternative valuation;

(c) what circumstances constitute 'special circumstances' for the purposes of subsection 31(2);

(d) how to value stock in relation to which special circumstances exist; and

(e) the lodgment of notices under subsection 31(3).

Ruling

3. This Ruling is not intended to fetter officers in the exercise of any discretion under subsection 31(2). The fair and reasonable value of trading stock is determined on a case by case basis. Each case must be decided on its own merits.

Meaning of 'obsolescence'

4. In the context of subsection 31(2), 'obsolescence' refers to stock which is either:

(a) going out of use, going out of date, becoming unfashionable or becoming outmoded (i.e. becoming obsolete); or

(b) out of use, out of date, unfashionable or outmoded (obsolete stock).

The reasoning applied in determining this meaning of obsolescence is set out in paragraphs 28 and 29 of this Ruling.

Valuing stock which by reason of obsolescence requires an alternative valuation

A. Stock in the process of becoming obsolete

5. Provided adequate documentation supporting the calculation is maintained, we accept any fair and reasonable value which is calculated taking into account the factors listed in paragraphs 31(2)(a)-(c). In addition, for the purposes of paragraph 31(2)(d), the following factors may also be relevant, depending on a taxpayer's circumstances:

(a) the age of the stock on hand;

(b) the quantities of the stock on hand which, according to the operating and sales budgets, are expected to be used or sold during the year and in the future;

(c) the length of time since the last sale, exchange or use of an item of the stock;

(d) industry experience/taxpayer expertise in relation to the same kind or class of trading stock;

(e) the price at which the last sale of the stock was made, the price of the stock on the taxpayer's price list, and the price at which the taxpayer is prepared to sell the stock; and

(f) if the stock is spare parts:

  (i) the past movements of the stock and the expected future movements of the stock compared with the total number of units in existence which might require that stock; and

  (ii) the approximate date by which the last of those units can be expected to have gone out of use.

6. If a taxpayer can make a reasonable estimate of the amount of stock which will never be sold due to obsolescence factors then an accurate value for stock will generally be:

(a) the value of the stock which it is reasonable to assume will be sold in the future, determined in accordance with subsection 31(1); **plus**

(b) an amount which represents the value of the stock which cannot be sold. If this stock can be sold as scrap, it should be given its scrap value. If the stock cannot be sold as scrap and has no other use (e.g., in manufacturing other stock), but remains on hand, it may be valued at nil. However, given that the stock is only becoming obsolete and is not yet obsolete, and that it remains on hand, particular care should be taken in determining the proportion of stock which can reasonably be valued at nil under this category, and in recording the reasoning used in coming to particular decisions under this category.

7. A valuation which creates a precautionary reserve in anticipation of a loss (that is, a valuation which amounts to depreciation of the stock) is not acceptable.

8. Stock can only be valued under subsection 31(2) after it is clearly established that the particular stock has started the process of becoming obsolete. The process of revaluing stock is commonly referred to as the "writing down" of the stock. When "writing stock down" to a fair and reasonable value, a taxpayer may make a once-off write-down or a progressive write-down. A progressive write-down is more appropriate if a taxpayer knows that an amount of trading stock will remain unsaleable but is unable to quantify that amount with any accuracy. The taxpayer should write down only that proportion of the stock which, at the end of the particular income year, it is reasonably certain will not be sold. A once off write down may be used if the taxpayer can predict accurately the proportion of stock which is likely to be unsold.

9. Taxpayers with large quantities of particular stock on hand may use statistical sampling techniques to estimate the amount of stock which will remain unsold. The use of those techniques must satisfy the requirements set out in the ATO document entitled 'Guidelines on Statistical Sampling in Tax Office Audits' (These guidelines are reproduced in the 'Additional Guidelines' section of the CCH Australian Income Tax Rulings service and the 'Other Guidelines' section of the Butterworths Rulings and Guidelines service).

10. A standard write down for a particular kind or class of stock will only be accepted if a taxpayer can show that the particular kind or class of stock is always subject to the same degree of obsolescence. If

previous models or versions of the stock have suffered differing degrees of obsolescence, a standard write-off will not be accepted. Therefore, as a general rule, the application of formulae based on predetermined criteria will not be appropriate in determining the amount of stock to be written down.

11. If at the end of the income year it becomes clear that stock valued under subsection 31(2) in an earlier year is not subject to obsolescence then it should be valued under subsection 31(1).

B. Obsolete stock

12. A taxpayer must be able to show that there is no reasonable prospect of future sales of the stock. If stock is obsolete, a taxpayer's historical accounting data will usually show that, due to the age of the stock, sales have progressively decreased over the preceding income years to such an extent that no more sales of the stock can reasonably be expected. Age is a relative concept and must be considered in the light of all the circumstances surrounding the particular stock. In addition to this information and the other factors listed in paragraph 5 of this Ruling, taxpayers should also consider whether the stock has been superseded. Stock is more likely to be obsolete if it has been superseded.

13. As a general rule, any stock which a taxpayer keeps on hand must be attributed some value. Therefore, obsolete stock which remains on hand should generally be valued at its scrap value. If the obsolete stock can be broken down into other items of saleable stock, those items should be valued under subsection 31(1). A nil valuation for stock is acceptable if the stock is to be 'dumped' or destroyed within a reasonable amount of time after the end of the income year in which it is written down. We generally consider that 6 months is a reasonable amount of time for these purposes. However, a longer period will be allowed if a taxpayer has to wait for government approval to dispose of, or destroy stock. A nil valuation is also acceptable, even though stock is not discarded or destroyed, if the stock has no economic scrap value and is cheaper to keep in storage rather than discard.

When must stock be identified as being in the process of becoming obsolete or as being obsolete?

14. In relation to stock which is in the process of becoming obsolete, it is acceptable to decide what stock was becoming obsolete at year end after the end of the income year. A valuation under subsection 31(2) is only allowed if the stock was in the process of becoming obsolete before the end of the particular income year.

Similarly, in relation to obsolete stock, it is acceptable to decide what stock was obsolete at year end after the end of the income year. However, the stock can only be valued under subsection 31(2) if it was obsolete before the end of the particular income year.

'Special circumstances' for the purposes of subsection 31(2)

15. For the purposes of subsection 31(2), special circumstances exist if:

(a) stock becomes less marketable or useable in manufacture because of changed circumstances which relate to the stock; and

(b) a true reflection of a taxpayer's taxable income for an income year will not be achieved if stock on hand at the end of that year is valued under subsection 31(1).

16. While it is not possible to give a comprehensive definition of special circumstances, fact situations which we do consider to be special circumstances include:

(a) a loss of market which spans a period of more than one income year;

(b) an error in over-ordering or overproducing stock where the stock is not likely to be sold in the foreseeable future;

(c) the inability to sell a substantial amount of stock due to damage or physical deterioration;

(d) an unavoidable overstocking of spare parts to satisfy warranties and future service needs;

(e) the failure of a sale of stock which was produced to meet the special requirements of a particular customer, where it is unreasonable to expect that another buyer could be found for that stock; or

(f) the permanent loss of saleability of stock due to the failure of that stock to comply with standards prescribed by law.

Valuing stock which by reason of special circumstances requires an alternative valuation

17. Provided adequate documentation supporting the calculation is maintained, we accept any fair and reasonable value which is calculated taking into account the factors listed in paragraphs 31(2)(a)-(c). In addition, for the purposes of subsection 31(2)(d), the following factors may also be relevant, depending on a taxpayer's circumstances:

(a) the quantities of the stock on hand which, according to the operating and sales budgets, are expected to be used or sold during the year and in the future;

(b) the length of time since the last sale, exchange or use of an item of the stock;

(c) industry experience/taxpayer expertise in relation to the same kind or class of trading stock;

(d) the price at which the last sale of the stock was made, the price of the stock on the taxpayer's price list, and the price at which the taxpayer is prepared to sell the stock; and

(e) if the stock is spare parts:

(i) the past movements of the stock and the expected future movements of the stock, compared with the total number of units in existence which might require that stock; and

(ii) the approximate date by which the last of those units can be expected to have gone out of use.

18. If a taxpayer can make a reasonable estimate of the amount of stock which will remain unsold as a result of the special circumstances then an accurate value for stock will generally be:

(a) the value of the stock which it is reasonable to assume will be sold in the future, determined in accordance subsection with 31(1); **plus**

(b) an amount which represents the value of the stock which cannot be sold. If this stock can be sold as scrap, it should be given its scrap value. If the stock cannot be sold as scrap and has no other use (e.g., in manufacturing other stock), but remains on hand, it may be valued at nil. Particular care should be taken in determining the proportion of stock which can reasonably be valued at nil under this category, and in recording the reasoning used in coming to particular decisions under this category.

19. A nil valuation for a complete line of stock may be justified in exceptional circumstances. For example, a nil valuation is acceptable if, due to the circumstances relating to the stock, the stock is, and will remain, legally unsaleable and cannot be sold for scrap.

20. Stock can only be valued under subsection 31(2) after it is clearly established that special circumstances apply to the particular stock . When writing stock down to a fair and reasonable value, a taxpayer may make a once-off write-down or a progressive write-down. A progressive write-down is more appropriate if a taxpayer knows that an amount of trading stock will remain unsaleable but is

unable to quantify that amount with any accuracy. The taxpayer should write down only that proportion of the stock which, at the end of the particular income year, it is reasonably certain will not be sold. A once off write down may be used if the taxpayer can predict accurately the proportion of stock which is likely to be unsold.

21. A standard write down for a particular kind or class of stock will only be accepted if a taxpayer can show that the particular kind or class of stock is always subject to special circumstances in the same degree. If previous models or versions of the stock have suffered differing degrees of special circumstances, a standard write-off will not be accepted. Therefore, as a general rule, the application of formulae based on predetermined criteria will not be appropriate in determining the amount of stock to be written down.

22. While it is acceptable to decide what stock was subject to special circumstances after the end of an income year, the circumstances that caused the stock to be subject to special circumstances must have occurred in the particular income year. Stock cannot be written down in anticipation that special circumstances will arise in the future.

23. If at the end of the income year it becomes clear that stock valued under subsection 31(2) in an earlier year is not subject to special circumstances then it should be valued under subsection 31(1).

Lodgment of notices under subsection 31(3)

24. In accordance with Taxation Rulings IT 2624 and IT 2662 and the authority conferred on us by subsection 31(3), the time within which taxpayers are required to notify the Commissioner in writing that they wish subsection 31(2) to apply is extended until such time as we require the notification to be made. However, if taxpayers do choose to value stock under subsection 31(2), they must maintain all records necessary to support the valuation applied to the stock.

Date of effect

25. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Valuing trading stock - sections 28-31

26. Section 28 requires a taxpayer to bring to account each year, opening and closing values of trading stock on hand. If the value of closing trading stock on hand exceeds the value of opening trading stock on hand, the excess is to be included in the taxpayer's assessable income. If the value of opening trading stock on hand exceeds the value of closing trading stock on hand, the excess is an allowable deduction. Subsection 31(1) gives the taxpayer the option of valuing stock on hand at the end of the year of income at cost price, market selling value or the price at which it can be replaced.

27. The inclusion of closing trading stock on hand in a taxpayer's calculation of assessable income for an income year ensures that, in the ordinary course of a business, the taxpayer's deduction for trading stock purchased in that year reflects the cost of the sales of stock made in that year. That is, a deduction for the cost of stock on hand is deferred until that stock is sold. However, subsection 31(2) recognises that a stock value ascertained in accordance with subsection 31(1) will be inappropriate if the stock cannot be sold or otherwise used to produce assessable income. In those circumstances, it is inappropriate to defer the deduction for the cost of the stock. Subsection 31(2) states that the following matters are relevant in determining a fair and reasonable value in such circumstances:

(a) the quantity of the trading stock on hand at the end of the year of income;

(b) the quantity of trading stock sold, exchanged or used in manufacture by the taxpayer after the end of the year of income and the prospects of sale, exchange or use in manufacture of further quantities of that trading stock;

(c) the quantity of trading stock of the same kind sold, exchanged or used in manufacture by the taxpayer during the year of income and preceding years of income; and

(d) such other matters as the Commissioner considers relevant.

Meaning of 'obsolescence'

28. The *Shorter Oxford English dictionary* defines obsolescence as 'the process of becoming obsolete'. Applying this definition to subsection 31(2), an alternative valuation of trading stock is allowed if, *by reason of the process of becoming obsolete*, the value of the trading stock to be taken into account at the end of the income year is less than the amount that is the lowest value that could be applicable

under subsection 31(1). The words 'by reason of the process' carry both a past and present connotation, that is, 'the process' referred to may have already taken place or may be presently taking place. Therefore, given its context in subsection 31(2), we consider that the term 'obsolescence' covers both:

(a) stock which is currently in the process of becoming obsolete, i.e., obsolescent stock; and

(b) stock which has passed through the process of becoming obsolete, i.e., obsolete stock.

29. The clear intention at the time subsection 31(2) was introduced was to allow obsolescent *and* obsolete stock to be valued at an amount less than the lowest valuation available under subsection 31(1). That intention is explicitly stated in the Explanatory Memorandum accompanying the Bill which substituted the current version of section 31 (i.e., the *Income Tax and Social Services Contribution Assessment Bill (No. 2) 1963*).

30. It has been put to us that subsection 31(2) has no operation in relation to obsolete stock because obsolete stock has a market selling value, for example, its scrap value or a nil value, and should therefore be valued under subsection 31(1). We do not agree with this view. Our view is that stock held by a taxpayer who does not normally deal in obsolete items, does not have a market selling value for the purposes of subsection 31(1). In *Australasian Jam Co. Pty Ltd v FC of T* (1953) 88 CLR 23 at 31, Fullagar J said in relation to the term 'market selling value':

> 'It is not to be supposed that the expression ..... contemplates a sale on the most disadvantageous terms conceivable. It contemplates, in my opinion, a sale or sales *in the ordinary course of the company's business* - such sales as are in fact effected. Such expressions in such provisions must be interpreted in a common sense way with due regard to business realities, and it may well be ..... that, in arriving at market selling value, it is legitimate to make allowance for the fact that normal selling will take place over a period. But the supposition of a forced sale on one particular day seems to me to have no relation to business reality.' (emphasis added).

31. It is our view that 'market selling value' refers to the value in the market in which the taxpayer normally sells. Taxpayers who seek to value stock under subsection 31(2) do not normally sell in a market for obsolete items.

32. Trading stock may be considered as being in the process of becoming obsolete and valued under subsection 31(2) if a taxpayer can show that stock on hand is going out of use, etc., and that in consequence a certain amount of the stock will therefore remain

unsold. The valuation should recognise that a loss has already been sustained by a taxpayer. The valuation should recognise that the taxpayer has bought or manufactured stock which will not be sold or used in manufacture.

Special circumstances

33. As noted in paragraph 27 of this Ruling, the purpose of subsection 31(2) is to allow a valuation of trading stock on hand at the end of an income year which gives a true reflection of a taxpayer's income for that year. The intention of the provision is to allow a valuation of trading stock , lower than a subsection 31(1) valuation, if the circumstances show that the stock will not be as marketable or as useable in manufacture in the future.

34. Unlike stock which is subject to obsolescence, a decreasing saleability or useability in manufacture of stock because of its increasing age does not, on its own, determine the existence of special circumstances in relation to that stock. Therefore, stock which is new and generally in use may nevertheless be subject to special circumstances if the stock is unsaleable or unusable in manufacture because of circumstances which relate to it.

Examples

35. Whether trading stock is in the process of becoming obsolete, obsolete or subject to special circumstances depends on the circumstances of the particular case. Therefore, the answers given in the following examples are not determinative of our views on cases with similar, but different, facts. It is necessary to look at all the circumstances in each individual case.

Overproduction of goods

36. Plastico Pty Ltd produce plastic containers which are ultimately used for containing foodstuffs and beverages. During the 1991-92 income year, Plastico made a slight miscalculation in the number of ice-cream containers it had to produce to satisfy its contracts with ice-cream producers. As a result, Plastico have an excess of ice-cream containers on hand at the end of the year. The containers are only suitable for food and beverages. The particular excess containers have the brand names of various customers printed on them. Contracts with those customers have not been renewed and therefore Plastico will not be able to use the containers to satisfy future orders. The only other

option Plastico has is to sell the containers as regrind material for use in non-foodstuff/beverage products.

37. These circumstances constitute special circumstances for the purposes of subsection 31(2). The stock is not obsolescent or obsolete. Ice cream containers of the same kind are still in use and are not going out of use. However, a true reflection of the taxpayer's income would not be achieved if the excess stock were to carry a subsection 31(1) valuation at the end of the income year.

38. Plastico may value the stock at an amount equal to that for which the containers can be sold as regrind materials.

Progressive write-down of obsolescent stock

39. Funco is an importer and wholesaler of toys. The toy market is subject to regular market changes. It is common for various models of toys to be discontinued or superseded. One line of stock imported by Funco is hand-held electronic games. These games are based on a standard form of technology but are subject to regular changes in format in line with market tastes. Games which cannot be sold in Funco's normal selling market are sold for scrap.

40. Having regard to the amount of stock on hand, past and projected sales of games, and industry experience, Funco finds that the games become less marketable over time and makes a rough estimate that the following amounts of stock on hand will not be sold:

Age of stock (yrs)	Percentage unsold
1-2	10
2-3	25
3 or more	40

41. On the basis of this estimate, 25 percent of Funco's stock on hand at the end of the income year will not be sold. However, Funco is only certain that 10 percent of its stock on hand at the end of the year will remain unsold. Therefore, Funco can write-down 10 percent of its stock on hand at the end of the year to its scrap value. The position in relation to the remaining 15 percent of stock should be assessed in the following income years - this stock can only be written down to its scrap value once Funco can say with a degree of accuracy that it will not be sold.

Goods which are subject to 'use by' dates

42. Synthetico Pty Ltd produces a pharmaceutical product which is used to treat an illness in dogs. The product has a life-span of 24 months and is not saleable in any form after it passes its use by date.

At the end of the income year, Synthetico have the following amounts of the product on hand:

(a) 100 items which are within 5 months of their use by date; and

(b) 100 items which are past their use by date and which will be disposed of within 6 months of the end of the income year.

43. *Category (a) items:* having regard to the quantity of stock on hand at the end of the year, the amount of stock sold after the end of the income year, the quantities of the stock sold in the income and preceding years and industry experience, only 20% of this stock will be sold before it reaches its use by date. The stock is considered obsolescent because its saleability is decreasing with age. A fair and reasonable value for this stock would be:

(a) 20% of the stock valued under subsection 31(1); plus

(b) an amount which fairly represents the value of the remaining stock (i.e., 80% of the items). This stock should be given a nominal value while it remains saleable.

44. *Category (b) items:* this stock is considered obsolete because its age makes it unsaleable. The fact that the company is going to dispose of the stock confirms its obsoleteness. A nil value is fair and reasonable in these circumstances.

Stock which cannot be sold because it is defective

45. Animalco manufactures veterinary products. One of the products Animalco produces is 'licequine'. Licequine is a shampoo which removes lice from horses. A recent batch of licequine was found to be contaminated with chemicals such that:

(a) it couldn't be returned to its correct form; and

(b) it was legally unsaleable.

Animalco will dispose of the contaminated batch after it receives approval from the relevant government authority.

46. These circumstances are considered special circumstances for the purposes of subsection 31(2). Writing the stock into income at the end of the year would not give a true reflection of Animalco's income for the year because the stock will not be sold in the future. As none of the stock will be sold in the future and the stock has no scrap value, the stock should be valued at nil at year end.

Circumstances causing a low value must exist during the income year

47. Dateco manufacture calendars for sale to overseas markets. At 30 June 1991, Dateco had a stock of 1992 calendars on hand. When it prepared its return for the 1990-91 income year, Dateco valued the calendars at the actual average selling price achieved during the 1992 year. That value was less than any subsection 31(1) valuation available. Dateco argue that this valuation is valid because special circumstances existed at the end of the 1990-91 income year in that a slow market was being predicted for the sale of calendars during 1992.

48. The valuation is disallowed. The calendars on hand at the end of the 1990-91 income year should have been valued in accordance with subsection 31(1). Predicting a slow market does not constitute special circumstances for the purposes of subsection 31(2). While it is acceptable to decide what stock was subject to special circumstances after the end of an income year, the circumstances that caused the stock to be subject to special circumstances must have occurred before year end.

Spare parts which become obsolescent

49. Cycleco manufactures widgets, a type of spare part for a particular make and model of motor bike. Cycleco sells the widgets to the relevant motor cycle distributors. Over the past two years, the sale of widgets has dropped dramatically. Current sales are about 2 per cent per annum of the present stock level. The main reason for the drop in sales appears to be due to the age of the model bike for which widgets are made. The bikes usually developed problems after about ten years use and it is now cheaper to replace the bikes than overhaul them. As a result, most owners are scrapping their bikes when they develop major problems.

50. After considering the factors in paragraphs 31(2)(a)-(c), the quantities of stock on hand compared with the quantities shown in operating and sales budgets, and the decreased number of bikes that are on the road, Cycleco estimates that sales of widgets will decrease further over the next five years to the stage where only a negligible amount of widgets will be sold. Specifically, Cycleco estimates the following sales of widgets:

(a) Current sales maintained for the next 3 years (i.e., sales of 2 per cent per annum of the present stock level);

(b) Sales of 1 per cent per annum of the present stock level for the 4th and 5th years;

(c) negligible sales after 5 years.

The widgets will remain on hand indefinitely. Cycleco should value the stock on hand as follows:

(a) 8 per cent of the stock (i.e., 3 years sales at 2 per cent of present stock levels and 2 years sales at 1 per cent of present stock levels) should carry a value which is acceptable under subsection 31(1);

(b) The remainder of the stock should carry a value which is fair and reasonable given that the stock is to remain on hand indefinitely and future sales may occur.

Spare parts which are subject to special circumstances

51. The Techno car company is a Japanese car manufacturer which produces cars for the Australian market. Middleco Pty Ltd owns the Australian distribution rights for Techno cars. Mr and Mrs Smith own a motor vehicle dealership in Perth called 'City Techno Sales' (CTS). They deal exclusively in Techno cars and provide a complete customer back-up service which includes sales of spare parts. Under their agreement with Middleco, CTS are obliged to carry certain types and quantities of spare parts for all models of Techno cars. Generally, the amount of stock carried is more than is actually required. However, the stock must be carried to ensure that the best customer service is available, for example, by having parts immediately available to cover customer warranties. If the stock were not held by CTS, they would have to order it from Japan. It usually takes about a month to get a part from Japan.

52. One range of spare parts held by CTS relate to a car called the 'Harmony' which was manufactured for a period of 3 years and ceased production 3 years ago. The Harmony spare parts consist of mechanical and electrical parts (e.g., motor parts, brakes, electrical cables) and non-mechanical parts (e.g. trim and accessories).

Treatment of mechanical and electrical parts

53. The Harmony has, in a mechanical sense, been a very reliable car and sales or use of mechanical and electrical spare parts for it have been very low since it was first introduced onto the market. It is unlikely that sales of these parts will ever increase. It is CTS's experience that owners of older model cars use generically named mechanical parts rather than genuine parts.

54. Taking into account the present level of sales of these spare parts, forecast sales, the age of the age of the parts and the factors outlined in paragraph 51, above, CTS estimate that a negligible amount (approximately 5 percent) of the parts on hand will be sold. The remainder of the parts will realise 20% of their cost value if they are sold as scrap. The parts are valued as follows:

(a) 5% to be attributed a subsection 31(1) value;

(b) 95% valued at 20% of cost.

Treatment of non-mechanical parts (trim and accessories)

55. Sales of trim and accessories have decreased markedly since the car first came onto the market. Again, it is CTS's experience that for Techno cars in general, sales of these parts decrease over time. Taking into account the same factors considered above in relation to mechanical and electrical parts, CTS make a reasonable estimate that 10% of the non-mechanical parts on hand will be sold. The parts are valued as follows:

(a) 10% to be attributed a subsection 31(1) value;

(b) 90% to be valued at 5% of a subsection 31(1) value, to account for the error margin present in determining the amount of stock which will remain unsold.

Standard write downs

56. ABCco is a world-wide supplier of parts for plant and equipment with a life expectancy greater than 20 years. The plant is still in production. ABCco categorises its parts into classes 1 to 4 depending upon turnover, with class 4 being stock with movement of less than 25% in the prior 24 months. ABCco has decided to revalue the parts in class 4 to nil under subsection 31(2).

57. Given the long life expectancy of the plant, and the fact that it is still in production, it is not accepted that a nil value is a fair and reasonable value of the stock. It would appear that the taxpayer has used a valuation which amounts to depreciation of the stock or has used a predetermined formula as per paragraphs 7 and 10.

58. This is not to say that some of the stock may not be obsolete, becoming obsolete or subject to special circumstances. In determining a fair and reasonable value for the stock, the criteria set out in paragraphs 5, 12, 15 and 17 will need to be examined. ABCco should either apply those criteria to each individual item of stock or use the statistical sampling methods outlined in paragraph 9 to determine a fair and reasonable value for the stock. ABCco should maintain all records necessary to support any valuation determined on this basis.

Commissioner of Taxation

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