INTERPRETATION NOTE: NO. 65 (Issue 2)

DATE: 5 February 2014

ACT : INCOME TAX ACT NO. 58 OF 1962
SECTION : SECTION 22(8)
SUBJECT : TRADING STOCK – INCLUSION IN INCOME WHEN APPLIED, DISTRIBUTED OR DISPOSED OF OTHERWISE THAN IN THE ORDINARY COURSE OF TRADE

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Preamble

In this Note unless the context indicates otherwise –

- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act No. 58 of 1962; and
- any word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides guidance on the application and interpretation of section 22(8) which deems an amount to be included in income when trading stock is applied, distributed or disposed of in specified circumstances, otherwise than by sale at market value in the ordinary course of trade.

2. Background

The cost of acquisition of trading stock should in principle not be deductible if it is –

- withdrawn for private consumption;
- donated;
- sold otherwise than in the ordinary course of the taxpayer's trade for less than its market value; or
- distributed *in specie* to a holder of shares.

A deduction results from these events because there would be no inclusion in income of closing stock while the cost price would have been allowed as a deduction.[1]

In these circumstances the purpose of the expenditure has changed to one that is not productive of income. Section 22(8) accordingly provides for a deemed inclusion in the taxpayer's income. The amount of the inclusion (for example, at cost, written-down value or market value) will depend on the manner in which the trading stock has been applied, distributed or disposed of.

3. The law

For ease of reference, the relevant sections of the Act are reproduced in the **Annexure**.

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[1] The deduction could be under section 11(*a*) (trading stock disposed of in the same year of assessment in which it was acquired), section 22(1)(*a*) (write-down of closing stock) or section 22(2) (opening stock).

4. Application of the law

4.1 Deemed inclusion in income – general

For section 22(8) to apply, the cost price of the trading stock must have been "taken into account" in the determination of the taxpayer's taxable income. Trading stock could be "taken into account" as a deduction under –

- section 11(*a*) if disposed of in the year of assessment in which the trading stock is acquired;
- section 22(1)(*a*) to the extent of any write-down in the value of the trading stock; or
- section 22(2) as opening stock.

4.2 Deemed inclusion in income – trading stock applied for private or domestic use or consumption [section 22(8)(A)]

Section 22(8)(A) provides for a deemed inclusion in income when trading stock is applied to a taxpayer's private or domestic use or consumption as envisaged in section 22(8)(*a*).

The amount to be included in the taxpayer's income is –

- the cost price of the trading stock if the cost price has been taken into account; or
- the written-down value of the trading stock if it has been written down under section 22(1)(*a*); or
- the market value of the trading stock if the taxpayer cannot readily determine the cost price.

Example 1 – Private or domestic use or consumption of trading stock

Facts:

X, a sole trader, owns a bottle store. During the current year of assessment X withdrew 20 cases of wine from stock for use at X's daughter's wedding at which the wine was served free of charge to the guests. The market value of the wine in question was substantially in excess of its cost price. X had accounted for the wine in opening and closing stock in previous years of assessment.

Result:

The bottles withdrawn from trading stock by X have been applied for X's private or domestic use or consumption. Under section 22(8)(A) read with section 22(8)(*a*) X is deemed to have recouped the cost price of each bottle so applied and not its market value.

4.3 Deemed inclusion in income at market value [section 22(8)(B)]

The market value of trading stock, and not its cost price or written-down value, will be deemed to be recouped by the taxpayer under section 22(8)(B) read with section 22(8)(*b*) in the five situations discussed below.

4.3.1 Trading stock donated otherwise than under section 18A [section 22(8)(*b*)(i)]

A donation of trading stock other than a donation made under section 18A results in the inclusion in income of the market value of that trading stock. See **4.4** for donations made under section 18A.

Section 22(8)(*b*)(i) does not define the word "donation" and it must therefore bear its common-law meaning.[2] In *Estate Welch v C: SARS* it was confirmed by Marais JA that the common-law test for a donation was as follows:[3]

> "[T]he disposition [must] be motivated by pure liberality or disinterested benevolence and not by self-interest or the expectation of a *quid pro quo* of some kind from whatever source it may come."

This means that unlike a deemed donation for donations tax purposes, if the donee gives any consideration the disposal will not be a donation.[4]

The distribution by a taxpayer of free samples of trading stock for promotional purposes is not a donation since it is not motivated by pure liberality or disinterested benevolence. There is an expectation that customers will purchase the taxpayer's products after sampling them.

4.3.2 Trading stock disposed of otherwise than in the ordinary course of trade for a consideration less than its market value [section 22(8)(*b*)(ii)]

A taxpayer must include in income the market value of trading stock which has been disposed of –

- otherwise than in the ordinary course of trade; and
- for a consideration less than its market value.

The circumstances surrounding the disposal must be considered in determining whether the trading stock has been disposed of otherwise than in the ordinary course of trade. It is not uncommon for traders to sell trading stock at less than market value in order to promote their businesses, for example, as a loss leader or during a price war. Disposals of this nature will not give rise to an inclusion in income at market value under section 22(8)(B) read with section 22(8)(*b*)(ii) since they are undertaken in the ordinary course of trade.

In *T v COT*[5] the court had to determine whether debentures had been acquired by a subsidiary from its holding company in the ordinary course of trade so as to constitute trading stock. Goldin J stated the following:[6]

> "It has been repeatedly held that the test is an objective one. One test suggested is whether the disposition would cause an ordinary businessman surprise. If so, it would be otherwise than in the ordinary course of business. (See *Michalow NO v Premier Milling Co Ltd* 1960(2) SA 59(W) at 65.) In *Downs Distributing Co (Pty) Ltd v Associated Blue Star Stores (Pty) Ltd* (1948) 76 CLR 463 Rich J said at 476:
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> > 'It means that the transaction must fall into place as part of the undistinguished common flow of business done, that it should form part of the

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2 *The Master v Thompson's Estate* 1961 (2) SA 20 (FC), 24 SATC 157.
3 2005 (4) SA 173 (SCA), 66 SATC 303 at 314.
4 *The Master v Thompson's Estate* 1961 (2) SA 20 (FC), 24 SATC 157.
5 1978 (4) SA 665 (R), 40 SATC 179.
6 At SATC 184.

> ordinary course of business as carried on, calling for no remark and arising out of no special or particular situation.' "

In *De Beers Holdings(Pty) Ltd v CIR* Corbett JA (as he then was) stated the following on whether a non-profitable transaction formed part of a taxpayer's trade:[7]

> "Of course, the attainment of a profit is not necessarily the hallmark of a trading transaction. A trader may for commercial reasons be compelled to resell goods at a loss. Conceivably also he may elect to resell goods at a loss in order to gain some other commercial advantage for his business. The practice of putting on sale the so-called 'loss leaders' by some merchants would fall into this category; and there seems little doubt that merchandise so sold would constitute stock-in-trade and the proceeds thereof gross income."

He continued:[8]

> "It is true, as I have already indicated, that the absence of a profit does not necessarily exclude a transaction from being part of the taxpayer's trade; and correspondingly moneys laid out in a non-profitable transaction may nevertheless be wholly or exclusively expended for the purposes of trade within the terms of s 23(*g*). Such moneys may well be disbursed on grounds of commercial expediency or in order indirectly to facilitate the carrying on of the taxpayer's trade (see in this regard the remarks of Jenkins LJ in *Morgan v Tate & Lyle Ltd* 1953 Ch 601 at 637-8 and *Boarland v Kramat Pulai Ltd* [1953] 2 All ER 1122). Where, however, a trader normally carries on business by buying goods and selling them at a profit, then as a general rule a transaction entered into with the purpose of not making a profit, or in fact registering a loss, must, in order to satisfy s 23(*g*), be shown to have been so connected with the pursuit of the taxpayer's trade, eg on ground of commercial expediency or indirect facilitation of the trade, as to justify the conclusion that, despite the lack of profit motive, the moneys paid out under the transaction were wholly and exclusively expended for the purposes of trade (cf *Nemojim's* case (*supra*) at 947H-948A). Generally, unless the facts speak for themselves, this will call for an explanation from the taxpayer."

A question to consider is whether the disposal of trading stock forming part of the sale of a business as a going concern falls within section 22(8)(*b*)(ii). A sale of this nature would not ordinarily be undertaken in the ordinary course of a taxpayer's trade. However, for this provision to apply the selling price must also be below market value. It is accepted that a sale of all the trading stock on hand may itself have a bearing on the price it would fetch in the market. For example, an arm's-length buyer of a business as a going concern will usually acquire trading stock at book value and in these circumstances book value would generally comprise the market value.

4.3.3 Distribution of trading stock *in specie* [section 22(8)(*b*)(iii)]

A company must include in its income the market value of trading stock which it has distributed *in specie* to any holder of shares on or after 21 June 1993. The term "distribution" is not defined in the Act and must therefore be given its common-law meaning for the purposes of section 22(8). In *CIR v Legal & General Asurance Society Ltd*[9] Steyn CJ ascribed to the word "distribute" in the context of the definition of a "dividend" at the time the wider meaning of –

> "apportion, appropriate, allocate or apply towards".

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7 1986 (1) SA 8 (A), 47 SATC 229 at 254.

8 At SATC 260.

9 1963 (3) SA 876 (A), 25 SATC 303 at 315.

He pointed out that the word should be defined with reference to the relevant context. It is submitted that a distribution relates to something given to a holder of shares without receiving consideration for it and without imposing an obligation to return it. Typical examples include the payment of a dividend or a return of capital. A disposal of trading stock for full consideration is therefore not a distribution.

A disposal of trading stock to a holder of shares for less than its market value must be considered under section 22(8)(*b*)(ii).

4.3.4 Trading stock applied for other purposes [section 22(8)(*b*)(iv)]

A taxpayer must include in income the market value of trading stock applied for a purpose other than –

- a disposal in the ordinary course of trade; and
- in the circumstances described in section 22(8)(*a*) (**4.2**), (*b*)(i) (**4.3.1**), (ii) (**4.3.2**) or (iii) (**4.3.3**).

Through a process of elimination it is evident that section 22(8)(*b*)(iv) was intended to cover, for example, trading stock which is –

- consumed by the taxpayer for the purposes of trade; or
- used by the taxpayer as a capital asset when the asset is manufactured, produced, constructed or assembled by the taxpayer and is similar to other assets so made by the taxpayer (that is, assets referred to in paragraph (*j*A) of the definition of the term “gross income”).

Section 22(8)(*b*)(iv) must be read with paragraphs (*a*) and (*d*) of the proviso to section 22(8). In this regard see –

- paragraph (*a*) of the proviso which enables the taxpayer to potentially claim a deduction for trading stock which is used or consumed in carrying on the taxpayer’s trade (see **4.5**); and
- paragraph (*d*) of the proviso which prevents double taxation when assets referred to in paragraph (*j*A) of the definition of the term “gross income” are applied for a purpose other than disposal in the ordinary course of trade (see **4.8**).

See Examples 3 and 4 in **4.5** and **4.8** respectively for the interaction between section 22(8)(*b*)(iv) and paragraphs (*a*) and (*d*) of the proviso to section 22(8).

4.3.5 Assets ceasing to be held as trading stock [section 22(8)(*b*)(v)]

Under section 22(8)(*b*)(v) a taxpayer must include in income the market value of assets held as trading stock which cease to be held as trading stock.

Since section 22(8)(*b*)(v) deals with a situation in which the taxpayer continues to hold the assets in question, it does not apply to the loss or destruction of trading stock. The provision envisages a change of use which results in trading stock ceasing to be trading stock. A typical example is a taxpayer that commences to use trading stock as a capital asset with the result that the asset falls outside the definition of the term “trading stock” in section 1(1).

Section 22(8)(*b*)(v) must be read with paragraph 12(3) of the Eighth Schedule which establishes a base cost for an asset which ceases to be held as trading stock – see **5.3**.

Paragraph (*a*) of the proviso to section 22(8) deems expenditure to have been incurred on an asset that is used or consumed in carrying on the taxpayer's trade. Such usage would include a taxpayer ceasing to hold an asset as trading stock because the asset has been deployed in the trade as a capital asset. The taxpayer is thus potentially enabled to claim capital allowances on the asset, depending on the wording of the particular allowance provision – see **4.5**.

Example 2 – Asset ceasing to be held as trading stock

Facts:

Company XYZ, a developer, acquires land on which it erects several office buildings for the purpose of selling them at a profit. It subsequently decides to keep one of the office buildings to house its head office.

Result:

Company XYZ has ceased to hold the office building in question as trading stock and has commenced to use it as a capital asset. The market value of the office building must accordingly be included in its income.

4.3.6 Determination of market value

The market value of trading stock must be determined on the basis that the transaction should have had the characteristic of one between independent parties trading at arm's length, each striving to gain the most benefit from the transaction. In other words, a willing buyer and a willing seller dealing at arm's length in an open market.

The market value of an asset is the best price at which the asset would have been sold unconditionally for a cash consideration on the date of valuation assuming –

- a willing seller and a willing buyer (under no duress at all);
- that, before the date of valuation, there had been a reasonable period (having regard to the nature of the asset and the state of the market) for the proper marketing of the interest and the sale to be concluded;
- that no account is taken of any additional bid by a prospective purchaser with a special interest;
- a sale either –
    - of the asset as a whole for use in its working place;
    - of the asset as a whole for removal from the premises of the seller at the expense of the purchaser; or
    - of individual items for removal from the premises of the seller at the expense of the purchaser; and
- that both parties to the transaction had acted knowledgeably, prudently and without compulsion.

The peculiar features prevailing in the market at the time must be taken into account, such as the seller disposing of a large quantity of trading stock all at once and not in the ordinary course of trade. The price of trading stock sold in large volumes will often be lower than when it is sold on an individual item basis; the market value of the trading stock in the two situations is often validly different. However, the price at which the transaction is concluded would not necessarily be market-related if it were made under duress, if there was insufficient time for the trading stock to be properly marketed or if the seller did not act prudently or knowledgeably.

Market value must be determined as at the date of the disposal and not at the end of the year of assessment.

4.4 Deemed inclusion in income at value – donations under section 18A [section 22(8)(C)]

A taxpayer that applies trading stock –

> "for the purpose of making a donation in respect of which the provisions of section 18A apply"

is deemed to recoup an amount equal to the amount that was taken into account as the value of that trading stock for that year of assessment.

The amount so "taken into account" could be the amount deducted under section 11(*a*) in the case of trading stock acquired and donated in the same year of assessment or it could be the amount taken into account as opening stock under section 22(2). Typically this would be the cost price of the trading stock or its written-down value in the case of trading stock which has been written down below its cost price.

The expression "in respect of which the provisions of section 18A apply" refers to a qualifying donee under section 18A(1). The donation in question need not necessarily result in a deduction under section 18A which contains a "10% of taxable income" limitation. Thus, even if a donation to a qualifying donee exceeds the "10% of taxable income" limitation in section 18A(1) such that only part of the donation qualifies for a deduction, the full income inclusion at cost or written down value as appropriate must be accounted for under section 22(8)(C). The 10% limitation is merely part of the process through which a qualifying donation must pass and thus "applies" to the donation regardless of whether it results in a deduction.

Section 18A provides for a deduction from the taxable income of a taxpayer of the sum of *bona fide* donations made in cash or of property made in kind, actually paid or transferred during the taxpayer's year of assessment to approved public benefit organisations and other qualifying organisations approved by the Commissioner which carry on approved public benefit activities.

Under section 18A(3)(*a)* the deduction for trading stock donated as property in kind to an approved public benefit organisation or other qualifying entity is deemed to be an amount equal to –

- in the case of a financial instrument, the lower of its fair market value on the date of the donation or the amount which has been taken into account with regard to that financial instrument for the purposes of section 22(8)(C); or
- in any other case, including livestock or produce in respect of which paragraph 11 of the First Schedule to the Act applies, the amount which has

been taken into account under section 22(8)(C) or paragraph 11, as the case may be.

4.5 Expenditure deemed to be incurred after the deemed inclusion in income [paragraph (*a*) of the proviso to section 22(8)]

Paragraph (*a*) of the proviso to section 22(8) stipulates that when trading stock is used or consumed by the taxpayer in carrying on the taxpayer's trade, the amount included in the taxpayer's income under section 22(8) is deemed to be expenditure incurred in respect of the acquisition by the taxpayer of the asset. In this way the taxpayer is able to secure a deduction for the trading stock so consumed or used in the carrying on of the trade provided the specific requirements of the relevant deduction or allowance provision are met. The deduction could be immediate [for instance, expenditure qualifying under section 11(*a*) or (*d*)] or it could take the form of an allowance over a period [such as a wear-and-tear or depreciation allowance under section 11(*e*)].

Example 3 – Deemed expenditure

Facts:

Company X is a paint manufacturer. It withdraws a tin of paint from its trading stock and uses it to paint its factory building.

Result:

Company X must include the market value of the tin of paint in its income under section 22(8)(B) read with section 22(8)(*b*)(iv) – see **4.3.4**.

Under paragraph (*a*) of the proviso to section 22(8) the amount so included in Company X's income is deemed to be expenditure incurred on the acquisition of the tin of paint.

The deemed expense will qualify as a deduction under section 11(*d*) since it comprises expenditure actually incurred during the year of assessment on repairs to property occupied for the purpose of trade.

4.6 Reduction of deemed inclusion in income by actual consideration [paragraph (*b*) of the proviso to section 22(8)]

The disposal of trading stock otherwise than in the course of the taxpayer's trade for an amount less than its market value results in the inclusion in the taxpayer's income of the full market value of that trading stock – see **4.3.2**. At the same time the receipt or accrual of the actual consideration will be included in the taxpayer's gross income thus creating the potential for double taxation.

Paragraph (*b*) of the proviso to section 22(8) prevents this potential double taxation by reducing the market value included in the taxpayer's income under section 22(8)(B) by the actual consideration received from the disposal.

4.7 Exclusion of livestock and produce [paragraph (*c*) of the proviso to section 22(8)]

Section 22(8) does not apply to trading stock consisting of livestock or produce to which paragraph 11 of the First Schedule to the Act applies [paragraph (*c*) of the proviso to section 22(8)]. This exclusion prevents double taxation because

paragraph 11 of the First Schedule contains income inclusion provisions which mirror those of section 22(8).

4.8 Exclusion of assets referred to in paragraph (*j*A) of the definition of "gross income" [paragraph (*d*) of the proviso to section 22(8)]

References in this paragraph to paragraph (*j*A) are to paragraph (*j*A) of the definition of the term "gross income" in section 1(1).

Section 22(8)(*b*)(iv) provides for a market value inclusion in income when trading stock is applied for a purpose other than its disposal in the ordinary course of trade and under circumstances other than those in section 22(8)(*a*), (*b*)(i), (ii) or (iii).

One such situation arises when an asset contemplated in paragraph (*j*A) is applied as a capital asset.

Paragraph (*j*A) includes in gross income –

> "any amount received by or accrued to any person during the year of assessment in respect of the disposal of any asset manufactured, produced, constructed or assembled by that person, which is similar to any other asset manufactured, produced, constructed or assembled by that person for purposes of manufacture, sale or exchange by that person or on that person's behalf;".

Paragraph (*j*A) therefore ensures that any amount received or accrued on disposal of such assets is included in gross income, even if they are used as capital assets. Such assets remain within the definition of the term "trading stock" in section 1(1) despite any change in usage.[10]

Paragraph (*d*) of the proviso to section 22(8) prevents double taxation by excluding from section 22(8)(*b*)(iv) any trading stock consisting of assets for which any amount received or accrued from their disposal is or will be included in the gross income of the taxpayer under paragraph (*j*A).

For more on paragraph (*j*A) see Interpretation Note No. 11 "Trading Stock: Assets not used as Trading Stock" dated 5 February 2014.

Example 4 – Trading stock applied for a purpose other than for disposal in the ordinary course of trade

Facts:

A company imports computer parts and assembles them into desktop computers which it sells. The parts and assembled computers comprise trading stock.

Some of the computers assembled by the company are used by its sales personnel for demonstration purposes. These computers are used as capital assets and not for disposal in the ordinary course of trade. After two years the demonstration computers are sold to the company's employees at their then prevailing market values.

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[10] Paragraph (ii) of the definition of the term "trading stock" in section 1(1) includes in that definition (with some exceptions) "anything the proceeds from the disposal of which forms or will form part of the taxpayer's gross income".

Result:

The demonstration computers comprise trading stock under paragraph (*a*)(ii) of the definition of the term "trading stock" in section 1(1) because any proceeds on their disposal will form part of the company's gross income under paragraph (*j*A).

Upon application of the demonstration computers as capital assets

Section 22(8)(*b*)(iv) deems the market value of the computers to be included in the company's income when they are used as capital assets. However, paragraph (*d*) of the proviso to section 22(8) prevents this deemed inclusion for paragraph (*j*A) assets.

Under the definition of the term "trading stock" the demonstration computers remain trading stock despite their deployment as capital assets. Therefore there will also be no deemed inclusion in the company's income under section 22(8)(*b*)(v) (assets held as trading stock which cease to be held as trading stock).

Upon sale of the demonstration computers to employees

Any amounts received by or accrued to the company from the disposal of its demonstration computers to its employees on or after 12 December 2001 are included in its gross income under paragraph (*j*A).

It follows that the company must include the market value of the demonstration computers in its gross income under paragraph (*j*A) only when they are ultimately disposed of to its employees and not when they are used as capital assets.

5. Miscellaneous issues

5.1 Foreign currency contracts

The definition of the term "trading stock" in section 1(1) specifically excludes from trading stock –

- a "foreign currency option contract"; and
- a "forward exchange contract",

as defined in section 24I(1). Accordingly, section 22 does not apply to such assets.

5.2 Capital gains tax implications

References under this heading to a "paragraph" are to paragraphs of the Eighth Schedule to the Act.

Paragraph 12(3) triggers a deemed disposal and reacquisition of an asset which ceases to be held as trading stock otherwise than as a result of a disposal under paragraph 11. In other words, paragraph 12(3) does not deal with an actual disposal of trading stock but a change of usage. For example, it could apply to a taxpayer who commences to use an item of trading stock as a capital asset or as a personal-use asset.[11] In these circumstances the taxpayer is deemed to have disposed of the asset for a consideration equal to the amount included in income under

[11] The term "personal use asset" is defined in paragraph 53(2).

section 22(8)[12] and to have immediately reacquired it at the same amount for purposes of determining expenditure actually incurred under paragraph 20(1)(*a*). The deemed consideration will be excluded from proceeds under paragraph 35(3)(*a*) because of the income inclusion under section 22(8). The deemed reacquisition expenditure establishes the base cost of the asset for the purposes of any future disposal of that asset.

Paragraph 12(3) does not apply to trading stock manufactured, produced, constructed or assembled by the taxpayer that is used as a capital asset in the circumstances contemplated in paragraph (*j*A) of the definition of the term "gross income" in section 1(1). Such assets remain "trading stock" as defined in section 1(1) because the proceeds from their ultimate disposal are included in "gross income" under paragraph (*j*A). In other words, they do not cease to be held as trading stock as required by paragraph 12(3).

However, trading stock that is acquired by a taxpayer by purchase or exchange does not fall within paragraph (*j*A) and will thus trigger a deemed inclusion in income under section 22(8)(*b*)(v) at market value, and will have a corresponding base cost for capital gains tax purposes equal to the same amount under paragraph 12(3). Thus a motor dealer that removes a purchased delivery vehicle from the showroom floor and uses it as an in-house delivery vehicle will fall outside paragraph (*j*A) and into section 22(8)(*b*)(v) and paragraph 12(3). The deemed disposal and reacquisition under paragraph 12(3) is deemed under paragraph 13(1)(*g*)(i) to occur on the date immediately before the date on which the change of usage occurs. Section 22(8)(B), which triggers an income inclusion at market value, does not contain a timing rule. Logically there should be symmetry between the amount included in income under section 22(8)(*b*)(v) and the base cost determined under paragraph 12(3). The inclusion in income under section 22(8)(*b*)(v) should therefore be based on the market value of the asset on the date immediately before the date on which the asset ceases to be held as trading stock. This is only likely to be an issue with traded assets such as listed shares, the prices of which tend to fluctuate from day to day.

For more information see Chapter 6, paragraph 6.2.3 of the *Comprehensive Guide to Capital Gains Tax* (Issue 4).

6. Conclusion

Section 22(8) deems an amount to be included in a taxpayer's income when trading stock is –

- applied for private or domestic use or consumption;
- donated;
- disposed of otherwise than in the ordinary course of trade for a consideration less than its market value;
- distributed *in specie* by a company;
- used or consumed in the course of trade or disposed of at market value otherwise than in the ordinary course of trade; or
- no longer held as trading stock.

[12] This is clearly a reference to section 22(8)(*b*)(v) which triggers an inclusion in income at market value under section 22(8)(B).

The amount to be included in income is, in the case of trading stock –

- applied for private or domestic use or consumption, its cost price or written-down value, or if the cost price cannot be determined, the market value;
- donated to an approved public benefit organisation or other qualifying entity referred to in section 18A, the value taken into account under section 22; or
- in any other case, the market value.

Consideration received for trading stock which is less than its market value is excluded from section 22(8) because the amount would already be included in gross income.

A taxpayer that uses or consumes trading stock for the purposes of trade is deemed to incur an amount of expenditure equal to the income inclusion under section 22(8) and may qualify for a tax deduction or allowance if the requirements of the relevant deduction or allowance provision are met.

Section 22(8) does not apply to –

- livestock or produce; or
- any assets the receipts or accruals from the disposal of which are included in gross income under paragraph (*j*A) of the definition of the term “gross income”.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE
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Annexure – The law

Section 22(8)

(8) If during any year of assessment—

(*a*) any taxpayer has applied trading stock to his private or domestic use or consumption; or

(*b*) any—

(i) taxpayer has applied trading stock for the purpose of making any donation thereof;

(ii) taxpayer has disposed of trading stock, other than in the ordinary course of his trade, for a consideration less than the market value thereof;

(iii) trading stock of any company has on or after 21 June 1993 been distributed *in specie* to any holder of shares in that company;

(iv) taxpayer has applied any trading stock for any other purpose other than the disposal thereof in the ordinary course of his trade and under circumstances other than those contemplated in paragraph (*a*) or subparagraph (i), (ii) or (iii) of this paragraph; or

(v) assets which were held as trading stock by any taxpayer cease to be held as trading stock by such taxpayer,

and the cost price of such trading stock has been taken into account in the determination of the taxable income of the taxpayer for any year of assessment, the taxpayer shall be deemed to have recovered or recouped—

(A) where such trading stock has been applied in a manner contemplated in paragraph (*a*), an amount equal to the cost price to him of such trading stock (less any sum which has been deducted therefrom under the provisions of subsection (1)) or where the cost price cannot be readily determined, the market value of such trading stock; or

(B) where such trading stock has been applied, disposed of or distributed in a manner contemplated in paragraph (*b*) (otherwise than in the manner contemplated in paragraph (C)) or ceases to be held as trading stock, an amount equal to the market value of such trading stock; or

(C) where such trading stock has been applied for the purpose of making a donation in respect of which the provisions of section 18A apply, an amount equal to the amount which was taken into account for that year of assessment in respect of the value of that trading stock,

and such amount shall be included in the income of the taxpayer for the year of assessment during which such trading stock was so applied, disposed of, distributed or ceased to be held as trading stock: Provided that where—

(*a*) an asset consisting of trading stock so applied is used or consumed by the taxpayer in carrying on his trade, the amount included in his income under this subsection shall for the purposes of this Act be deemed to be expenditure incurred in respect of the acquisition by him of such asset;

(*b*) the provisions of paragraph (*b*)(ii) apply and any consideration contemplated in that paragraph has been received by or accrued to the taxpayer, the amount included in his income in terms of this subsection shall be reduced by such consideration;

(*c*) such trading stock consists of livestock or produce in respect of which the provisions of paragraph 11 of the First Schedule are applicable, the provisions of this subsection shall not apply; or

(*d*) such trading stock consists of assets in respect of which any amount received or accrued from the disposal thereof is or will be included in the gross income of the taxpayer in terms of paragraph (*j*A) of the definition of “gross income”, the provisions of paragraph (*b*)(iv) shall not apply.