



Inland Revenue
Te Tari Taake

Industry Guidelines

The valuation of trading stock

for winemakers for income tax purposes

Introduction

The Income Tax Act 1994 sets out the rules for the valuation of trading stock at balance date. Trading stock held at balance date for wineries will include stock in the process of fermenting, maturing wines and wines held for sale.

Small taxpayers

There are simplified rules for “small” taxpayers, those who, together with associates, have an annual turnover of \$3 million or less.

Small taxpayers may value their stock at either cost or market value.

Valuation at cost

In valuing their stock at cost, small taxpayers may determine cost as other taxpayers are required to do.

However, small taxpayers are allowed to include a lesser level of costs than other taxpayers. This is because of the compliance costs of requiring a higher level of cost absorption.

In determining the cost of closing stock, small taxpayers who manufacture or produce trading stock must include the following costs of production:

- direct and indirect material costs
- direct and indirect labour costs
- utilities costs such as heat, light and power
- cost of repairs and maintenance to factory plant
- cost of rent or depreciation of factory plant.

Direct material costs

For winemakers, the direct materials are the grapes used to make the wine.

- For wineries that purchase their grapes, the costs in relation to the grapes include:
 - the cost of the grapes
 - associated transport and handling costs
 - any other directly attributable costs of acquisition of the grapes.
- For wineries that grow their own grapes, the costs will include the following directly attributable costs:
 - yearly allowable claims in relation to land improvements that have been capitalised, such as:
 - (a) the planting of vines
 - (b) the construction on the land of trellis posts for the growing of the grapes.
 - depreciation claims in relation to fixed assets which have been capitalised, such as:
 - (a) plant and equipment used in planting, maintenance and harvesting of the grapes
 - (b) capitalised irrigation costs
 - (c) mulchers.

If a small taxpayer chooses to determine cost by including a lesser level of cost than other taxpayers, then either accounting or tax depreciation rates can be used. The method used must be applied consistently from year to year.

- **The costs of wines purchased for blending purposes**
This will include associated transport and handling costs and any other directly attributable costs of acquisition.
- **The purchase cost of bottles, corks, labels, capsules and cartons**
This will include associated transport and handling costs and any other directly attributable costs of acquisition.

The labour and indirect material costs incurred in relation to the growing of the grapes are discussed below.

Indirect material costs

Indirect materials are consumables used in the production process:

- **Grapes** – these include fertiliser, herbicides, pesticides and other chemicals used in soil, weed, pest and disease control.
- **Wine** – these include chemicals and additives used in the prefermentation process (such as sugar) or in the fermentation process (such as yeast).

The cost of the indirect materials also includes associated transport and handling costs and any other directly attributable acquisition costs.

Direct labour costs

These costs relate to those persons directly involved in the production process such as those:

- involved in the maintenance and harvesting of the grapes, including contract labour
- involved in the pressing of the grapes
- involved in the prefermentation phase
- directly involved in the fermentation process of the wine and the post-fermentation processes (for example, racking)
- involved in the bottling, labelling and packaging of the wine.

Indirect labour costs

These costs relate to those persons indirectly involved in the production process such as:

- foremen and managers overseeing the growing and harvesting of the grapes and the fermentation, maturing, bottling and labelling of the wine
- plant maintenance staff and cleaning staff.

Utilities costs

These costs include the heat, light and power of the winery and the cost of utilities incurred when the wine is being stored for maturing.

Cost of repairs and maintenance and rent or depreciation allowances for factory plant

This includes the plant used in the fermentation, maturing, bottling, labelling and packaging process.

The plant includes storage tanks and barrels used in the fermentation and maturing processes.

Contract costs

If any of the production processes, such as the fermentation, bottling or labelling, are contracted out, include the contract costs in “cost”.

Additional costs

If costs apart from those that must be included for tax purposes are in the value of stock for financial statement purposes, these additional costs must also be included in the cost of the stock for tax purposes.

Alternative cost methods

Discounted selling price

The discounted selling price of trading stock is the amount equal to the market selling value, less the normal gross profit margin applicable to that category of stock.

For wine held for sale at balance date, the normal gross profit margin must be calculated for each category of stock. Winemaking is not a cost-plus industry. The selling price of each wine depends on its perceived quality and prevailing market conditions. Therefore the discounted price method is not considered a practical one for valuing wine held for resale at balance date.

The method is also not considered a practical one for valuing fermenting or maturing stock held at balance date for the above reason and also because at balance date no market selling price would be known for that stock.

Replacement price

Under this method, cost represents the price at which stock can be replaced at balance date.

As each winery produces its own distinctive wine, this method is not considered a practical one for wineries as the winery could not purchase that particular wine with the same qualities elsewhere.

Market selling value

Small taxpayers may value their stock at market selling value, when that value is lower than cost.

For example, if wineries have vintages that have been slow in selling and are being sold at balance date at a price that is less than cost, they can value their stock at the market selling value.

A small taxpayer may also value their stock at market selling value when that value is above cost. However, if a small taxpayer chooses to use the market selling value option in this circumstance, they must do so consistently from year to year.

The market selling value of finished goods is the gross amount that a taxpayer will normally receive from selling trading stock in the ordinary course of business. It is based on the actual selling price of goods in an open market.

Market selling value will generally be determined at balance date.

Market selling value is GST-exclusive.

Fermentation stock and maturing stock held at balance date

The market value of work in progress is determined by reference to the gross amount that will normally be received from the sale of the completed goods in the ordinary course of business, reduced by the cost of completing the goods.

For wine still being matured at balance date by the winery before being put up for sale, the market value method is not considered a practical valuation method as the future price of the finished wine cannot be determined.

Maturing wine at balance date must be valued at cost.

For similar reasons stock undergoing the fermentation process at balance date must also be valued at cost.

Selling costs

If the expected costs have been taken into account for financial reporting purposes, direct costs of selling stock which have not been incurred at balance date may be deducted when calculating the market selling value. These costs are:

- transport and insurance
- sales commission
- discount to purchasers.

Determining market selling value when goods are sold in different markets

Wineries may sell wine in both the domestic and export markets with market selling values being different between markets.

In these cases, the market selling value at balance date of stock held should be based on the most appropriate of either the percentage of actual sales or the anticipated volume of sales into each market.

Evidence requirements in relation to market selling value

Small taxpayers who value their stock at market selling value and that value is less than cost, are required to have reasonable evidence to substantiate market values. Evidence includes offering prices of goods and actual sales for a reasonable period before and/or after balance date.

If there is no open or active market for the stock, or if the stock has not been sold for some time and would sell at a price less than their current price, the market selling value at balance date can be substantiated by a valuation from a qualified person.

Consistency requirements for small taxpayers

Small taxpayers must be consistent from year-to-year in:

- the extent to which indirect production costs are included in the cost of manufactured or produced trading stock
- the cost-flow method of assigning cost
- the cost valuation method chosen
- the method of calculating discounted selling price
- the use of market selling value when it is above cost.

Small taxpayers may change their method of calculating the value of closing stock if there are sound commercial reasons. Tax benefits are not considered a sound commercial reason. An acceptable example is if there is a change in ownership and the new owners apply different valuation methodologies.

Taxpayers other than small taxpayers

Trading stock must be valued using a cost valuation method or, when the market selling value is lower than cost, market selling value can be used.

Valuation at cost

Cost is determined using generally accepted accounting principles. The requirements of *Financial Reporting Standard No 4: Accounting for inventories (FRS-4)* therefore are applicable to the extent that they apply to stock that is trading stock for tax purposes.

The costs to be included are the costs which have been incurred in the ordinary course of business to bring the stock to their present condition and location.

As well as including those costs (set out above) that a small taxpayer must include, other taxpayers must also include certain overhead costs, such as:

- winery building costs, for example, repairs and maintenance, insurance, rent, rates and depreciation
- building costs associated with the holding of the wine when it is being held for maturing
- excise duty, if it has become payable due to the wine having been removed from the licensed manufacturing area, for example, wine held at a restaurant operated by the taxpayer.

Costs relating to general administration, marketing and distribution to customers are not to be included in "cost".

If budget or standard cost method of cost allocation is used, any variance between the budgeted or standard costs and the actual cost of production must be apportioned on a pro rata basis between costs of goods sold and the closing stock.

Discounted selling price and replacement price

Both of these methods can be used. However, the practical limitations mentioned above relating to small taxpayers, mean that neither of these methods are considered practical for wineries to use.

Consistency requirements

Wineries have to comply with *Financial Reporting Standard No 1: Disclosure of Accounting Policies (FRS-1)* which states that accounting policies adopted are normally consistent from one period to another and are to be applied to all items of a similar nature.

If there are any changes to the method of valuing stock, a disclosure requirement in FRS-1 necessitates a record-keeping requirement of the changes made.

General comments for all taxpayers

- All costs are to be GST-exclusive.
- The cost valuation method used must be consistent with those adopted for financial reporting purposes.
- When using a cost method to value stock at balance date, an obsolescence adjustment can no longer be made. Any such factor can be only taken into account if it is reflected in the market selling value of the stock and the market selling value method is used to value stock.
- The same valuation method does not have to be used for all trading stock held. For example, a cost valuation method can be used for some stock and the market selling value for other stock that has a value less than cost.

- If the aggregate of the stock of consumables on hand used in the production of grapes and wine exceeds \$58,000 in total at balance date, the total cost of these materials must be included in the taxpayer's gross income for the income year.

Consumables are materials used in the production of the grapes and wine.

For the production of grapes, these could include fertilisers, herbicides, pesticides and other such chemicals.

For the production of wine, these could include additives and chemicals used in the fermentation process.