

BINDING PRIVATE RULING: BPR 094

DATE: 18 February 2011

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)

SECTION : SECTIONS 11(a), 22 and 23(g)

SUBJECT : CHARGES INCURRED IN RELATION TO THE ACQUISITION OF TRADING STOCK

1. Summary

This ruling deals with the question as to whether certain charges in relation to the acquisition of trading stock from a supplier will be deductible for income tax purposes.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 76Q of the Act.

In this ruling legislative references to sections are to sections of the Act applicable as at 12 November 2010 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This ruling has been requested under the provisions of –

- section 11(a);
- section 22; and
- section 23(g).

3. Parties to the proposed transaction

The Applicant: An industrial entity in the manufacturing sector

The Supplier: An independent manufacturing company in the same industry as the Applicant

4. Description of the proposed transaction

The Applicant is an industrial concern that manufactures a high volume of trading stock for sale to the public and to retailers. The Applicant proposes

to establish another reliable source (the Supplier) to provide trading stock for cases of emergency and/or peak periods. The Applicant will enter into a fixed term contract (the supply agreement) with the Supplier who will be able to manufacture the same product as that of the Applicant to secure an alternative source of trading stock.

In order for the Supplier to supply trading stock to the Applicant, it must link its manufacturing facility to the Applicant's distribution network or use another distributor's network. During the initiation process the Supplier will manufacture the product for supply to the Applicant and perform a run through of the process to deliver the stock.

In terms of the supply agreement the Supplier will be required to reserve capacity in its manufacturing facility to be able to manufacture and supply trading stock to the Applicant as and when called upon.

The charges that will be payable by the Applicant in terms of the supply agreement are as follows –

- commissioning payment;
- cost recovery charges; and
- payments for the acquisition of trading stock.

The commissioning payment will only be for the trading stock received by the Applicant during the initiation process.

The cost recovery charges will be the distribution charges levied on the Supplier.

No separate payment will be made to the Supplier in relation to reserving capacity in its manufacturing facility for the production of the Applicant's trading stock.

5. Conditions and assumptions

This ruling is not subject to any conditions and assumptions.

6. Ruling

The ruling made in connection with the proposed transaction is as follows:

- The commissioning payment, cost recovery charges and the acquisition of trading stock payments payable in terms of the supply agreement will qualify for deduction under the provisions of section 11(a) read with sections 22 and 23(g).

7. Period for which this ruling is valid

This binding private ruling issued in November 2010 is valid for the duration of the supply agreement.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**