# Corporate tax treatment of inventory loss 2/21/22

A company that suffers inventory loss has to forecast a shrinkage rate for the financial year. This may have corporate income tax (CIT) implications. Since the company is allowed to adjust its CIT return for the last month of the financial year without incurring late fees before it files its annual accounts, this article explores the CIT treatment of inventory loss.

## Inventory loss and forecasting a shrinkage rate

Inventory is liable to loss as well as impairment. Inventory loss has a variety of causes:

- The technological process (chips, scraps etc)
- The process of transport and storage (spillage, drying loss etc)
- Expired inventory write-offs
- Inventory damage due to improper transport or storage (breakage)
- Inventory lost in natural disasters (due to force majeure)
- Theft

A company that suffers inventory loss has to forecast a shrinkage rate for the financial year.

Shrinkage rates for the financial year are estimated according to the actual inventory loss levels in the last three financial years. The expected shrinkage rate is expressed as a percentage of net revenue or cost of goods according to the function (production, transport, storage etc) for which the rate is set. So each company has to adopt an approach to estimating shrinkage rates that best suits its business.

Companies that are incorporated during the financial year and traders whose line of business, raw materials or inventory ranges (goods) have changed significantly should estimate anticipated shrinkage rates based on the trader’s forecast for the financial year and according to the nature of their business. If certain inventory (goods) has a shrinkage rate laid down by statute, the taxpayer has to adopt that rate according to the law.

If the company does not have a management-approved shrinkage forecast policy, the value of shrinkage and goods written off will be considered a non-business expense.

## Inventory loss due to force majeure

When it comes to measuring the actual inventory loss for the financial year and comparing it with the approved shrinkage forecast, remember that inventory loss due to force majeure is considered a business expense. For example, the Covid-19 infection is recognised as force majeure, but the company must be able to demonstrate a direct impact on inventory loss. This will be excluded from the total actual inventory loss to be compared with the approved shrinkage forecast after the financial year has ended.

## The amount to be included in the CIT base

It follows from the CIT rules that any inventory loss exceeding the trader’s approved shrinkage forecast must be added to non-business expenses and included in the CIT base.

Under the CIT Act, the tax rate is 20% of the taxable base adjusted (i.e. divided) by a coefficient of 0.8.

## Reporting on the CIT return

Any shrinkage that is not considered a business expense should be reported on the CIT return for the last month of the financial year after the shrinkage forecast has been compared with the value of goods actually written off during the financial year. Any excess over the approved shrinkage forecast should go on line 6.1, *Non-Business Expenses*, of the CIT return.

Under section 17(8) of the CIT Act, late fees prescribed by the Taxes and Duties Act are waived on an additional tax liability arising after the taxpayer adjusts the CIT return for the last month of the financial year based on changes arising during the preparation of the annual accounts duly filed the State Revenue Service (SRS). So the value of goods written off to be included in the taxable base can be reported on the last CIT return for the financial year before the annual accounts are filed with the SRS, with no further implications.