


# ***TR 95/D25 - Income tax: sale of wool***

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This document has been finalised by TR 97/9.



## Draft Taxation Ruling

### Income tax: sale of wool

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#### other Rulings on this topic

IT 2670; TR 94/13; TR 95/7

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*DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling. Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.*

## What this Ruling is about

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### Class of person/arrangement

- This Ruling applies to taxpayers who are woolgrowers. For the purpose of this Ruling a 'woolgrower' is a person who conducts a business of growing and selling wool.
- The Ruling deals only with:
  - establishing the point in time at which a woolgrower is considered to derive income from the sale of wool under section 25 of the *Income Tax Assessment Act 1936* ('the Act'); and
  - establishing the point in time at which wool ceases to be trading stock of the woolgrower for the purposes of the trading stock provisions contained in sections 28 to 37 of the Act.
- The Ruling examines the taxation issues mentioned in paragraph 2, in the context of four methods by which wool is sold, namely:
  - sale by auction
  - sale by private treaty
  - sale by forward contract
  - sales of pooled wool.

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## Ruling

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### **Appropriate basis for returning income from the sale of wool**

4. Taxation Ruling IT 321 endorsed the Commissioner's long standing practice of accepting that, in limited circumstances, income from the sale of wool by auction could be returned as assessable income in the year in which payment was received. However, this view of the law is not consistent with the established principle that traders should return income on an accruals basis. The views expressed in this Ruling are based on the principle that, for the vast majority of woolgrowers, the accruals basis is the appropriate method under which income from the sale of wool should be returned.

5. Under the accruals method income is derived by the woolgrower once a debt for an ascertainable sum comes into existence in connection with the sale of wool.

### **Trading stock principles applicable to the sale of wool**

6. The primary test for determining the point in time at which wool ceases to be trading stock on hand of the grower is whether the grower has lost dispositive power over the wool. This will usually, but not always, coincide with the point in time when property in the wool passes to the buyer.

### **Taxation consequences of the different methods of sale**

#### ***Sales by auction***

7. When wool is sold at auction, property passes to the buyer at the fall of the hammer. A debt for an ascertainable sum is created at this point in time. It follows that income is derived at the fall of the hammer.

8. As the woolgrower loses title and dispositive power over the wool at the fall of the hammer, the wool ceases to be trading stock of the woolgrower at this time.

#### ***Sales by private treaty***

9. Although the terms of private treaty sales of wool vary from contract to contract, a debt in relation to most sales will not be fully quantified until the wool, having been delivered to the premises of the private treaty merchant, is weighed and tested by the Australian Wool Testing Authority. We consider that income is derived once testing has been carried out, enabling the price of the contract to be

ascertained. The fact that a sale contract may provide that property in the wool will not pass to the merchant until payment is made does not, in our view, delay the time at which income is derived.

10. The practical effect of most private treaty contracts is that the woolgrower loses dispositive power over the wool once it has been delivered to the private treaty merchant. Consequently we consider that the wool will cease to be trading stock of the woolgrower at this time.

### ***Sales by forward contract***

11. We do not consider that there has been a sale of wool at the time of making the forward contract. Similarly, the amount of the debt will not be fully ascertainable at this point. Sales by forward contract are essentially a specialised form of private treaty sale. Consequently, for the reasons given in paragraph 9, income is generally derived when the wool, having been delivered to the buyer, has been weighed and tested.

12. For similar reasons to those given in paragraph 10, we consider wool ceases to be trading stock of the woolgrower at the point when the wool is delivered to the buyer.

### ***Sales of pooled wool***

13. Any initial payment made to the woolgrower will, with one exception, be derived when the amount of the payment is declared by the pool operator. This will normally be immediately before, or at the same time as, the payment is received. Any subsequent advance payments which are declared prior to the pool being finalised are similarly derived when declared. The exception is where the payment takes the form of a loan to the woolgrower which is made available on a commercial basis. In this latter case, the initial payment is not income.

14. The final payment will be derived at the time that the amount is declared by the pool operator. This will be after all wool in the pool has been sold and the pool operator has performed the necessary calculations.

15. The pool operator, acting as agent, does not purchase wool from the woolgrower but has irrevocable authority to sell the wool in accordance with the pool contract. As such, the woolgrower loses dispositive power over the wool once it is delivered to the pool operator. It is at this time that wool ceases to be trading stock on hand of the woolgrower.

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## Previous Rulings

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16. This Ruling will, on finalisation, withdraw Taxation Ruling IT 321.

## Date of effect

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17. This Ruling applies, subject to the following paragraph, 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).

18. To the extent that the views contained in this Ruling conflict with the views expressed in IT 321, or, where a taxpayer has a more favourable private ruling (whether legally or administratively binding), this Ruling applies to those taxpayers to the extent of the inconsistency only in respect of arrangements entered into after the issue of this ruling (in its final form).

## Explanations

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### Appropriate basis for returning income from the sale of wool

19. The leading case on the question of whether a cash basis or accruals basis of returning income is more appropriate for a taxpayer is *Commissioner of Taxes (SA) v. Executor Trustee & Agency Co of SA Ltd* (1938) 63 CLR 108 (*Carden's case*). Here Dixon J said at 152-154 that the answer to a question of this type is:

'...governed by the principles recognised or followed in business and commerce, unless legislature has itself made some specific provision affecting a particular matter or question... Which of the methods of accounting should be applied depends upon an inquiry as to which method is in the circumstances of the case calculated to give a substantially correct reflex of the taxpayer's true income.'

20. At 155 Dixon J quoted from Sir Houldsworth Shaw and Mr Baker's *Law of Income Tax*, p.111:

'There is an important distinction between debts due to a trading company and unpaid in a particular year of income and other

income which is not a trade receipt. Trading debts due but not yet paid must be included in arriving at the balance of profits or gains...'

21. In the same case, Latham CJ said at 123:

'In the case of traders, where tax is imposed upon the profits of a trade, profits are calculated both in Australia and in England on an earnings basis; that is to say, the trade debts which fall due to the taxpayer during the year are credited and allowance is made for bad debts.'

22. Wool which is grown for sale falls within the inclusive definition of 'trading stock' in subsection 6(1) of the Act, as indeed do the sheep which carry the wool. Consequently, woolgrowers are considered to be 'traders' in the sense that the term is used in *Carden* and other leading cases. We consider that an adoption of the approach in *Carden* requires that woolgrowers should generally return income on an accruals basis.

23. Confirmation of this view can be found in *Dawson v. Botten* (1952) 6 AITR 35; (1952) 10 ATD 252 and Taxation Board of Review *Case No L12* (1960) 11 TBRD 68; *Case 45* 9 CTBR (NS) 289. In the former case, the Tasmanian Supreme Court had cause to consider whether a wool dealer should return income from the sale of wool under the accruals (earnings) or receipts (cash) basis. At AITR 39; ATD 255, Crisp J said:

'That "earnings" and not "receipts" should be the basis of a trader's accounts rendered for the purposes of the Income Tax Assessment Act would not, as a matter of law, appear to be open to argument... Prima facie, therefore, as a trader, the taxpayer's undoubted obligation was to account for his earnings and not merely his receipts.'

24. At issue in *Case No L12*; *Case 45* was the point in time at which income from the sale of wool by auction is derived. Mr RE O'Neill, at TBRD 75-76; CTBR 297 made the following observation, which supported the comments made by Messrs JL Bourke (Chairman) and RC Smith QC, at TBRD 71; CTBR 293:

'When one considers the plan of the present Assessment Act, I think the conclusion is inevitable that on the reasoning in *Carden's Case* the appropriate system of measuring the income of a pastoral or grazing business is the accruals system, there being no contrary provision in the legislation.'

25. The views expressed above are now almost universally accepted as being correct. A rare contrary view may be found in *Marshall v. Commissioner of Inland Revenue (NZ)* (1960) 12 ATD 209.

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There, Gresson P of the New Zealand Court of Appeal, in a dissenting judgment, commented at 212:

'But the usual method of assessing the profit in regard to a farming business is to do so substantially on a computation of actual receipts and outgoings.'

It is noteworthy here that his Honour described the cash basis as the 'usual method' rather than the 'correct method'.

*What consequences flow from woolgrowers returning income on an accruals basis?*

26. The accruals basis of returning income requires that a taxpayer determine at what point in time each item of assessable income is **derived**. There is considerable case law on the subject of **derivation** of income. In *FC of T v. Australian Gas Light Co & Anor* 83 ATC 4800, at 4805; (1983) 15 ATR 105, at 111, Bowen CJ, Fisher and Lockhart JJ described some of the tests that have been adopted by the courts:

'The fees of accountants are derived when they have matured into recoverable debts: *Henderson v. F.C. of T.* (1970) 119 CLR 621; 70 ATC 4016; 1 ATR 596. Fees paid in advance for provision of dancing lessons are not derived until they are earned: *Arthur Murray (N.S.W.) Pty. Ltd. v. F.C. of T.* (1965) 114 CLR 314; (1965) 14 ATD 98. The income of a trading business is derived when its stock is sold and a debt is created: *Rowe J. & Son Pty. Ltd. v. F.C. of T.* 71 ATC 4157; (1971) 124 CLR 421.'

27. In reference to these tests, their Honours went on to say (at ATC 4805; ATR 111):

'Helpful as these tests may be as signposts, each of them has been conceived in and applied to varied and contrasting circumstances. As signposts they indicate that invariably something more than provision of goods or services by the taxpayer is required. **It is necessary to determine whether the consequence is that a debt has been created or whether the taxpayer is obliged to take further steps before becoming entitled to payment**' [emphasis added].

28. In the case of *Gasparin v. FC of T* 94 ATC 4280; (1994) 28 ATR 130, von Doussa J, with whom Spender J and Jenkinson J agreed, noted at ATC 4288; ATR 140 that his decision was in accordance with the 'signposts' in *Australian Gas Light Co.* At issue in *Gasparin* was at what point was income derived from the sale of land. The sale process commenced in one income year with the

making of contracts and concluded in the following income year when settlement took place. The court found that the answer to the question of derivation lay in establishing the point in time at which a debt came into existence. In the case of the sale of real property, it was held that a debt was due to the vendor at the time of settlement.

*Income from sale of trading stock derived when debt is created in relation to a sale*

29. The main income derivation 'signpost' in the context of the sale of trading stock is contained in the decision of Menzies J in *J Rowe and Son Pty Ltd v. FC of T* (1970-1971) 124 CLR 421; 71 ATC 4157; 2 ATR 497, who said at CLR 450; ATC 4160; ATR 500:

'I consider income from the sale of stock is derived when the stock is sold and a debt is created. It need not be payable in the year of income.'

30. We consider that his Honour was referring to the usual case where the sale of stock and creation of the debt take place simultaneously. In those instances where a debt arises either before or after a sale is completed, the income will be derived at the point of debt creation rather than on the completion of the sale. Thus in *Australian Gas Light Co* the inquiry was into whether the taxpayer's claims against customers for gas supplied but not yet billed had matured into recoverable debts (ATC 4806; ATR 112). It was held that they had not.

31. Income from the sale of wool will be derived when, as a result of a sale which may not yet be completed, a debt is owed to the wool grower.

*Amount of debt should be ascertainable*

32. The notion that income is derived when a debt comes into existence has been the subject of further judicial refinement. In *Gasparin* at ATC 4287; ATR 138, von Doussa J noted:

'The element of contingency is an important one. In *Barratt & Ors v FC of T* 92 ATC 4275 at 4281 - 4282; (1992) 23 ATR 339 at 346 Gummow J, with whom the other members of the court agreed, said:

"No doubt a debt that is presently recoverable by action generally will be an amount 'derived' in the relevant sense by the creditor. The creditor will have a present right to receive the amount in question, something both earned and quantified, without the presence of any element of

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contingency or defeasibility. At the other end of the scale, where the right of the taxpayer is contingent, there will be no derivation before the contingency is satisfied: see Parsons, *'Income Taxation in Australia'* paragraph 11.49. Nor will there be derivation if the debt is yet to be quantified: *Farnsworth v. F.C. of T.* (1949) 9 ATD 33 at 37; (1949) 78 CLR 504 at 513 per Latham CJ." '

33. We believe it is important, in the context of the sale of wool, that income should not be treated as being derived unless there is a significant degree of certainty about the amount of the debt which has been created as a result of the sale.

## Trading stock principles

34. Section 28 of the Act requires that the value of all 'trading stock on hand' at the beginning and at the end of a year of income is taken into account in ascertaining the taxable income of a taxpayer carrying on a business. Taxation Ruling IT 2670 sets out our views on the meaning of 'trading stock on hand'. While wool will generally only cease to be trading stock of the woolgrower once property in the wool has passed to a buyer, this may not always be the case.

35. The primary test set out in IT 2670 is that of whether the grower has lost dispositive power over the wool. This test was developed in *Farnsworth v. FC of T* (1949) 78 CLR 504; 9 ATD 33 and followed in *FC of T v. Suttons Motors (Chullora) Wholesale Pty Ltd* (1984-5) 157 CLR 277; 85 ATC 4398; (1985) 16 ATR 567 and *All States Frozen Foods Pty Ltd v. FC of T* (1990) 21 FCR 457 90 ATC 4175; (1990) 20 ATR 1874.

36. The pivotal importance of loss of dispositive power has received the support of von Doussa J in *Gasparin* in his discussion of *Farnsworth*. In his judgment von Doussa J also considered the nature of the relationship between the concepts of 'trading stock on hand' and 'derivation of income'. At ATC 4288; ATR 139 he said:

'The [*Farnsworth*] decision, in my opinion, does not support the Commissioner's argument that notions of matching require a loss of dispositive power ... to be balanced at the same time by treating as derived income profits expected to be received at a later date under the unsettled contracts of sale. On the contrary I think the decision is against this argument.'

37. These comments highlight the fact that there are exceptions to the rule that the point of income derivation will normally coincide with the time trading stock ceases to be on hand. Such a situation is discussed in Taxation Ruling TR 94/13, which examines trading stock and income derivation issues in the context of the cotton industry.

In pool marketing arrangements it will often be the case that cotton ceases to be trading stock on hand of the grower at a point before income is derived.

38. In *Farnsworth* the taxpayer had delivered dried fruit to a packing house to be mixed with the produce of other growers and to ultimately be sold. As the taxpayer had lost all power to direct or control the disposal of the fruit, and her own fruit was no longer distinguishable from other growers, the fruit ceased to be trading stock on hand upon delivery to the packing house. However, the sale proceeds were not derived until some later time when the cooperative made interim and final distributions in relation to the sale of the fruit.

### **Application of derivation and trading stock principles to different methods of sale**

39. Taxation Ruling IT 321 dealt only with the issue of derivation in the context of the sale of wool by auction. While the vast majority of wool is still sold by auction, changing economic circumstances, particularly the collapse of the wool floor price system, have led to woolgrowers exploring other sale options in order to maximise returns and/or create a more stable income flow. This Ruling looks at how derivation of income and trading stock principles apply to four different methods of selling wool.

#### ***Auction sales***

40. Wool broking firms who conduct auction sales invariably adopt terms and conditions of sale which are similar to the Australian Wool Exchange's (AWE) recommended Member's Terms and Conditions of Sale. Clause 5(a) of the recommended terms and conditions states that the property and risk in the goods shall pass to the buyer on the fall of the hammer. This is consistent with the approach taken in the various *Sale of Goods Acts* and accords with common law principles (e.g., *Dennant v. Skinner* [1948] 2 KB 164; [1948] 2 All ER 29 and *McPherson, Thom, Kettle & Co v. Dench Bros* [1921] VLR 437; (1921) 27 ALR 272).

41. There will be circumstances where a sale which ostensibly has occurred at the fall of the hammer will not ultimately come to fruition. For example, the AWE recommended Terms and Conditions of Sale at clause 3(d)(i), allow for a 'buyer in error' to have the wool lot resubmitted for sale if the error is notified before the sale of the 10 succeeding lots. The possibility of the buyer reneging is catered for in sub-clauses 6(h)(d) and (e), which allow the broker to resubmit wool which has not been paid for and provide that the buyer will be liable to the broker and vendor for any damage suffered.

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42. Despite these contingencies, the view of Messrs JL Burke and RC Smith in *Case No L12*; TBRD at 72; *Case 45* CTBR at 293 seems best to describe the arrangement:

'As at present advised we hold the view that on a sale by auction there comes into existence on the fall of the hammer a contract which is a valid contract even though it be voidable on the ground of fraud or misrepresentation and it remains a valid contract unless and until it is so avoided (see *Chitty on Contracts*, 21st ed, Vol 1, at p.533).'

43. For all practical purposes, title in the wool can be considered to change at the fall of the hammer, with the vendor being entitled either to payment within a designated period or to compensation in those instances where the buyer reneges.

44. A recoverable debt also comes into existence at the fall of the hammer. This is so even though the buyer generally has until the Friday following the week of the sale to make payment. The various *Sale of Goods Acts* provide that the seller may sue for the price once property in the goods has passed. The amount of this debt is fully ascertainable as the sale price and broker's commission will be known when the hammer falls. It follows that the woolgrower derives income at this point in time.

45. As property in the goods passes to the buyer on the fall of the hammer, or shortly thereafter, it is at this time that the woolgrower loses dispositive power over the wool. Up until this point, the grower will have the opportunity to withdraw the wool from auction. It follows that the wool will cease to be trading stock of the grower at the time the hammer falls.

## ***Private treaty sales***

46. Unlike the auction system, where a wool broker acts as agent for the wool grower who sells wool to a third party, private treaty sales involve a purchase by the private treaty merchant who subsequently on sells the wool to a third party. The terms and conditions of private treaty contracts are subject to an almost infinite number of variations. In each case, these terms and conditions of sale are important in establishing the point(s) in time at which the debt for the sale proceeds arises and title in the wool passes to the merchant.

47. The contract will often provide that property in the wool passes upon payment. Payment usually takes place about 14 days after the wool has been delivered to the merchant. The merchant normally carries the risk associated with the wool upon taking delivery, even though property has not yet passed.

48. Soon after delivery the wool is weighed and tested by the Australian Wool Testing Authority. It is after weighing and testing that the price of the contract is fully ascertained. As Crisp J stated at 6 AITR at 42; 10 ATD at 259, in *Dawson v. Botten*, in the context of a wool trader:

'If the final amount of the debt is not capable of precise ascertainment because it is subject to some adjustment, ... then it appears it is not an ordinary ascertained trading debt to be brought to account in the year in which it begins to accrue.'

49. It is at the point immediately after weighing and testing that income from the sale of the wool is considered to be derived. While not having full ownership of the wool the merchant has possession and risk of the wool and will owe the grower a debt for an ascertainable amount.

50. We consider that the grower loses dispositive power over the wool at the time of delivering the wool to the merchant since the delivery of the wool constitutes the fulfilment of the woolgrower's obligations in respect of the contract of sale. At this time, wool ceases to be trading stock of the grower.

### ***Sale by forward contract***

51. Forward contract sales are essentially a specialised form of private treaty sale whereby the wool grower undertakes to deliver a quantity of wool, usually from a designated flock of sheep, to the merchant at some time in the future. It is normally the case that the contracted wool is still 'on the sheep's back' at the time of making the contract. The ultimate value of the contract to the wool grower will be subject to the quantity and class of wool finally delivered.

52. The case of *FC of T v. Woolcombers (WA) Pty Ltd* 93 ATC 5170; (1993-94) 27 ATR 302 established that, from the buyer's point of view, expenses associated with purchasing wool by forward contract may be deductible at the time of making the contract. It does not follow that income is derived by the woolgrower at the same time. The concepts of when expenses are incurred and when income is derived are not necessarily symmetrical, even where both the buyer and seller of wool return income on an accruals basis.

53. One impediment to income being derived at the time of the contract is that the exchanging of a forward contract between parties is, under *Sale of Goods* legislation, not a sale but an 'agreement to sell'. An agreement to sell becomes a sale when the time specified in the forward contract elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

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54. Additionally, the unshorn wool which is the subject of most forward contracts is considered to be unascertained goods (see *Halsbury's Laws of Australia*, 375-910). Under *Sale of Goods* legislation there can be no change in title until goods have been ascertained. In this instance, goods will not be ascertained until the sheep have been shorn.

55. By way of contrast, it is not unusual for the terms of a forward contract to stipulate that property in the wool will not change until payment has been made in respect of the contract. This is normally some time after the grower has delivered the wool to the purchaser. For reasons similar to those given at paragraphs 47 to 49 we consider the time of payment, and hence the time of property in the wool actually passing, is not relevant to the timing of derivation of income from the sale of wool. Rather, the crucial point in time will be when the debt in respect of the sale becomes ascertainable.

### *Two main types of forward contract*

56. Forward contracts for the sale of wool can be conveniently classified as fixed contracts or variable contracts. Variable contracts are often referred to as 'rise and fall' contracts. A variable contract will contain a base price per kilogram of wool but this price will be subject to adjustment depending on the micron level and vegetable matter content of the wool delivered. The actual quantity of wool will also be subject to variation since the wool is unshorn at the time of making the contract.

57. It is only after the Australian Wool Testing Authority weighs and tests the wool that all necessary calculations can be made to quantify the price payable to the grower under the contract. At this point in time income is considered to have been derived.

58. Under a fixed forward contract, there is a greater degree of certainty in regard to some of the variables which form the sale price. In particular, the price to be paid per kilogram of wool will be set. However, until the wool is weighed and tested the overall sale price can only be estimated. Prior to this time the precise quantity of wool being sold will usually not be known. In addition, the price per kilogram may be subject to some variation in instances where the quality of the wool delivered does not fall within a range which may be designated in the contract.

59. In summary, under both a fixed and a variable forward contract for the sale of wool, a 'sale' will not generally take place at the time of making the contract since unshorn wool constitutes unascertained goods. Shearing is a necessary prerequisite to the sale price being quantified since the wool cannot be weighed or tested until it has been

shorn. Immediately after the wool has been weighed and tested the debt in respect of the sale is quantified and the grower will have derived income in respect of the sale. This is so regardless of any stipulation in the contract to the effect that property in the wool passes upon payment.

60. Upon entering into a forward contract a woolgrower is substantially committed to the delivery of, as yet, unascertained goods to the purchaser. On one view, such wool ceases to be trading stock immediately upon its ascertainment - when the sheep are shorn. The facts in *Woolcombers* possibly support this view. Evidence was given in *Woolcombers* that between 1976 and 1988 only one of the forward contracts entered into by the wool buyer was not completed.

61. However, until the wool is actually delivered the grower has the right to sell the wool to another buyer, with the other party to the forward contract being entitled to indemnification from the woolgrower for any loss suffered. As such, it is clear that dispositive power is not finally relinquished until delivery of the wool. It is at this point that the wool ceases to be trading stock on hand of the grower.

### ***Sales of pooled wool***

62. Pooling schemes, although common in the cotton, grain and milk industries, are still comparatively new in the wool industry. When discussing terms and conditions of contracts associated with pooling schemes, it is difficult to speak of 'industry norms' since this method of selling does not have a long history of activity. While details of the arrangements may change over time we consider that the main features of these schemes are unlikely to change materially in the near future and the views expressed in this ruling are given on this basis.

63. From the grower's point of view pooling schemes are essentially a risk management instrument whereby the grower receives an averaged return based on the total income over the life of the pool. The pool operator, in the scheme we are aware of, does not buy the wool from the grower but rather, acts as agent for the grower in the sale of the wool. All growers participating in the pool, upon delivering wool in accordance with the pooling contract, give the pool operator irrevocable authority to deal with and sell the wool in accordance with that contract. Title in the wool will not pass upon delivery of the wool to the pool operator, but rather at some later time when the wool is sold to a third party.

64. The pooled wool is insured on behalf of the grower by the pool operator. In the event of fire in the wool store, the proceeds of any

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insurance claim would be incorporated into the pool proceeds, rather than being paid directly to the affected growers.

65. It is usually cost effective for the pool operator not to unpack the wool from the grower's bales and to sell the wool under each grower's own brand. However the pool operator reserves the right to remove the wool from any bale in the pool and to further treat the wool or amalgamate the wool with that of other growers so as to obtain the best sale price.

66. A final distribution of sale proceeds will not take place until all wool in the pool is sold and the pool operator has made the necessary calculations required by the contract. It is common for the pool operator to make one or more advance payments to the grower, usually based on the percentage of the likely sale price. The final distribution will be net of these payments.

67. A debt will have been established in relation to any advance payments when the pool operator declares such an amount. This will be shortly before or at the time of making payment. Even though the grower's wool is usually unsold at the time of declaring the advance payment, the advance payment is made as a consequence of the inevitable future sale of wool. This sale is, as a matter of commercial reality, certain to take place. Further, as the grower has irrevocably delivered the wool to the pool operator for ultimate sale, the payment is not considered to be income not yet earned as in *Arthur Murray (NSW) Pty Ltd v. FC of T* (1965) 114 CLR 314; 14 ATD 98.

68. We consider that growers derive income from advance payments made by pool operators at the time such payments are declared. This view is consistent with that put forward in Taxation Ruling TR 95/7 at paragraphs 5, 7 and 31, in relation to non-refundable deposits received by a seller in a lay-by sale transaction prior to a sale taking place. The treatment of advance payments is also in line with comments in Taxation Ruling TR 94/13, in respect to advance payments from pool operations received by cotton growers and accords with the treatment of the progress payment in *Farnsworth*.

69. Advance payments should not be confused with grower loans in which the pool operator acts as lender. Loan funds are not assessable income of the woolgrower. In order to be accepted as a legitimate loan such funds would need to be made available to the woolgrower on a commercial basis. It would be expected that such loans would be repayable, interest bearing and supported by appropriate documentation. Where these elements are not present, funds received by the grower from the pool operator will be treated as assessable advance distributions.

70. While it will be the case that all of a grower's wool will have been sold prior to the pool being finalised, there will not be a quantifiable debt in respect of all the grower's wool until such time as the pool operator declares the final contract price. Once this price has been declared, the grower will have derived all remaining income under the contract.

71. In summary, a grower will generally have multiple income derivation points under a pooling contract. Any advance payments and the final payment will be derived when the pool operator declares such amounts. In practice, this will generally be shortly before such amounts are received by the grower.

72. Once the wool has been delivered to the pool operator the terms of the pool agreement, coupled with the pool operator's physical possession of the wool, effectively prevent the woolgrower from regaining possession of the wool. We believe that on delivery, the woolgrower relinquishes dispositive power over the wool and therefore the wool ceases to be trading stock on hand of the woolgrower at this time.

## Your comments

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73. If you wish to comment on this Draft Ruling, please send your comments by: 15 December 1995 to:

Contact Officer: Geoff Bridges  
 Telephone: (08) 208 3843  
 Facsimile: (08) 208 3888  
 Address: Tax Law Services  
 Australian Taxation Office  
 Pulteney Branch  
 GPO Box 200  
 ADELAIDE SA 5001  
 Attention: Geoff Bridges.

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### Commissioner of Taxation

1 November 1995

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ATO references

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