TR 96/D19 - Income tax: whether packaging items (i.e., containers, labels, packing materials, binding materials and accessories) are trading stock

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Draft Taxation Ruling

Income tax: whether packaging items (i.e., containers, labels, packing materials, binding materials and accessories) are trading stock

other Rulings on this topic

TR 96/D20

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What this Ruling is about

Class of person/arrangement

1. This Ruling explains the circumstances in which packaging items held by a manufacturer, wholesaler or retailer are 'trading stock' as defined in subsection 6(1) of the *Income Tax Assessment Act 1936* ('the Act').

2. The Ruling applies to packaging items produced, manufactured, acquired or purchased by a taxpayer engaged in business and held for:

(a) purposes of sale - if the taxpayer is either:

(i) trading in the packaging items; or

(ii) disposing of the packaging items in trading in other goods ('core' goods), for example, cardboard boxes being packaging items for tubes of toothpaste; or

(b) purposes of manufacture - if the taxpayer is incorporating the packaging items in 'core' goods in the course of manufacturing the 'core' goods, e.g., cans for canned soup.

3. The Ruling also considers whether returnable packaging items are 'trading stock'.

4. The Ruling does not deal with the alternative methods of valuing packaging items that are trading stock. However, Taxation Board of Review No 1 in *Case 115* (1951) 1 TBRD (NS) 485; *Case 120*

(1951) 1 CTBR (NS) 568 decided, on the facts of that case, that the market selling value for packaging items that were trading stock, was not less than their cost price.

5. The Ruling also does not deal with packaging items held by a person engaged in a business of performing services for reward, for example, a builder, electrician, dry cleaner or a repairer of electrical or electronic appliances. This is covered in draft Taxation Ruling TR 96/D20.

6. The key terms in this Ruling, 'packaging items' and 'returnable packaging items', are explained in paragraphs 24 to 27.

Previous Rulings

7. This draft Ruling supersedes draft Taxation Ruling TR 93/D16, which is now withdrawn. The draft Ruling also incorporates Taxation Determination TD 93/23, which will be withdrawn when this Ruling is finalised. That Determination deals with cartons, containers, labels and packing materials used by fruit and vegetable producers in the marketing and distribution of their produce.

Ruling

Scope of the term 'trading stock'

8. A thing is trading stock for the purposes of the Act if it is within either the definition in subsection 6(1) or within the meaning of the term 'trading stock' without the aid of the definition, that is, if it is within the ordinary meaning of the term.

9. The definition of the term 'trading stock' in subsection 6(1) is expansive and extends the ordinary meaning of the term.

10. We take the view that the ordinary meaning of 'trading stock' encompasses the aggregate of packaging items which a taxpayer has on hand if:

(a) the taxpayer is in business trading in 'core' goods; and

(b) (i) the packaging items are sold by the taxpayer with the 'core' goods in one transaction for one inclusive price; or

(ii) the items are disposed of by the taxpayer in association with the sale of the 'core' goods - whether the items are supplied to customers before, at the time of, or after the point of sale of the 'core' goods.

Packaging items for purposes of sale

Packaging items held by a taxpayer trading in these items

11. Packaging items held by a taxpayer who is or will be engaged in business trading in these items (whether as a manufacturer, wholesaler or retailer and whether or not the items are returnable packaging items in the hands of a customer) and who 'produces, manufactures, acquires or purchases' (referred to in this Ruling for brevity as 'obtains') the items for sale are 'trading stock' as defined in subsection 6(1).

Packaging items held by a taxpayer trading in goods other than these items

12. Packaging items held by a taxpayer who is or will be engaged in business trading in 'core' goods, and who obtains the items for purposes of sale of the 'core' goods, either come within the ordinary meaning of the term 'trading stock' or within the subsection 6(1) definition, extending as it does to 'anything' produced, manufactured, acquired or purchased ('obtained') 'for purposes of ... sale'. This is so whether the taxpayer is a manufacturer, wholesaler or retailer of the 'core' goods. The packaging items in these circumstances are obtained 'for purposes of ... sale' of the 'core' goods if the items:

(a) are sold by the taxpayer with the 'core' goods in one transaction for one inclusive price; or

(b) are disposed of by the taxpayer in association with the sale of the 'core' goods - whether the items are supplied to customers before, at the time of, or after the point of sale of the 'core' goods.

A disposal of packaging items is associated with a sale of the 'core' goods, for instance, if the items are supplied under a contract of sale of the 'core' goods or if the items are supplied in furthering sales of the 'core' goods. We take the view in this regard that the expression 'purposes of ... sale' in the definition of 'trading stock' in subsection 6(1) pertains not only to the subject-matter of the sale (or the contract of sale) but also relates to the process or activity of selling the things obtained by the taxpayer.

13. The level of distribution in which the taxpayer is trading is a relevant factor in determining whether packaging items are associated with the sale of 'core' goods, and thus, whether the items are trading stock. Although packaging items used by a manufacturer might be different from those used by a retailer, the items each uses, if they come within the description in paragraph 12 of this Ruling, are trading stock. A manufacturer, for example, ordinarily packs, wraps up or

secures 'core' goods for sale to a wholesaler or a retailer in quantities commercially expedient for the wholesaler's or retailer's business. These may be larger quantities, for instance, than those in which the retailer might in turn sell the 'core' goods to consumers. Packaging items in which a manufacturer intends to sell 'core' goods could be different, therefore, from packaging items in which a retailer intends to sell the goods.

Packaging items for purposes of manufacture

14. Packaging items held by a taxpayer who carries on business as a manufacturer and who obtains the items for purposes of manufacture of other goods, incorporating the items in the course of the process of manufacture of the other goods, are 'trading stock' as defined in subsection 6(1). For instance, a manufacturer of baby powder may purchase and hold tins in which to incorporate the final product, namely, tins of baby powder.

Returnable packaging items

15. Returnable packaging items are not 'trading stock' as defined in subsection 6(1) if they are held by a taxpayer who is or will be engaged in business trading in 'core' goods but who does not dispose of, or pass property in, the items to its customers. Returnable packaging items held by a taxpayer are not trading stock whether the items are:

(a) obtained to make them available to customers, or

(b) have been returned by customers for re-use.

16. Returnable packaging items are likely to be depreciable plant or articles for the purposes of subsection 54(1).

Date of effect

17. This Ruling applies only from and including the 1996-97 year of income, unless a taxpayer chooses to apply it to earlier income years.

18. Section 28 requires that the value of trading stock on hand at the end of a year of income be compared with the value of trading stock on hand at the beginning of that year of income to ascertain whether an amount is assessable under subsection 28(2) or deductible under subsection 28(3).

19. In the earliest year of income to which a taxpayer applies the Ruling ('the first year of income'), the value of packaging items that are trading stock on hand at the end of that year must be ascertained in accordance with the provisions of section 31.

20. The value to be taken into account under section 28 in relation to packaging items that are trading stock on hand at the beginning of the first year of income must be identical in amount with the closing figure for packaging items on hand at the end of the immediately preceding year: see *Australasian Jam Co Pty Ltd v. FC of T* (1953) 88 CLR 23; (1953) 10 ATD 217 per Fullagar J at CLR 27; ATD 218 where his Honour made it clear that the opening figure for trading stock in any year of income must be identical with the closing figure of the preceding year.

21. Accordingly, if no value for packaging items was taken into account in determining the value of trading stock on hand at the end of the income year immediately preceding the first year of income, the opening value of packaging items in the first year of income will be nil.

22. A taxpayer may apply for amendment of assessments for years of income before 1996-97, to the extent permitted by section 170. However, unless the value of packaging items on hand at the end of a particular year of income can be determined on the basis of reasonably objective and supportable data, amendment of an assessment for that year to give effect to the Ruling will not be available to a taxpayer.

23. 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).

Explanation of key words

24. The expression 'packaging items' is used in this Ruling to refer to containers, labels, packing materials, binding materials and accessories. These terms are used in this Ruling to refer to the following:

'Containers'	includes items such as cartons, tins, cans, bottles, jars, sacks, boxes, cases, crates, plastic wrap and bags in which 'core' goods are packed or secured for marketing, sale or delivery, including outer containers of other containers (whether or not the item forms an

	integral part of the 'core' goods or are part and parcel of the 'core' goods).
'Labels'	includes tags, tokens and stickers which become integral parts of the containers to which they are affixed.
'Packing materials'	includes cotton wool, tissue paper, shredded paper, polystyrene beads and bubble plastic.
'Binding materials'	includes wrapping paper, string, tape, shrink wrap, staples and glue.
'Accessories'	includes serviettes, cutlery, refresher towels and drinking straws.

25. The above packaging items are examples only. The list is illustrative only and is not meant to be exhaustive.

26. The packaging items referred to in this Ruling:

- pack, wrap up or secure 'core' goods before, at the time of their sale or after the point of sale; or
- may be sold or disposed of with 'core' goods under the contract of sale of the 'core' goods; or
- their cost may be the subject of a separate charge; or
- their cost may be included in the amount for which 'core' goods are sold; or
- their cost may be recovered in the prices for which other goods are sold;

and the property in them passes to the purchaser of the goods.

27. The expression 'returnable packaging items' is used in this Ruling to refer to packaging items:

(a) which are not sold with 'core' goods sold by a taxpayer engaged in business trading in those goods; and

(b) the property in the items remains with the taxpayer; and

the taxpayer expects, if not requires, that the items will be returned to the taxpayer. Examples of returnable packaging items are wooden pallets, gas cylinders and drink bottles that remain the property of the manufacturer. In some cases a refundable deposit is paid on the return of returnable packaging items, for example, drink bottles.

Explanations

Scope of the term 'trading stock'

Statutory definition of 'trading stock'

28. Subsection 6(1) provides that, in the absence of a contrary intention, ' "trading stock" includes anything produced, manufactured, acquired or purchased for purposes of manufacture, sale or exchange, and also includes livestock'.

29. The definition uses the word 'includes' and is therefore expansive. A thing is trading stock for income tax purposes if it is within the definition in subsection 6(1) or within the ordinary meaning of the term.

Ordinary meaning of trading stock

30. If a thing is within the ordinary meaning of 'trading stock', it is trading stock for the purposes of the Act: *FC of T v. Suttons Motors (Chullora) Wholesale Pty Ltd* (1985) 157 CLR 277; 85 ATC 4398; (1985) 16 ATR 567. In that case, the High Court of Australia said (157 CLR at 281-282; 85 ATC at 4400; 16 ATR at 570):

> 'The ordinary meaning of the term "trading stock" upon which [the definition in subsection 6(1)] builds is that which is attributed to it by legal and commercial people for accounting and other purposes. That ordinary meaning has been held to include shares purchased and held for resale by a share trader (*Investment and Merchant Finance Corporation Ltd. v. Federal Commissioner of Taxation* (1971) 125 CLR 249) and land which a dealer in land holds as an object of his dealing: *St Hubert's Island case* ((1978) 138 CLR at 225). It has been said to include the stock of raw materials which a manufacturer holds for use in manufacture: *St Hubert's Island case* ((1978) 138 CLR at 226-227) and cf. Act, s. 6(1). It is not necessary for present purposes however to explore the outer limits of the area covered by that ordinary meaning of the term. Its traditional and narrower denotation still lies at the centre of that meaning and is adequate for present purposes. That denotation is of goods held by a trader in such goods for sale or exchange in the ordinary course of his trade.'

31. See also *John v. FC of T* (1989) 166 CLR 417 at 429; 89 ATC 4101 at 4107; (1989) 20 ATR 1 at 7.

32. Goods held by a trader for sale or exchange in the ordinary course of his or her trade are therefore within the ordinary meaning of the term 'trading stock'. It is clear from what the High Court said in

the *Suttons Motors* case, however, that the ordinary meaning of that term extends beyond the traditional (and narrower) denotation referred to in that case.

33. A thing is trading stock for income tax purposes if it is within the meaning of the term without the aid of the definition; that is, it is 'trading stock' in the ordinary sense of the term. The definition of 'trading stock' in subsection 6(1) does not restrict the ordinary meaning of the term 'trading stock'.

34. *The Macquarie Dictionary* defines 'trading stock' to mean 'stock not held for permanent investment'. The word 'stock' means the aggregate of goods which a trader has on hand as a provision for the possible future requirements of customers: see *The Shorter Oxford English Dictionary*, vol II, at 2133. The word 'trade' is commonly used 'to denote operations of a commercial character by which [a] trader provides to customers for reward some kind of goods or services' (see *Ransom (Inspector of Taxes) v. Higgs* [1974] 3 All ER 949 per Lord Reid at 956 and *Kowloon Stock Exchange Ltd v. Inland Revenue Commissioner* [1985] 1 All ER 205 at 210).

35. In some respects we consider that dictionary definitions of 'stock' are too broad to apply to the expression 'trading stock' in its context in subsection 6(1). We take the view that the ordinary meaning of 'trading stock' encompasses the aggregate of packaging items which a taxpayer has on hand if:

(a) the taxpayer is in business trading in 'core' goods; and

(b) (i) the packaging items are sold by the taxpayer with the 'core' goods in one transaction for one inclusive price; or

(ii) the items are disposed of by the taxpayer in association with the sale of the 'core' goods - whether the items are supplied to customers before, at the time of, or after the point of sale of the 'core' goods.

Extended statutory meaning of 'trading stock'

36. The definition of the term 'trading stock' in subsection 6(1) extends the scope of the term in its ordinary sense.

37. The definition operates 'cumulatively upon the ordinary meaning' of trading stock and confers 'added meaning for the purposes of the Act': *FC of T v. St Hubert's Island Pty Ltd* (1978) 138 CLR 210; 78 ATC 4104; (1978) 8 ATR 452 per Stephen J at 138 CLR 216; 78 ATC 4106-7; 8 ATR 454-455 and see, to the same effect, Mason J at 138 CLR 229; 78 ATC 4113-4; 8 ATR 463 and Jacobs J at 138 CLR 235; 78 ATC 4117; 8 ATR 467.

Packaging items for purposes of sale

Packaging items held by a taxpayer trading in these items

38. Goods obtained by a taxpayer who is or will be trading in these goods and who obtains the goods in carrying on business for purposes of sale are 'trading stock' as defined in subsection 6(1). They come within either the ordinary meaning of the term or the extended definition in the subsection.

39. Therefore, packaging items held by a taxpayer who is or will be trading in these items and who, in carrying on a business, obtains the items for sale are, in our view, 'trading stock' as defined in subsection 6(1).

Packaging items held by a taxpayer trading in goods other than these items

40. We take the view that the packaging items described in paragraph 12 of this Ruling are within either the ordinary meaning of the term 'trading stock' or the extended statutory meaning of the term.

41. In reaching this conclusion, we are guided by the decision of Taxation Board of Review No 1 in *Case 115* (1951) 1 TBRD (NS) 485; *Case 120* (1951) 1 CTBR (NS) 568.

Taxation Board of Review Case 115; Case 120

42. In that case, a company engaged in business as a manufacturing chemist sold its finished products in various types of containers. Many of these products were placed in further wrappings and then placed for bulk sales in larger packages. The containers, wrappings and packages were, in general, labelled or printed to indicate the nature of the product and the identity of the maker. At 30 June 1944 a large quantity of these items was on hand. The company did not include any of these items as trading stock. The Commissioner treated them as trading stock, valued them at cost and assessed accordingly.

43. At the hearing, and after the conclusion of the evidence, the company admitted that labels, containers, wrappers and packing materials were properly included by the Commissioner as trading stock. The dispute in the case was, therefore, narrowed to certain cleaning agents, consumable aids to manufacture, goods purchased or produced for sale (both saleable and unsaleable), raw materials (in both good and spoilt condition), packing material and obsolete spools.

44. Mr R R Gibson, Chairman, stated in his reasons for decision that the company was well advised in making this admission. He said (1 TBRD at 490; 1 CTBR at 571):

> 'The labels, containers and packing materials are purchased by the company and become parts of goods which are sold by the company in the ordinary course of its trade. The entity which is sold consists of a combination of such goods (or some of them) and one of the company's finished products, and none of these things loses its physical identity in consequence of the operations of combination. Thus it can be said that the sale of the entity is the sale of the several physically identifiable things (because the property in each of them passes to the purchaser) of which it is a combination. In a sense, therefore, the labels, containers and packing materials are goods bought and sold by the company in the ordinary course of its trade, but if, because of the fact that they are not sold as separate articles, they are not trading stock within the ordinary meaning of the term they are certainly purchased by the company "for the purposes of sale" and are therefore trading stock within the meaning of the Act.'

45. Mr Gibson later added (1 TBRD at 491-492; 1 CTBR at 572-573):

> 'The conclusion I have come to is that **the main legislative purpose of the definition of trading stock ... is to ensure, beyond the possibility of any question, that goods which are not sold, or not separately sold, by a manufacturer or other trader (and might therefore not be trading stock as the term is ordinarily understood) but which (whether raw materials or not) become parts or constituents of the goods which he does sell, shall be treated as trading stock for the purposes of the Act**.
>
> Such a view would give a sensible meaning to, and place a sensible limit on the application of, the very wide meaning of the definition. It would mean, in short, that within the meaning of the definition, goods are not "purchased for purposes of sale" unless they are purchased for the purpose of being sold, either separately or as parts or constituents of the combined entity which is to be sold, and that goods are not "purchased for purposes of manufacture" unless they are purchased for the purpose of being manufactured into other goods.' (emphasis added)

46. And later (1 TBRD at 497; 1 CTBR at 579), Mr Gibson provided the following example:

> 'An illustration of what I call a "combined entity" would be - to take one line of goods marketed by the company - "a tin of baby powder" which consists of a tin container with an adjustable sprinkler top and the baby powder with which it is filled.'

47. Mr Gibson similarly took the view that such materials as wrapping paper and string which are used by a retailer to make parcels of the goods he or she sells are trading stock. According to Mr Gibson, these materials form part, although only an incidental part, of the goods the property in which passes to the purchaser. For that reason, Mr Gibson regarded the materials as 'purchased for purposes of sale' and therefore as trading stock within the meaning of the definition.

48. For the reasons expressed by Mr Gibson, we take the view that packaging items described in paragraph 12 of this Ruling are 'trading stock' within the ordinary meaning of 'trading stock' or the extended meaning in subsection 6(1). The items in some cases 'become parts or constituents' of 'core' goods sold by a taxpayer who is in business trading in 'core' goods in the course of that business. The items may either physically become 'parts or constituents' of the 'core' goods sold or become 'parts or constituents' of the sale of the 'core' goods in the sense that the items are supplied under the contract of sale of the 'core' goods or supplied in furthering the contract of sale. In other cases, the items are sold separately from the 'core' goods in the course of a 'sale of the several physically identifiable things (because the property in each of them passes to the purchaser) of which it is a combination'. That is, there is a sale of both articles ('core' goods and packaging item) in one transaction for one inclusive price. In yet other cases, the items, if not sold as separate articles, are obtained 'for purposes of sale'.

49. We also agree with Mr Gibson's view that wrapping paper and string are trading stock.

50. It makes sense to adopt the interpretation outlined above because:

(a) it results in a correct reflex of income for the packaging items; and

(b) packaging items obtained for purposes of sale are analogous with goods obtained for purposes of manufacture; and

(c) packaging items described in paragraph 12 of this Ruling have a similarity with the accounting concept of inventories.

Correct reflex of income

51. We consider that the proper tax accounting procedure for the packaging items described in paragraph 12 of this Ruling, in the sense of being the method 'calculated to give a substantially correct reflex of the taxpayer's true income' (in the language of Sir Owen Dixon in *Commissioner of Taxes (SA) v. Executor Trustee and Agency Co of SA Ltd* (1938) 63 CLR 108 at 154 (*Carden's* case), is to take the value of those packaging items into account at the end of an accounting period.

52. It is a well settled tax accounting practice to recognise raw materials and partly manufactured goods as trading stock. This practice enables the value of raw materials and partly manufactured goods to be included in the value of trading stock at the beginning and end of an accounting period. This leads to the making of a more accurate calculation of the profit earned or the loss sustained by a trader in that period.

53. Equally, an accurate calculation of profit or loss cannot be made unless the value of packaging items on hand at the beginning and end of an accounting period are taken into account.

Analogy with goods obtained for purposes of manufacture

54. We consider that the packaging items described in paragraph 12 of this Ruling are obtained for purposes of sale and are analogous with goods obtained for purposes of manufacture. Just as goods obtained for purposes of manufacture (for example, raw materials) are trading stock even though the taxpayer is not engaged in trade in those goods, packaging items described in paragraph 12 of this Ruling obtained for purposes of sale are trading stock even though the taxpayer is not engaged in trade in those goods.

55. In addition to raw materials (e.g., sugar) that a manufacturer might buy to process in order to sell a finished product (e.g., confectionery), a manufacturer might buy and have on hand goods (e.g., catalysts) which he or she consumes in the course of manufacture. These goods, as 'a reflection of commercial usage arising from the development of accounting principles over a long period of time' (see *FC of T v. St Hubert's Island Pty Ltd* where Mason J, 138 CLR at 226; 78 ATC at 4112; 8 ATR at 461 quoted with approval a passage from *Whiteman and Wheatcroft on Income Tax*, 2nd ed (1976)), are regarded as part of the manufacturer's trading stock. The example there involved a manufacturer that had on hand coal which it consumed in the course of manufacture.

56. Jacobs J in the *St Hubert's Island* case (138 CLR at 235; 78 ATC at 4117; 8 ATR at 466) similarly regarded as trading stock

'property ... which is intended to be worked on or even used up in a process of manufacture'.

57. Just as goods, such as the coal, may be obtained by a taxpayer 'for purposes of manufacture' (if it is to be 'consumed in the course of manufacture' or 'used up in a process of manufacture') even though the taxpayer is not nor will be engaged in trade in those goods, we take the view that a taxpayer may obtain the packaging items in paragraph 12 of this Ruling for purposes of sale even though the taxpayer is not nor will be engaged in trade in those items.

Comparison between packaging items and inventories

58. In commercial parlance, the terms 'trading stock' and 'inventory' are commonly used interchangeably.

59. The definition of 'inventories' in Australian Accounting Standard AAS2 covers goods and property:

- held for sale in the ordinary course of operations;
- in the process of production for such sale; and
- to be used up in the production of goods, other property or services for sale, including consumable stores and supplies.

60. The definition is wide enough, in our view, to encompass the packaging items described in paragraph 12 of this Ruling. Most items fit the description 'goods, property and services ... to be used up in the production of goods, other property or services for sale'.

Alternative views

61. One alternative view that has been suggested is that packaging items should only be treated as trading stock if the item attaches to, and is incorporated as part of, 'core' goods held for resale.

62. Under this alternative view, packaging items (which are not incorporated into the 'core' goods) which a manufacturer uses to deliver 'core' goods to the recipient are not trading stock. For example, cardboard boxes for cans of fruit or packets of biscuits, it is contended, are not trading stock. On this view, the packaging items are used for marketing or distributing the 'core' goods. Their cost, it is claimed, is a marketing or distribution expense.

63. We take the view that there should be no difference, in principle, between the tax treatment of packaging items that attach directly to 'core' goods (e.g., tins and jars) and those items that do not attach directly (e.g., cardboard boxes). Nor is any such difference justifiable

in interpreting the words of the statutory definition. The cardboard boxes are nonetheless for use to pack or secure the finished goods, for example, cans of fruit or packets of biscuits, for their sale. The boxes are disposed of by the manufacturer in association with the sale of the fruit or biscuits and are supplied to wholesalers or retailers at the time of sale. The physically identifiable things (the box and the contents) are what is sold. In any event, the boxes are acquired 'for purposes of sale' (like the containers and packing materials in *Case 115*; *Case 120*).

64. Another alternative view that has been expressed is that, if a taxpayer is in business trading in 'core' goods, a sufficient connection would only exist between the packaging items and the sale of the 'core' goods - to regard the items as being obtained for the purposes of sale - if the items:

(a) bring the 'core' goods into the form, state or condition in which they are intended to be sold; and

(b) are disposed of (that is, property in them passes) to the customer.

65. Under this alternative view, packaging items such as supermarket and department store plastic carry bags provided to customers at cash registers and accessories such as serviettes, drinking straws and plastic cutlery provided by food outlets would not bring 'core' goods into the form, state or condition in which they are intended to be sold and would be regarded as marketing or distribution expenses.

66. We consider that the more appropriate view is that the plastic carry bags and accessories are disposed of by the taxpayer in association with the sale of the 'core' goods. These items are, therefore, obtained 'for purposes of sale' of the 'core' goods.

67. If we were to take the more limited approach that packaging items are only trading stock of a taxpayer trading in 'core' goods if the items bring the goods into the form, state or condition in which the goods are intended to be sold, fine distinctions would inevitably need to be drawn between different types or uses of packaging items. For example, brown paper bags that a general store proprietor uses to place loose fruit in for sale would be trading stock because they bring the fruit into the form, state or condition in which it is sold. But the same bags used by the proprietor to hold five pre-packaged ice creams after the point of sale would not be trading stock. On the view we take in this Ruling, the bags in both instances are trading stock.

68. There is no Australian court decision directly on the above issues. The justices of the High Court in the cases of *Suttons Motors*, *St Hubert's Island* and *John* did not have before them (and, therefore,

presumably did not apply their minds to) the question whether it suffices for things such as packaging items to be 'trading stock' if the taxpayer is in business trading in 'core' goods and the items are obtained for purposes of sale of the 'core' goods that are traded. Litigation on the issues would help clarify the matter.

Packaging items for purposes of manufacture

69. Raw materials obtained for purposes of manufacture are 'trading stock' within the definition of that term in subsection 6(1): *St Hubert's Island* case per Mason J, 138 CLR at 227-228; 78 ATC at 4112-4113; 8 ATR at 462; *Suttons Motors* case, 157 CLR at 281-282; 85 ATC at 4400; 16 ATR at 570-571.

70. Raw materials are obtained by a taxpayer carrying on business as a manufacturer to incorporate the materials into final products in the course of the process of manufacture producing the manufacturer's final products.

71. Similarly, some packaging items are obtained by a taxpayer carrying on business as a manufacturer to incorporate the items into final products in the course of the process of manufacture producing the manufacturer's final products. For example, a manufacturer of baby powder, lemonade or baked beans purchases tins, bottles or cans respectively in which to incorporate the manufacturer's final product, namely, tins of baby powder, bottles of lemonade or cans of baked beans. The packaging item in these cases is indispensable to the sale of the baby powder, etc., because the powder, etc., must be placed in some form of container for its sale and use.

72. When a manufacturer's final products emerge at the end of the production line, they ordinarily emerge in a form, state or condition in which they are intended for sale.

73. We consider that these packaging items are obtained for purposes of manufacture if they are obtained by a taxpayer carrying on business as a manufacturer to incorporate the items into other goods. These items are therefore 'trading stock' as defined in subsection 6(1).

Overall effect

74. The overall effect of the operation of subsection 51(1), subsection 51(2) and section 28 is to defer an allowable deduction for the cost of packaging items (together with other trading stock) to the year of income in which they are realised and any proceeds of sale are derived as income. The provisions of section 36 also apply, in the case of the sale of a business of a taxpayer, in relation to the stock of packaging items on hand.

75. If packaging items are not 'trading stock' as defined in subsection 6(1), the provisions of section 28 would not apply. An allowable deduction for their cost would be available earlier, namely, when that cost is incurred in terms of subsection 51(1).

Examples

Example 1

76. Sue P Marquet carries on a retail grocery business. Ms Marquet provides her customers at the cash register, in the normal course of business, with plastic bags to hold packaged groceries. Those bags are trading stock of Ms Marquet.

Example 2

77. Tay Ke Way operates a fast food outlet. Tay provides, with the take-away food which she sells in plastic containers with lids, some disposable cutlery, a paper serviette and a refresher towel. The plastic containers and lids are trading stock of the outlet. The disposable cutlery, paper serviette and refresher towel are trading stock.

Example 3

78. Lighthead Ltd carries on a brewery business. Lighthead's beer emerges from the production line in cans secured in six-packs bound in plastic binding and packed in cardboard cartons of 24 cans. The cartons of beer are stored in this form for sales to Lighthead's customers. The cans, plastic binding and cartons are acquired by Lighthead for use in the course of the beer manufacturing process. These items are acquired for purposes of either manufacture or sale and are 'trading stock' of the brewery.

79. If it is Lighthead's normal business practice to deliver cartons of beer to retail outlets on shrink-wrapped, non-returnable pallets, the pallets and shrink-wrap plastic are trading stock.

Example 4

80. Sandra Collie, a fruit and vegetable producer, uses cardboard cartons, labels and packing materials to pack or secure her produce for sale to wholesalers and retail stores. Ownership of these items passes to the wholesalers and store proprietors with the produce on their sale. The items are trading stock.

Example 5

81. Grand Mammoth Ltd operates a series of department stores, variety stores, distribution centres, restaurants and food outlets. It purchases a wide range of different bags, wrapping paper, sticky tape, string, foam and plastic trays, labels and stickers to pack, wrap up or secure goods that the company sells or to supply with the goods it sells in the ordinary course of its trade. Property in these packaging items passes on the sale of the goods traded by the company. They are trading stock.

Miscellaneous examples of packaging items that are 'trading stock'

82. Below are examples of packaging items which are considered to be 'trading stock':

- Packages or boxes in which shirts or other clothing items are intended to be sold.
- Plastic bags and hangers used at the time clothing items are sold to secure those items for delivery to the customer.
- Padded boxes in which jewellery is intended to be sold.
- Plastic bags in the roll for taxpayers or customers to select and secure fruit and vegetables for their sale.
- White paper and polystyrene trays used by a seafood store proprietor to wrap up or secure fish and chips for sale.
- Cardboard boxes and foam in which electrical or electronic appliances, e.g., television sets or computers, are secured for sale.
- Tins, bottles, jars, packets, sachets and plastic bags in which foodstuffs and other goods are intended to be sold, e.g., tins of powder, cans for canned drink, packets of cereals, bags for olives, loose peanuts or loose confectionery and bottles or cartons of milk.
- Dispensers in which goods are intended to be sold, e.g., tubes for toothpaste, aerosols for insecticide, liquid soap dispensers and cosmetic sprays and dispensers.
- Trays and shrink-wrap plastic for use to pre-pack meat, fruit, vegetables, etc., for sale.
- Plastic sheaths placed around magazines for their display and sale.
- If a retail delicatessen store proprietor places food items in either greaseproof paper or a plastic bag and then further

wraps the food item in white paper, binding the paper with sticky tape, and places an adhesive price label or tag on the paper, the plastic bag, greaseproof paper, wrapping paper, sticky tape, label and tag are trading stock.

- Drinking straws affixed to fruit juice boxes.
- If a take-away chicken store proprietor places hot chicken pieces in a cardboard box with greaseproof paper inserted loosely in the box as a liner, along with a serviette, plastic knife and fork and a refresher towel, the cardboard box and the paper liner are trading stock. So, too, the serviette, plastic knife and fork, and the refresher towel are trading stock.
- Supermarket and department store carry bags provided to customers at cash registers to assist them to carry goods after their purchase.
- Serviettes, drinking straws, plastic cutlery, etc., placed in dispensers or other receptacles for use by customers with food items they purchase.
- Bags, wrapping paper, sticky tape and string which are used to further pack or wrap up goods that, at the time the goods are sold, are already packed, wrapped up or secured for delivery to the customer, e.g., Christmas wrapping paper.

(Note: all these examples have the common feature that the packaging item is disposed of in association with the sale of the 'core' goods - as paragraph 12 of this Ruling requires).

Your comments

83. If you wish to comment on this Draft Ruling, please send your comments by: 28 February 1997

to:

Contact Officer: Grant Murphy

Telephone: (07) 3213 5143

Facsimile: (07) 3213 6300

Address: Mr Grant Murphy
Large Business Income
Australian Taxation Office
PO Box 9990
BRISBANE QLD 4001.

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- Investment and Merchant Finance Corp Ltd v. FC of T (1971) 125 CLR 249
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