


IT 2150 - Income tax : trading stock - seed cotton subject to ginning contracts

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TAXATION RULING NO. IT 2150

INCOME TAX : TRADING STOCK - SEED COTTON SUBJECT TO
GINNING CONTRACTS

F.O.I. EMBARGO: May be released

REF H.O. REF: 84/413-6 DATE OF EFFECT: IMMEDIATE

B.O. REF: DATE ORIG. MEMO ISSUED: -

F.O.I. INDEX DETAIL

REFERENCE NO: SUBJECT REFS: LEGISLAT. REFS:

I 1174832	TRADING STOCK	28
	: SEED COTTON SUBJECT TO	
	GINNING CONTRACTS	
	: COTTON SEED	
	: RAW COTTON	

PREAMBLE A ruling has been sought in relation to whether harvested cotton the subject of a ginning contract is trading stock on hand of the grower at the end of the year of income.

FACTS 2. Harvesting of seed cotton commences in April and ends in mid July. Harvested seed cotton is delivered from time to time to a processor under the terms of a ginning contract (ginning being the term used for the processing of seed cotton). As the seed cotton is harvested it is usually compressed into modules ready for transport from the farm to the cotton gin.

3. Each grower enters into a ginning contract with the processor. Ginning involves the separation of seed cotton into cottonseed and raw cotton and the cleaning and baling of the raw cotton. The cottonseed is pooled and sold to seed oil producers. The raw cotton is baled and sold. Growers participate in the proceeds of the sale of both the raw cotton and the cottonseed on a pool basis.

4. When the seed cotton is ginned and the raw cotton baled a bale number is allocated to the bale which is then matched with the name of the grower. These bales are then removed to warehouses owned by third parties. The bales are sold by the processor within the terms of the ginning contract. Although the bales of raw cotton can still be identified by their numbered tags as the cotton of a particular grower, because of the pooling system applied in respect of the sale of cotton the grower participates in the distribution of the proceeds of the pool rather than the proceeds of sale of his specific bales of raw cotton.

5. Essential features of the ginning contract are:-

(a) property (but not possession) in the seed cotton

remains with the grower until (at least) the seed cotton has been processed or the bailment otherwise terminated;

- (b) bales of raw cotton and cottonseed produced from the seed cotton are to be pooled with other raw cotton and cottonseed according to grade but the processor holds as bailee only the raw cotton and cottonseed in the pools for the growers;
- (c) the processor determines each grower's interest in a pool in accordance with the terms of the ginning contract;
- (d) the processor is authorised to sell and deliver the raw cotton and the cottonseed produced to third parties on terms and conditions determined by the processor;
- (e) the processor has a general lien on the seed cotton, raw cotton and cottonseed produced therefrom in its possession in respect of all moneys owing to the processor by the grower;
- (f) the processor makes a ginning charge in accordance with the contract; and
- (g) the processor may be authorised to enter into futures contracts and currency hedging contracts for the benefit of the grower.

6. A grower may enter into one of two further contracts described respectively as a "Module Purchase Contract" and a "Bale Purchase Contract".

7. Under the Module Purchase Contract the processor agrees to purchase the modules of seed cotton for a consideration equal to amounts which the grower would have been entitled to if the grower had participated in the raw cotton and cottonseed pools. An "advance payment" of \$1 per module is payable within 21 days of the date of the contract.

8. The Bale Purchase Contract applies to bales of raw cotton processed by the processor and in its possession. The agreement also provides for an "advance payment" of \$1 for each bale.

9. Both contracts also provide for further "advance payments" to the grower in accordance with the contract. Such advance payments are based on a discounted purchase price.

RULING

10. Modules of seed cotton on hand at the grower's premises or in transit from the grower to the processor as at 30 June are property of the grower. Where the grower has entered into a Module Purchase Contract on or before 30 June such modules of seed cotton are goods sold to the processor and therefore trading stock of the processor. Bales of raw cotton processed

from the modules of seed cotton sold to the processor of course remain the property of the processor.

11. Modules of seed cotton on hand at the processor's premises and which are not subject to a Module Purchase Contract or any other contract specifically providing for transfer of ownership of the seed cotton to the processor are not within the terms of the decision of the High Court in *Farnsworth v. F.C. of T.*, (1949) 78 CLR 504, 4 AITR 258, 9 ATD 33, being readily identifiable as the property of the grower. Similarly, bales of raw cotton processed from such modules are also identifiable to a particular grower and remain trading stock of the grower as at 30 June. The exception is where the bales became the subject of a Bale Purchase Contract entered into on or before 30 June in which case the bales of raw cotton will be goods sold to the processor and therefore trading stock of the processor.

12. Cottonseed extracted from seed cotton which is the property of a grower remains the property of the grower but will be accepted as coming within the terms of *Farnsworth's Case*. This means that it will be accepted that cottonseed extracted from a grower's seed cotton prior to 30 June and subject to the pooling arrangements will not be trading stock on hand of the grower for the purposes of section 28 of the Act. Neither is it trading stock of the processor.

13. So far as the processor is concerned the cost price of modules of seed cotton which form part of its trading stock at 30 June and which were purchased from growers under a Module Purchase Contract shall be \$1 per module. The cost price of a bale of raw cotton purchased by the processor from the grower under a Bale Purchase Contract and forming part of the processor's trading stock at 30 June is the amount payable to the grower under the Contract. The cost price of the bales of raw cotton produced from seed cotton from a module which is subject to a Module Purchase Contract is also the amount payable to the grower under the Contract. In the two latter cases, the amount actually paid to the grower will be accepted as the cost price.

14. This ruling does not apply to raw cotton and cottonseed sold from the pool prior to 30 June. Clearly such goods are no longer trading stock on hand of either the grower or the processor and the proceeds of sale are to be brought to account in the ordinary way.

COMMISSIONER OF TAXATION
10 April 1985

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