

# ***TR 93/D16 - Income tax: whether containers, labels, packing materials, binding materials and accessories are trading stock***

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## Draft Taxation Ruling

### Income tax: whether containers, labels, packing materials, binding materials and accessories are trading stock

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TD 92/156

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## What this Ruling is about

1. This Ruling considers whether stocks of items such as containers, labels, packing materials, binding materials and accessories (referred to in this Ruling as 'materials') held in the course of business are 'trading stock' as defined in subsection 6(1) of the *Income Tax Assessment Act 1936*.
2. It applies to all taxpayers who derive income from the sale of goods whether the goods are manufactured, produced or resold. The goods sold may be contained in, or by the materials, or both. For example, a carton of stubbies of beer is normally comprised of four lots of six stubbies bound together by plastic shrink wrap and placed inside a cardboard carton.
3. It does not deal with the alternative methods of valuation of trading stock. It also does not deal with returnable containers as these are not considered to be trading stock.
4. Key terms in this Ruling are explained in paragraph 7.

## Ruling

5. Materials are 'trading stock' as defined in subsection 6(1) if either of the following conditions are met:

- (a) The materials form part of the product produced, manufactured, sold or exchanged; or

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- (b) The materials are held for purposes of sale, or to be provided to the customer as an incidental part of the goods sold in the course of business; and

in either case, ownership of the materials transfers to the purchaser.

## Date of effect

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6. This Ruling applies 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).

## Explanation of keywords

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7. The following items of materials are examples only. The list is illustrative only and is not meant to be exhaustive:

Containers	includes cartons, bags, jars, bottles, plastic wrap
Labels	includes tags, tokens, stickers
Packing materials	includes cotton wool, tissue paper, shredded paper, polystyrene beads, bubble plastic
Binding materials	includes paper, string, tape, shrink wrap, staples, glue
Accessories	includes serviettes, cutlery, refresher towels, straws

## Explanations

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### Statutory meaning

8. Trading stock is defined in subsection 6(1) as follows:

**"trading stock"** includes anything produced, manufactured, acquired or purchased for purposes of manufacture, sale or exchange, and also includes livestock.'

It should be noted that the definition uses the word 'includes'.

9. The *Income Tax Assessment Act 1922*, which preceded the current legislation, also defined the term trading stock. It stated:

**"trading stock"** means anything produced, manufactured, acquired or purchased for purposes of manufacture, sale or exchange.'

It is significant that this definition used the word 'means' instead of the word 'includes'.

10. This suggests that the intention of the Legislature was to have a wider meaning of the term 'trading stock' than that previously used by substituting the word 'includes' for the word 'means' in the legislation.

11. For the purposes of statutory interpretation, the effect of using 'includes' is that the word or words defined have their ordinary meaning in addition to the matters specified in the definition. This is so even if the matters specified come within the ordinary meaning of the words being defined. That is, the defined word or words would include anything which falls within the ordinary meaning of the term and include anything else which would be covered by the words of the definition. (*Cohns Industries Pty Ltd v. Deputy Federal Commissioner of Taxation* (1979) 24 ALR 658)

12. On the other hand, if the word 'means' is used, the definition is generally meant to be an exhaustive statement of what is encompassed by the defined word or words. (*Cohns Industries Pty Ltd v. Deputy Federal Commissioner of Taxation* above)

13. Accordingly we consider that the definition of trading stock is not an exhaustive or exclusive statement of its meaning, but extensive or expansive of the ordinary meaning of the term.

14. Support for this view can be obtained from the High Court of Australia in *FC of T v. St Hubert's Island Pty Ltd* (1978) 138 CLR 210; 78 ATC 4104; 8 ATR 452 where Stephen J. stated at 216 (CLR); 4106 (ATC); 454 (ATR):

'An examination of s 6(1) suggests that care has been taken to use "includes" where it is not intended to substitute a statutory meaning for the ordinary meaning of words but, rather, to confer some meaning additional to the ordinary meaning'.

### **Ordinary commercial usage**

15. In considering the ordinary meaning of the term trading stock, accounting concepts and principles, and also the commercially accepted usage of the expression, are relevant (*FC of T v. Suttons Motors (Chullora) Wholesale Pty Ltd* (1985) 157 CLR 277; 85 ATC 4398; 16 ATR 567).

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16. In commercial parlance trading stock is commonly known as inventory. 'Inventories' is defined in Australian Accounting Standard AAS2 as:

"Inventories" means goods, property and services:

- (1) held for sale in the ordinary course of business, or
- (2) in the process of production for such sale, or
- (3) to be used up in the production of goods, other property or services for sale, including consumable stores and supplies, but is not to be read as a reference to depreciable assets as defined in Statement AAS4, '*Depreciation of Non-Current Assets*.'

17. This definition is as least as wide as the definition of 'trading stock' in subsection 6(1) of the Income Tax Assessment Act.

18. In our view there also has developed a common understanding of the expression trading stock to mean goods which are held by a trader or manufacturer for sale in the course of business in the condition, or near condition that they had when they were purchased or otherwise acquired.

19. However, this generally accepted understanding is considered to be too narrow. An example of how the statutory definition is wider than the commercial understanding is the treatment of raw materials.

20. Raw materials are not sold by manufacturers in their original condition. They are however sold by the manufacturer as an integral part of the product manufactured. They therefore are clearly 'purchased for purposes of manufacture' and are trading stock within the income tax definition of that term.

21. Support for this view can be had from the comments of Jacobs J., in his judgment in *St Hubert's Island Pty Ltd* above, where he stated at 235 (CLR); 4117 (ATC); 466 and 467 (ATR):

'The purpose of the definition is to ensure that not only that which is in a condition ready for sale but also that property (at any rate movable property) which is intended to be worked on or even used up in a process of manufacture will fall within the meaning of the words "trading stock" in the Act, as well as the things produced or manufactured and things acquired or purchased for purposes of sale and exchange.'

## **Materials (the subject of this Ruling)**

22. Materials also form a part of the product sold, even though they may only be an incidental part.

23. This matter was considered by Mr RR Gibson, Chairman of the Board of Review No 1, in *Case 115*, (1951) 1 TBRD (NS) 485; Case 120 1 CTBR (NS) 568, where he stated at 491 and 492:

'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 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... 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.'

24. Mr Gibson used as an example such items as wrapping paper and string when he stated at 491:

...I mention ... such materials as wrapping paper and string which are used by (say) a retailer to make parcels of the goods he sells. I doubt whether they would be regarded, commercially, as trading stock, but they nevertheless form part, although only an incidental part, of the goods the property in which passes to the purchaser and for that reason must be regarded as goods "purchased for purposes of sale" and therefore as trading stock within the meaning of the definition.'

25. In our view the same principle would apply to materials as that term is used in this Ruling. Accordingly, the overall effects of subsection 51(1), subsection 51(2) and section 28 are to allow a deduction for those materials together with other trading stock, on a usage basis. The provisions of section 36 would also apply, in the case of the sale of a business of a taxpayer, in relation to the stock of materials on hand.

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## Examples

26. Sue P. Marquet carries on a grocery business. Ms Marquet provides , in the normal course of business, plastic bags to hold fruit

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or vegetables or to carry the purchases of her customers. Those bags would be considered to be trading stock of Ms Marquet.

27. Tay Ke Way operates a fast food outlet. Tay provides with the food sold, some disposable cutlery, a paper serviette and refresher towel. Those items provided with the take-away food would be trading stock of the outlet.

28. Lighthead Ltd carries on a brewery business. The cardboard or plastic binding used in the marketing and distribution of Lighthead's beer would be trading stock of the company.

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## Commissioner of Taxation

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ATO references

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*legislative references*

- ITAA 6(1)
- ITAA 28
- ITAA 36
- ITAA 51(1)
- ITAA 51(2)

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- FC of T v. St Hubert's Island Pty Ltd (1978) 138 CLR 210; 78 ATC 4104; 8 ATR 452
- Cohns Industries Pty Ltd (1979) 24 ALR 658
- Suttons Motors (Chullora) Wholesale Pty Ltd (1985) 157 CLR 277; 85 ATC 4398; 16 ATR 567
- Case 115 (1951) 1 TBRD (NS) 485; Case 120 1 CTBR (NS) 568

*subject references*

- accessories
- binding materials
- containers
- labels
- materials
- raw materials
- trading stock