

# ***TR 96/D20 - Income tax: whether materials, spare parts and packaging items held by a taxpayer supplying services are trading stock***

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This document has been finalised by TR 98/8.



## Draft Taxation Ruling

# Income tax: whether materials, spare parts and packaging items held by a taxpayer supplying services are trading stock

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### other Rulings on this topic

IT 333; TR 93/20;  
TR 96/D19

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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.*

## What this Ruling is about

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### Class of person/arrangement

1. This Ruling explains the circumstances in which materials, spare parts and packaging items held by persons carrying on a business providing services for reward (for example, a builder, tradesperson, repairer or other service provider) are 'trading stock' as defined in subsection 6(1) of the *Income Tax Assessment Act 1936* ('the Act').
2. The term 'packaging items' as used in this Ruling is explained at paragraphs 14 to 16.
3. The Ruling does not deal with the alternative methods of valuing materials, spare parts and packaging items that are trading stock. However, in respect of packaging items, mention is made of the decision in *Case 115* (1951) 1 TBRD (NS) 485: *Case 120* (1951) 1 CTBR (NS) 568 that, on the facts of the case, the market selling value for packaging items that were trading stock, was not less than their cost price.
4. The Ruling also does not deal with packaging items held by a taxpayer engaged in business and held for purposes of sale or manufacture. This is covered in draft Taxation Ruling TR 96/D19.

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## Ruling

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### Materials and spare parts

5. We take the view that materials and spare parts held by a taxpayer who 'produces, manufactures, acquires or purchases' (referred to in this Ruling for brevity as 'obtains') them for supply to customers are 'trading stock' as defined in subsection 6(1) of the Act if:

- (a) the taxpayer is carrying on a business providing services to customers for reward; and
- (b) the materials or spare parts are supplied by the taxpayer to the customer in association with the services in the sense that they are supplied in the course of, and as an essential part of, performing the services; and
- (c) the materials or spare parts are separately identifiable things which retain their individual character or nature, that is, they are not used up or changed in performing the services; and
- (d) the materials or spare parts are to be disposed of, that is, property in them is to pass to the customer.

### Packaging items

6. If a taxpayer holds a stock of packaging items, the items are 'trading stock' as defined in subsection 6(1) if:

- (a) the taxpayer is carrying on a business providing services to customers for reward; and
- (b) the packaging items are supplied by the taxpayer to the customer in association with the services in the sense that they are supplied in the course of, and as an essential part, of performing the services; and
- (c) the packaging items are to be disposed of, that is, property in them is to pass to the customer.

## Date of effect

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

8. 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).

9. In the earliest year of income to which a taxpayer applies the Ruling ('the first year of income'), the value of materials, spare parts and 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.

10. The value to be taken into account under section 28 in relation to materials, spare parts and 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 materials, spare parts and 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.

11. Accordingly, if no value for materials, spare parts and 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 materials, spare parts and packaging items in the first year of income will be nil.

12. 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 materials, spare parts and 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.

13. 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**

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14. 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 |
|--------------|---|

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|                     |   |
|---------------------|---|
|                     | wrap and bags in which goods are packed or including outer containers of other containers.                  |
| '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.   |

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

16. The packaging items referred to in this Ruling:

- pack, wrap up or secure goods in performing a service for reward; or
- may be sold or disposed of with goods under the contract of services; or
- their cost may be the subject of a separate charge; or
- their cost may be recovered in the charge made for the services or in the prices for which goods are sold;

and the property in them passes to the customer provided the services.

## Explanations

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### Materials and spare parts

17. Materials and spare parts held by a taxpayer who obtains them for supply to customers are 'trading stock' within the ordinary meaning of the term if:

- (a) the taxpayer is carrying on a business providing services to customers for reward, for example, as a builder, tradesperson, repairer or other service provider; and
- (b) the materials or spare parts are supplied by the taxpayer to the customer in association with the services in the sense that they are supplied in the course, and as an essential part, of performing the services; and
- (c) the materials or spare parts are separately identifiable things which retain their individual character or nature,

that is, they are not used up or changed in performing the services; and

- (d) the materials or spare parts are to be disposed of; that is, property in them is to pass to the customer.

18. The expression 'retain their individual character or nature' in subparagraph 17(c) means that the form, state or condition of the materials or spare parts when disposed of to the customer is the same as that when the materials or spare parts are held by the service provider.

19. For example, building materials supplied by a builder in the course of contracts for building, extending or renovating premises retain their character or nature and are an essential part of the services. So, too, materials and spare parts supplied by an electrician or plumber in providing their services. These things are 'trading stock'.

20. Materials or spare parts that are supplied by a taxpayer to customers, but only as a minor and incidental aspect of providing services to the customer, are not 'trading stock'. For example, amalgams supplied by a dentist incidentally in providing dental treatment are not 'trading stock'.

21. Paint held by an artist or by a house painter is not 'trading stock'. On providing the service (that is, doing a painting or painting a house), the paint is no longer in the same form, state or condition that it was in when it was held by the artist or house painter. Similarly, solder used by an appliance repairer in repairing circuits or other parts in appliances is not 'trading stock' because the solder in the repaired appliance is no longer in the same form, state or condition that it was in when it was held by the repairer.

22. If materials or spare parts are within the ordinary meaning of 'trading stock', they are 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

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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.'

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

24. 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.

25. Materials or spare parts are trading stock for income tax purposes if they are 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'.

26. *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).

27. In some respects we consider that the 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 materials or spare parts which a taxpayer has on hand if:

- (a) the taxpayer is carrying on a business providing services to customers for reward; and
- (b) the materials or spare parts are supplied by the taxpayer to the customer in the course, and as an essential part, of performing the services.

28. Materials and spare parts also fall within the extended statutory meaning of the term 'trading stock' in subsection 6(1) if they are either:

- (a) 'produced, manufactured, acquired or purchased' ('obtained') for purposes of sale. This is so if, for instance:

- (i) the materials or spare parts are sold or disposed of under the contract in one transaction for one inclusive price; or
  - (ii) a separate charge is made for the materials and spare parts supplied; or
  - (iii) the cost of the materials or spare parts are recovered in the charge made for the service; or
- (b) obtained for purposes of exchange if, for instance, the spare parts are supplied in return for the customers' defective parts: compare Taxation Ruling TR 93/20, paragraph 59.

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

30. 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**

31. Builders, tradespersons, repairers or other service providers do not ordinarily hold a stock of 'packaging items' for supply to their customers in performing their services. They normally obtain goods for supply, in a packaged state, as the need arises.

32. If a builder, tradesperson, repairer or other service provider does hold a stock of packaging items, however, the items are 'trading stock' in the ordinary meaning of the term. The stock of packaging items is 'trading stock' in the ordinary sense of the term because it is an aggregate of goods (namely, the packaging items) which the trader has on hand for supply to customers and:

- (a) the trader is carrying on a business providing services to customers for reward (for example, as a builder, tradesperson, repairer or other service provider); and
- (b) the packaging items are supplied by the trader to the customer in the course, and as an essential part, of performing the services; and
- (c) the packaging items are to be disposed of, that is, property in them is to pass to the customer.



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## Alternative views

33. An alternative view has been expressed (consistent with the alternative view referred to in paragraph 64 of Taxation Ruling TR 96/D19) that, as a service provider does not trade in 'core' goods, if packaging items are supplied by the service provider there will be no sale of core goods to which the supply of the packaging items can be connected. The packaging items, on this view, are not capable of being obtained for the purposes of sale. They are only supplied in providing the service. Unlike packaging items associated with the sale of 'core' goods (see Taxation Ruling TR 96/D19), packaging items supplied by a service provider are not part of any goods sold and are not part of what is traded. On this view, the packaging items constitute merely a convenience offered to customers and supplied as an 'add-on' ancillary to the principal function of providing the service.

34. In our view, however, it is sufficient for packaging items to be 'trading stock' in the ordinary meaning of the term if the service provider **trades** - in the sense that he or she engages in commercial operations providing services to customers for reward - but does not trade in goods. *Ransom (Inspector of Taxes) v. Higgs* [1974] 3 All ER 949 per Lord Reid at 955 and *Kowloon Stock Exchange Ltd v. Inland Revenue Commissioner* [1985] 1 All ER 205 at 210 support the view that 'trading' extends to operations of a commercial character by which a trader provides goods **or services** to customers for reward. We take the view that packaging items disposed of in conjunction with the provision of a service, such that the supply of the items is an essential part of the service, are part of what the taxpayer trades.

## Contrast with consumable stores

35. The treatment of materials, spare parts and packaging items in this Ruling should be contrasted with the treatment of consumable stores in Taxation Rulings IT 333 and TR 93/20, paragraphs 26, 105 and 106. Consumable stores such as fuel, oil, lubricants, detergents and glue, by their very nature, are not 'trading stock': they are destroyed or expended by use by the taxpayer in carrying on business and property in them does not pass (whether as goods or in some other form) to customers.

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## **Examples**

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### **Example 1**

36. A1 Master Plumbing Services holds at all times a stock of PVC pipes, elbow joints, tap washers, glue, etc., to repair customers' burst water pipes, downpipes, drains, etc.

37. The PVC pipes, elbow joints and tap washers are trading stock. They are disposed of by A1 Master Plumbing Services to its customers in the course, and as an essential part, of performing its plumbing services and the pipes, elbow joints and tap washers retain their individual character or nature. The glue, on the other hand, is not trading stock. It is a consumable because it is destroyed or expended by use by A1 Master Plumbing Services in carrying on its business and property in the glue does not pass, as glue, to customers.

### **Example 2**

38. Highflyer Airlines places a supply of baggage identification tags on its check-in counters for use by its customers. The tags are not trading stock because Highflyer Airlines does not dispose of them as an essential part of performing its airline services. Rather, the tags are supplied only as a minor and incidental aspect of providing airline services to customers.

### **Example 3**

39. Snappy Electronic Repairs decides to capture a niche in the market in repairing electronic appliances by placing all appliances that it repairs in polystyrene packaging material and glossy printed cardboard containers. All repaired appliances are returned to customers in this way. At 30 June 1995, Snappy Electronic Repairs has a stock of polystyrene packaging material and cardboard containers on hand. The polystyrene packaging material and cardboard containers are trading stock. These items protect the repaired appliances and they are disposed of as an essential part of the repair service that Snappy Electronic Repairs supplies.

### **Example 4**

40. Dirty Dacks Dry Cleaners holds a large quantity of coat hangers, cardboard shields (which it places on the horizontal part of the coat hangers) and plastic bags that it uses in returning to customers their dry cleaned garments. The coat hangers, cardboard shields and plastic bags are trading stock. They are directly used in the dry cleaning

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process in that the garments are placed on the hangers before customer identification tags are attached to the garments. They are stored on the hangers awaiting collection. They also maintain the garments in their cleaned and pressed state or condition for the customer's use. The coat hangers, cardboard shields and plastic bags therefore form an essential part of the dry cleaning service that Dirty Dacks provides.

## Your comments

41. 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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|   |                           |
|---|---------------------------|
| ATO references                                      | <i>subject references</i> |
| NO 96/11013-8                                       | - accessories             |
| 96/8188-4   | - binding materials       |
| 96/4507-1   | - consumables             |
| 95/9779-4   | - containers              |
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- ITAA 6(1)
- ITAA 28
- ITAA 28(2)
- ITAA 28(3)
- ITAA 170

*case references*

- Australasian Jam Co Pty Ltd v. FC of T (1953) 88 CLR 23; (1953) 10 ATD 217
- FC of T v. St. Hubert's Island Pty Ltd (1978) 138 CLR 210; 78 ATC 4104; (1978) 8 ATR 452
- FC of T v. Suttons Motors (Chullora) Wholesale Pty Ltd (1985) 157 CLR 277; 85 ATC 4398; (1985) 16 ATR 567
- Investment and Merchant Finance Corp Ltd v. FC of T (1971) 125 CLR 249
- John v. FC of T (1989) 166 CLR 417; 89 ATC 4101; (1989) 20 ATR 1
- Kowloon Stock Exchange Ltd v. Inland Revenue Commissioner [1985] 1 All ER 205
- Ransom (Inspector of Taxes) v. Higgs [1974] 3 All ER 949
- Case 115 (1951) 1 TBRD (NS) 485; Case 120 (1951) 1 CTBR (NS) 568