TR 98/7 - Income tax: whether packaging items (ie, containers, labels, etc) held by a manufacturer, wholesaler or retailer are trading stock

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Taxation Ruling

Income tax: whether packaging items (ie, containers, labels, etc) held by a manufacturer, wholesaler or retailer are trading stock

other Rulings on this topic

TR 98/8

contents para

What this Ruling is about 1
Previous Rulings 7
Ruling 8
Date of effect 20
Explanation of key words 22
Explanations 26
Examples 73
Detailed contents list 82

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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 section 70-10 of the *Income Tax Assessment Act 1997* ('the 1997 Act').

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

(a) purposes of sale in the ordinary course of business - 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 electric light globes; or

(b) purposes of manufacture in the ordinary course of business - if the taxpayer is incorporating the packaging items in 'core' goods in manufacturing the 'core' goods, for example, 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 key terms in this Ruling, 'packaging items' and 'returnable packaging items', are explained in paragraphs 22 to 25.

Cross reference table of provisions

6. In this Ruling, a reference to a provision in the 1997 Act should be read, where appropriate, as a reference to the equivalent provision in the *Income Tax Assessment Act 1936* ('the 1936 Act'). The following table provides cross references between the relevant provisions of the 1997 Act and the corresponding provisions in the 1936 Act:

1997 Act	1936 Act
section 70-10	subsection 6(1)
section 70-35	section 28
subsections 70-40(1) and (2)	section 29
subsection 70-45(1)	subsection 31(1)
subdivision 70-D	section 36
subsection 8-1	subsection 51(1)
section 70-25	subsection 51(2)
section 42-15	subsection 54(1)
no equivalent provision yet	section 170

Previous Rulings

7. This Ruling incorporates Taxation Determination TD 93/23 which is withdrawn. That Determination dealt 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 1997 Act if it is within either the statutory definition in section 70-10 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 statutory definition of the term 'trading stock' in section 70-10 is expansive and extends the ordinary meaning of the term.

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

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

(b) the items are closely associated with the 'core' goods sold in the sense that the items either:

(i) form part of the 'core' goods sold; or

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

(c) the items are disposed of by the taxpayer (that is, property in them passes) in conjunction with the sale of the 'core' goods.

Packaging items held 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, or acquires' (referred to in this Ruling for brevity as 'obtains') the items for sale in the ordinary course of the business are 'trading stock' as defined in section 70-10.

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 in the ordinary course of the business, may come either within the ordinary meaning of the term

'trading stock' or within the statutory definition, extending as it does to 'anything produced, manufactured, or acquired ('obtained') 'for purposes of ... sale ... in the ordinary course of a business'. The packaging items in these circumstances are trading stock if:

(a) the taxpayer is, or will be, engaged in business trading in 'core' goods; and

(b) the items are closely associated with the 'core' goods sold in the sense that the items either:

(i) form part of the 'core' goods sold; or

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

(c) the items are disposed of by the taxpayer (that is, property in them passes) in conjunction with the sale of the 'core' goods.

This will be so whether the taxpayer is a manufacturer, wholesaler or retailer of the 'core' goods.

13. We take the view that the word 'sale' in the expression 'held for purposes of ... sale' in the definition of 'trading stock' in section 70-10 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. Packaging items are obtained and held 'for purposes of ... sale' of 'core' goods if the items form part of the 'core' goods or bring them into the form, state or condition in which they are to be sold. Items which do not form part of the 'core' goods, or which do not bring the 'core' goods into the form, state or condition in which the taxpayer sells them, or intends to sell them, are not sufficiently closely associated with the 'core' goods to be trading stock.

14. The level of distribution in which the taxpayer is trading is a relevant factor in determining whether packaging items bring 'core' goods into the form, state or condition in which they are to be sold, 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 brings 'core' goods into the form, state or condition in which the manufacturer sells, or intends to sell, 'core' goods could be different, therefore, from packaging items in which a retailer brings those goods into the form,

state or condition in which the retailer sells, or intends to sell, the goods.

Packaging items held for purposes of manufacture

15. 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 in the ordinary course of business, incorporating the items in the process of manufacture of the other goods, are 'trading stock' as defined in section 70-10. For instance, a manufacturer of baby powder may purchase and hold tins in which to incorporate the final product in the ordinary course of business, namely, tins of baby powder.

Returnable packaging items

16. Returnable packaging items are not 'trading stock' as defined in section 70-10 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.

17. Returnable packaging items are likely to be depreciable plant or articles for the purposes of section 42-15.

Practical treatment of packaging items with mixed uses

18. If a type of packaging item can have mixed uses as either trading stock or not trading stock, as in **Examples 5** and **6** of this Ruling, the extent of the trading stock component on hand at the end of the year must be determined and valued for purposes of subsection 70-5(3) of the 1997 Act. The value of each item of trading stock on hand at the end of the year can, by virtue of section 70-45, be either its cost, its market selling price or its replacement price.

19. If a type of packaging item has mixed uses, a determination based on a realistic estimate of past (or current) use of similar items is an acceptable means of calculating the extent of trading stock on hand in order that it can be valued for purposes of subsection 70-5(3) (see **Example 5** of this Ruling). If the degree of mixed use is such that there is an insignificant trading stock component, then it is acceptable to disregard this component for purposes of Division 70 (see **Example 6** of this Ruling).

Date of effect

20. This Ruling applies only from and including the 1997-98 year of income unless a taxpayer chooses to apply it to earlier income years. Assessments for years earlier than the 1997-98 income year may be amended if a taxpayer wishes, but only to the extent permitted by section 170 of the 1936 Act. Application of this Ruling to earlier income years is only available if the value of trading stock that is ascertained by the taxpayer is calculated on reasonably objective and supportable data.

21. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of 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

22. 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 the 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.

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

24. The packaging items referred to in this Ruling:

- pack, wrap up or secure 'core' goods before, or at 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; and

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

25. 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'

26. Section 70-10 provides that, in the absence of a contrary intention:

' "Trading stock" includes:

(a) anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange in the ordinary course of a business; and

(b) live stock.'

27. The definition uses the word 'includes' and is therefore expansive. A thing is trading stock for income tax purposes if it is within the statutory definition in section 70-10 or within the ordinary meaning of the term.

Ordinary meaning of 'trading stock'

28. 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 (CLR at 281-282; ATC at 4400; ATR at 570):

> 'The ordinary meaning of the term "trading stock" upon which sec. 6(1) [the equivalent of section 70-10 in the new Act] 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.'

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

30. 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.

31. 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 section 70-10 does not restrict the ordinary meaning of the term 'trading stock'.

32. *The Macquarie Dictionary* defines 'trading stock' to mean 'stock not held for permanent investment'. The word 'stock' means an 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).

33. In some respects we consider that dictionary definitions of 'stock' are too broad to apply to the expression 'trading stock' in its context in section 70-10. We take the view that the ordinary meaning of 'trading stock' encompasses an aggregate of packaging items which a taxpayer has on hand if:

(a) the taxpayer is, or will be, engaged in business trading in 'core' goods; and

(b) the items are closely associated with the 'core' goods sold in the sense that the items either:

(i) form part of the 'core' goods sold; or

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

(c) the items are disposed of by the taxpayer (that is, property in them passes) in conjunction with the sale of the 'core' goods.

Extended statutory meaning of 'trading stock'

34. The definition of the term 'trading stock' in section 70-10 extends the scope of the term in its ordinary sense.

35. 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 CLR 216; ATC 4106-7; ATR 454-455 and see, to the same effect, Mason J at CLR 229; ATC 4113-4; ATR 463 and Jacobs J at CLR 235; ATC 4117; ATR 467.

Packaging items held for purposes of sale

Packaging items held by a taxpayer trading in these items

36. 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 in the ordinary course of the business are 'trading stock' as defined in section 70-10. They come within either the ordinary meaning of the term or the extended definition in the subsection.

37. 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 in the ordinary course of the business are, in our view, 'trading stock' as defined in section 70-10.

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

38. 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.

39. 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

40. 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.

41. 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.

42. Mr R R Gibson, Chairman, stated in his reasons for decision that the company was well advised in making this admission. He said (TBRD at 490; 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 purposes of sale" and are therefore trading stock within the meaning of the Act.'

43. Mr Gibson later added (TBRD at 491-492; 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)

44. And later (TBRD at 497; 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.'

45. 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.

46. 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 within the extended meaning in section 70-10. 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 they bring the 'core' goods into the form, state or condition in which they are sold, or intended to be sold, to the customer.

47. We also agree with Mr Gibson's view that wrapping paper and string are trading stock but only if they bring 'core' goods into the form, state or condition in which they are sold, or intended to be sold.

48. 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 and held 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

49. 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. The Executor Trustee and Agency Co of South Australia 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.

50. 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.

51. Equally, an accurate calculation of profit or loss cannot be made unless the value of packaging items referred to in paragraph 12 on hand at the beginning and end of an accounting period are taken into account.

Analogy with goods obtained for purposes of manufacture

52. We consider that the packaging items described in paragraph 12 of this Ruling are obtained for purposes of sale in the ordinary course of a business 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.

53. In addition to raw materials (for example, sugar) that a manufacturer might buy to process in order to sell a finished product (for example, confectionery), a manufacturer might buy and have on hand goods (for example, catalysts) which are consumed 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, CLR at 226; ATC at 4112; 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.

54. Jacobs J in the *St Hubert's Island* case (CLR at 235; ATC at 4117; 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'.

55. 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 in the ordinary course of a business even though the taxpayer is not, nor will be, engaged in trade in those items.

Comparison between packaging items and inventories

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

57. 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.

58. 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

59. 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 in the ordinary course of a business.

60. Under this alternative view, packaging items (that are not incorporated into the 'core' goods) that 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.

61. We take the view that there should be no difference, in principle, between the tax treatment of packaging items which attach directly to 'core' goods (for example, tins and jars) and those items which do not attach directly (for example, cardboard boxes). Nor is any such difference justifiable in interpreting the words of the statutory definition. Cardboard boxes are no less for use to pack or secure cans of fruit or packets of biscuits, for their sale than the cans and packets are for use to pack or secure the fruit or biscuits. The boxes are closely associated with the cans of fruit or packets of biscuits in that they bring the cans of fruit or packets of biscuits into the form, state or condition in which they are sold, or intended to be sold, and are disposed of by the manufacturer in conjunction with the sale of the cans of fruit or packets of biscuits. The physically identifiable things (the box and the contents) are what is sold. In any event, the boxes are acquired 'for purposes of sale' in the ordinary course of a business (like the containers and packing materials in *Case 115*; *Case 120*).

62. Another alternative view has been expressed that, if a taxpayer is in business trading in 'core' goods, all packaging items disposed of in association with the sale of the 'core' goods are trading stock:

(a) whether or not the items bring the 'core' goods into the form, state or condition in which they are to be sold; or

(b) whether the items are for supply to customers before, at the time of, or after the point of sale of the 'core' goods.

63. Under this alternative view, packaging items such as supermarket and department store plastic carry bags provided to customers at cash registers would be regarded as 'trading stock'. So too, accessories such as serviettes, drinking straws and plastic cutlery provided by food outlets would be regarded as 'trading stock'.

64. We think that this view would take the concept of trading stock too far. In our view, the term 'trading stock' as defined in section 70-10 does not embrace these kinds of packaging items.

65. 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 held for purposes of manufacture

66. Raw materials obtained and held for purposes of manufacture in the ordinary course of a business are 'trading stock' within the definition of that term in section 70-10: *St Hubert's Island* case per Mason J, CLR at 227-228; ATC at 4112-4113; ATR at 462; *Suttons Motors* case, CLR at 281-282; ATC at 4400; ATR at 570-571.

67. 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.

68. 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. Like raw materials, the packaging items are consumed or used in the production of 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.

69. 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.

70. We consider that these packaging items are obtained and held for purposes of manufacture in the ordinary course of a business 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 section 70-10.

Overall effect

71. The overall effect of the operation of section 8-1, section 70-25 and section 70-35 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 subdivision 70-D in Part 2-25 of the 1997 Act also apply, in the case of the sale of a business of a taxpayer, in relation to the stock of packaging items on hand.

72. If packaging items are not 'trading stock' as defined in subsections 70-10 , the provisions of section 70-35 do not apply. An allowable deduction for their cost is available earlier, namely, when that cost is incurred in terms of section 8-1.

Examples

Example 1

73. 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 not trading stock of Ms Marquet.

Example 2

74. 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 not trading stock.

Example 3

75. 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 in the ordinary course of Lighthead's business and are 'trading stock' of the brewery.

76. 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

77. Sandra Collie, a fruit and vegetable producer, uses cardboard cartons, bags, sacks, labels and packing materials (including twine and tying wire) 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

78. 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. Where these items bring the goods into the form, state or condition in which the company sells, or intends to sell, the goods, they are trading stock. However, if the items are separately provided to customers to enable them to carry prepacked goods, packages or parcels purchased, these items are not trading stock. Nor are the items trading stock if the items are used to further wrap up goods that, at the time the goods are sold, are already packed, wrapped up or secured for delivery to customers, for example, wrapping paper, sticky tape and string. If Grand Mammoth Ltd can establish a basis for determining the extent of packaging items that are trading stock, which takes into account the differing uses to which the packaging items are put, this basis may be

used to estimate the level of trading stock on hand from the total amount of such packaging items held. For instance, if on average 60 per cent of the wrapping paper, sticky tape and string has been used to further wrap prepacked core goods, and are not regarded as trading stock, then it is acceptable for Grand Mammoth Ltd to use the balance (that is, 40 per cent) to estimate the level of wrapping paper, sticky tape and string that is regarded as trading stock.

Example 6

79. Maisy runs a general store in a small country town. She holds a stock of brown paper bags that she provides at the fruit and vegetable counter to enable her customers to place loose fruit or vegetables in for sale. These brown paper bags are, in our view, trading stock. The bags are used to bring 'core' goods into the form, state or condition in which they are sold, or intended to be sold, in the ordinary course of the business. Maisy also holds at the cash register brown paper bags in which, on occasions, she places loose vegetables directly from the scales, as a service to her customers. At times, Maisy also uses the brown paper bags at the cash register to hold pre-packaged goods (for example, ice-creams in protective wrappers or milk in cartons) after their purchase for the convenience of her customers. These bags do not bring the goods into the form, state or condition in which they are sold, or intended for sale, and are not trading stock. If Maisy can estimate from past (or current) usage the trading stock component of the paper bags, this estimate can be used to apportion the value of the bags on hand. However, if the estimate is that, on average, at least 95 per cent of the brown paper bags have been used to further wrap prepacked core goods, and are not regarded as trading stock, then it is acceptable for Maisy to regard all the brown paper bags as not being trading stock.

Miscellaneous examples of packaging items that are 'trading stock'

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

- Packages or boxes in which shirts or other clothing items are sold, or intended to be sold.
- Wool-packs and binding materials (including twine and tying wire) used by wool producers in the marketing or distribution of their produce.
- Padded boxes in which jewellery is sold, or 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 sold, or intended to be sold,, eg., 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 sold, or 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.
- Plastic bags and hangers used at the time clothing items are sold to secure those items for delivery to the customer.
- Bags, wrapping paper, sticky tape, and string used to wrap up or pack up, loose or unpacked 'core' goods, eg nuts, or confectionery.
- 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 The serviette, plastic knife and fork and refresher towel are not trading stock - see example below.

(**Note:** all these examples have the common feature that the packaging item is closely associated with 'core' goods in the sense that the item either forms part of the 'core' goods or brings the 'core' goods

into the form, state or condition in which they are sold, or intended to be sold, to the customer and the item is disposed of in conjunction with the sale of the 'core' goods - as paragraph 12 of this Ruling requires).

Miscellaneous examples of packaging items that are not 'trading stock'

81. Below are examples of packaging items which are not considered to be 'trading stock':

- A serviette, plastic knife and fork and a refresher towel which a take-away food store proprietor places in a cardboard box (along with hot food on greaseproof paper) are not trading stock. The cardboard box and greaseproof paper are trading stock -see example above).
- 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 (e.g., Christmas or gift 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., boxed shirts or tins of biscuits.

(**Note:** all these examples have the common feature that the packaging item does not form part of the 'core' goods nor bring the 'core' goods into the form, state or condition in which they are sold, or intended to be sold.)

Detailed contents list

82. Below is a detailed contents list for this Ruling:

	paragraph
What this Ruling is about	**1**
Class of person/arrangement	1
Cross reference table of provisions	6
Previous Rulings	**7**
Ruling	**8**

Scope of the term 'trading stock' 8
Packaging items held for purposes of sale 11
Packaging items held by a taxpayer trading in these items *11*
Packaging items held by a taxpayer trading in goods other than these items *12*
Packaging items held for purposes of manufacture 15
Returnable packaging items 16
Practical treatment of packaging items with mixed uses 18
Date of effect **20**
Explanation of key words **22**
Explanations **26**
Scope of the term 'trading stock' 26
Statutory definition of 'trading stock' *26*
Ordinary meaning of 'trading stock' *27*
Extended statutory meaning of 'trading stock' *34*
Packaging items held for purposes of sale 36
Packaging items held by a taxpayer trading in these items *36*
Packaging items held by a taxpayer trading in goods other than these items *38*
Taxation Board of Review Case 115; Case 120 *40*
Correct reflex of income *49*
Analogy with goods obtained for purposes of manufacture *52*
Comparison between packaging items and inventories *56*
Alternative views 59
Packaging items held for purposes of manufacture 66
Overall effect 71
Examples **73**
Example 1 73
Example 2 74
Example 3 75
Example 4 77
Example 5 78

Example 6 79
Miscellaneous examples of packaging items that are 'trading stock' 80
Miscellaneous examples of packaging items that are not 'trading stock' 81
Detailed contents list **82**

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ATO references
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- raw materials
- trading stock
- trading stock on hand
- trading stock valuation

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- ITAA97 70 40(2)
- ITAA97 70-45
- ITAA97 70-45(1)
- ITAA97 Subdiv 70-D
- ITAA36 6(1)
- ITAA36 28
- ITAA36 28(2)
- ITAA36 28(3)
- ITAA36 29
- ITAA36 31
- ITAA36 31(1)
- ITAA36 36
- ITAA36 51(1)
- ITAA36 51(2)
- ITAA36 54(1)
- ITAA36 170

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