Food and beverage industry

Country of origin guidelines to the Trade Practices Act

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Important notice

Please note that this guideline is a summary designed to give you the basic information you need. It does not cover the whole of the *Trade Practices Act 1974* and is not a substitute for professional advice.

Because it avoids legal language wherever possible there may be some generalisations about the application of the Act. Some of the provisions referred to have exceptions or important qualifications. In most cases, the particular circumstances of the conduct need to be taken into account when determining the application of the Act to that conduct.

While it refers to other legislation, such as the *Commerce (Trade Descriptions) Act 1905*, the purpose of this guideline is only to outline the relevant principles to country of origin representations under the Act. Issues and queries arising out of other legislation should be raised with either the relevant government body that administers the legislation (in the above example, Customs) or with independent legal advisers.

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Disclaimer

This guide is designed to help the food and beverage industry understand the provisions of the *Trade Practices Act 1974* that relate to making country of origin representations. It aims to provide businesses and industry groups with information that will help them develop strategies to improve compliance with the Trade Practices Act.

This paper cannot be relied upon as stating 'the law' on country of origin claims. While this guide reflects the Australian Competition and Consumer Commission's current views, they may well change as courts make rulings on cases, or government regulations are made or changed. Ultimately, interpretation of the law will always be up to the courts. Prudent businesses will take legal advice to ensure they stay abreast of developments in the law.

This statement of the ACCC's views also constitutes a statement of its current enforcement policy for country of origin claims.

Private actions

Businesses should be aware that persons other than the ACCC (such as competitors or customers) are sometimes able to start private legal proceedings to enforce ss. 52, 53(a), 53(eb) and 55 of the Trade Practices Act. The ACCC generally has no say about the types of private actions that might be brought to the courts. Private litigants are not required to take the ACCC's views, expressed in this publication, into account.

Except in limited circumstances, only the ACCC can institute legal proceedings for criminal offences under Part VC the Act, including ss. 75AZC(1)(a), 75AZC(1)(i) and 75AZH.

State and territory laws

The Trade Practices Act is Commonwealth legislation. State and territory fair trading acts generally mirror the obligations set out in the consumer protection provisions of the Act, including the general provisions relating to country of origin claims contained in ss. 52, 53(a), 53(eb) and 55. Businesses may, therefore, have obligations under state and/or territory laws in addition to the Trade Practices Act.

The defences set out in Part V, Division 1AA of the Act (ss. 65AA to 65AN) only apply to ss. 52, 53(a), 53(eb), 75AZC(1)(a) and 75AZC(1)(i) and are not, at the time of publication, mirrored in state and territory legislation.

The ACCC understands that state and territory legislation will be amended eventually.

Contents

Introduction and background

Food and beverage industry profile

The Australian food and beverage industry is Australia's largest manufacturing sector. Its annual turnover is $50 billion, which is more than 18 per cent of total Australian manufacturing turnover. The industry is also a major employer and the fastest growing manufacturing employer in regional Australia.

The processed food sector is one of only two Australian manufacturing sectors which is a net exporter. In 2000–01 processed food exports generated a trade surplus of $11.3 billion.

The food and grocery industry is a major user of Australian agricultural products and substantially enhances their value. The industry's output covers a comprehensive range of food and grocery products consumed in Australia including processed meats, dairy products, beverages, fruits and vegetables, flour and cereal products, bakery products, sugar, confectionery, seafood and pet food.

Its products are used in further food production and in foodservice outlets such as restaurants, hospitals and other institutions. However, most are sold packaged for final consumption through supermarkets, convenience stores and other retail outlets.

Key statistics

The food and grocery industry:

- generates annual turnover of $50 billion and value added in excess of $14 billion per annum
- exports more than $16 billion worth of goods per annum, with highly processed food exports increasing by more than 150 per cent in the last decade
- directly employs 166 000 people.

Background to guide

Following the production, in December 1999, of a guide specifically for the complementary health care industry, the ACCC decided to progressively convene joint working parties in the textile, clothing and footwear (TCF); electrical and whitegoods; food and beverage; furniture and furnishings; and toy industries, to produce guidelines for each industry.

Food and beverage working party

The ACCC set up and led the food and beverage working party. The Australian Food and Grocery Council (AFGC), selected as the lead participating industry association, was represented by its deputy director and assistant director, scientific and technical. The other key industry representative was the executive director of the Australian Made Campaign who also represented the Australian Chamber of Commerce and Industry (ACCI). Government representation included officers from the Business Law and Competition Reform Section of the Department of Industry, Tourism and Resources and Food Standards Australia New Zealand (FSANZ), formerly the Australia and New Zealand Food Authority. The working party visited several food companies to gain an understanding of industry specific manufacturing processes. These companies are listed at the end of the guide.

Manufacturing processes

Processes in the following manufacturing sectors were considered by the working party:

- Fruit juices
- Jams
- Peanut products
- Coffee
- Frozen fish products
- Canned fruit/vegetable products
- Mixes of dried fruits
- Herbs and spices
- Smallgoods
- Mixed products

Country of origin claims

Revised provisions for country of origin representations came into effect on 13 August 1998.

A country of origin representation is any labelling, packaging, logo or advertising that makes a statement, claim or implication about which country goods come from.

The most common claims are 'Made in Australia' and 'Product of Australia'—or similar claims about goods from other countries.

Under the Trade Practices Act it is not mandatory for companies to state where goods are from, but if they do then the claims must be accurate. Therefore the revised provisions are not proscriptive but clarify the steps that firms may take to ensure that their country of origin labelling or promotions do not breach the Act.

Companies may be obliged to state where goods are from under other pieces of legislation such as the *Commerce (Trade Descriptions) Act 1905*. Queries about these requirements should be directed to Customs or independent legal advisers. In addition, the food acts in each state and territory and the *Imported Food Control Act 1992*, adopts without variation, the labelling requirements outlined in the Australia New Zealand Food Standards Code.

At the time of printing the Commerce (Trade Descriptions) Act and Regulations are under review.

The law

The Trade Practices Act contains provisions of relevance to country of origin claims made by businesses.

Section 52 provides a general prohibition against conduct that misleads or deceives or is likely to mislead or deceive.

Section 53(a) provides a broad prohibition against making a false representation that goods, among other things, have a particular history.

Section 53(eb) provides a specific prohibition against making a false or misleading representation about the place of origin of goods. (See page 9 for an explanation of the differences between 'place' of origin and 'country' of origin).

Section 55 prohibits a person from engaging in conduct which is liable to mislead the public as to the nature, manufacturing process, the characteristics, the suitability for their purpose or the quantity of any goods.

Sections 75AZC(1)(a), 75AZC(1)(i) and 75AZH, contained in Part VC of the Act, mirror ss. 53(a), 53(eb) and 55 respectively. There is no mirror provision of s. 52 contained in Part VC of the Act.

Breaches of ss. 52, 53(a), 53(eb) and 55 give rise to **civil** action. Breaches of ss. 75AZC(1)(a), 75AZC(1)(i) and 75AZH give rise to **criminal** sanctions.

Sections 53(a) and 75AZC(1)(a) are relevant because a representation about the country of origin of goods is a representation of the history of those particular goods.

Sections 55 and 75AZH are relevant because a representation about the country of origin may be a representation about the nature, manufacturing process or the characteristics of particular goods.

Division 1AA of Part V of the Act (ss. 65AA to 65AN) specifically applies to country of origin representations. These provisions set out defences (also called safe harbours) to the prohibitions in ss. 52, 53(a), 53(eb) and 75AZC(1)(a) or 75AZC(1)(i). This means that where certain tests are met, claims about the origin of goods do not breach ss. 52, 53(a), 53(eb), 75AZC(1)(a) or 75AZC(1)(i) of the Act. These defences are explained below. It is important to note that the defences are not available for proceedings brought under ss. 55 or 75AZH of the Act.

'Made in *Country of origin*' defence

The first defence, or safe harbour, is for general country of origin claims that may include:

- Made in *Country of origin*
- *Country of origin* Made
- Manufactured in *Country of origin*

The defence has two components that must be met:

- the goods must have been substantially transformed in the country claimed to be the origin
- 50 per cent or more of the costs of production must have been carried out in that country.

This defence does not apply to claims that goods are the 'product of' a particular country. These now come under the 'Product of *Country of origin*' defence.

Substantial transformation

The provisions define substantial transformation as:

> a fundamental change ... in form, appearance or nature such that the goods existing after the change are new and different goods from those existing before the change.

Ultimately, it is the court's view that is important. The court will usually arrive at a view on whether a substantial transformation has occurred by considering the average consumer's perspective of any label claim, and whether goods are new or different.

The Australian Government can make regulations stating that certain changes (i.e. unsophisticated processes) are not considered to be fundamental changes for the purposes of the legislation. Currently there are no such regulations.

Costs of production

The provisions set out how to calculate the cost of production or manufacture of goods. Three broad categories of costs are considered: expenditure on materials, labour and factory overheads.

What does that mean?

Generally, calculating the cost of materials is straightforward. They can be allocated to the final goods fairly easily. But labour and overheads count towards costs only where they can reasonably be allocated to the final goods.

Under the law the government can make regulations to allow or disallow certain costs from being counted towards production and manufacturing costs. Currently there are no such regulations.

In forming its view of whether the production cost test is met, the ACCC will, however, accept the 50 per cent rule criteria contained in the attached edited extract from ANZCERTA (as at June 2001) joint Australia/New Zealand customs information booklet on *Rules governing entitlement to preferential rates of duty for trans-Tasman trade*.

'Product of *Country of origin*' defence

'Product of *Country of origin*' is the premium claim about a good's origin.

The defence, or safe harbour, for claims that a good is a product of a certain country is more demanding than the 'Made in *Country of origin*' defence.

For goods to qualify, two rigorous criteria must be met:

- the country of the claim must be the country of origin of each significant ingredient or significant component of the goods
- all, or virtually all, processes involved in the production or manufacture of the goods must have happened in that country.

These criteria apply to any variations of the words 'product of', such as 'produce of' and 'produced in'.

Logos

Logos are frequently used to promote goods to build brand recognition, or to associate the goods with desirable characteristics that may include their origin.

The law allows for a country of origin logo or logos to be prescribed by regulation. A prescribed logo will signify that both substantial transformation and a certain percentage of costs (above 50 per cent) of producing the goods occurred in a given country. No regulations have yet been made to prescribe any logos.

What if you don't want to use a safe harbour?

In circumstances where a product cannot meet the requirements of the 'Product of *Country of origin*' or 'Made in *Country of origin*' defences, a qualified claim that implies a lesser connection with the country represented may be used. Examples might be 'Packaged in Australia', 'Bottled in Australia', 'Australian Owned' or 'Made/Manufactured in Australia from imported ingredients'.

If goods do not qualify for the defences, claims made about country of origin will be assessed on their merits. Manufacturers then run the risk of challenge and potential legal action by the ACCC or any person who is able to commence private legal action.

Place of origin claims

Paragraphs 53(eb) and 75AZC(1)(i) refer to 'place of origin' claims. 'Country of origin' claims are a subset, and are distinct from place claims.

A place of origin claim can be that a good originates from a narrower or more localised region than a country. For instance, 'Made in Melbourne' or 'Product of the Hunter Valley'.

All false and misleading claims about the place of origin are prohibited by paragraphs 53(eb) and 75AZC(1)(i). If the claim is place of origin only, and not also a country of origin claim, the August 1998 changes do not affect it. Place only claims will be assessed on their merits. They may also use the qualified claims that might imply a lesser connection with the place, such as ' Packed in Melbourne' or 'Bottled in the Hunter Valley'.

The August 1998 Part V Division 1AA defences—the safe harbours—specifically relate only to country of origin claims.

Issues raised by the industry

Made in *Country of origin*

Food processing and substantial transformation

As stated earlier, the Act defines substantial transformation as:

> a fundamental change ... in form, appearance or nature such that the goods existing after the change are new and different goods from those existing before the change.

Food processing ranges from the apparently simple process of packaging a single ingredient food, such as dried fruit or nuts to the preparation and packaging of elaborately transformed products such as ready prepared meals. Getting the raw commodity from delivery to the food processing plant into the package even for dried fruit, such as sultanas, requires the application of several processing steps and results in some form of transformation.

Although it is not possible to outline the processes applied to each and every individual food, listed below is a brief description of a number of individual processes. These may be combined in different ways and at different stages in the overall processing to prepare foods found on the supermarket shelf. While a single manufacturing process may not result in substantial transformation, several processes in combination may produce substantial transformation.

The following categorisation of processes is intended to provide guidance to companies in assessing the origin claims they can make about their products. It reflects current case law and a considered assessment by the ACCC, with industry advice, of the likelihood of the process to satisfy the substantial transformation test. However, whether or not these processes impart substantial transformation is ultimately decided by the courts.

Companies also need to recognise that acceptability of an origin claim must also satisfy the local production cost test (50 per cent for 'made in'). While substantial transformation may be achieved by a process, unless the local production cost test is also satisfied an unqualified 'made in' claim cannot be made.

Preparation

All major raw materials going into food are subject to one or more of the following three methods of preparation at some stage during their production.

Cleaning—generally this is done by washing with water with or without sanitising agents such as chlorine.

Sorting—removal of blemished or otherwise unsuitable material and foreign matter such as stalks, leaves, stones etc. This may be done in a variety of ways including using water to allow stones to sink, sieves, air pressure to remove lightweight material, filtration, photo-electric methods and sorting by hand.

Grading—sorting of foods into groups with the same characteristics e.g. size, colour and texture. This can be done mechanically, photo-electrically or by hand.

None of these on its own or in combination is likely to be considered substantial transformation.

Processing

In addition to these preparatory steps, food may also be subjected to one or more additional processes including those listed below. Depending on whether the fundamental nature of the product has changed, these may or may not impart substantial transformation.

Size reduction—cutting, dicing, slicing, grating, mincing and grinding are different methods of creating smaller size particles of the original food. However, the product retains essentially the same general characteristics. This would be unlikely to be considered substantial transformation. However, when the characteristics are significantly changed, e.g. production of flour from wheat, this may be considered to be substantial transformation.

Concentrating—the removal of some of the water (usually at least 50 per cent) from a liquid food. This would be unlikely to be considered substantial transformation, as the fundamental nature of the product is unlikely to change.

Drying/dehydration—the removal of the majority of water from a food. Generally this would be unlikely to be considered substantial transformation when the fundamental nature of the product has not changed significantly. However, in some cases there has been a fundamental change and it may be considered to be substantial transformation, e.g. sultanas, raisins and milk powder.

Reconstitution—adding back the water removed by the above two processes to produce a product close to the original fresh product. In most cases it is unlikely that this would be considered substantial transformation.

Blending—the blending together of the same product, e.g. wine, vegetable oil, tea or orange juice. This does not change the essential nature of the product and would be unlikely to be considered to be substantial transformation.

Mixing—the mixing together of similar or different products, e.g. diced vegetables, fruit juices or spices to make mixed diced vegetables, tropical fruit juice blend and curry powder or a range of ingredients to make tomato sauce or a cake mix. This does change the essential nature of the product and would be likely to be considered as substantial transformation.

Homogenisation—the mixing together of fat/oil and water based products to form a uniform product that does not separate out into fat and water soluble fractions. This does change the essential nature of the product and would be likely to be considered as substantial transformation.

Coating—partially or totally encasing a food with another food, e.g. a chocolate coating on biscuits or ice cream or breadcrumbs on fish fingers. This does change the essential nature of the product and would be likely to be considered as substantial transformation.

Curing—the treatment of meat with curing salts resulting in preservation and colour and flavour change when cooked, e.g. ham, corned silverside and salami production. This does change the essential nature of the product and would be likely to be considered as substantial transformation.

Extraction—removal of a portion of a food, e.g. oil from oilseeds or coffee extract from coffee beans. This does change the essential nature of the product and would be likely to be considered as substantial transformation.

Granulation—the manufacture of granules can involve significant processing of a product. Spray dried coffee powder is mixed with steam which causes the powder particles to stick together and agglomerate into granules. In combination these processes would be likely to be considered as substantial transformation.

Pasteurisation—limited heat treatment followed by rapid cooling to kill bacteria, e.g. pasteurisation of milk or fruit juice. While this process causes some transformation resulting in increased safety and shelf life, the essential nature of the product remains unchanged. Pasteurisation would be unlikely to be considered a process that imparts substantial transformation.

Cooking—heat treatment, including baking, frying and boiling. These treatments result in considerable changes in flavour, texture and colour. This does change the essential nature of the product and would be likely to be considered as substantial transformation.

Fermentation—treatment with microorganisms. Fermentation may be 'alcoholic' in which alcohol is produced as in the brewing of beer or 'lactic' in which lactic acid is produced as in the production of yoghurt. This results in considerable changes in flavour and texture and sometimes colour. This does change the essential nature of the product and would be likely to be considered as substantial transformation.

As stated earlier, processes that may amount to substantial transformation in the food and beverage industry are too many to cover in detail. The classic example is the processing of local and/or imported ingredients into a finished food product, for example the production of a cake from imported spices and Australian sugar, fruit, flour and eggs.

However, the reconstitution of imported concentrated fruit juice into fruit juice for sale, whether or not Australian water, sugar, preservatives and packaging are used, would not be viewed as substantial transformation. The substantial transformation occurs at the time and place where the concentrated fruit juice is manufactured or processed from the fresh fruit.

On its own the addition of water does not bestow substantial transformation on a product. However, it is often a necessary inclusion in a manufacturing process which creates the required change in the original product or ingredients.

It should be remembered that the process of substantial transformation does not, of itself, enable food and beverage products to meet the 'Made in' defence. The test of 50 per cent or more of the costs of production must also be met.

Minimum 50 per cent production cost

Specifically the following provisions would apply:

- All inputs into the manufacturing process (other than those materials treated as overheads) are to be treated as materials entering that process.
- Qualifying expenditure on materials is 100 per cent where the material is an unmanufactured raw product of the claimed country of origin, e.g. water.

The status of water and its classification as a production cost is dealt with in the attachment.

Subject to later qualifications, the following overhead costs associated with manufacturing functions may form part of qualifying expenditure: energy, fuel, water, lighting, lubricants, rags and other materials and supplies not directly incorporated in manufactured goods.

To the extent that any of the listed costs:

- are incurred by the manufacturer of the goods
- relate directly or indirectly to the production of the goods
- can reasonably be allocated to the production of the goods
- are not specifically excluded (see exclusions under overhead)
- are not included elsewhere, e.g. under overhead

they may be included, in whole or in part, within qualifying expenditure. In other words no cost, like water, may be taken into account more than once.

Qualified claims

Businesses unable or unwilling to make an unequivocal claim of 'Made in Australia' for their product may wish to consider making a qualified claim.

A qualified claim gives more information than the general claim. For example, 'Made in Australia' is an unqualified claim, while 'made in Australia from local and imported ingredients' is a qualified claim. A qualified claim may have several levels of qualification like 'made from a blend of local and imported ingredients subject to seasonal availability'.

Care must be taken to ensure the contents of the products correspond with the claims made in the packaging of the products.

The ACCC's enforcement view

The Trade Practices Act does not require you to make an origin claim. However, if you do, it must be accurate and correct.

On the other hand, the Customs administered *Commerce (Trade Descriptions) Act 1905* and the *Commerce (Imports) Regulations 1940* require imported 'articles used for food or drink by man, or from which food or drink for use by man is manufactured or prepared' to have and maintain origin labelling. Also under the Australia New Zealand Food

Standards Code, administered by FSANZ, food must be labelled for both country of origin and ingredients. The code regulates country of origin for all packaged and some unpackaged foods in the Australian market irrespective of their source. The Food Standards Code gets its legislative force via its adoption, without variation, into state and territories food acts and the *Imported Food Control Act 1995*. State and territory health or agriculture departments and the Australian Quarantine Inspection Service enforce the labelling requirements of the code.

At the time of printing both the Commerce (Trade Descriptions) Act and the country of origin labelling (of food) provisions contained in the Australia New Zealand Food Standards Code are under review.

The ACCC has previously agreed that claims such as 'Made in Australia from local and imported ingredients' do **not** have to use or meet in full the requirements for the substantial transformation and 50 per cent production cost defences. It also encourages the use of qualified claims when the extra information provided is accurate, relevant and useful and does not give a false or misleading impression. For example, where the imported content of a product is greater than the local content, the label claim should read 'Made in Australia from imported and local ingredients' or where the local content is greater, 'Made in Australia from local and imported ingredients'.

For claims with several levels of qualification like 'Made from a blend of quality local and imported ingredients subject to seasonal availability', it is the ACCC's view that the qualifier 'subject to seasonal availability' means that:

- the relative proportions of local and imported ingredients depend on the availability of local and imported ingredients during different seasons and not other factors including price
- the manufacturer as far as possible uses local ingredients when local ingredients are seasonally available
- the manufacturer is not absolved from having to include both local and imported ingredients at all times. Relative proportions may vary from time to time but there must be a substantial local content in one or more seasons during the year.

Product of *Country of origin*

Eligibility to use the premium claim of 'product of *Country of origin*' appears to be well understood and is not a big issue in the industry. However, there is still some uncertainty regarding the tests for this defence particularly the first one, that is 'each significant ingredient (or component) of the good must originate from the country of the claim'.

The question of 'significant ingredient' or 'significant component' is not necessarily related to the percentage that the ingredient makes up of the good in question. In the Explanatory Memorandum to the amending legislation, the following example was given:

> …for an apple and cranberry juice to be able to carry a 'produce of Australia' label, both the apple and the cranberry juice would have to be sourced from Australia. This is despite the cranberry juice being, on average, about 5 per cent of the total volume of the product. If, however, a local source can be found for the apple juice and the cranberry juice then it would be legitimate to employ a 'product of Australia' label, even if, say, a preservative was added to the juice and the preservative was imported. This is because the preservative does not go to the nature of the good.

This would make claims of 'product of *Country of origin*' difficult to sustain for any product with a significant imported ingredient or component. This may be particularly relevant to a number of processed foodstuffs and beverages. For example, any food or beverage product that depended on an imported ingredient for its specific nature would not be eligible for the 'product of *Country of origin*' defence.

Packaged or processed foodstuffs and beverages are often complex products. They may undergo a series of processes and may require a range of ingredients. The processing may be carried out at different locations, outside the claimed country of origin, and the ingredients may also come from different sources. If any processing locations or sources of significant ingredients are not within the claimed country of origin, it would be inadvisable to use the 'product of *Country of origin*' claim.

General

Silence

In some circumstances failure to disclose important information can be misleading. If the overall impression is misleading in any way, then more information needs to be provided or the representation needs to be made clearer. The misleading impression must be corrected at the same time and with the same impact as the initial representation. While there is no general duty of disclosure in the Act, including origin claims, it is up to a business to make sure that the combination of what is said and what is left unsaid does not give consumers the wrong overall impression.

Internet assistance

On its webpage at <http://www.accc.gov.au> the ACCC has a country of origin site with an interactive question and answer (Q&A) segment that will provide an email response within 48 hours to any issues or queries not already covered there or in this guide.

Other relevant websites include FSANZ in terms of the Australia New Zealand Food Standards Code at <http://www.foodstandards.gov.au>, Australian Wine and Brandy Corporation for Rules of Origin covering exports of wine and brandy at <http://www.awbc.com.au>, Customs for Rules of Origin covering imports at <http://www.customs.gov.au> and Industry, Tourism and Resources at <http://www.industry.gov.au/labelling>.

Companies inspected

For the working party's terms of reference it was agreed that a representative range of the industry's manufacturing processes would be inspected to help determine if they would satisfy the tests relating to country of origin representations. The AFGC arranged the following program of visits.

NSW

Simplot, frozen and canned vegetables, frozen fish, baked goods

VIC

Henry Jones, jam

Berri, fruit juices

McCormicks, herbs and spices

Don Smallgoods, hams and smallgoods

Ardmona, canned fruit and vegetables

Unilever, processed tomatoes, dry soups

Kraft, cheese, peanut butter, Vegemite

SA

Angas Park, dried fruits

Qld

Nestlé, instant coffee

Attachment

Edited extract from ANZCERTA as at June 2001.

Joint Australia/New Zealand Customs information booklet, *Rules governing entitlement to preferential rate of duty for trans-Tasman trade*.

The 50 per cent rule—criteria

What is the setting for the 50 per cent and who must incur it?

The scheme of current Australian legislation is built around 'the factory' which is defined as the place where the last process in the manufacture of the goods was performed. It is important to understand that the manufacturer is defined as the person undertaking the last process in the manufacture of the goods. Manufacture of the goods must take place in Australia. When put together, the significance of these concepts is that:

- all inputs into the manufacturing process (other than those materials treated as overheads) are to be treated as materials entering that process
- all expenditure forming part of the 50 per cent requirement must be incurred by the manufacturer of the goods.

Another important aspect of the 50 per cent calculation is that no cost may be taken into account more than once.

How is the 50 per cent calculated?

The 50 per cent rule is a value added test and is based on the formula:

$$\frac{\text{qualifying expenditure (Q/E) \%}}{\text{factory cost (F/C)}}$$

Q/E = Qualifying expenditure on materials + qualifying labour and overhead (includes inner containers)

F/C = Total expenditure on materials + qualifying labour and overhead (includes inner containers)

The elements of factory cost i.e. material, labour and overhead and inner containers are dealt with below.

Elements of the 50 per cent

Materials

Total expenditure on materials includes all directly attributable costs of acquisition into the manufacturer's store.

This will **include**:

- the purchase price
- overseas freight and insurance
- port and clearance charges
- inward transport to store

but **excludes**:

- customs duty
- anti-dumping or countervailing duty
- excise duty
- sales tax
- goods and services tax

incurred by the manufacturer in Australia.

When materials:

- are provided free of charge or at a cost which is found to be more or less than normal market value or
- are added or attached to goods in order to artificially raise qualifying expenditure

the ACCC may determine a value which will apply.

Qualifying expenditure on materials

Qualifying expenditure on materials is 100 per cent when:

- the material is an unmanufactured raw product of Australia or
- the material is wholly manufactured in Australia from the unmanufactured raw products of this country.

Materials of mixed origin

These are materials which incorporate both imported and Australian content. Australia treats materials of mixed origin which reach 50 per cent or more local content as 100 per cent qualifying materials. Australia calculates the percentage of local content as the sale price of the material minus the imported content. This applies to Australian goods both exported and sold locally.

The following example illustrates the Australian outcome where the 50 per cent local content is not reached:

e-x-a-m-p-l-e

		$
(a)	Cost of imported materials	150
(b)	Cost of materials manufactured in Australia	20
(c)	Labour and factory overhead for manufacture of materials	30
(d)	Total factory cost of materials	= 200
(e)	Other overhead and profit	50
(f)	Selling price of material to factory	= 250

Qualifying expenditure (b+c) = $50

Qualifying expenditure ÷ total factory cost (d) = $50 ÷ $200 = 25%

Qualifying expenditure on materials = 25% of f ($250) = $62.50

Materials recovered from waste and scrap

Australia has agreed to the following interpretation of this provision. Thus, expenditure:

- on waste and scrap resulting from manufacturing or processing operations in Australia and
- on used articles collected in Australia, which are fit only for the recovery of raw materials

shall be treated as qualifying expenditure on materials used in manufacture of goods.

Inner containers

Inner containers includes any container or containers into which any finished goods are packed other than pallets, containers or similar articles which are used by carriers for cargo conveyancing.

Australia treats materials for inner containers in the same manner as any other materials. The effect of this is that where there is less than 50 per cent Australian content, Australia may allow some qualifying expenditure.

Labour

Labour costs associated with the following functions may form part of qualifying expenditure:

- manufacturing wages and employee benefits
- supervision and training
- management of the process of manufacture
- receipt and storage of materials
- quality control
- packing goods into inner containers
- handling and storage of goods within the factory.

To the extent that any of the listed costs:

- are incurred by the manufacturer of the goods
- relate directly or indirectly to the production of the goods
- can reasonably be allocated to the production of the goods
- are not specifically excluded (see exclusions under **Overhead** below)
- are not included elsewhere, for example, under **Overhead**

they may be included, in whole or in part, within qualifying expenditure.

Overhead

Subject to later qualifications, the following overhead costs associated with manufacturing functions may form part of **qualifying expenditure**:

- inspection and testing of materials and the goods
- insurance of the following kinds:
  - plant, equipment and materials used in the production of the goods
  - work-in-progress and finished goods
  - liability
  - accident compensation
  - consequential loss from accident to plant and equipment
- dies, moulds, tooling and the depreciation, maintenance and repair of plant and equipment
- interest payments for plant and equipment

- research, development, design and engineering
- the following real property items used in the production of the goods:
  - insurance
  - rent and leasing
  - mortgage interest
  - depreciation on buildings
  - maintenance and repair
  - rates and taxes
- leasing of plant and equipment
- energy, fuel, water, lighting, lubricants, rags and other materials and supplies not directly incorporated in manufactured goods
- storage of goods at the factory
- royalties or licences in respect of patented machines or processes used in the manufacture of the goods or in respect of the right to manufacture the goods
- subscriptions to standards institutions and industry and research associations
- the provision of medical care, cleaning services, cleaning materials and equipment, training materials and safety and protective clothing and equipment
- the disposal of non-recyclable waste
- subsidisation of a factory cafeteria to the extent not covered by returns
- factory security
- computer facilities allocated to the process of manufacture of the goods
- the contracting out of part of the manufacturing process within Australia
- employee transport
- vehicle expenses
- any tax in the nature of a fringe benefits tax.

NOTE: The cost of any depreciation must be worked out in accordance with generally accepted accounting principles applied by the manufacturer.

To the extent that any of the costs included in qualifying expenditure:

- are incurred by the manufacturer of the goods
- relate directly or indirectly to the production of the goods
- can reasonably be allocated to the production of the goods
- are not specifically excluded (see below)
- are not included elsewhere for example, under **Labour**,

they may be included, in whole or in part, within qualifying expenditure.

The following costs are specifically **excluded as qualifying expenditure**:

- any cost or expense relating to the general expense of doing business (including, but not limited to, any cost or expense relating to insurance or to executive, financial, sales, advertising, marketing, accounting or legal services)
- telephone, mail and other means of communication
- international travel expenses including fares and accommodation
- the following items in respect of real property used by persons carrying out administrative functions:
  - insurance
  - rent and leasing
  - mortgage interest
  - depreciation on buildings
  - maintenance and repair
  - rates and taxes
- conveying, insuring or shipping goods after manufacture
- shipping containers or packing the goods into shipping containers
- any royalty payment relating to a licensing agreement to distribute or sell the goods
- the manufacturer's profit and the profit or remuneration of any trader, agent, broker or other person dealing in the goods after manufacture
- any other cost incurred after the completion of manufacture of the goods.

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