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## Editorial Comment

### • Free Trade in Cars from 2006

With Federal Parliament just returned from its winter break, final consideration of the Howard Government's post-2005 automotive industry assistance arrangements is likely to be concluded in parliamentary sessions through to Xmas - as consideration is given to the Customs Tariff Amendment (ACIS) Bill 2003, and the ACIS Administration Amendment Bill 2003.

With John Howard on the verge of having to write into legislation the Government's commitments in terms of the previously-announced assistance package out to 2015, Work-place Relations Minister, Tony Abbott, is again stirring-the-pot in terms of the expectation of senior Ministers that automotive company managers will screw down hard in union negotiations - to ensure the benefits of the new assistance package are not frittered away too early in the term of the post-2005 Scheme.

This is good advice, as companies will need every cent for on-going investment to ensure they remain competitive in a domestic automotive market that is already flush with imports. The situation will only get worse, however, as the industry is forced over the next five years to deal with duty free cars and components coming in from the United States - under the AUSFTA agreement currently under negotiation - but also the Free Trade Agreement being pushed through with Thailand.

Whilst it is likely the Thai agreement will fail in the immediate term to achieve sectoral 'zero-for-zero' tariffs at the heart of the Government's negotiating objectives, the initial deal's tariff reductions will still shave-off a reasonable margin from what is left of the industry's tariff protection going forward from 2005.

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## Vendor tooling still a 'supply pain'

AusIndustry wrote to ACIS participants recently outlining that compliance monitoring activity had revealed anomalies in the claims of a number of Automotive Component Producers (ACPs), Automotive Machine Tool Producers (AMTPs) and Motor Vehicle Producers (MVPs) seeking ACIS benefits for similarly described recoverable or vendor tooling.

The correspondence intimated each of these ACPs, AMTPs and MVPs appeared to be claiming ACIS benefits for similar (or the same) tooling, leading to the issuance of a warning that under the ACIS Administration Act 1999, only one ACIS participant in the supply chain can receive ACIS credits for a particular eligible activity.

According to AusIndustry, vendor tooling involves 'one party contracting another to produce a tool.' Under this relationship, the seller (the party producing the tool) is envisaged as entering into a commercial relationship to produce and sell the tool to the buyer (the party commissioning the tool).

Consequently, the vendor tooling relationship - governed by Section 6(1) of the ACIS Act and Regulation 12(2)(a) - involves the sale of a good, with the ultimate eligibility for ACIS claims by ACPs, AMTPs and MVPs for investment in such tooling depending upon the ultimate ownership of the tool.

In this regard, AusIndustry advised, 'a tool is not an allowable item of plant and equipment of an ACP or an AMTP if the tool is intended to be sold to an MVP or another party, even where the tool is used to produce components for an MVP'. Further, the sale of a tool 'would contribute to the determination of the value of a participant's ACIS sales, and therefore, raises that participant's 5% sales cap', the correspondence says.

## Vendor tooling claims histories being checked

AusIndustry is now checking its claims database with a view to highlighting the incidence of recoverable or vendor tooling in ACIS claims to date, and is proposing to recover ACIS duty credits which have been paid incorrectly. Such action may have an adverse financial impact on a number of ACIS participants if so-called 'double claims' are found to have been made.

AusIndustry's approach, nevertheless, falls well short in its coverage of industry practices in the utilisation of vendor tooling and, as such, leaves industry uncertain over the concept of 'ultimate ownership' of a tool. For example, what is the treatment of entitlements under circumstances where some payment is made for an ACP's tooling plant and equipment by their customers?

TCF Services considers there are a number of ways to interpret who can/who can't claim ACIS benefits on vendor tooling, which may be summarised as follows:

### 1 - Vendor delivers own tool to component manufacturer for making of parts

In this case, the component manufacturer cannot claim the tool for ACIS, even though they may be responsible for insurance, damage etc. The tool will form the basis of an ACIS claim for the Vendor if registered for ACIS.

### 2 - Vendor places order for supply of a tool on component supplier

In this case, financial accommodation is made on a lump sum payment basis or progress payment basis, with final payment on commissioning. The subject 'tool' remains on the premises of the component supplier - who is responsible for insurance, damage, maintenance, re-cuts, etc. As such, the component manufacturer cannot claim for ACIS, as he is merely building a 'stock item' that is intended for sale upon successful commissioning.

In terms of the claim for ACIS benefits, TCF Services would ignore the commercial conditions of the sale (eg: ownership not transferring to vendor until fully paid), as this type of 'asset' does not meet the intended definition under Section 6 of the Act, as allowable plant and equipment. We would also ignore the historical accounting treatment of 'Capital WIP, or Plant under Construction', as these are merely holding accounts to build the cost up to final stage of sale. In our view, such arrangements are not tooling or plant that the component supplier will own during the Standard Volume Production (SVP) stage.

### 3 - Vendor places an order for supply of a tool upon a component supplier - partial payment/shared ownership

In such a case, the financial accommodation is on a partial payment basis or shared ownership. The tool remains on the premises of the component supplier, who is responsible for insurance, damage, maintenance, re-cuts, etc. In this scenario, we would view it as essential the purchase order states the ownership ratio, so that both parties claim only their eligible portion of the tool as part of their ACIS claim. The recoverable portion of the tool for the component supplier is then amortised in the piece price, in accordance with the purchase order. Each party is therefore able to claim their portion of the tool cost as ACIS eligible. In essence, the purchase order should state this as fact. The tool may then fully revert to the Vendor's ownership after the model run (ie: 3-5 years), given the tool would usually continue to be used for parts and accessories (P&A) manufacture after completion of the subject model run. By this stage, the subject plant and equipment falls outside the 12 Qtr average, so no value is lost.

### 4 - Option 3, but total order value (including finance costs) to be amortised in the piece price

In this case, the total order value (including finance costs) is to be amortised in the piece price in accordance with the purchase order. The tool remains on the premises of the component supplier, who is responsible for insurance, damage, maintenance, re-cuts, etc. In its traditional definition, recoverable tooling is owned by the component supplier, who also picks-up all the inherent risks of ownership (insurance, finance costs, damage, maintenance, modifications, re-cuts, etc). Further, the subject tooling is amortised in the piece price on an accelerated basis (ie: period to be agreed upon with Vendor), or over the model life (3-5 years) - the purchase order usually states this. The amortisation aspect is similar to depreciation for normal taxation and accounting policy, in that the tool or die is written off over its effective life (eg: the current allowance for tax purposes is 3-5 years). In TCF Services view, recoverable tooling is eligible for the component supplier to claim as 'owned P&E'. Ownership can then revert to the Vendor, but by this stage, the plant and equipment is out of the 12 Qtr average, so no value is lost. The tool usually continues to be used for P&A parts supply.

## Legal hassles, but big benefits in question

In summary, TCF Services view Scenarios (1) & (2) as not being defensible positions from a component supplier's perspective. Scenarios (3) and (4) allow scope for component suppliers to mount a valid defence to past, present and future claims, depending on the circumstances and agreements, or purchase orders put in place. Under scenarios (3) and (4), AusIndustry may still hold the view that the intention was always to transfer ownership to the Vendor at some stage, and therefore, cannot form part of a valid claim for the component supplier. Accordingly, the issue of vendor tooling is not yet settled, and any future adverse AusIndustry decision on claims of this nature should be reviewed with the intention of appeal to a higher authority.

AusIndustry is now asking ACIS participants to help them identify shortfalls in previous claims where such claims may have been paid on subject vendor tooling, which is now resident in another persons' hands, other than the original claimant. Many would argue that even though the tooling has passed on, the original claimant was correct in seeking ACIS benefits for, at the time, they were undertaking an eligible activity.

Still, those ACIS participants wishing to push the boundaries on vendor tooling should prepare themselves to ride the wave of uncertainty, given that in the event of a negative decision, they will be facing a large unearned credit liability (UCL), and the prospect of having to defend their actions in the Administrative Appeals Tribunal (AAT).

Whilst current legislation does not clearly define who is the eligible claimant regarding the tooling issue, participants are left with the dilemma of having to deal with the prospect of a UCL calculated back to the very beginning of ACIS, or in fact, face up to the reality that for the life of the ACIS Scheme, they will be perpetually under-claiming. In such endeavours, a level playing field is unlikely to exist, as different players will adopt different approaches to resolving liabilities moving forward.

## Managing the prospect of a substantive UCL

On a lesser note, but with much the same ramifications, the continued claiming of labour costs in tooling manufacture - either in house or contracted - also remains clouded. Early information sessions run by industry consultants yielded advice to Scheme participants to claim the 'build cost' of the tool, in addition to that for design and development. AusIndustry is now insisting that the build is a matter of routine, and as such, the labour costs are ineligible as part of the ACIS claim. We will comment further on this aspect at a later date.

The most pressing question at the moment is, will you have an UCL when AusIndustry get around to conducting the inevitable audit of previous quarters' claims, or do you take the safe route and be ultra conservative in your approach to claims?

**Call TCF Services to discuss your particular situation further.**



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