PR 1999/17 - Income tax: Summerhill Orchards Project No 1

Product Ruling
Income tax: Summerhill Orchards Project No 1

Contents Para

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the Taxation Administration Act 1953. Product Ruling PR 98/1 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Summerhill Orchards Project No 1, or just simply as 'the Project', or the 'product'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 25-25 of the ITAA 1997;
- section 42-15 of the ITAA 1997;
- section 387-55 of the ITAA 1997;
- section 387-125 of the ITAA 1997;
- section 387-185 of the ITAA 1997;
- Part IVA of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KL of the ITAA 1936; and
- section 82KZM of the ITAA 1936.

Class of persons

3. The class of persons to whom this Ruling applies ('Growers') is those who enter into the arrangement described below on or after the date this Ruling is made. They will have an intention of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires) with a purpose of deriving assessable income from this involvement as set out in the description of the arrangement.

4. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

5. The Ruling provides this specified class of persons with a binding ruling as to the tax consequences of this product. The Commissioner accepts no responsibility in relation to the commercial viability of this product, and gives no assurance the prices charged for the product are reasonable, appropriate or represent industry norms. A financial (or other) adviser should be consulted for such information.

6. The Commissioner rules on the precise arrangement identified in the Ruling.

7. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 12 to 36) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

Date of effect

9. This Ruling applies prospectively from 28 April 1999, the date this Ruling is made. However, 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).

10. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, the product ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2001. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

12. The arrangement that is the subject of this Ruling is described below. This description is based on the documents listed below and these documents, or relevant parts of them, as the case may be, form part of and are to be read with this description:

- The new Summerhill Orchards Project No 1 Prospectus received by the Australian Taxation Office ('ATO') on 4 March 1999;
- Farm Allotment Agreement between the Grower and Summerhill Orchards Limited ('Manager');
- Management Agreement between the Grower and Summerhill Orchards Limited;

- Draft loan proposal between AMM Finance Corporation (No 5) Pty Limited and the Grower provided on 4 March 1999;
- Project Deed between Summerhill Orchards Limited, Geoffrey Thompson (Harcourt) Pty Ltd (Land Owner) and Australian Rural Group Limited (Trustee);
- Product Ruling request dated 17 November 1998 lodged by Summerhill Orchards Limited;
- Correspondence from Summerhill Orchards Limited to the ATO dated 25 November, 21 and 24 December 1998, 29 January and 29 March 1999;
- Copies of default insurance agreements and funding security details provided by Summerhill Orchards Limited to the ATO on 7 April 1999.

The salient features and effect of these arrangements are summarised below:

13. An orchard of 271 acres is to be planted with 337,677 apple and pear trees, with planting to be completed by 31 July 2000. Growers entering into the Project will acquire an interest in, and licence to use, 0.22 acres (or multiples thereof including half Allotments) of this farm.

14. It is proposed to plant 'Packham' pears as well as 'Royal Gala', 'Pink Lady', 'Fuji' and 'Sundowner' apples. Trees are planted using the 'Open V Tatura Trellis System' which allows a greater concentration of trees in a given area and, as a result, each individual Allotment will have 276 trees. A side effect of this method, however, is that the trees will have a shortened productive life.

15. Growers will participate in the Project over a 17 year period. This period is considered to be the commercial limit of the Project. At the end of the period the Grower will hand back their interest in the farm for nil consideration. The Grower may remove the trees and other improvements from their Allotment, but it is not required.

16. A detailed irrigation plan has been commissioned, which will provide even sprinkler flow to all sections of the orchard and all trees will be spray irrigated. The entire orchard has been laser graded with run-off collected in a 10 megalitre dam constructed on the property.

17. The Grower is vested with the seedlings purchased for the Grower, by virtue of the Grower's application being accepted. The trees or seedlings on the Grower's Allotment, the Grower's interest and the produce attributable to the Grower's Allotment, as well as any by products from the sale of this produce, are also vested in the Grower via the Project Deed.

18. The Trustee holds all investments, the Application fund and the Proceeds fund for the benefit of the Grower.

Farm Allotment Agreement

19. The registered owner of the land, Geoffrey Thompson (Harcourt) Pty Ltd, leases the land to the Trustee, Australian Rural Group Limited, who then subleases it to the Manager, Summerhill Orchards Limited. For $50 per year the Manager then grants a licence to the Growers to use and occupy an Allotment(s) through Farm Allotment Agreements.

20. The license granted is for the Grower only to use and occupy the Allotment for the purpose of establishment, growing, maintenance and harvesting of the trees for the term of the agreement. Both the Farm Allotment Agreement and Management Agreement will specify the Grower's separate and distinct Allotment(s) or half Allotments.

21. No Grower will have an exclusive right to occupy an Allotment and at the end of the agreement the Grower must return the Allotment to the Manager in good condition. At this time the Grower may, if they wish, remove all trees and equipment from their Allotment; however if they do not remove them within 30 days after the end of the agreement they will become the property of the landowner.

Management Agreement

22. The Grower engages the Manager as an independent contractor to manage the Allotment for the Grower for the term of the agreement. The Manager's duties are to establish the orchard and to maintain the Allotment(s) on behalf of the Grower. The Manager is required to perform these services according to good horticultural practices and may provide the services directly or through consultants or other specialists engaged at the Manager's expense. These duties include:

- prepare the Grower's Allotment so that it is suitable for planting and growing at least 276 trees of the type and variety of fruit as determined by the Manager;
- ensure the Grower's Allotment has adequate drainage;
- supply at least 126 trees per Allotment and sufficient fertile rootstock that a further 150 trees per Allotment will be planted over the following two years;
- tend the tree seedlings;
- once the rods have reached an appropriate stage of development, plant out the rods;

- establish the trees and the Grower's Allotment in a proper and skilful manner;
- prepare and implement an irrigation plan for the Grower's Allotment; and
- acquire and install trellising, on the Grower's behalf.

23. The Manager will insure against public risk as well as risks associated with the storage and transport of the produce attributable to the Grower's Allotment. The Grower is at liberty to insure the Grower's Allotment, the trees or the produce attributable to the Grower's Allotment for other risks.

24. The Manager is also responsible for the harvesting, marketing and sale of the produce on behalf of the Grower. The Manager is required to report regularly to the Grower on their farm's progress and, once income is generated, the Manager must give the Grower regular reports verifying production, sales, costs and any other expenditure incurred.

25. The Manager will have commenced these business operations on behalf of the Grower by 30 June 1999, for units settled before 30 June 1999. For units settled after 30 June 1999, the Manager will have commenced these business operations by 30 June 2000.

Fees

26. Growers are required to make the following subscription fee payments for a single Allotment:

- $6,000 in year one, $3,000 for ½ Allotments;
- $5,000 in year two, $2,500 for ½ Allotments; and
- $2,000 in year three, $1,000 for ½ Allotments.

27. Years one to three payments include a licence fee of $50 as well as a number of capital expenses. These are:

	Year 1	Year 2	Year 3
Trees, Rods, Rootstock	$1,877	$112	
Earthworks	$96	$101	$51
Labour – planting	$81	$86	$44
Trellis	$167	$172	$88
Irrigation	$215	$159	$79
Farm Plans	$16		

28. The purchase of trees, rods and rootstock, together with earthworks and labour for planting, are considered to be establishment expenditure and it is this amount that is written off over the effective life of a horticultural plant (see paragraph 72).

29. In later years, management payments are for operation costs only. The Prospectus shows these costs to be $2,150 for year four, $1,075 for ½ Allotments, and $2,400 for year five, $1,200 for ½ Allotments. From year five on, the payments increase in proportion with the Consumer Price Index (All Groups) Melbourne.

30. From year four on, management fees are paid directly from the profits of the business; however, Growers remain personally liable for any shortfall.

Financing

31. Growers can choose to fund their investment themselves, borrow from an unassociated lending body or borrow through finance arrangements set up with AMM Finance Corporation (No 5) Pty Limited ('AMM'). Finance arrangements organised directly by the Grower with independent lenders are outside the arrangement to which this Ruling applies and, consequently, have not been ruled on.

32. Each Grower will deposit with the Trustee a total of $6,000 being the total first year farm, licence and management fees. Each Grower will then pay the Trustee a further $5,000 in year 2, and $2,000 in year 3. Each Grower will pay a total of $13,000 into the Project during the first three years. The Trustee will forward these funds to the Project Manager when it meets the requirements of the Project Deed.

33. Geoffrey Thompson (Harcourt) Pty Ltd may provide the Project land to the National Australia Bank as partial security for the wholesale funds the bank supplies to AMM.

34. AMM make funds available on a full recourse basis to the Growers to finance a maximum of $13,000 of their participation. The finance will be fixed at an indicative interest rate of 10.5% per annum for nine years and is secured by the Grower's interest in the Project. AMM may increase the rate by the amount of any increase between 1 March 1999 and the date this loan is made, in wholesale money market interest rates. The determination of the amount of any increase by AMM, supported by a confirmation from the National Australia Bank Limited of the increase in wholesale money market interest rates for fixed loans of a similar term, will be final. The Grower will pay an application fee of $300 and, if accepted, will be personally liable

for the full amount of the loan irrespective of the performance of their orchard.

35. The Grower must provide the following security for the loan to AMM:

- all entitlements under the Project;
- the Farm Allotment Agreement;
- the Management Agreement; and
- any insurances effected pursuant to the Investment.

36. If a borrower defaults, the lender will pursue the borrower to the full extent permitted by law including bankrupting the borrower if necessary. There are no circumstances where the debt will not be required to be repaid by the borrower. Not more than 10% of the monies advanced to the borrower and paid to the Trustee will be used to secure the financing arrangements.

Ruling

37. For a Grower who invests in the Project by 30 June 1999 the following deductions will be available for the years ended 30 June 1999 to 30 June 2001:

		Deductions available in each year		
	ITAA	Year 1	Year 2	Year 3
Fee type	1997 section	30/6/1999	30/6/2000	30/6/2001
Management fee	8-1	1,028	2,643	1,582
Licence fee	8-1	99	173	67
Loan interest	8-1	as incurred	as incurred	as incurred
Trellising	42-15	see paragraph 39	120 (pcm)	135 (pcm)
Farm Plans	387-55	31	-	-
Irrigation	387-125	142	325	360
Plant costs	387-165	see paragraph 43		

Management, Licence fees

38. That part of the management fee which is capital or of a capital nature is not an allowable deduction. The deduction for management fees under section 8-1, shown in the table, has been calculated after taking out the capital element of this fee. The licence fees are fully deductible under section 8-1 and have been marked-up in accordance with the formula discussed at paragraphs 61 and 62.

Loan interest

39. Interest on monies borrowed by Growers from AMM (see paragraphs 31 to 36) for the purpose of making subscription payments are deductible in years 1 to 3.

Depreciation of trellising

40. Depreciation of trellising will be an allowable deduction under section 42-15. Depreciation deductions in the table above have been calculated using the 'Prime cost method' ('pcm') only. See paragraphs 64 to 66 for further details.

Farm Plans

41. The 'Farm Plan' expenses are capital expenses. A deduction under section 387-55 is available to Growers carrying on business in the year the Farm Plan expenses are incurred. The amount of the Farm Plan deduction has been calculated by marking-up the projected expenditure figures shown in the Prospectus, in accordance with the formula discussed at paragraphs 61 and 62.

Irrigation

42. The irrigation expenses set out at paragraph 27 are a capital expense. A deduction under section 387-125 is available to a Grower in the year the projected expenditure is incurred, and two years following, at the rate of 33.3% per annum. The amount of the irrigation expense deduction has been calculated by marking-up the expenditure figures shown in the Prospectus, in accordance with the formula discussed at paragraphs 61 and 62, and then multiplying that amount by one third.

Plant costs

43. As discussed at paragraph 28, plant costs (i.e., 'establishment expenditure') include the purchase of trees, rods and rootstock

together with earthworks and labour for planting. A deduction of 13% of the capital cost will be available to the Grower under section 387-185, calculated from the year in which the tree enters its first commercial season. An example of how this amount is calculated is at paragraph 74.

Loan application fees

44. Loan application fees / other up front borrowing costs for loans covered by this Ruling would be deductible over a five year period from the time the loan agreement is entered into under section 25-25.

Section 82KZM

45. The expenditure by Growers does not fall within the scope of section 82KZM.

Section 82KL

46. Section 82KL does not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA

47. Part IVA does not apply to deny a deduction for the expenditure by Growers or interest on any loans covered by this Ruling, that are taken out to fund payment of their expenditure.

Explanations

Section 8-1

48. Consideration of whether licence and management fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoing is not deductible under the second limb if it is incurred when the business has not commenced; and
- where a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has

commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

Growers carrying on business

49. An orchard scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from fruit from the scheme will constitute gross assessable income. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will include the planting, tending, maintaining and harvesting of the apple and pear trees, as well as the distribution and marketing of the apples and pears.

50. Generally, a Grower will be carrying on a business of an orchard where:

- the Grower has an identifiable interest in specific growing trees coupled with a right to harvest and sell the fruit produced;
- the orchard activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business as used by the courts point to the carrying on of a business.

51. For this Project, Growers have, under the Farm Allotment and Management Agreements, rights in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of a commercial orchard. Under these agreements Growers appoint Summerhill Orchards Ltd, as Manager, to provide services such as planting, tending, pruning, training, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. The Manager is also responsible for the harvesting, marketing and sale of the produce from the trees.

52. The Management Agreement gives Growers an identifiable interest in specific trees and Growers have a legal interest in the land by virtue of the Farm Allotment Agreement.

53. Growers have the right to use the land in question for horticultural purposes and to have Summerhill Orchards Ltd come onto the land to carry out its obligations under the Farm Allotment and Management Agreements. The Growers' degree of control over

Summerhill Orchards Limited, as evidenced by the agreements and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive a yearly account for the proceeds of the sale of fruit from, as well as regular reports of, the Summerhill Orchards' activities. Growers are able to terminate arrangements with Summerhill Orchards Ltd in certain instances, such as cases of default or neglect. The activities described in the Farm Allotment and Management Agreements are carried out on the Growers' behalf.

54. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. The independent horticultural report in the Prospectus considers that the Project is realistic and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

55. Growers will engage the professional services of a Manager with appropriate credentials. There is a means to identify which trees Growers have an interest in. These services are based on accepted horticultural practices and are of the type ordinarily found in orchards that would commonly be said to be businesses.

Apportionment of management fees

56. Growers have a continuing interest in the trees from the time they are acquired until they reach the end of the most productive period of their life. The orchard activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' orchard activities will constitute the carrying on of a business.

57. The activities the Manager is required to undertake are listed in the Management Agreement between the Grower and Manager (see summary at paragraph 22). Some of these activities are of a capital nature. The Manager's Allocation of Subscription Expenses table in the Prospectus, outlines how the Growers' subscription monies will be spent. These monies, which principally consist of a management fee, will be spent on items that are either of a revenue or capital nature.

58. Under the Management Agreement the management fee is an undissected lump sum in return for which the Grower obtains services of both a revenue and capital nature. *Ronpibon Tin v. Federal Commissioner of Taxation* (1949) 78 CLR 47; (1949) 8 ATD 431

provides authority for the apportionment of the management fee in determining deductibility under section 8-1.

59. The joint judgment of the High Court in *Ronpibon Tin* stated that subsection 51(1) of ITAA 1936 'contemplates apportionment' and 'there are at least two kinds of expenditure which require apportionment'. One of the described kinds of apportionable expenditure is a 'single outlay or charge which serves both objects indifferently', those objects being previously described as 'expenditure in respect of things or services of which distinct and severable parts are devoted to gaining or producing assessable income and distinct or severable parts to some other cause' (CLR at 59; ATD at 437). The management fee paid by the Growers is an example of such an expenditure.

60. The management fee paid by the Grower is for activities that are of a revenue and capital nature and, in accordance with paragraph 8-1(2)(a), the management fee is not an allowable deduction to the extent it is a loss or outgoing of capital or of a capital nature. That part of the management fee that is deductible under section 8-1 is shown in the table at paragraph 37.

61. From the Manager's Allocation of Subscription Expenses table, and having regard to the contractual terms of the various agreements, an estimation of the cost of various advantages that will directly accrue to the Growers has been identified. Some of the costs and profits of the Manager's business do not provide a direct advantage to the investor and these have been apportioned across the items that more directly provide advantages to the Growers. In allocating these indirect costs to direct revenue and capital costs, the percentage that the indirect costs bear to direct costs is calculated as follows:

$$\frac{\text{Total projected overheads (indirect expenses) plus profit}}{\text{Total projected direct expenses}} \times \frac{100}{1}$$

62. The resulting percentage is a 'mark-up' figure that is applied to all direct costs. By applying the mark-up figure to all direct costs, all indirect costs and profits will be absorbed in the costs that more directly advantage the investor, ensuring that the entire sum of subscription monies in years 1 to 3 is referable to one advantage or another.

63. The marked-up revenue component of the management fee is the relevant deduction for management fees under section 8-1. Expenditures that are acceptable as being incurred for the purposes Subdivisions 387-A, 387-B and 387-C, as shown in the Manager's

Allocation of Subscription Expenses table, are also to be increased by the same mark-up percentage shown above. The expenditures that are deductible under Subdivisions 387-A and 387-B are stated in the table at paragraph 37.

Section 42-15

64. Trellising is plant for the purposes of section 42-18 and can be depreciated under section 42-15. Deductibility for depreciation will depend, for the purposes of either section 42-160, 'Diminishing value method' (dvm) or section 42-165, 'Prime cost method' (pcm), on the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising. Summerhill Orchards Limited are to advise Growers of this for the year ended 30 June 1999.

65. Deductions for the two succeeding years have only been calculated in the table at paragraph 37 using the prime cost method at the rate of 13%. The 'dvm' rate is 20%. Later years have not been calculated for 'dvm' as they depend on the number of days owned in the first year for the opening value to be depreciated in the second and subsequent years.

66. The amount that has been depreciated has been determined by marking-up the amounts shown for trellising in the Prospectus, in accordance with the formula discussed at paragraphs 61 and 62.

Subdivision 387-A

67. Subdivision 387-A allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on landcare operations. The deduction is allowed in the year it is incurred. The expenditure must be incurred in one of the following operations:

- eradicating or exterminating animal or vegetable pests from the land;
- destroying weed or plant growth detrimental to the land;
- preventing or combating land degradation, otherwise than by erecting fences on the land;
- erecting fences on the land primarily and principally to exclude animals from areas affected by land degradation;
- erecting fences to separate different land classes in accordance with an approved management plan;

- constructing a levee on the land or other improvements with a similar purpose; or
- constructing surface or sub-surface drainage works on the land primarily and principally for the purpose of controlling salinity or assisting drainage control.

68. The expenditure attributable to 'Farm Plans' would qualify for this Subdivision under the final dot point.

Subdivision 387-B

69. Subdivision 387-B allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed would be covered by this Subdivision.

70. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, lessee or licensee who is conducting a primary production business on land in Australia, a deduction would be available to the Growers in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

Subdivision 387-C

71. Subdivision 387-C allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. A lessee or licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land.

72. Under this Subdivision, if the effective life of the plant is less than three years the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant with an effective life of 13 to 30 years, as in this Project, the rate is 13%.

73. An example of how the Subdivision 387-C deduction is calculated is shown below. Growers will need to confirm when plants on their particular Allotment enter their first commercial season in calculating their deduction under section 387-165.

Example

74. Grower Jim owns one Allotment, with plants to the value of $4,081 having been planted by 30 June 1999 and plants to the value of $1,035 having been planted by 30 June 2000 on this Allotment. The value attributed to the plants in each year includes earthworks and planting costs (establishment expenditure). Jim can claim the following amounts, based on the assumption that only those plants planted in the Grower's Allotment by 30 June 1999 enter their first commercial season in the year ended 30 June 2000.

Fee type	ITAA 1997 section	Year 1 – 30/6/99	Year 2 – 30/6/00	Year 3 – 30/6/01
Plant costs	387-165	Nil	531	666

The amounts of $531 and $666 were calculated as follows:

- Year 2 - $4081 x 13% = $531;
- Year 3 – ($4081 x 13 %) + ($1035 x 13%) = $666.

Section 82KZM

75. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

76. Management fees of $1,028, $2,643 and $1,582 are deductible in years 1 to 3, respectively, as discussed previously in this Ruling. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description that the management fees have been inflated to result in reduced management fees being payable for subsequent years. The management fees are expressly stated to be for a number of specified services. There is no evidence that might suggest the services covered by management fees could not be provided within 13 months of incurring the expenditure in question.

77. Thus, for the purposes of this Ruling, it can be accepted that no part of the management fees that are deductible under section 8-1 in years 1 to 3 are to do 'things' that are not to be done wholly within 13 months of the management fee expenditure being incurred. On this basis, the basic precondition for the operation of section 82KZM is not

satisfied and this section will not apply to the deductible part of the management fee expenditure incurred by the Growers in years 1 to 3.

Section 82KL

78. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

79. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

80. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, there may be a loan provided by AMM to the Grower. The loan is provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. Section 82KL will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

81. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

82. The Summerhill Orchards Project No 1 will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the tax deductions for the amounts indicated in this Ruling that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

83. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of the fruit from the trees. Further, there are no features of the Project, for example, such as the management fees being 'excessive', not commercial, and predominantly financed by a non-recourse loan, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Detailed contents list

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

Commissioner of Taxation
28 April 1999

Previous draft:

No draft issued

Related Rulings/Determinations:

PR 98/1; TR 92/1; TR 97/11; TR 97/16; TD 93/34

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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