PR 1999/21 - Income tax: Tarwoona Olives Scheme No 1

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This document has changed over time. This is a consolidated version of the ruling which was published on *12 May 1999*

Australian Taxation Office

Product Ruling
Income tax: Tarwoona Olives Scheme 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 Tarwoona Olives Scheme No 1, or just simply as 'the Project', or the 'product'.

Tax laws

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

- section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Subdivision 387-A of the ITAA 1997;
- Subdivision 387-B of the ITAA 1997;
- Subdivision 387-C 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 is those who enter into the arrangement described below on or after the date this

Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and 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 49) 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.

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Date of effect

9. This Ruling applies prospectively from 12 May 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 2002. 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 change 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 following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Draft Prospectus prepared for Tarwoona Olives Scheme No 1;
- Draft copy of the Tarwoona Olives Scheme No 1 Constitution, between North West Rural Services Co Limited ('NWRS') and Tarwoona Olives Co Limited ('TOC') and the Farmer, which also incorporates a Joint Venture Agreement between NWRS, TOC and each Farmer in the Joint Venture;
- Draft copy of Application for shares in TOC;
- Draft copy of Application for Finance, Principal and Interest, Loan;

- draft Custodian Agreement between Australian Rural Group Limited ('ARG') and NWRS, to appoint ARG as the Custodian of the Managed Investment Scheme;
- draft copy of Loan Deed between Intagpro Pty Limited and the Borrower; and
- correspondence from NWRS's tax professional adviser to the Australian Taxation Office ('ATO') dated 3 February, 16 March, 17 March and 13 April 1999.

Note: certain information received from North West Rural Services Co Limited has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

13. The effect of these agreements is summarised as follows: this arrangement is called the Tarwoona Olives Scheme No 1 and will be registered as a Managed Investment Scheme under the Corporations Law. By entering into the Joint Venture Agreement, a Farmer will conduct, in joint venture with others, the business of growing olive trees with the objective of producing olives or olive products over a period of 25 years from the commencement date for commercial sale. A Farmer will commence business by entering into a Joint Venture Agreement with NWRS ('the Manager'), TOC ('the Landowner') and other Farmers whereby NWRS will be engaged to manage the Joint Venture and the Farmers' interest in it for 25 years.

14. The Joint Venture Farmers will grow the olive trees on the property known as 'Pethers', which is part of 'Ravensworth' situated near Hay, New South Wales. The relevant property will be leased to the Joint Venture Farmers by TOC via ARG. The property is the subject of an agreement for lease including an option to purchase the properties necessary for the Project. It is intended that TOC will complete the purchase of the property after 30 June 1999 and before 30 June 2000. A guaranteed sale of the property has been ensured by the arrangement of a call option over the leased land which will enable purchase without any restrictions.

15. The Project aims to establish an olive grove of up to 1,200 hectares and, in this regard, up to 6,000 interests in the Joint Venture are on offer. The minimum investment per Farmer will be one participation or interest in the Joint Venture. The Project will not commence unless at least two hundred (200) Joint Venture participations are taken up by Joint Venture Farmers by 30 June 1999. There is no maximum investment per Farmer in the Joint Venture.

16. Each Joint Venture Farmer in the Project is required to subscribe for an equity stake in TOC, the Landowner, or to nominate another person or entity to do so. The required equity stake being the minimum equity interest in TOC comprises ten (10) ordinary shares

with a total cost of $1,800. Additional equity of a multiple of ten (10) ordinary shares must be taken to equate to the number of participation interests in the Project.

17. The relevant property will be owned by TOC, which company will be owned as to sixty percent (60%) by Joint Venture Farmers or their nominated entities / persons in the same proportion as their Joint Venture participation.

18. Australian Rural Group Limited will act as Custodian of the Project for the Joint Venture Farmers.

19. Possible projected returns for Joint Venture Farmers are set out in the Draft Prospectus. However, these are dependent upon a range of assumptions and NWRS does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Joint Venture. Olive production is projected to commence in the year ending 30 June 2004. A harvest yield of 5,000 kilograms per hectare of olives in the fifth year of the Project increasing to 25,000 kilograms per hectare in year 11 onwards is anticipated. The Project is forecast to return (before allowing for any tax benefits) in excess of 20% averaged over the first 25 years.

20. All of the harvested olives will be sold to the highest bidder in the market.

Constitution and Joint Venture Agreement

21. In respect of the Project, a Farmer has an interest in specific property comprising the Managed Investment Scheme ('Scheme') property which is defined in the Constitution. ARG will act as Custodian of the Project for the Joint Venture Farmers. Farmers execute a power of attorney enabling NWRS to act on their behalf as required.

22. Farmers do not have any right to withdraw from the Scheme nor do they have a right to require their interest in the Scheme to be bought by the Manager or any other person or to have their interest in the Scheme redeemed (Clause 11, Constitution). A Farmer's Scheme interest may be transferred, provided such transfer is a transfer of the entire unencumbered interest in the Scheme (Clause 16, Constitution). NWRS keeps a register of Farmers.

23. The Farmers intend to remain Scheme members until the Scheme is determined on 30 June 2024, unless it is wound up earlier (Clause 7, Constitution).

24. The Farmers will each enter into a Joint Venture Agreement to carry out the Project as a Joint Venture and to appoint NWRS to manage the Joint Venture. The Project as defined in the Joint Venture Agreement is essentially the business of planting, growing and

cultivating olive trees to produce olives and olive products and the harvesting, marketing and sale of the olives and olive products produced therefrom.

25. TOC, being the Landowner, will grant to ARG, the Custodian, as agent for the Manager, a lease of the relevant land. The Manager will hold the interest in the land, being the lease, on behalf of the Joint Venture of Farmers to enable the plantation to be planted out with olive trees.

Fees

26. The fees and contributions payable are as detailed below:

Management fees

27. A management fee of $6,610 will be payable for each interest in the Joint Venture in respect of the first year of the Project, which will be payable on settlement of the application in respect of the Joint Venture Farmer. This fee is payable in advance for services to be provided by the Manager for the period of twelve (12) months from the date of payment.

28. Management fees in years subsequent to the first year will be payable on the anniversary of the settlement date yearly in advance on the basis of $1,618 for the 2nd year and then that amount increased by the Consumer Price Index (All Groups) Sydney in each subsequent year, until there are sufficient funds from income of the Joint Venture to enable management fees to be payable yearly in advance from those funds.

29. In addition to the annual management fee, the Manager shall be entitled to be paid harvest expenses as set out in the Joint Venture Agreement comprising an amount equal to the greater of:

- 20% of the gross sale proceeds; or
- $0.27 per kilogram of olives harvested, commencing in the year of harvest and indexed annually by the CPI (All Groups) Sydney.

30. Out of this payment, the Manager will attend to payment of harvest expenses. Where such payment is insufficient to meet the harvest expenses, then the harvest expenses shall be borne by the Farmers.

Lease rent contribution fees

31. The property necessary for the Project, and necessary fencing and machinery sheds and other structural improvements excluding

irrigation equipment, will be leased to the Farmers in year 1 for $200 per year for each interest in the Joint Venture, and in years 2 onwards $200 per year for the first year and then the previous year's lease rent contributions fee increased by the CPI (All Groups) Sydney, for each interest in the Joint Venture.

Joint Venture contributions

32. Each Joint Venture Farmer will be required to pay to the Manager the following upon settlement date of the Farmer's interest in the Joint Venture:

- an irrigation fee of $2,050 per participation;
- an erosion control fee of $180 per participation;
- an olive grove establishment fee of $780 per participation; and
- a land clearing fee of $95 per participation.

33. In addition, a further olive grove establishment fee of $275 is due per participation at the commencement of the second year.

34. These fees must be applied by the Manager to undertake the necessary capital works for the benefit of the Joint Venture.

35. Each Joint Venture Farmer (or interests nominated by the Joint Venture Farmer) will be required to purchase shares in Tarwoona Olives Co Limited. A participation will require the payment of $1,800 of capital to acquire 10 shares in the company, which payment will be required to be made on settlement date.

36. In the event that the gross income of the Joint Venture is insufficient in any year to meet payment of the relevant management fees and lease rent contribution fees, the shortfall will be met by the Joint Venture Farmers and not from gross income of future years.

37. NWRS considers the fees and contributions payable above are reasonable and commercial.

Manager's services

38. The services to be provided by NWRS to the Joint Venture are specifically set out in the Joint Venture Agreement and they include:

- caring and maintaining the olive tree seedlings in the nursery during the first 12 month period;
- cultivating, fertilising and planting out the plantation with olive trees in a healthy condition in the required number of trees per hectare;

- irrigating and applying water to the plantation to maintain the olive trees on the plantation in a healthy condition;
- pruning the olive trees as required from time to time in order to promote the growth and production of olives in accordance with the good agricultural practice for growing olives;
- taking such reasonable measures as may be required to control the growth of weeds and other vegetable pests on the plantation upon which the olive trees are growing, including the cultivation of the plantation between the rows of olive trees;
- taking all reasonable measures in accordance with the principles of good husbandry and to the extent reasonably possible to deter and eradicate any insect, bird or animal pests from the plantation which may detract from the health and vigour of the olive trees or the yield of olive fruit therefrom;
- replacing at the expense of the Joint Venture any olive trees that die or become unproductive;
- applying manure, fertiliser, mulch and such other material as is necessary in accordance with good agricultural practice to encourage growth and fruiting of the olive trees;
- repairing and maintaining in a good condition all fences, stakes, accessways and other structural improvements and irrigation plant and equipment on the plantation;
- marketing and arranging sales of the olives produced from the plantation including entering into a contract or contracts to supply olives harvested from the plantation;
- effecting the necessary insurances;
- employing such staff and labour as are necessary for the aforesaid purposes;
- performing any of the duties of the Manager as required under the Joint Venture Agreement and the Scheme Constitution; and
- doing all other things that are necessary or incidental to carrying out the Project to produce a viable business of growing, marketing and sale of olives or olive produce.

39. The land clearing fee is payable by each Farmer to the Manager, for the clearing of the plantation so that it is suitable for the planting out of olive trees.

40. The olive grove establishment fee is payable by each Farmer to the Manager for the purchase of the olive tree seedlings to establish the plantation, the cost of caring for the seedlings in the nursery and the planting out of the seedlings in the ground to be undertaken in the first and second years of the Project.

41. The irrigation fee is payable by each Farmer to the Manager for irrigation works to provide water reticulation to the olive trees on the plantation.

42. The erosion control fee is payable by each Farmer to the Manager for the provision of erosion control measures to the land.

43. The Manager, NWRS, will subcontract all proposed services and work to Intagpro Pty Limited, its holding company.

Planting

44. Olive seedlings will be purchased from various nurseries for the Project as and when required. It is proposed that the necessary number of young seedlings will be acquired by the Joint Venture from the nurseries and transferred to a special purpose built nursery of the Manager to be operated on the property. This nursery will be important to ensure the quickest possible growth under best practice agricultural management of the young seedlings. It is intended that the seedlings will, as they grow in the first year in this environment, be transferred to larger containers to ensure that they are strong and ready to be planted in the Joint Venture leased land in the second year of the Project.

45. The ground to take the seedlings in the second year will have been cleared, erosion controls implemented, fertilising and irrigation having occurred throughout the first year to ensure the best possible soil structure to receive the strongest possible advanced seedlings. The land works will occur in the first year of the Project.

Finance

46. Farmers can finance their participation in the Joint Venture Project themselves, borrow from an unassociated lending body or via an option offered by Intagpro Pty Limited (the Manager's holding company). Intagpro Pty Limited will, if a loan option is taken, advance funds of $9,750 on the settlement date for each Joint Venture interest. Security is to be enforced over the Farmer's interest in the Project, i.e., the Farmer's interests in the Joint Venture including the rights obtained as a result of the various agreements entered into and

payments made. Finance arrangements organised directly by the Farmer with independent lenders are outside the arrangement to which this Ruling applies.

47. An interest rate will be charged of 10% payable yearly in advance totalling $975 for each Joint Venture interest. This loan will be repayable in full over the first 12 months from settlement at the rate of $812.50 per month. The first repayment is required to be made on the first day of the month following the date of settlement of the loan.

48. Further, loans will be made over the next four years as detailed in the Loan Deed included in the Draft Prospectus. The further loans will only be made on the basis that interest is payable 12 months in advance and the additional loans are each repayable in the 12 months after the loan is made by equal monthly instalments.

49. The finance is provided as full recourse loans and Intagpro Pty Limited will pursue legal action against outstanding borrowers.

Ruling

50. For a Farmer 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	$3,204	$1,343	$1,667
Licence fee	8-1	$444	$333	$206
Loan interest	8-1	as incurred	as incurred	as incurred
Erosion control	387-55	$361	nil	nil
Irrigation	387-125	$1,380	$1,380	$1,380
Establishment	387-165	See paragraph 53		

Management and licence fees

51. 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 above has been taken as being calculated after taking out the capital component of this fee. The licence fees are fully deductible under section 8-1. Both the

management fee and licence fee have been marked-up in accordance with the formula discussed at paragraphs 66 to 72.

Irrigation

52. Irrigation expenses are a capital expense. A deduction under section 387-125 is available to a Farmer in the year the 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 Draft Prospectus, in accordance with the formula discussed at paragraphs 66 to 72, and then multiplying that amount by one third.

Establishment expenditure

53. Establishment expenditure includes the purchase of trees, stakes and fertiliser together with earthworks and labour for planting. A deduction of 7% of the capital cost will be available to the Farmer under section 387-185 of the ITAA 1997, calculated from the year in which the tree enters its first commercial season. The capital cost of the establishment expenditure has been calculated in accordance with the formula discussed at paragraphs 66 to 72.

Loan application fees

54. Loan application fees and/or 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 of the ITAA 1997.

Section 82KZM

55. The expenditure by Farmers does not fall within the scope of section 82KZM of the ITAA 1936.

Section 82KL

56. Section 82KL of the ITAA 1936 does not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA

57. For a Farmer who invests in this Project, the provisions of Part IVA of the ITAA 1936 will not be applied to the arrangement described in this Ruling.

Explanations

Section 8-1

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

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer contractually commits himself 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 and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

59. The growing of olive trees can constitute the carrying on of a primary production business. Where there is a business, or a future business, the gross sale proceeds from the sale of the olives or olive products from the Project will constitute gross assessable income in their own right. 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 be the planting, tending and maintaining of the olive trees and harvesting the produce.

60. For this Project, Farmers have under the Joint Venture Agreement, rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing olive trees to produce olives for commercial exploitation. Under the Joint Venture Agreement, Farmers appoint NWRS as Manager of the Joint Venture, to provide services such as planting, cultivating, tending, pruning, fertilising, spraying, maintaining and otherwise caring for the olive trees. From the information provided, Farmers control their investment in the Joint Venture.

61. The Joint Venture Agreement gives Farmers full right, title and interest in the olive trees and their produce and the right to have the olive produce sold for the Joint Venture Farmers' benefit.

62. The Joint Venture Farmers will not use the land for any purpose other than the growing of olive trees for producing olives. They will appoint NWRS to perform the obligations and duties as imposed on the Manager under the Joint Venture Agreement. The Farmers' degree of control over NWRS, as evidenced by the Constitution of the Project being a Managed Investment Scheme that also incorporates the Joint Venture Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, the Joint Venture Farmers are entitled to receive regular progress reports on NWRS' activities. In addition, they are able to terminate arrangements with NWRS in certain instances, such as cases of default or neglect. The primary production activities described in the Joint Venture Agreement are carried out on the Farmers' behalf.

63. 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 discussed in that Ruling. Farmers to whom this Ruling applies intend to derive assessable income from the Joint Venture Project. This intention is related to projections contained in the Draft Prospectus that suggest the Joint Venture Project should return a 'before tax' profit to the Farmers, i.e., a 'profit' in cash terms that does not depend on its calculation on the fees in question being allowed as a deduction.

64. Farmers will engage the professional services of a Manager with appropriate credentials. The Manager will subcontract certain works and services as appropriate. These services are based on accepted commercial agricultural practices and are of the type ordinarily found in ventures that would commonly be said to be businesses.

65. Farmers have a continuing interest in the Project from the time they enter into the Joint Venture. The 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 Farmers' activities of conducting in joint venture the growing of olive trees for producing olives or olive products for commercial sale will constitute the carrying on of a business.

66. The activities the Manager is required to undertake are listed in the Management Agreement between the Farmer and Manager (see summary at paragraph 38). Some of these activities are of a capital nature. Project costings obtained from NWRS's tax professional adviser outline how the Farmers' subscription monies will be spent. These monies, which principally consist of a management fee, will be spent on items that are of a revenue or capital nature, while other expenditures are more properly classified as something else.

67. Under the Management Agreement, the management fee is an undissected lump sum in return for which the Farmer 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.

68. The joint judgment of the High Court in *Ronpibon Tin* stated that subsection 51(1) of the 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 Farmers is an example of such an expenditure.

69. The management fee paid by the Farmer is for activities that are of a revenue and capital nature and, in accordance with paragraph 8-1(2)(a) of the ITAA 1997, 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 which is deductible under section 8-1 is shown in the table at paragraph 50.

70. From the information supplied by NWRS's tax professional adviser, 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 Farmers 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 Farmers. 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:

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

71. 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.

72. 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 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 50.

Land clearing

73. The land clearing fee that is identified and payable by a Farmer upon settlement of the Joint Venture, is capital expenditure and not allowable as a deduction under section 8-1. This amount will also have to be calculated using the formula discussed at paragraphs 66 to 72.

Subdivision 387-A

74. 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 term 'landcare operation' is defined in section 387-60.

75. In accordance with the Joint Venture Agreement, an erosion control fee is payable by a Farmer upon settlement of the Joint Venture. This is considered to be capital expenditure incurred at a particular time on a 'landcare operation' for the prescribed purposes as set out in section 387-55. Landcare operation, as relevant to the Project, comprises constructing surface or subsurface drainage works on the land primarily and principally for controlling salinity or assisting in drainage control. In order to qualify for a deduction under section 387-55, a business must be carried on at the time the expenditure is incurred.

76. It is considered that a business has commenced at the time the expenditure is incurred. It is accepted that the execution of the Joint Venture Agreement is sufficient to constitute the commencement of a business. The business is considered to have commenced at the time the management fees are incurred by the Joint Venture Farmers. Further, it is considered that the erosion control fee is primarily and principally for the purpose of assisting in drainage control. Accordingly, the expenditure is deductible to a Joint Venture Farmer under section 387-55 in the year of income in which it is incurred.

Subdivision 387-B

77. 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.

78. In accordance with the Joint Venture Agreement, an irrigation fee is payable by a Farmer upon settlement of the Joint Venture. This is considered to be capital expenditure incurred on the construction, manufacture, installation or acquisition of a 'water facility', primarily and principally for the purpose of conveying water for use in a primary production business as set out in section 387-125. Examples of a water facility include a dam tank bore, irrigation channel (or similar improvement), pipe and pump. Under section 387-125, there is no requirement that the taxpayer actually own the 'water facility'.

79. The growing of olive trees to produce olives for commercial exploitation is considered to be a primary production business, provided the taxpayer is actually carrying on a business. The Joint Venture Farmers of the Project satisfy the requirements of section 387-125. Accordingly, the irrigation fee is deductible in equal amounts over three (3) years of income, commencing the year of income that the Farmers incur the expenditure, which will be the year of income ending 30 June 1999 or 2000, as the case may be.

Subdivision 387-C

80. 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.

81. 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 is first used to produce assessable income. The write-off rate is detailed in section 387-185. For a plant with an effective life in excess of 30 years, as in this Project, the rate is 7%.

82. In accordance with the Joint Venture Agreement, an olive grove establishment fee is payable by a Farmer upon settlement of the Joint Venture. A further fee is payable at the commencement of the second year of the Project. This is considered to be capital expenditure attributable to the establishment of a horticultural plant for use in a horticulture business as set out in Subdivision 387-C. It is considered that the necessary conditions for the application of section 387-165 are satisfied, having regard to the following matters:

- olive trees fall within the definition of a horticultural plant;
- the Joint Venture Farmers are treated as owners of the horticultural plant, on the basis that they hold a lease over the relevant lands to which the plant is attached (section 387-210);
- expenditure of a capital nature will be incurred in the establishment of the olive trees, such expenditure not being deductible under any other provision of the ITAA;
- the olive trees are considered to have an effective life in excess of 30 years;
- the activities being carried on by the Farmers in Joint Venture constitute a horticulture business; and
- no part of the expenditure is in respect of draining swamp or low-lying land or the clearing of land.

83. A deduction is only available in the year in which the plant is first used or held ready for use. A plant is considered to be first used or held ready for use from the beginning of what is expected to be its first commercial season. In the case of this Project, this is considered to be 2004.

84. Section 387-165 provides a write-off for the olive grove establishment fees at the rate of 7% pa. In this case, the deduction for both the first and second year establishment fees will commence in the year ended 30 June 2004.

Section 82KZM

85. 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.

86. Under the Joint Venture Agreement, fees will be incurred by a Farmer on execution of the Joint Venture Agreement. The fees are payable by a Joint Venture Farmer for services that are provided within 13 months from the execution of the Joint Venture Agreement.

87. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description, that the fees have been inflated to result in reduced fees being payable for subsequent years. The fees are s expressly stated to be for a number of specified services. There is no evidence that might suggest the services covered

by the fees could not be provided within 13 months of incurring the expenditure in question. Thus, for the purposes of this Ruling, it can be accepted that no part of the fees are for the doing of things that are not to be wholly done within 13 months of the fees being incurred.

88. On this basis, the basic precondition for section 82KZM's operation is not satisfied and it will not apply to the expenditure incurred by Farmers in respect of the year ending 30 June 1999 or 2000, as the case may be, and calculated in accordance with the formula discussed at paragraphs 66 to 72.

Section 82KL

89. 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'.

90. '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 that is saved if a deduction is allowed for the relevant expenditure.

91. 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 Intagpro Pty Limited to the Joint Venture Farmer. 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. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA

92. For Part IVA to apply there must be a 'scheme' (section 177A of the ITAA 1936); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Tarwoona Olives Scheme No 1 will be a 'scheme' commencing when the Prospectus is issued. The Joint Venture Farmers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the amount detailed at paragraph 50 per Joint Venture interest allowable under section 8-1, that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

93. Farmers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting and sale of the olives. Further, there are no features of the Project, for example, such as the lease rent contribution fee or the management fee being 'excessive' and uncommercial, and predominantly financed by a non-recourse loan, and resulting in insufficient 'real money' coming into the Manager's hands 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.

Interest deductibility

94. Some Farmers intend to finance the investment through a loan facility detailed at paragraphs 46 to 49. Whether the interest is deductible under section 8-1 depends on the same reasoning as that applied to whether the lease rent contribution fee and management fee will be deductible. The interest incurred in the years ending 30 June 1999 and 2000, as the case may be, and in subsequent years of income will be in respect of a loan to finance the business operations that are directly connected with the gaining of 'business income' from the Project. Such interest will, thus, have a sufficient connection with the gaining of assessable income.

Detailed contents list

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

Commissioner of Taxation
12 May 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

Legislative references:
- ITAA36 51(1)
- ITAA36 82KH(1)
- ITAA36 82KH(1F)(b)
- ITAA36 82KL
- ITAA36 82KL(1)
- ITAA36 82KZM
- ITAA36 Pt IVA
- ITAA36 177A
- ITAA36 177C
- ITAA36 177D
- ITAA97 8-1
- ITAA97 8-1(2)(a)
- ITAA97 25-25
- ITAA97 387-A
- ITAA97 387-55
- ITAA97 387-B
- ITAA97 387-125
- ITAA97 387-C
- ITAA97 387-165
- ITAA97 387-185

Case references:

Ronpibon Tin v. FC of T (1949) 78 CLR 47; 8 ATD 431

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