



# ***PR 1999/78 - Income tax: Kingsford Olives Project***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *23 June 1999*



## Product Ruling

### Income tax: Kingsford Olives Project

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#### ***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**

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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 Kingsford Olives Project, or ‘the Project’ or the ‘product’.

#### **Tax law(s)**

2. The tax law(s) dealt with in this Ruling are sections 6-5, 8-1, 42-15, 70-35, 387-125, and 387-165 of the *Income Tax Assessment Act 1997* (‘ITAA 1997’), and sections 82KL and 82KZM, and the relevant provisions of Part IVA of the *Income Tax Assessment Act 1936* (‘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 (that is, 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. In this Ruling these persons are referred to as ‘Growers’.

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 32) 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

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9. This Ruling applies prospectively from 23 June 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, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

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## Withdrawal

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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, who entered into the specified arrangement 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.

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## Arrangement

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12. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Application for a Product Ruling, dated 27 April 1999;
- Information Memorandum prepared for the Kingsford Olives Pty Ltd Olive Oil Project, as provided on 27 April 1999, undated;
- Draft **Management Agreement** between Kingsford Olives Pty Ltd (The Manager) and Potential Investor (The Grower) as provided on 27 April 1999, undated;
- Headlease between Kingsford Olives Pty Ltd (The Manager) and Kingsford Nominees Pty Ltd (The Landholder), as provided on 10 June 1999, dated 9 June 1999;
- Draft Memorandum of **Underlease** between Kingsford Olives Pty Ltd (The Manager) and Potential Investor (The Grower) as provided on 27 April 1999, undated; and
- Letters and facsimile transmissions from Applicant dated 27 April, 27 May 1999, 7 June 1999 and 15 June 1999.

**Note: Certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.**

13. The documents highlighted are those that Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate<sup>1</sup> of a Grower, will be a party to, which are part of the arrangement to which this Ruling applies. The effect of the agreements listed above is summarised as follows.

14. This arrangement is called the Kingsford Olives Olive Oil Project. The Manager proposes to offer to Growers a Underlease to occupy a specified 5 hectare allotment of land and enter into an agreement to manage the allotment on behalf of The Grower.

15. The Manager has entered into a headlease of land at Kingsford in the Southern Mallee district, South Australia from Kingsford Nominees Pty Ltd ('The Landholder'). The total area leased is 768 hectares. The total area to be subleased is 190 hectares, divided into 5 hectare allotments. The land has been identified in Section 10 of the Information Memorandum as being suitable for establishing an olive plantation. If all the Underleases which are offered are taken up, 67,830 olive trees will be planted on behalf of Growers.

## Interests applied for

16. All persons applying to participate in the Project must apply for a 20 year Underlease of a 5 hectare allotment of land (a Grove) for the purpose of growing olive trees and harvesting the resulting olives for the production of olive oil or for sale and must enter into a 20 year Management Agreement with the Manager in respect of that allotment. The Underlease(s) cannot be assigned without the consent of the Lessor. The Grower will not be released from obligations under the Underlease even if this is assigned (clause 2.3 of the Underlease).

17. To be accepted into the Project each Grower will be required to initially contribute \$93,495, payable in two instalments as follows:

- \$10,000 payable on entering into the Management Agreement
- \$83,495 payable within 30 days of entering into the Management Agreement.

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<sup>1</sup> In this Ruling 'associate' has the meaning as defined in section 318 of the ITAA 1936.

## **The Management and Lease Agreements**

### ***Management conditions***

18. The Grower and The Manager enter into a 20 year Lease Agreement (The Underlease). The Grower also appoints The Manager and enters into a Management Agreement with The Manager for a period of 20 years. (clause 3<sup>2</sup>). The Management Agreement may be terminated earlier in the final year of the lease if the trees are harvested and the Grove proceeds are sold and distributed. The Management Agreement may be extended by mutual agreement.

19. The Manager is then responsible for the establishment of an olive tree plantation, the ongoing maintenance of those trees, the harvesting and processing of olives from those trees, and the production of olive oil on behalf of the Growers. The Manager must plant no less than 1785 olive trees on each Olive Grove within 13 months of the date of the Agreement (clause 5.2). The trees will remain the property of The Landholder.

20. The Manager will also arrange for olives or the olive oil produced to be sold on a pooled basis. The Grower may choose to take possession of his share of the pooled olive oil rather than participate in the sale of pooled olive oil.

21. A Grower may terminate their agreement with The Manager where The Manager commits a material breach of any of its obligations and the default is not remedied within 90 days of The Manager receiving notice of the breach from the Grower (clause 13.2).

22. Any fencing affixed to the land on behalf of The Grower will remain the property of The Grower and may be removed or sold by the Grower at the end of the Project (clause 13.7).

### ***Fees payable and work to be performed***

23. Under clause 7, initial fees payable by the Grower in relation to each Grove, on the Grower's entering into the Management Agreement are:

- \$12,495 for the acquisition of seedlings;
- \$6,000 for the erection of fencing which will be 'plant' for the purposes of Division 42 of the ITAA 1997;
- \$50,000 for the installation of irrigation items that will be 'water facilities', as defined in section 387-130 of the ITAA 1997; and
- \$25,000 for the initial management fee.

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<sup>2</sup> In this Ruling all references to clauses are to clauses in the Management Agreement unless otherwise stated.

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24. An annual lease fee of \$5,125 per Grove is payable in equal monthly instalments on the first day of the month with the first payment due on the date the Grower enters into the Management Agreement.
25. Management fees in years subsequent to the first year will be payable annually in advance with the first payment due on 30 June 2000 on the basis of \$40,000 for the second year and then that amount increased by the Consumer Price Index (All Groups) in each subsequent year.
26. The Grower is responsible for insurance related to the Underlease of the Grove. The Manager shall effect insurance against damage to or destruction of Grove produce and will be reimbursed by the Grower (clause 8.1). The Management Agreement has not quantified the cost of obtaining the crop insurance but the Information Memorandum refers to an initial payment of \$525 per Grove for insurance.
27. The Manager will determine the appropriate time to harvest the Grove produce and The Grower will pay, in addition to the annual management fee, a Harvest Fee of \$4 for each of the trees on the Grove. (clauses 6.1.1 and 6.3.1).
28. The Manager will arrange for the Grove produce to be processed into olive oil and The Grower will pay a Production Fee of \$0.20 per litre of oil produced to The Manager. (clauses 6.1.2 and 6.3.2).
29. The Manager will retain the proceeds of sales of olives and olive oil and meet the harvest and production expenses out of these funds. If the proceeds are insufficient to meet the cost of the Harvest Fee and the Production Fee, The Grower will pay the balance within 30 days of demand for payment by The Manager (clause 6.3.5).

## **Derivation of income**

30. Growers may choose to retain and sell the olive oil produced from their Olive Groves in their own right or they may appoint The Manager as their agent to sell the olive oil produced (clause 6.2).
31. The olives and / or the olive oil of The Grower may be pooled with produce of some or all of the other Groves. The proceeds of the sales will then be divided on a pro rata basis based on the number of hectares on which the Grower's business is conducted as a percentage of the total number of hectares harvested.
32. Growers will be entitled to the proceeds from the sale of the olive oil. Sale proceeds will be derived by each Grower based on the number of Groves held. Possible projected returns for Growers are set out in Section 16 of the Information Memorandum. They depend on a

range of assumptions and The Manager does not give any assurance or guarantee whatsoever in respect of the future success of, or financial returns associated with entering into the Underlease and Management Agreements. However, based on the cash projections prepared for the Project, Growers can expect to achieve a total return of \$456, 557 before tax from a cash investment of \$214,331 over the first four years of the Project.

## Ruling

### Sections 8-1, 42-15, 387-125 and 387-165

33. For a Grower who enters the Project by 30 June 1999 and who incurs and pays the fees set out in paragraphs 23 to 28 by 30 June 1999, the following deductions will be allowable to them for the years ended 30 June 1999 to 30 June 2003, as set out in the following table:

Fee type (tax law applicable)	Year ended 30 June 1999	Year ended 30 June 2000	Year ended 30 June 2001	Year ended 30 June 2002	Year ended 30 June 2003
Management Fees (8-1)	\$25,000	\$40,000	\$40,000	\$40,000	\$40,000
Fencing (42-15, 42-130))	\$2 (See note i)	\$598	\$540	\$486	\$438
Irrigation (387-125)	\$16,666 ( $\frac{1}{3}$ each year)	\$16,666	\$16,667		
Insurance (8-1)	(See note ii)				
Tree establishment (387-165)	-	-	-	-	\$729 (See note iii)
Lease Fee	(See note iv)	\$5,125	\$5,125	\$5,125	\$5,125
Harvest Fees (8-1)	-	-	-	-	\$7,140 (See note v)
Olive Oil Production Costs (8-1)	-	-	-	-	(See note vi)

**Notes**

- (i) Deductions for depreciation under section 42-15 for the income years shown will depend, for the purposes of either section 42-160, 'Diminishing value method', or section 42-165, 'Prime cost method', on the number of 'days owned', being the number of days in the income year in which the Grower owns an interest in the plant. The Manager is to advise Growers of this and the relevant depreciation rate that applies. Growers will need to choose which depreciation method they use. The figures shown in the table are therefore included for illustrative purposes only and are subject to change. The deductions shown are based on the fences being purchased in June 1999, using a depreciation rate of 10% and adopting the diminishing value method.
  - (ii) The Manager will arrange crop insurance on behalf of The Grower at current market rate. The Grower will be entitled to a deduction for this reimbursed cost.
  - (iii) Deductibility under section 387-165, for horticultural plant establishment expenditure, will commence from the time that the olive trees, as horticultural plants, enter their first commercial season. The Manager will advise Growers of this, but anticipate that the trees to be planted will enter their first commercial season in September 2002. The Manager considers that The Grower will be able to determine, for the purposes of section 387-175, that the trees have an 'effective life' for the purposes of section 387-185 of 30 years or more, resulting in a write-off rate of 7%. For the purposes of illustration, the deductions shown in the table are based on a 7% write-off rate commencing from 1 September 2002.
  - (iv) The lease fee is payable in instalments. If the annual lease fee is prepaid in advance before 30 June 1999, it will be deductible in the year it is paid by The Grower. The Lease fees will be reviewed annually so the amount payable and thus the amount of deduction may be subject to change.
  - (v) The deduction for the Harvest Fee assumes that the Manager achieves the planting level of 357 trees per hectare set out in the Information Memorandum. The actual amount paid may vary and may be increased by a CPI component.
  - (vi) The deduction for the Production Fee will depend on the olive yield per tree and the average amount of olive oil extracted.
34. For a Grower who enters into the Project after 30 June 1999, but before 30 June 2000, and who incurs and pays the fees set out in paragraphs 23 to 28 before 30 June 2000, the Grower will be entitled to the same deductions as set out in the Table above, except:
- the deductions will not commence until they year ended 30 June 2000 (that is, all the deductions are 'moved forward' a year); and

- the deduction for depreciation will depend on the date on which The Grower enters into the Management Agreement and so owns an interest in the plant.

**Section 82KZM**

35. Section 82KZM of the ITAA 1936 does not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997, as set out in the above table.

**Section 82KL**

36. Section 82KL of the ITAA 1936 does not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997, as set out in the above table.

**Part IVA**

37. The relevant provisions of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

**Section 6-538.** Growers deriving gross proceeds from the sale of olives and olive oil must include these proceeds in their assessable income for the relevant year, under section 6-5 of the ITAA 1997.

**Section 70-35**

38. Growers who have harvested olives on hand at the end of any income year will be holding trading stock of a business carried on by them. The excess of the value of this trading stock at the end of any income year over the value of trading stock at the start of that income year must be included in their assessable income under section 70-35 of the ITAA 1997.

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**Explanations****Section 8-1**

39. Consideration of whether the fees payable to The Manager are deductible under section 8-1 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;

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- the outgoings are not deductible under paragraph 8-1(1)(b) if they are incurred when the business has not commenced; and
- where all that happens in a year of income is 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 paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

40. An agriculture scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross proceeds from sale of the agricultural produce from the scheme, will constitute 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, maintaining and harvesting of the agricultural crops, in this case, olives, and sometimes processing of those crops, as in this case.

41. Generally, an investor will be carrying on a business of agriculture where:

- the investor has an identifiable interest in specific growing crops coupled with a right to harvest and sell the produce from those crops;
- the agriculture activities are carried out on the investor's behalf; and
- the weight and influence of the general indicators of a business, as developed by the Courts, point to the carrying on of a business.

42. For this Project Growers have, under the Underlease, rights to farm an identifiable area of land consistent with the intention to carry on a business of growing olives. Under the Management Agreement, Growers appoint The Manager to provide services such as planting, cultivating, tending, fertilising, spraying, watering, maintaining and otherwise caring for their olive trees and harvesting olives and producing olive oil. Growers are considered to have control of their investment.

43. The Management Agreement gives Growers an interest in the olives grown on their behalf and the right to have those olives processed and the olive oil sold for their benefit. The Project

documentation contemplates that Growers will have an ongoing interest in the growing crops. The crops belong to the Growers in the sense that they have an interest in the land on which they are growing and a profit à prendre in respect of the produce, which confers an equitable interest in the crops upon the Grower.

44. Growers have the right to use their Olive Grove areas for agricultural purposes and to have The Manager come onto the land to carry out its obligations under the Management Agreement. The Grower's degree of control over The Manager, as evidenced by the Management Agreement is sufficient. The Growers are able to terminate the arrangements with The Manager in certain instances, such as default in performance of its duties and failure to rectify the default. The agriculture activities described in the Management Agreement are therefore carried out on the Grower's behalf.

45. The general indicators of a business, as developed 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. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to cash flow projections contained in the Information Memorandum that suggest the Project should return a 'before-tax' profit to the Growers, that is, a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

46. 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 agricultural practices and are of the type ordinarily found in farming ventures that would commonly be said to be businesses.

47. Growers have a continuing interest in the trees from the time they are acquired and planted on their behalf. The agricultural 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' agricultural activities will constitute the carrying on of a business.

48. The fees associated with the agricultural activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the sale of the olive oil or the crop produce), is to be gained from this business. They will thus be deductible under section 8-1, except to the extent they are capital, or of a capital nature. The capital component of the fees relating to fencing and planting have been identified above. No additional capital component, or 'non-income producing purpose' in incurring the fees is identifiable from the arrangement. The tests of deductibility under section 8-1 are met. The exclusions in subsection

8-1(2) do not apply, other than in relation to the capital exceptions noted above.

## **Section 387-125**

49. Section 387-125 allows a deduction for capital expenditure on the construction, manufacture, installation or acquisition of a water facility, if incurred primarily and principally for the purpose of conserving or conveying water for use in a primary production business conducted on land in Australia.

50. The section allows this expenditure to be deducted over a 3 year period, that is, at a rate of 33.3 per cent per annum, starting with the year in which the expenditure is incurred. The taxpayer to whom such deductions are allowable does not need to own the land in question. Irrigation works of the kind to be carried out for Growers in this project by The Manager are of the type to which section 387-125 applies.

## **Section 387-165**

51. Subdivision 387-C allows deductions in respect of capital expenditure on establishing horticultural plants for use in a horticultural business. For the purposes of this Subdivision, a lessee or licensee of land, such as the Growers in this Project, carrying on a business of horticulture, is treated as owning the plants growing on the land, rather than the actual owner. The deductions allowable under section 387-165 commence from the time the plants enter their first commercial season. The Manager will advise Growers of this event.

52. Horticultural plant establishment expenditure is capital expenditure on establishing the horticultural plants, and includes such things as the cost of acquiring the plants, costs of pre-planting and planting, such as ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure on draining swamps or the initial clearing of land.

## **Section 42-15**

53. The Growers will acquire interests in fencing, which will be used by The Manager in carrying out its obligations under the Management Agreement. The fencing will constitute plant for the purposes of Division 42, and will be used for the purpose of producing assessable income for the Growers. Under Taxation Ruling IT 175 these Growers will be considered to be the 'owners' of the fencing which will be used for the purpose of producing assessable income from the time they are installed, which is expected to be before 30

June 1999. The Manager will advise Growers of the details required for them to calculate their depreciation deductions for expenditure on these items. The Growers will need to choose which method of depreciation that they will use.

### **Section 82KZM**

54. Under the Management Agreement the fee for management services deductible under section 8-1 in respect only of the year ended 30 June 1999, is charged for providing services to a Grower only for a maximum period of 13 months from incurring the relevant expenditure. The fee is for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that this fee has been inflated to result in reduced fees being payable for subsequent years. There is also no evidence that might suggest the services covered by this fee 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 fee is for The Manager doing 'things' that are not to be wholly done within 13 months of the fees being incurred. On this basis the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure of \$25,000 by Growers under the Management Agreement.

### **Section 82KL**

55. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. No additional benefits have been identified in the arrangement so section 82KL has no application. It will not apply to deny the deductions otherwise allowable under section 8-1.

### **Part IVA**

56. 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). The Project will be a 'scheme' commencing generally on the date the Information Memorandum was issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deductions for the fees payable to The Manager, 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(s).

57. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the regular harvesting of the crops. Further, there are no features of the Project,

for example, such as the fees being ‘excessive’, and uncommercial, predominantly financed by a non-recourse loan, and resulting in insufficient ‘real money’ coming into the manager’s or land owner’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.

## **Detailed contents list**

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

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**Commissioner of Taxation**

23 June 1999

*Previous draft:*

No draft issued

- tax avoidance
- tax benefits under tax avoidance schemes

*Related Rulings/Determinations:*

IT 175; IT 333; PR 98/1; TR 92/1;  
TR 92/20; TR 97/11; TR 97/16;  
TD 93/34

- tax shelters
- tax shelters project

*Legislative references:*

- ITAA1936 82KL
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1997 6-5
- ITAA1997 8-1
- ITAA1997 8-1(1)(a)
- ITAA1997 8-1(1)(b)
- ITAA1997 8-1(2)
- ITAA1997 42-15
- ITAA1997 70-35
- ITAA1997 387-125
- ITAA1997 387-165

*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

*Case references:**ATO references:*

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