



PR 1999/97 - Income tax: Mondall Almond Project

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Product Ruling

Income tax: Mondall Almond 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**, **Previous Rulings**, **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 1999/95 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.*

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities in future years to confirm the arrangement has been implemented as described below and to ensure that participants in the arrangement include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' 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 Mondall Almond Project, or just simply as 'the Project' or the 'product'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are sections 6-5, 8-1, 25-25, 387-55, 387-125, 387-165 and 387-355 of the *Income Tax Assessment Act 1997* ('ITAA 1997') and sections 82KL, 82KZM and 97, and the relevant provisions of Part IVA of the *Income Tax Assessment Act 1936* ('ITAA 1936').

3. This Ruling does not deal with the consequences or effects of the Goods and Services Tax or any associated 'A New Tax System' legislative reforms, including the proposed changes announced as part of The New Business Tax System or their effect on the various Income Tax Acts (including the provisions set out above). On 21 September 1999, the Government announced a number of changes to the tax system as part of the New Business Tax System. A number of those changes could affect the tax laws dealt with in this Ruling. Some of those changes apply from the date of the announcement and others are proposed to apply from nominated dates in the future. This Ruling does not deal with the announced changes. We cannot rule on those changes until the relevant legislation is enacted.

Class of persons

4. 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. In this Ruling these persons are referred to as 'Growers'.

5. 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

6. 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

8. This Ruling applies prospectively from 20 October 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).

9. 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).

Withdrawal

10. 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.

Previous Rulings

11. This Ruling applies to the Project that was ruled on in Product Ruling PR 1999/65. PR 1999/65 is now withdrawn on and from the date this Ruling is made. The former Ruling applies to investors who entered into the arrangement prior to 20 October 1999. This Ruling applies to Growers wishing to take up an interest or interests that were not sold prior to 20 October 1999.

Arrangement

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

- Draft Prospectus prepared and issued by Brownport Management Limited ('Brownport' or 'the Manager') for the Mondall Almond Project;
- Constitution of the Mondall Almond Project, dated 9 April 1999, between Brownport, each Grower and each person who is allotted units ('Unit Holder');
- Farm and Management Agreement between Brownport and the Grower;
- Deed of Assignment of Farm and Management Agreement between Brownport and the Transferor and the Transferee;
- Unit Trust Deed for the Mondall Almond Unit Trust, dated 9 April 1999, between Mondall Almond (Properties) Limited ('MAPL') and Brownport as the Property Trustee ('the Property Trust');
- Compliance Plan for the Mondall Almonds Project dated 9 April 1999;
- Advisory Services Agreement, dated 22 April 1999, between Brownport and Russell Horticultural Services Pty Ltd ('Russell');
- Orchard Management Agreement, dated 22 April 1999, between Brownport and Russell;

- Almond Processing and Marketing Agreement, dated 28 April 1999, between Brownport and Select Harvests Limited ('Select');
- Contract of Sale of Real Estate dated 8 September 1998 between the landowners of Lot 2, plan of subdivision 209186K, Parish of Carwarp and Mondall Holdings Pty Ltd;
- Custodian Agreement, dated 12 April 1999, between Brownport and Australian Rural Group Limited ('ARGP');
- Access Agreement, dated 15 April 1999, between the adjacent landowners and Mondall Holdings Pty Ltd;
- Four Agreements for the Sale of Water Entitlement dated 6, 16 and 23 February 1999 between four vendors of water entitlement and MAPL;
- Proposed Amendments of 27 May 1999 to the Four Agreements for the Sale of Water Entitlement; and
- Irrigation Services Agreement, dated 22 April 1999, between Brownport as the Trustee and Brownport as the Manager.

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 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 associate¹ of a Grower, will be a party to, which are part of the arrangement to which this Ruling applies. The effect of these agreements is summarised as follows.

14. This arrangement is called the Mondall Almond Project. Brownport proposes to offer 1,000 Farms at \$18,330 each and 2,000 Units in the Property Trust at \$340 each. Each Farm is a parcel of land 0.304 hectare in size comprising 82 almond trees and is 'stapled' to two Units. Growers or their associates may acquire the Units. Growers or their associates must sell or transfer and assign the Farms and Units together. There is no provision for a Grower or an associate to require Brownport to buy back either the Farms or the Units. Prior to 30 June 2024 a Grower does not have any right to withdraw from the Project.

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

15. Applications must be for at least one Full Farm and Two Units and thereafter in multiples of Half Farms and one Unit. The minimum level of subscription is 500 Farms and 1,000 Units on or before the expiry of 12 months from the date of the Prospectus. Brownport may waive the minimum level of subscription downwards in its discretion. Brownport, at its discretion, may accept over subscriptions for another 100 Farms and 200 Units.

16. The Property Trust has been nominated to purchase the land on which the almond orchard will be planted. On full subscription of the Units, the Property Trust will be owned 49% by Growers (or associates) and 51% by MAPL.

17. Pursuant to the Farm and Management Agreement, each Grower is granted a licence to use a certain part of the land to grow almonds. The Growers appoint Brownport to establish and manage their Farms. The Farm and Management Agreement is for 25 years and will expire on 30 June 2024 when all trees and improvements remaining on the Farms revert to the Property Trust.

18. Possible projected returns (without finance) for each Grower are outlined on pages 18 and 19 of the Prospectus. These depend upon a range of assumptions made by Brownport. There is no assurance or guarantee whatsoever in respect of the future success of or financial returns associated with the Project. Based on the assumptions, Brownport forecasts that a Grower could expect to obtain an arithmetic average rate of return of 19% per annum pre-tax on an investment of \$19,010.

19. A Grower can arrange their own finance to make some or all of the payments of \$19,010. Brownport has approached a number of independent lending institutions for the provision to Growers or associates of finance on normal commercial terms to acquire Farms or Units.

Years 1 to 3 payments

20. The fees payable by a Grower or an associate in the Project in the first three years for one Farm and two Units therefore are:

	Year 1 Application Fee	Year 1	Year 2	Year 3	Total
Landcare	750				
Electricity Connection	75				
Road/Hardstand	120				
Planting	680				
Irrigation	4,359				
Land Preparation	188				
Management Fee	3,100	2,542	2,531	2,520	
Licence	358	358	369	380	
Two Units	680				
Total	\$10,310	\$2,900	\$2,900	\$2,900	\$19,010

The Constitution

21. The Constitution is a document binding on and enforceable by Brownport, each Grower and each Unit Holder on acceptance of the Grower and Unit Holder into the Project.

22. Upon acceptance of an Application by a Grower and a Unit Holder, Brownport must designate the area that will constitute that Grower's Farm and also execute the relevant Farm and Management Agreement as attorney for the Grower, and cause the Units to be issued. The application fee must be applied for the payment of the initial management fee, the licence fee for the first year, the amount payable for almond trees and the subscription price for the Units and any GST or other moneys payable to Brownport.

23. Brownport, in managing the Farms and carrying out and performing the duties and obligations on its part under the Constitution, the Unit Trust Deed and any Farm and Management Agreement, may appoint and engage any persons necessary, usual or desirable for the purpose of exercising its power or performing its obligations.

24. Growers are entitled to the Gross Proceeds arising out of the sale of the almonds, lucerne, water entitlements and any other receipts. Brownport will distribute any Net Proceeds annually to the Growers after deducting the following expenses:

- any costs that ARGP is entitled to claim;
- annual management fees and any moneys due and payable to Brownport; and
- any other costs provided for under the Constitution or the Farm and Management Agreements.

25. Brownport must maintain a register of Growers and a separate register of Unit Holders.

26. The relationship between any of the Growers, Unit Holders and Brownport is not to be treated as a partnership, joint venture or an association between those parties.

The Farm and Management Agreement

27. Pursuant to each Farm and Management Agreement, Brownport, as the Property Trustee, grants a licence to the Grower to use and occupy a portion of the almond orchard for the growing of almonds. The land allocated to each Grower must be suitable for the growing of almonds. Each Grower is granted the right to travel across the almond orchard to conduct farming operations and to harvest almonds on the Grower's Farm. The Grower is required to pay an annual licence fee in advance.

28. The Grower appoints Brownport to manage the Farm for the term of the Project and pays to it annual management fees. Brownport is not entitled to a reimbursement of expenses incurred in carrying out its principal obligations. Those costs are considered to be covered by the management fees.

29. Brownport will provide Growers with an annual report setting out the progress of the Project and certify that it has performed its obligations. It will also maintain records of the almonds harvested and works carried out by it and these records will be made available for inspection by Growers.

30. Brownport may be removed as the Manager in accordance with the Corporations Law or it may retire by giving six months notice. If it is removed or retires, the Farm and Management Agreements are terminated.

31. Brownport, as the Property Trustee, will pay all rates and taxes relating to the almond orchard.

The Unit Trust Deed

32. The initial holder of Units in the Unit Trust is MAPL. Units issued to other Unit Holders are treated as a separate class of Units known as 'Scheme Units'. It is a condition of holding a Scheme Unit that the Scheme Unit Holder or an associate of the Scheme Unit Holder continues to be a party to a Farm and Management Agreement and the Constitution.

33. Until 30 June 2024 no Scheme Units may be redeemed.

34. Among other things, a Unit Holder is entitled to receive income and other distributions attributable to Units held.

35. Brownport, as the Property Trustee, must keep proper accounts and once each year must cause to be prepared a profit and loss account and balance sheet. Unit Holders are entitled to inspect those financial statements.

36. Seventy five per cent of Unit Holders may by resolution remove Brownport as the Property Trustee and appoint a new trustee.

Finance

37. There are no funding arrangements to be offered by Brownport or any associated entity, in connection with the Project. Growers may use their own funds, or arrange finance from an independent lender. Loan transactions to which this Ruling applies will exhibit the following features:

- all loan terms will be of an arm's length nature;
- borrowers will remain fully liable for the balance of the loan outstanding at any time, and the lender will take full legal action against defaulting borrowers;
- none of the funds lent will be transferred back to the lender, or any associate, as part of any 'round robin', or equivalent transaction;
- the loan will not be a 'split loan', of the type described in Taxation Ruling TR 98/22;
- there will be no indemnity, or equivalent agreement, to reduce the borrower's liability; and
- repayment of principal and payment of interest will not be linked to deriving income from the Project, and will be made regularly, commencing from or about, the time of the making of the loan.

Growers may incur various borrowing costs within the meaning of section 25-25.

Ruling

38. For a Grower who invests in the Project by 30 June 2000, who incurs the fees set out in paragraph 20, the following deductions will be available for the years ended 30 June 2000 to 30 June 2002:

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Fee type (tax law applicable)	ITAA 1997	Year 1	Year 2	Year 3
		30/6/2000	30/6/2001	30/6/2002
Management Fee	8-1	\$5,642 (see Note (i) below)	\$2,531	\$2,520
Licence Fee	8-1	\$716 (see Note (ii) below)	\$369	\$380
Landcare	387-55	\$750 (see Note (iii) below)		
Irrigation	387-125	\$1,453 (see Note (iv) below)	\$1,453	\$1,453
Planting	387-165	(See Note (v) below)		\$89
Electricity Connection	387-355	\$8	\$8	\$8
Land Preparation	387-165	(See Note (vi) below)		\$24
Borrowing costs	25-25	(See Note (vii) below)		
Interest on loan	8-1	(See Note (viii) below)		

Notes:

- (i) $\$(3,100 + 2,542) = \$5,642$, where:
- \$3,100 for management fees being the cost of managing the Grower's Farm from the Commencement Date until the end of the First Financial Year; and
 - \$2,542 being the annual management fee for the Second Financial Year.
- (ii) $\$(358 + 358) = \716 , where:
- \$358 being the licence fee for the First Financial Year payable on the Commencement Date; and
 - \$358 being the licence fee for the Second Financial Year payable on or before 30 June of the First Financial Year.
- (iii) Deductibility under section 387-55 is dependent on the Grower carrying on a 'primary production business' at the time the expenditure in question is incurred. A Grower who applies and is accepted into the Project on, say, the 30 June 2000, but for whom no services are provided in that year of income, will not be considered to be carrying on such a business.
- (iv) Deductibility under section 387-125 is calculated on the basis of one-third of the capital expenditure in the year in which the expenditure is incurred, and for each of the next 2 years of income.
- (v) Deductibility under section 387-165 is calculated on the basis of the almond trees, as horticultural plants, entering their first commercial season in July 2001, and a Grower determining under section 387-175 that they have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years, resulting in a write-off rate of 13%.

- (vi) Land preparation costs of \$188 are attributable to the establishment of almond trees in the Project and are deductible under section 387-165 as explained in Note (v).
 - (vii) Deductibility of borrowing costs under section 25-25 is calculated on the basis of the loan used by the Grower to finance investment in the Project. Where the borrowing costs exceed \$100, they are deductible over the period of the loan specified in the loan contract, or the actual loan period, or five years, whichever is the shorter period, beginning with the year in which they are incurred. Where the borrowing costs are \$100 or less, they are deductible when incurred. Where some portion of the loan is used by an associate to acquire Units in the Property Trust, the borrowing costs must be apportioned between the Grower and the associate.
 - (viii) Deductibility of interest costs under section 8-1 is calculated on the basis of the loan used by the Grower to finance investment in the Project. Where some portion of the loan is used by an associate to acquire Units in the Property Trust, the interest costs must be apportioned between the Grower and the associate.
39. For Growers who invest in the Project any income received by them from the sale of almonds from their Farms will be assessable income to them under section 6-5. Growers presently entitled to income from the Property Trust, who are not under a legal disability, must include the appropriate amount in their assessable income under section 97 of the ITAA 1936.

Sections 82KZM and 82KL; Part IVA

40. For a Grower who invests in the Project the following provisions of the ITAA 1936 do not apply:

- the expenditure by Growers does not fall within the scope of section 82KZM;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- 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.

Explanations

Section 8-1

41. Consideration of whether the management and licence fees are deductible under section 8-1 proceeds on the following basis:

- the outgoings are not deductible under section 8-1(1)(a) if they do not 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 section 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 that 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 and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

42. An outgoing or a loss incurred in carrying on a business for the purpose of gaining or producing assessable income is deductible under the general deduction provision, section 8-1, provided it is not expenditure or a loss of capital or of a capital, domestic or private nature. A business includes a 'primary production business', which is defined under subsection 995-1(1) to include a business of propagating and cultivating plants. Where there is a business, or a future business of growing almonds for sale at a profit, the gross sale proceeds from the sale of almonds from the Project will constitute assessable income under section 6-5. 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 almond trees and the harvesting of the almonds.

Is the Grower in business?

43. Generally, a Grower will be carrying on a business of growing almonds where:

- they have an identifiable interest in specific growing almond trees coupled with a right to harvest and sell the almonds resulting from those trees;
- the horticulture activities are carried out on their behalf; and
- the weight of the general indicators of a business, as developed by the Courts, point to them carrying on such a business.

44. By weighing up all of the attributes of the Project, it is accepted that Growers in the Project will be in a business of primary production from the date that 'business operations' are first commenced on their behalf. 'Business operations', in this context, means such things as surveying of the land, installation of the irrigation items, and other preplanting work, all conducted as part of a co-ordinated and concerted plan to grow and harvest almonds for sale at a profit.

45. Under the Farm and Management Agreements, Growers have, among other things, an occupancy right over an identifiable area of land (0.304 hectare in size) growing 82 almond trees, consistent with the intention to carry on a business of growing almonds.

46. Under the Farm and Management Agreements, Growers appoint Brownport, as Manager, to provide services such as planting of almond trees, the installation of irrigation, and all horticultural operations necessary to develop a mature almond bearing tree. Brownport will manage the Farms and harvest, process, market and sell almonds on behalf of the Growers. Brownport will distribute any Net Proceeds annually to the Growers after deducting certain expenses as mentioned above.

47. Growers have the right to use the land in question for horticulture purposes and to have Brownport come onto the land to carry out its obligations under the Farm and Management Agreements. The Growers' degree of control over Brownport, as evidenced by the Agreements and supplemented by the Corporations Law, is sufficient. Under the Agreements, Growers are entitled to receive annual reports on Brownport's activities. Growers are able to remove Brownport as Manager in accordance with the Corporations Law. The horticulture activities described in the Farm and Management Agreements are carried out on the Growers' behalf. Growers control their investment.

48. 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 in this Ruling for all these indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained 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.

49. Growers will engage the professional services of a Manager who holds itself out as having the appropriate credentials. There is a means to identify which trees Growers have an interest in. The services are based on accepted horticultural practices and are of the type ordinarily found in horticulture ventures that would commonly be said to be businesses.

50. Growers have a continuing interest in the trees from the time they are acquired until the termination of the Project. The horticulture 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' horticulture activities will constitute the carrying on of a business.

Deductibility of expenses

51. The management and licence fees payable in years one, two and three, associated with the horticulture activities, will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income is to be gained. They will, thus, be deductible under section 8-1(1)(a), to the extent that they are not capital or of a capital nature (see further below). Further, no 'non-income producing' purpose in incurring the fees is identifiable from the arrangement. The fees, on the basis of the information provided, cannot be said to be grossly excessive. The tests of deductibility under section 8-1(1)(a) are met. The exclusions do not apply, except as set out below.

Expenditure of a capital nature

52. Any part of the expenditure of a Grower entering into the horticulture business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. It is apparent from the Project's Agreements that certain payments made are attributable to the acquisition of capital assets. This includes preplanting costs, the cost of establishing the trees, the cost of electricity connection, and the erection and establishment of such items as irrigation to support and water the trees. However, expenditures of this nature can fall for consideration under specific deduction provisions of the ITAA 1997 relevant to the carrying on of a business of primary production.

53. The Manager, Brownport, has identified the relevant expenditures that are of a capital nature (refer page 18 of the Prospectus). These amounts are detailed at paragraph 20 of this Ruling.

Subdivision 387-A: landcare provisions

54. Capital expenditure incurred by a person carrying on a primary production business in respect of various measures primarily and principally for the prevention of land degradation qualifies for a 100% deduction in the year in which the expenditure is incurred, under

Subdivision 387-A. Eligible expenditure includes, among other things, expenditure on the eradication of animal and vegetable pests and on other measures, including fencing, to prevent soil erosion, salinity, and preserve natural vegetation (see section 387-60).

55. In order for the expenditure to qualify as a deduction under section 387-55, a business must be being carried on at the time the expenditure was incurred. A taxpayer incurring such expenditure need not be the owner of the land so long as it is used at that time for carrying on a primary production business. In this case there will generally be no delay between the signing of the Agreements and the commencement of 'business operations'. Accordingly, a Grower's business of primary production will generally have commenced at the time the expenditure was incurred. The necessary requirements under Subdivision 387-A will, thus, have been met in this respect.

56. However, where all that occurs in an income year, is that a person has been accepted into the Project as a Grower, but no business operations have been commenced on their behalf, they will not be accepted as having commenced a primary production business, and no deduction under Subdivision 387-A will be allowable for that, or any other, year of income.

57. Brownport has identified that the relevant expenditure attributable to eligible Landcare measures, for the purposes of sections 387-55 and 387-60, is \$750. A deduction for this amount will be allowed in the year in which a participant enters into contractual arrangements with Brownport and commences to carry on a primary production business.

Subdivision 387-B: expenditure on conserving or conveying water

58. Capital expenditure incurred by a person carrying on a primary production business, on the construction, acquisition and installation of plant, equipment and structural improvements to be used primarily and principally for the purpose of conserving or conveying water for use in such a business, qualifies for a write-off over a three year period (i.e., $33\frac{1}{3}\%$ with no pro rating required), under Subdivision 387-B, specifically section 387-125. A taxpayer incurring this expenditure need not be the owner of the land to claim the deduction, so long as they are in a business of primary production. In this case, there will generally be no delay between the signing of the Agreements and the commencement of 'business operations'. Accordingly, a Grower's business of primary production will generally have commenced at the time the expenditure was incurred. The requirements of Subdivision 387-B have, thus, been met in this respect.

59. Brownport has identified that the expenditure applicable to the conserving or conveying of water for a Farm, that meets the requirements of section 387-130, amounts to \$4,359. For a Grower entering into the Project by 30 June 2000, and commencing to carry on a primary production business by that date, a deduction will be allowable under section 387-125 for the years ended 30 June 2000 to 30 June 2002 inclusive, of \$1,453 per year.

Subdivision 387-C: horticultural provisions

60. The capital costs relating to establishing the almond trees are deductible as a 'write-off', over time, under Subdivision 387-C. This Subdivision allows capital expenditure incurred in establishing horticultural plants to be written off where the plants are used in a business of 'horticulture'. Under subsection 387-170(3), the definition of 'horticulture' covers the cultivation of almond trees.

61. The write-off commences from the time the trees are used or held ready for use for the purpose of producing assessable income in a horticultural business (see sections 387-165 and 387-170). The write-off rate will be 13% per year, assuming an effective life of the plants of greater than 13 but less than 30 years (see section 387-185). The write-off deductions will, for a Grower who has been accepted into the Project by 30 June 2000 and whose primary production business has commenced, start in the third year of the Project, on the basis it is then the almond trees enter their first commercial season and, hence, begin to be used for the purpose of producing assessable income in a horticultural business.

62. Costs of establishing horticultural plants may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or the clearing of land.

63. Brownport has identified that the relevant expenditure attributable to the establishment of the almond trees is \$680. This amount will be subject to the horticultural provisions, and also allowable as a deduction under Subdivision 387-C.

64. Similarly, the land preparation costs of \$188 are attributable to the establishment of almond trees in the Project. They will be subject to the horticultural provisions, and allowable as a deduction under Subdivision 387-C.

65. For a Grower entering into the Project by 30 June 2000, no deduction will be allowable for the years ended 30 June 2000 and 30 June 2001. There will be an amount deductible for the year ended 30 June 2002, in accordance with paragraph 38.

Alternative view

66. The applicant has indicated disagreement with the view that the almond trees do not commence to be used for the purpose of producing assessable income in a horticultural business until their first commercial season, and has submitted an alternative view that the almond trees commence to be so used immediately after their planting.

Subdivision 387-E: expenditure on electricity connection

67. A deduction is allowable under Subdivision 387-E for capital expenditure incurred by a person on ‘*connecting power to land or upgrading the connection’ if the person has an interest in land, or is a share-Grower carrying on a business on the land, and they intend to use all or some of the electricity to be supplied in carrying on a business on that land for the purpose of producing assessable income.

68. The deduction is calculated under section 387-355, over a period of 10 years from the time the expenditure is incurred, i.e., you deduct 10% of the expenditure each year. Work that constitutes ‘*connecting power to land or upgrading the connection’ is exhaustively defined in section 387-360. The work to be performed by Brownport, for which a fee of \$75 is to be charged, meets the requirements of section 387-360.

69. Growers accepted into the Project will also have an ‘interest in land’ at the time of incurring the expenditure by virtue of their rights under the Constitution and their licence to use their Farms.

Section 82KZM

70. Under the Farm and Management Agreement an initial management fee of \$3,100 and a licence fee of \$358 per Farm will be incurred on execution of that Agreement in year one. In addition, management and licence fees are payable in each of years one, two and three. In each instance, the fees are charged for providing services to a Grower only for the period of 12 months from the time they are incurred. The fees are expressly stated to be for a number of specified services. In effect, the Manager is promising to provide significantly more services, in terms of value, in year one of the Project, compared to years two and three.

71. No explicit conclusion can be drawn from the arrangement’s description, that the fees in year one have been inflated to result in reduced fees being payable for subsequent years. 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, no part of the initial management fee of \$3,100 or for the fees incurred in years one, two and three, is for Brownport doing 'things' that are not to be wholly done within 13 months of each fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditures identified above in each of the financial years ended 30 June 2000 to 30 June 2002.

Section 82KL

72. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, no 'additional benefit' has been identified to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

73. 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 Mondall Almond Project will be a 'scheme'. It will commence generally on the date the Prospectus is issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the management fees and licence fees allowable under section 8-1, and deductions allowable under Subdivisions 387-A, 387-B and 387-C, 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.

74. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the yearly sale of almonds. Further, there are no features of the Project, for example, such as the management and licence fees being 'excessive', and uncommercial, 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.

Assessable income

75. Gross sale proceeds derived from the sale of almonds harvested and processed from the Project will be assessable income of the Growers, under section 6-5, in the year in which a recoverable

debt accrues to them. This will depend on the terms of the specific sale contracts entered into.

Interest deductibility

76. Some Growers may finance the investment through a loan facility. Whether the resulting interest fees are deductible under section 8-1 depends on the same reasoning as that applied to whether the management and licence fees are deductible. The interest fees incurred will be in respect of a loan to finance the establishment of the Farm, and its development in the first years - which will continue to be directly connected with the gaining of 'business income' from the Project. These fees will, thus, also have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them.

Borrowing costs deductibility

77. The expenses incurred by a Grower for borrowing money to finance their investment are deductible under section 25-25.

Detailed contents list

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Commissioner of Taxation

20 October 1999

Previous draft:

Not previously released to the public in draft form

- taxation administration
- tax avoidance

Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 97/11;
TR 97/16; TR 98/22; TD 93/34

Legislative references:

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 - ITAA1936 82KZM
 - ITAA1936 97
 - ITAA1936 Pt IVA
 - ITAA1936 177A
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 - ITAA1997 25-25
 - ITAA1997 387-A
- Subject references:*
- carrying on a business
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 - fee expenses
 - interest expenses
 - management fees expenses
 - producing assessable income
 - product rulings
 - public rulings
 - schemes and shams

- ITAA1997 387-55
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