



# ***PR 2000/108 - Income tax: Southern Cross Bamboo Project #1***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *18 October 2000*



## Product Ruling

### Income tax: Southern Cross Bamboo Project #1

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Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

#### *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 Ruling**, **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 to confirm the arrangement has been implemented as described below and to ensure that the 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 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 Southern Cross Bamboo Project # 1, or just simply as 'the Project', or the 'product'.

### Tax law(s)

2. The tax law(s) that are dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - section 8-1 of the ITAA 1997;
  - section 17-5 of the ITAA 1997;
  - section 35-10 (ITAA 1997);
  - section 35-30 (ITAA 1997);
  - section 35-35 (ITAA 1997);
  - section 35-40 (ITAA 1997);
  - section 35-45 (ITAA 1997);
  - section 35-55 (ITAA 1997);
  - section 387-165 of the ITAA 1997;
  - Part IVA of the *Income Tax Assessment Act 1936* ('ITAA 1936');
  - section 82KL (ITAA 1936);
  - section 82KZM (ITAA 1936); and
  - section 82KZMB – 82KZMF (ITAA 1936).

### Goods and Services Tax

3. In this ruling all fees and expenditure referred to include Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered, for GST and hold a valid tax invoice.

**Business Tax Reform**

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

**Note to promoters and advisers**

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

**Class of persons**

7. 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'.

8. 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**

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

10. If the arrangement described in this 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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12. This Ruling applies prospectively from 18 October 2000, 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).

13. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely upon 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

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14. This Product Ruling is withdrawn and ceases to have effect on 30 June 2003. 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 the 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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## Previous Ruling

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15. This Ruling applies to the Project that was ruled on in Product Ruling PR 2000/20. PR 2000/20 is withdrawn on and from the date this ruling is made.

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## Arrangement

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

- Product Ruling application dated 1 August 2000;
- Southern Cross Bamboo Project # 1 Prospectus;
- Southern Cross Bamboo Project # 1 Constitution;
- Southern Cross Bamboo Project # 1 Compliance Plan;
- **Southern Cross Bamboo Project # 1 Management Agreement between Bamboo Plantations of Australia Limited ('BPA' or the 'Responsible Entity') and Growers;**
- **Southern Cross Bamboo Project # 1 Farm Allotment Agreement between Glen Allyn Plantations Ltd (the 'Land Owner') and Growers;**
- Southern Cross Plantations Project # 1 Operations Agreement between BPA and Bamboo Plantations Management Pty Ltd ('BPM' or the 'Manager');
- Lease Agreement between the Land Owner and Australian Rural Group Limited (the 'Custodian');
- Sub-lease Agreement between the Custodian and the Responsible Entity;
- Sub-sub-lease Agreement between the Responsible Entity and the Land Owner;
- Letters from the applicant to the ATO, dated 8 December 1999, 5 January 2000, 20 January 2000 and 1 August 2000.

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

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17. The documents highlighted are those Growers enter into. For the purpose of describing the arrangement to which this Ruling applies, 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 the Grower will be party to, other than any finance agreement to which paragraphs 40 to 42 applies. The effect of these agreements is summarised as follows.

**Overview**

18. The arrangement is called the Southern Cross Bamboo Project # 1.

Location	The Atherton Tablelands district of Northern Queensland
Type of business each participant is carrying on	Commercial growing of bamboo for the production of bamboo shoots and timber
Number of hectares under cultivation	The prospectus provides for 1,000 hectares to be planted
Name used to describe the product	Southern Cross Bamboo Project # 1
Size of the leased area	0.25 hectares
Number of plants per hectare	Minimum of 200
Expected production	Between 10,000 and 15,000 kilograms per hectare of edible shoots and 800 culms (bamboo timbers) per hectare
The term of the investment	15 years
Initial cost	\$14,504 if paid by \$1,370 on application and 11 monthly instalments of \$1,194, or \$13,200 if paid in advance
Initial cost on a per hectare basis	\$58,016 or \$52,800
Ongoing costs	\$2,585 for management and administration fees which is increased by the greater of the CPI or Labour Award Rate increases after year 2 and \$165 for licence fees which is increased by the CPI increase after year 2
Other costs	Growers will be charged for the cost of all insurance except Public Liability Insurance as well as harvesting, freight and marketing costs, and performance fees payable to the Responsible Entity
Minimum subscription	80 Farms must be subscribed for before any Farms are allocated to Growers

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

19. BPA will offer up to 4,000 interests to Growers representing up to 1,000 arable hectares of plantation. Investors taking an interest shall be entitled to subscribe for shares representing up to 40% of the capital of the Land Owner. In total, 10,800,000 shares of \$1.00 each in the Land Owner will be on offer. The Land Owner will carry out any capital works associated with the Project, excluding Plant Establishment works. Acceptance of a Grower into the Project will not occur until applications equating to 80 Farms have been received.

### **Farm Allotment Agreement**

20. Growers will take licences from the Land Owner for Farm allotments, which will be clearly identifiable by way of reference to surveys, comprising areas of not less than 0.25 hectares arable land. The term of the licences commences upon acceptance by BPA and terminates on 30 September 2015. The licences permit the Growers to occupy the Farm(s) for the purposes of establishing a commercial bamboo plantation, and no other purpose.

21. Licence fees of \$165 pa per Farm are payable for Years 1 and 2 of the Project and are indexed to the CPI from Year 3 onwards. Licence fees are paid annually in advance. The Growers' interests are terminated upon expiry of the licences.

22. The Land Owner has secured parts of the land, and will procure further land as required. Further land purchased must meet the same suitability criteria as land presently purchased and be approved by an independent expert.

23. The land does not need to be cleared or levelled as it is already cleared farming land that has undergone many improvements during the years prior to its use in this Project.

24. BPA does not propose irrigating the bamboo plants as the average annual rainfall and rainfall distribution over the year mean that the plants will receive sufficient natural rainfall to produce good crop yields.

25. The registered proprietor of the land is, and will be, the Land Owner. Any mortgage or encumbrance given by the Land Owner will be subject to the Growers' priority interests in the land. To further secure and protect the Growers' priority interests in the land, the Land Owner will grant a Lease to the Custodian, Australian Rural Group Ltd, who will then sub-Lease the land to the Responsible Entity. The Responsible Entity will then sub-sub-lease the land back to the Land Owner. The Lease, Sub-lease and Sub-sub-Lease will be registered on the titles to the land.

26. The Licences give Growers the right to use the Farm(s) solely for the purpose of establishing, maintaining and harvesting Bamboo



and related purposes. The Growers must comply with sound agricultural practices in respect to the Farm.

## **Management Agreement**

27. Growers appoint BPA to establish and manage their Farm(s) by way of a Management Agreement. The term of the Management Agreement commences upon acceptance by BPA, and expires on 30 September 2015.

28. BPA will, in the first 12 months of the Project, carry out those duties which are usual or necessary for carrying on the business of establishing bamboo plantations on each Grower's Farm. BPA will (clause 4.1):

- (a) prepare the Grower's Farm so that it will be suitable for the planting and growing of Bamboo Plants;
- (b) ensure each Grower's Farm has adequate drainage;
- (c) supply at least 50 Bamboo Plants to each Grower selected from high yield stock in healthy condition;
- (d) tend the Plants supplied to each Grower;
- (e) once the Plants have reached an appropriate stage of development, plant at least 50 Bamboo Plants on each Grower's Farm;
- (f) establish the Plants and each Grower's Farm in a proper and skilful manner;
- (g) comply with the constitution of the Land Owner in so far as it relates to the use of each Grower's Farm (other than the payment of fees); and
- (h) embark on such operations as may be required to prevent or combat land degradation on the Farms.

29. Immediately after the plants have been established, and for the balance of the term of the Project, BPA will carry out the following plantation management duties (clause 4.3):

- (a) tend and nurture the bamboo, including periodic slashing and weeding, fertilising, plant inspection, and culm thinning and general husbandry, including training the bamboo towards the necessary plant management system in order to maximise shoot production;
- (b) carry out pest treatment where and when necessary;
- (c) attend to repairs and maintenance as required;

- (d) selectively cull and replace under or non-performing Plants;
- (e) embark on such operations as may be necessary to prevent or combat land degradation on each Grower's Farm or land surrounding each Grower's Farm;
- (f) subject to a Grower's right to harvest its own Plants following at least three months written notice from the Grower to the Responsible Entity prior to a Production Period, harvest the Plants on the Grower's Farm at or around the time estimated by the Responsible Entity to maximise the return of produce from all of the Farms established at or around the same time as the Grower's Farm;
- (g) subject to a Grower's right to take and market produce following at least three month's written notice from the Grower to the Responsible Entity prior to a Production Period, market and sell the Bamboo Attributable to the Grower's Farm, as agent for the Grower, using reasonable endeavours to obtain the maximum price available;
- (h) if the Responsible Entity markets and sells the Bamboo Attributable to a Grower's Farms under clause 4.3(g), account to the Grower and, if relevant, the Custodian for the proceeds of such sale; and
- (i) provide sufficient information to enable each Grower to lodge statements for Goods and Service Tax in respect to the Farm.

30. BPA will carry out harvesting, freight, handling and marketing of the Bamboo attributable to the Farms.

31. BPA will use its best endeavours to sell Farm carbon credits when and if a market for such arises. Proceeds of any such sales are to be paid into the Proceeds Fund and dealt with in accordance with clause 25 of the Constitution (clause 5.7).

32. BPA may, for the better performance of its obligations under the Management Agreement, employ agents, contractors, professional advisers and other consultants (Clause 8). The operational aspects of the Farms will be carried out by an associated company, BPM. BPM is a company that has developed experience in the establishment and management of commercial bamboo plantations.

**PR 2000/108****Fees**

33. The Growers will make the following payments, in the first 3 years of the Project:

<b>Item</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
Plant establishment expenses	\$1,168	-	-
Management & administration fees	\$13,171	\$2,585	\$2,585 (see Note 1)
Licence fee	\$165	\$165	\$165 (see Note 2)
<b>Total</b>	<b>\$14,504</b>	<b>\$2,750</b>	<b>\$2,750</b>

**Notes:**

- (1) Management and administration fees are increased after year 2 by the greater of CPI or Labour Award Rate increases.
- (2) Licence fee is increased after year 2 by the CPI.
- (3) Payment of the Year 1 fees is by \$1,370 on application and 11 monthly instalments of \$1,194.
- (4) Year 2 fees are payable on 1 July 2001, regardless of a Grower's date of entry to the Project.

34. If the Growers pay the Year 1 fees in advance, the amounts payable are as follows:

<b>Item</b>	<b>Year 1</b>
Plant establishment expenses	\$1,062
Management & administration fees	\$11,973
Licence fee	\$165
<b>Total</b>	<b>\$13,200</b>

35. Plant establishment expenses represent 8% of the costs and accordingly 8% of the overheads and administration costs, being \$88, are attributed to such where fees are paid by instalments and \$80, where fees are paid in advance.

36. BPA will be entitled to a profit share bonus calculated on the following incremental basis:

<b>Net income per Farm as calculated by the Responsible Entity</b>	<b>Bonus % of Net Income payable to the Responsible Entity</b>
Less than \$ 2,500	Nil
Between \$ 2,500 - \$ 5,000	10%
Between \$ 5,001 - \$ 7,500	15%
Between \$ 7,501 - \$ 10,000	20%
Greater than \$ 10,000	25%

37. The bamboo plantations will produce 2 annual crops: edible shoots and timber. The first shoot season will be in Year 4 of the Project, and the first timber harvest in Year 6 of the Project. The shoots will be marketed to the major consuming countries in the Northern Hemisphere as out of season shoots, and are expected to command premium prices. The timber is a by-product of the production of shoots and will be marketed locally. BPA has identified significant markets for the timber.

38. BPA has had independent marketing and agricultural experts prepare reports as to the agricultural aspects and market prospects for the Project. The reports confirm that BPA has the expertise to establish and manage the plantations and that significant market opportunities exist for the shoots and timber. The Directors of BPA have experience in establishing and managing commercial bamboo plantations and have accountancy, legal, marketing and agricultural expertise. Victor Cusack, a director of BPA and BPM, is stated to be a leading world expert on bamboo. Three of the BPA Directors hold key positions in the industry body, the Australian Commercial Bamboo Corporation Ltd.

39. BPA's financial projections are based upon its expertise and that of experts it has consulted. Total gross income per Farm for the life of the Project is predicted to exceed a Grower's total expenses of participating in the Project (see Supplementary Prospectus – Grower Projections).

## **Finance**

40. Growers can fund the investments themselves, borrow from an unassociated lending body or borrow through finance arrangements organised by BPA. BPA has engaged the services of Laton Consolidated Pty Ltd ('Laton'), a company not associated with BPA, or any associated entities, to broker loans from nominated independent lenders to cover the fees payable to BPA. Apart from the arrangement with Laton, there is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance to the Growers for any purpose associated with the Project.

41. The loans brokered by Laton will be on the normal commercial terms of the particular lender, they will be both in form and substance full recourse and borrowers will be obliged to make regular repayments regardless of any income derived from the Project. BPA will receive funds directly as a result of these loans upon the Growers being accepted as borrowers. BPA will not be placing any of the funds on deposit with Laton, the lender or any associated entities of Laton, BPA or the lender, but will substantially use these funds in carrying out its obligations under the Management Agreement.

42. This Ruling does not apply if a Grower enters into a finance arrangement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements, or equivalent collateral agreements, in relation to the loan, designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers, for the purposes of section 82KL, or the funding arrangements transform the Project into a scheme' to which Part IVA applies;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project, but are transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved, or become involved, in the provision of finance to Growers for the Project.

## **Derivation of income**

43. Budget forecasts contained in the Prospectus predict each Grower's Farm will generate gross income of \$358,026 by 30 September 2015. This is predicted to exceed comfortably Growers' expenses in operating their Farm over this period. Income from the sale of edible shoots is expected to be derived from Year 4, and from the sale of timber from Year 6.

44. Budget forecasts and associated assumptions have been supported by experts reports and overseas bamboo shoot prices as shown below.

45. An agricultural report written by a independent agricultural consultant, contained in the Prospectus, states, "BPA have taken a conservative approach to projected yields (12,000 kilograms per hectare per year) on the Atherton Tableland property. However, with

good management and growing conditions with these species, it is possible to harvest 15,000 kilograms of shoots per hectare per year.”

46. A marketing report written by an independent management consultant, included in the Prospectus, states, “the cost of production is low, enabling Australian fresh shoots to be marketed out of season at virtually no premium to the prices of local on season fresh shoots – for which an already substantial market exists.....there appears to be a viable market for out of season fresh shoots from Australia and it also appears that BPA’s assessments so far is sound”.

47. Finally, the Prospectus provides a graph which shows the sale price of shoots for the years 1994 to 1998, as per published figures from 9 Tokyo city wholesale markets. For the months November to March, BPA’s estimate of \$6.00 per kilogram sale price of shoots is below each of those sale prices.

## **Ruling**

### **Assessable income**

48. A Grower’s share of the gross sale proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

### **Minimum subscription**

49. A Grower will not incur the fees shown in the Tables below before the minimum subscription for the Project is reached and the Grower’s application to enter the Project is accepted (the date the investment is made). Under the prospectus, a Grower’s application will not be accepted and the Project will not proceed until the minimum subscription of 80 interests is achieved. Tax deductions are not allowable until these requirements are met.

### **Section 8-1**

#### **Deductions where a Grower is not registered nor required to be registered for GST**

50. A Grower may claim tax deductions in the Tables below where the Grower:

- participates in the Project by 30 June 2001 to carry on the business of growing bamboo;
- incurs the fees shown in paragraph 33 or 34; and

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- is not registered nor required to be registered for GST.

***(A) Deductions available – fees paid in instalments***

Fee type	30/06/2001	30/06/2002	30/06/2003
<b>Management and administration expenses</b>	\$13,083 See Note (i) (below)	\$2,585 See Note (i) (below)	\$2,585 (Indexed) See Notes (i), (iii) (below)
<b>Licence fees</b>	\$165 See Note (i) (below)	\$165 See Note (i) (below)	\$165 (Indexed) See Notes (i), (iii) (below)
<b>Interest</b>	See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)
<b>Total</b>	\$13,248	\$2,750	\$2,750

***(B) Deductions available - fees paid in advance***

Fee type	30/06/2001	30/06/2002	30/06/2003
<b>Management and administration expenses</b>	\$11,893 See Note (i) (below)	\$2,585 See Note (i) (below)	\$2,585 (Indexed) See Notes (i), (iii) (below)
<b>Licence fees</b>	\$165 See Note (i) (below)	\$165 See Note (i) (below)	\$165 (Indexed) See Notes (i), (iii) (below)
<b>Interest</b>	See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)
<b>Total</b>	\$12,058	\$2,750	\$2,750

**Notes:**

- (i) Where a Grower incurs the management and administration fees and the licence fees as required by the Management Agreement and the Farm Allotment Agreement those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 80 to 87 unless

the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than \$1,000, is an 'exception' to any prepayment rules that apply and is deductible in full in the year in which it is incurred.

- (ii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraph 91 to 93 below as those rules may be applicable if interest is prepaid.
- (iii) Management and administration expenses are to be increased in Year 3 by the greater of the CPI increase or Labour Award Rate increase. Licence fees in Year 3 are to be increased by the CPI increase.

### **Tax deductions for capital expenses**

51. A Grower who participates in the Project will also be entitled to the following tax deductions for both fees paid in instalments and fees paid in advance:

<b>Fee type</b>	<b>30/06/2001</b>	<b>30/06/2002</b>	<b>30/06/2003</b>
<b>Plant establishment expenses</b>	Nil - See Note (iv) below	Nil	Nil

- (iv) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the bamboo plants for use in a horticultural business. The deduction is allowable when the bamboo plants, as horticultural plants, enter their first commercial season. If the bamboo plants have an 'effective life' for the purposes of section 387-185 of greater than 30 years, this results in a write-off rate of rate of 7% prime cost. The Project's manager will inform Growers of when the bamboo plants enter their first commercial season (which is expected to be in Year 4 of the Project).

### **Deductions where a Grower is registered or required to be registered for GST**

52. Where a Grower who is registered or is required to be registered for GST:



- participates in the Project by 30 June 2001 to carry on the business of growing bamboo plants;
- incurs the fees shown in paragraphs 33 or 34; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 98.

## **Section 35-55 – losses from non-commercial business activities**

53. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2007 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

54. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies (see paragraph 72 in the Explanations part of this Ruling, below).

55. Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

## **Sections 82KZM, 82KZMB-82KZMD, 82KL and Part IVA**

56. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Farm Allotment Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 80 to 87);

- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 80 to 87);
- expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 80 to 87);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in 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**

57. Consideration of whether the management and administration fees and licence fees are deductible under section 8-1 begins with paragraph 8-1(1)(a) on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoing is not deductible under the second limb if it is incurred when the business has not commenced; and
- where 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 in determining whether the outgoing in question would have a sufficient connection with activities to produce assessable income.

### **Is the Grower carrying on a business?**

58. A bamboo growing scheme can constitute the carrying on of a business. Where there is a business, or a future business, the Gross Harvest Proceeds each year from shoots and timber from farms comprising 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, maintaining and harvesting of the shoots and timber each year from the farms. Generally, a Grower will be carrying on a business of growing bamboo where:

- the Grower has an identifiable interest in specific growing plants coupled with a right to harvest and sell the shoots and timber each year from the plants;
- the bamboo growing activities are carried out on the Grower’s behalf; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

59. For this Project Growers have rights under the Farm Allotment Agreement in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of growing bamboo. Under the Management Agreement Growers engage the Project Managers to acquire bamboo plants and plant them on the licenced land and to provide ongoing services to care and maintain the plants. Growers are considered to have control of their operations.

60. The Farm Allotment Agreement provides Growers with more than a chattel interest in the vines. The Project documentation contemplates Growers will have an ongoing interest in the vines.

61. Growers have the right to use the land in question for viticulture purposes and to have the Responsible Entity come onto the land to carry out its obligations under the Management Agreement. The Growers’ degree of control over the Responsible Entity as evidenced by the Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Project Manager’s activities. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect. The bamboo growing activities described in the Management Agreement are carried out on the Growers’ behalf.

62. 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. 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.

63. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify which plants Growers have an interest in. These services are based on accepted bamboo growing practices and are of the type ordinarily found in bamboo growing ventures that would commonly be said to be businesses.

64. Growers have a continuing interest in the plants from the time they are acquired until the cessation of the Project. The bamboo growing 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' bamboo growing activities will constitute the carrying on of a business.

65. The licence fees and management fees associated with the bamboo growing activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which income (from the regular sale of shoots and timber) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

### **Expenditure of a capital nature**

66. Any part of the expenditure of a Grower entering into a bamboo growing 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. In this Project, the costs of purchase and establishment of bamboo plants are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

### **Subdivision 387-C - Vines and horticultural provisions**

67. Section 387-165 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 (section 387-210).

68. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant, such as the bamboo plants in this Project, with an effective life in excess of 30 years, that rate is 7%.

### **Division 35 - losses from non-commercial business activities**

69. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law partnership) from certain business activities will not be allowable in an income year unless:

- the 'Exception' in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

70. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

71. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

72. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project, they are beyond the scope of this Product Ruling and are not considered further.

73. In broad terms, the objective tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);

- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

74. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project during the year ended 30 June 2001 is unlikely to pass one of the objective tests until the income year ended 30 June 2007. Growers who acquire more than one interest in the Project may, however, pass one of the tests in an earlier income year.

75. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

76. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the term of this Product Ruling.

77. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

- (i) the business activity has started to be carried on; and
- (ii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

78. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 53), in the manner described in the Arrangement (see paragraphs 16 to 47), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

79. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent agricultural consultant;
- the report of the independent management consultant;
- information in the Prospectus showing the sale price of bamboo shoots at Tokyo wholesale markets over the past several years; and
- the Prospectus for the Project that issued on 18 February 2000 which sets out projected bamboo shoot and timber production yields at the Glen Allyn properties, and bamboo shoot and timber prices of the projected market in the geographical regions where the shoots and timber are to be sold.

## **Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD, and 82KZME – 82KZMF**

80. The prepayments provisions of the ITAA operate 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. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

81. In this Project, the Management and Administration Fee of either \$11,973 or \$13,171 and a Licence Fee of \$165 per farm will be incurred on execution of the Management Agreement and the Farm Allotment Agreement. The Management Fee and the Licence Fee are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. In particular, the Management Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Management Fee has been inflated to result in reduced fees being payable for subsequent years.

82. There is also no evidence that might suggest the management services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the

agreements as set out in paragraph 33 and 34 then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

***Growers who choose to pay fees for a period in excess of that required by the Project's agreements***

83. Although not required under either the Management Agreement or the Farm Allotment Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 82 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

84. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Licence Fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means generally, the period over which the services are to be provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and, where the 'eligible service period' exceeds 13 months, whether the Grower is a 'small business taxpayer'.

85. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

In the formula, the 'eligible service period' means, generally, the period to which the services are to be provided.

86. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Grower is a 'small business taxpayer' or section 82KZMD if the Grower is not a 'small business taxpayer'. For a 'small business taxpayer' (see paragraphs 88 to 90), the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same, or



effectively the same as that shown in paragraph 85 above, concerning section 82KZMF.

87. A prepaid management fee and/or a prepaid licence fee of less than \$1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(7) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than \$1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of a prepaid management fee or a prepaid licence fee is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

#### **Subdivision 960-Q - Small business taxpayers**

88. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

89. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

90. Whether a Grower is a 'small business taxpayer' depends upon the circumstances of each Grower and is beyond the scope of this Product Ruling. It is the responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

#### **Interest deductibility**

91. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by, the Tax Office.

92. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in sections 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass

activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

93. Therefore, unless the prepaid interest is ‘excluded expenditure’, where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. Where a prepayment is for more than 13 months, any tax deduction that may be allowable must be determined under section 82KZM (for a ‘small business taxpayer’) or section 82KZMD (for a taxpayer who is not a ‘small business taxpayer’). The relevant formula is the same, or effectively the same, as that shown above in paragraph 85 above.

#### **Section 82KL**

94. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefit(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

#### **Part IVA**

95. 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).

96. The Southern Cross Bamboo Project # 1 will be a ‘scheme’. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of the tax deductions for the amounts detailed at paragraphs 50 and 51 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.

97. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of bamboo shoots and timber. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm’s length, or, if any parties are not at arm’s length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

## Example

### Example 1 – entitlement to an ‘input tax credit’

98. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year’s management fees of \$5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees, however, is reduced by the amount of any input tax credit to which she is entitled. The Project Manager provides Margaret with a tax invoice which includes its ABN and shows the price of the taxable supply for management services (\$5,500). Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

Therefore the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 less \$500).

## Detailed contents list

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# PR 2000/108

*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*

PR 1999/95; TR 92/1;  
TR 92/20; TR 97/11; TR 97/16;  
TR 98/22; 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:*

- ITAA 1936 82KL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD

- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 17-5
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 387-165
- ITAA 1997 387-185
- ITAA 1997 387-210
- ITAA 1997 960-335
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- ITAA 1997 960-345
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