



PR 2000/109 - Income tax: Frankland River Olive Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 November 2000*



Product Ruling

Income tax: Frankland River Olive Project

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Preamble

The number, subject heading, and the **What this Product Ruling is about** (including Tax law(s), Class of persons and Qualifications sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the Taxation Administration Act 1953. Product Ruling PR 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.

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.

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 Frankland River Olive Project, or just simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- Section 6-5 (ITAA 1997);
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZM and sections 82KZMB - 82KZMD (ITAA 1936);
 - Section 82KZME (ITAA 1936);
 - Section 82KZMF (ITAA 1936); and
 - Part IVA (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. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

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- the Ruling will be withdrawn or modified.

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may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

11. This Ruling applies prospectively from 1 November 2000, the date the 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).

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 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 withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 29 August 2000;
- The Frankland River Olive Company Limited Draft Prospectus, undated;
- Constitution for Frankland River Olive Company Limited, undated;

- **Draft Management Agreement for the Frankland River Olive Project between The Frankland River Olive Company Ltd [the ‘Responsible Entity’], Southern Olive Management Pty Ltd [‘the Manager’] and the Grower, undated;**
- **Draft Lease Agreement for the Frankland River Olive Project between The Frankland River Olive Company Ltd [the ‘Responsible Entity’] and the Grower, undated;**
- Compliance Plan for the Frankland River Olive Project, undated;
- Additional correspondence dated 26 September 2000 and 20 October 2000.

Note: certain information received from The Frankland River Olive Company Ltd has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

15. The documents highlighted are those the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be a party to, with the exception of finance agreements, to which paragraphs 43 and 44 apply. The effect of the agreements is summarised as follows.

Overview

16. This arrangement involves the Frankland River Olive Project.

Location	South West Region of Western Australia near Frankland
Type of business each participant is carrying on	Commercial growing, and cultivation of olive trees for producing premium olives and olive products.
Number of hectares under cultivation	500
Name used to describe the product	Frankland River Olive Project
Size of each Grove	0.2 hectares
Number of trees per hectare	250
Expected production	15 tons / hectare
The term of the investment in years	21
Initial cost	\$4,521

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Initial cost per hectare	\$22,605
Ongoing costs	Management and Lease Fees.

17. Growers applying under the Prospectus enter into a Lease Agreement and a Management Agreement. The Lease Agreement gives a Grower a lease from The Frankland River Olive Company Ltd, over an identifiable area of land called a 'Grove', until the Project is terminated pursuant to the provisions of the Constitution, or the date of the final distribution to the Communal Growers, or the date on which the Growers resolve to terminate the Management Agreement or the 30th day of June 2021, whichever happens first. Each Grove is 0.2 hectares in size.

18. The Project Land is situated in the South West Region of Western Australia. The Frankland River Olive Company Ltd is the owner of the property.

19. The Frankland River Olive Company Ltd will lease the Grove to the Grower to enable the Grower to carry on the business of running an olive grove for the commercial production of olive products. Growers are specifically granted rights to harvest the olives from time to time on their Grove for this purpose.

20. There is no minimum subscription for this Project and applications made under the Prospectus will not be accepted after 31 December 2000. Each investor may subscribe for a minimum of one Grove, at a cost of \$4,521 per Grove. A minimum of 50 trees per Grove (250 trees per hectare) will be planted on or before 30 June 2001, following the execution of the Lease and Management Agreements (Cl.3.5 of Constitution).

21. Each Grower must also subscribe for 1000 shares in The Frankland River Olive Company Ltd at \$0.70 per share. Shareholders may not hold more than 71.4% of the shares on issue in The Frankland River Olive Company Ltd.

22. Possible projected returns for Growers are outlined on pages 22 and 23 of the Draft Prospectus. The project is of a long term nature and subject to certain risks such as agricultural risks in the nature of natural disasters, the weather, pest infestation and crop diseases as well as financial risks and general commercial market risks. However, based on the example set out on page 22 of the Prospectus, a Grower could expect to achieve an after tax internal rate of return of 13.95% per Grove. Growers will execute a Power of Attorney enabling the Responsible Entity, The Frankland River Olive Company Ltd, to act on their behalf as required, when they make an application for a Grove.

Constitution

23. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Grower and to manage the Project. The Responsible Entity will keep a register of Growers (cl 7.1). Growers are entitled to assign their Grower's Interest in certain circumstances (cl 5.1). The Lease and Management Agreements are annexed to the Constitution and will be executed on behalf of a Grower following them signing the Application and a Power of Attorney Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

Compliance Plan

24. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Law. Under the Compliance Plan, a Compliance Committee will monitor to what extent the Responsible Entity meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

Interest in Land

25. A lease is granted by the Land Owner, The Frankland River Olive Company Ltd, to the Grower under the terms of the Lease Agreement (Cl 2). Growers are granted an interest in land in the form of a lease to use their Groves for carrying on the business of running an Olive Grove (cl 4.1). Growers must pay rent annually to the Lessor. The term of a Grower's lease is up to 30 June 2021.

Management Agreement

26. Each Grower enters into a Management Agreement with the Responsible Entity for each Grove. The termination of the project will be the date on which the Project is wound up pursuant to clause 20 of the Constitution, or the date of payment of the final distribution to the Communal Growers, or the date on which the Growers resolve to terminate the Management Agreement or the 30th day of June 2021, whichever happens first.

27. Growers contract with the Responsible Entity to cultivate and care for the olive trees consistent with Good Horticultural Practice. Growers pay a Management Fee for each Grove on subscription and an annual management fee thereafter.

28. The Manager will carry out the following services under this agreement:

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- cultivate, tend, train, prune, fertilise, replant, spray and otherwise care for the Olive Trees as and when required that is consistent with Good Horticultural Practice;
- Use all reasonable measures to keep the Grove free from vermin, noxious weeds, pests and diseases;
- maintain all trellising and fences;
- arrange for harvesting of the Olives; and
- use reasonable endeavours to arrange the processing of the Olives and packaging, marketing and sale of the Olive Products.

29. A Grower may elect to collect their own harvested olives and to take sole responsibility for their processing and for marketing of any resultant Olive Oil (cl.6.1). However, where Growers do not elect, the Manager will harvest and process the Olives and package and market the Olive Products on any such terms as the Manager considers appropriate and advantageous for the Grower. (cl.7). The Manager will be responsible for paying for the cost of annual insurance on the Grove (cl. 9.1).

30. The Responsible Entity may only be removed from its appointment in accordance with section 601FL and 601FM of the Corporations Law.

Fees

31. The initial fee payable under the Management Agreement is the Subscription Sum of \$4,111.80 per Grove payable on application for the care and cultivation of the trees (cl.10 of Management Agreement). This service will be carried out by 30 June 2001.

32. A Management Fee of \$1,586.20, to be indexed by the percentage increase in the Consumer Price Index between 1 July 2000 and the quarter preceding the Annual Payment Date, is payable on or before 31 July of each year for services to be carried out in the periods 1 July to 30 June for the years ending 30 June 2002 to 30 June 2004.

33. A Management Fee of \$1,529.55, to be indexed by the percentage increase in the Consumer Price Index between 1 July 2000 and the quarter preceding the Annual Payment Date, is payable on or before 31 July of each year for services to be carried out in the periods 1 July 2004 to 30 June 2005 and 1 July 2005 to 30 June 2006.

34. For the periods commencing 1 July 2006 and onwards, an annual Management Fee of \$1472.90, to be indexed by the percentage increase in the Consumer Price Index between 1 July 2000 and the quarter preceding the Annual Payment Date, is payable each year for

the period 1 July to 30 June and is payable on or before 31 July of the year in which the services are provided.

35. After harvest, Growers must pay the Manager a Harvest Fee of \$2.20 per tree and a Processing and Packaging Fee of \$1.82 per package litre and a Marketing Fee of 3% (plus GST) of Sale Proceeds. These amounts will be withheld by the Responsible Entity from the Communal Grower's Proportional Interest in the Gross Proceeds before the proceeds from the sale of the Olive Products are paid out to the Growers.

36. A Lease Fee of \$409.20 is payable on application for rent for the period up to 30 June 2001. For the period commencing 1 July 2001 and onwards, an annual Lease Fee of \$408.10, to be indexed by the percentage increase in the Consumer Price Index between 1 July 2000 and the quarter preceding the Annual Payment Date, is payable on or before 31 July each year for the period 1 July to 30 June of the same year.

37. Growers can elect each year to pay their lease and management fees on a yearly or quarterly basis. Where the quarterly payments option is taken, all payments will be made within the same financial year.

38. The Independent Expert has stated, at pages 30 to 33 of the Draft Prospectus, that the Project has excellent chances of success. The Frankland environment is very well suited to high quality olive and olive product production and given competent management, the projected average yield after 10 years of 15 tons/hectare looks reasonable and achievable.

39. There are however two reservations. Firstly, olives tend to be biennial bearing which can be partly controlled by water and management. Secondly, there are the other hazards, which are to varying degrees uncontrollable, to which agriculture and horticulture enterprise is subject to.

40. The Application Monies will be banked in the Subscription Fund bank account formed under the Project's Constitution (cl 10.2).

Planting

41. During the period up to 30 June 2001 the Responsible Entity will be responsible for planting the Olive Trees on the leased area. After 30 June 2001, the Manager will maintain the trees in accordance with Good Horticultural Practice. The services to be provided by the Manager over the term of the Project are outlined in the Management Agreement (item 6 of schedule).

42. The Manager will be responsible for arranging the marketing and sale of the Olive Produce. The Harvest shall take place in each

year of the Term that there is a commercially harvestable crop, at such time or times as in the opinion of the Manager will maximise the return to the Grower.

43. The Gross Proceeds of the sale of the Olive Produce will be paid into the Proceeds Fund Bank Account. Proceeds received by the Responsible Entity are to be distributed in the following order of priority:

- to the Responsible Entity for any amounts it is entitled to under clause 10.3(b) of the Constitution;
- any annual payments due by any of the Communal Growers that may be due but unpaid;
- any amounts payable by the Growers under the Lease Agreement and Management Agreement and the Constitution. (cl 10.3(b) of Constitution).
- The Net Proceeds to the Communal Growers.

Finance

44. All Growers are required to fund their investment in the Project themselves or borrow from an independent lender. The Responsible Entity has however made arrangements whereby Growers may apply through Lincoln Financial for a finance package with Bendigo Bank Ltd to assist in financing the investment. This finance will be on a full recourse basis.

45. This Ruling does not apply if a Grower enters into a finance agreement 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 other 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 may apply;
- terms or conditions are 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 will be

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, other than Lincoln Financial and Bendigo Bank Ltd, are involved or become involved, in the provision of finance to Growers for the Project.

Ruling

Assessable income

46. A Grower's share of the gross sales 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.

Section 8-1

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

47. A Grower may claim tax deductions in the Table below where the Grower

- participates in the Project by 30 June 2001 to carry on the business of growing olives;
- incurs the fees shown in paragraphs 31 to 36; and
- is not registered nor required to be registered for GST:

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Fee Type	ITAA 1997 Section	Year 1 deductions	Year 2 deductions	Year 3 deductions
Management Fee	8-1	\$4111.80 – See Note (i) (below)	\$1586.20 (to be indexed) – See Note (i) (below)	\$1586.20 (to be indexed) – See Note (i) (below)
Lease Fee (Rent)	8-1	\$409.20 – See Note (i) (below)	\$408.10 (to be indexed) – See Note (i) (below)	\$408.10 (to be indexed) – See Note (i) (below)
Interest		See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)

Notes:

- (i) Where a Grower incurs the management fees and the lease fees as required by the Management Agreement and the Lease Agreement those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (eg, 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 74 to 81 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 85 to 87 below as those rules may be applicable if interest is prepaid.

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

48. 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 olives;
- incurs the fees shown in paragraphs 31 to 36; and
- is entitled to an input tax credit for the fees

then the tax deductions shown in the Table above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 92.

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

49. 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 2005 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.

50. 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 66 in the Explanations part of this Ruling, below).

51. 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, ie, 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.

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Sections 82KZM, 82KZMB – 82KZMD, 82KZME - 82KZMF, 82KL and Part IVA

52. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Lease 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 74 to 81);
- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 74 to 81);
- expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 74 to 81);
- 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

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

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is 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 paragraph 8-1(1)(a), and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

54. A horticultural scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the sale of the olive produce from the scheme, will constitute assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the olives from the trees.

55. Generally, a Grower will be carrying on a business of horticulture where:

- the Grower has an identifiable interest in specific growing trees coupled with a right to harvest and sell the produce from the trees;
- the horticulture 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.

56. For this Project Growers have, under the Lease Agreement and the Management Agreement, rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing olive trees. Under the Management Agreement Growers appoint Southern Olive Management Pty Ltd, as Manager, to cultivate, tend, train, prune, fertilise, replant, spray and otherwise care for the Olive Trees as and when required that is consistent with Good Horticultural Practice and to use all reasonable measures to keep the Grove free from vermin, noxious weeds, pests and diseases. Growers are considered to control their investment. The specific cost of these services provided by 30 June 2001 is \$4111.80 per Grove.

57. The Lease Agreement provides Growers with more than a chattel interest in the trees. The project documentation contemplates Growers will have an ongoing interest in the trees.

58. Growers have the right to use the land in question for the business of running an olive grove and to have the Manager come onto the land to carry out its obligation under the Lease and Management Agreements. The Growers' degree of control over the Manager, 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 by The Frankland River Olive Company Ltd. Growers are able to terminate arrangements with the Manager in certain instances,

such as where there has been any substantial breach by the Manager of any material obligation under the Management Agreement or the Manager committing an act of bankruptcy or going into liquidation. The horticultural activities described in the Management Agreement are carried out on the Growers' behalf.

59. 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 Draft 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.

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

61. Growers have a continuing interest in the olive trees from the time they are acquired until the cessation of the Project. The horticultural 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' horticultural activities will constitute the carrying on of a business.

62. The lease and management fees associated with the horticultural activities will relate to the gaining of income from this business and, hence, have a sufficient connection to the operations by which this income (from the sale of olive produce) 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 section 8-1 are met. The exclusions do not apply.

Division 35 - losses from non-commercial business activities

63. 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.

64. 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.

65. 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.

66. 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.

67. 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).

68. 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 is unlikely to pass one of the objective tests until the income year ended 30 June 2005. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

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69. 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.

70. 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.

71. 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.

72. 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 49), in the manner described in the Arrangement (see paragraphs 14 to 45), 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.

73. 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 viticulturist.

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

74. 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.

75. In this Project, the Management Fee of \$4111.80 and Lease Fee of \$409.20 per Grove will be incurred on execution of the Management Agreement and the Lease Agreement. The Management Fee and the Lease 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.

76. 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 paragraphs 31 to 36, 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

77. Although not required under either the Management Agreement or the Lease 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 76 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.

78. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Lease 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'.

79. 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.

80. 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 82 to 84) 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 79 above, concerning section 82KZMF.

81. A prepaid management fee and/or a prepaid lease fee of less than \$1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(4) 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 lease 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

82. 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.

83. '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).

84. 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

85. 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.

86. 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.

87. 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 a 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 79 above.

Section 82KL - recouped expenditure

88. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefits(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 - general tax avoidance provisions

89. 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).

90. The Frankland River Olive Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 47 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.

91. 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 the olive produce. 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 'input tax credit'

92. 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' showing its ABN and the 'Price value of the taxable supply' for management services as \$5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

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

93. 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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Commissioner of Taxation

1 November 2000

<i>Previous draft:</i>	- ITAA 1997 17-5
Not previously issued in draft form	- ITAA 1997 Div 27
	- ITAA 1997 Div 35
	- ITAA 1997 35-10
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-10(2)
PR 1999/95; TR 92/1; TR 97/11;	- ITAA 1997 35-10(3)
TR 97/16; TD 93/34; IT 175;	- ITAA 1997 35-10(4)
IT 2001; TR 92/20; TD 93/34	- ITAA 1997 35-30
	- ITAA 1997 35-35
<i>Subject references:</i>	- ITAA 1997 35-40
- carrying on a business	- ITAA 1997 35-45
- commencement of business	- ITAA 1997 35-55(1)
- primary production	- ITAA 1997 35-55(1)(a)
- primary production expenses	- ITAA 1997 35-55(1)(b)
- management fee expenses	- ITAA 1997 960-335
- producing assessable income	- ITAA 1997 960-340
- product rulings	- ITAA 1997 960-345
- public rulings	- ITAA 1997 960-350
- schemes and shams	- Corporations Law 601FL
- taxation administration	- Corporations Law 601FM
- tax avoidance	- ITAA 1936 82KL
- tax benefits under tax avoidance - schemes	- ITAA 1936 82KZL(1)
	- ITAA 1936 82KZM
- tax shelters	- ITAA 1936 82KZM(1)
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	- ITAA 1936 82KZMB
	- ITAA 1936 82KZMC
<i>Legislative references:</i>	- ITAA 1936 82KZMD
- ITAA 1997 6-5	- ITAA 1936 82KZMD(2)
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- ITAA 1997 8-1(1)(a)	- ITAA 1936 82KZME(4)

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 - ITAA 1936 177D
 - ITAA 1936 177D(b)
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