



PR 2000/110 - Income tax: Victorian Olive Oil Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *22 November 2000*



Product Ruling

Income tax: Victorian Olive Oil 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.

[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

No guarantee of commercial success

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.

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 Victorian Olive Oil Project, or simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Section 387-55 (ITAA 1997);
 - Section 387-125 (ITAA 1997);
 - Section 388-55 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Section 82KZM (ITAA 1936);
 - Section 82KZMD (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 the Project.

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

12. This Ruling applies prospectively from 8 November 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 on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

14. 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 material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

15. The arrangement that is the subject of this Ruling is described below. The relevant documents, or parts of documents, incorporated into this description of the arrangement include:

- Application for Product Ruling dated 28 July 2000;
- Draft Constitution of The Victorian Olive Oil Project;
- Draft Compliance Plan of The Victorian Olive Oil Project;
- Draft Prospectus for The Victorian Olive Oil Project;
- Draft Lease Agreement between Victorian Olive Oil Project Limited and Lanyons Paddock Pty Ltd;
- Draft **Sub-Lease Agreement** (i.e., Grove Lease Agreement) between Victorian Olive Oil Project Limited and the Grower;
- Draft **Grove Management and Harvesting Agreement** between Terrapee Contractors Pty Ltd and the Grower represented by the Responsible Entity;
- Draft **Irrigation System Agreement** between Terrapee Contractors Pty Ltd and the Grower represented by the Responsible Entity;
- Draft **Crushing and Marketing Agreement** between Victorian Olive Processors Pty Ltd and the Grower represented by the Responsible Entity;
- Correspondence from the Applicant's representative dated 21 September 2000;
- Orchard Establishment Plan for the Victorian Olive Oil Project;
- Orchard Management Plan for the Victorian Olive Oil Project;
- Revised Water Strategy for the Victorian Olive Oil Project dated 31 August 2000;
- Draft Olive Tree Supply Agreement between Lanyons Paddock and a supplier; and
- Draft Custodian Agreement between Victorian Olive Oil Project Limited and Custodial Limited.

Note: Certain information received from the applicant regarding the Project has been provided with an understanding that it is on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.

16. The documents highlighted in paragraph 15 in bold are those that may be entered into by the Grower. For the purposes of describing the arrangements to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not

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legally enforceable, to which the Grower, or an associate of the Grower, will be a party.

17. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

18. This arrangement is called "The Victorian Olive Oil Project".

Location	14kms south west of Boort, Victoria
Type of Business each participant is carrying on	Commercial growing and cultivation of an olive grove for the purpose of producing olive oil
Number of Hectares to be cultivated	400
Size of each Olive Grove	1 hectare
Number of trees per Olive Grove	No less than 250; between 250-330 depending on variety
Expected Production	First harvest expected in 2005, reaching maturity in 2009 with expected average production of 15 tonne of fruit per hectare
Term of the Project	Initial term to 30 June 2025, with option for a further 25 years
Minimum Subscription	250 hectares
Subscription amount per olive grove (1 hectare)	\$25,058 on application, comprising: Lease to 30 June 2002 \$5,698 Irrigation \$9,900 Management fees to 30 June 2004 \$9,460
Lease fee	\$2,849 each year for 2003 to 2010 then indexed by CPI
Management fee	\$5,060 each year from 1 July 2004 indexed by CPI

19. A Grower will participate in the Project by:

- entering into a 'Grove Lease Agreement' with Victorian Olive Oil Project Limited (VOOP) (the responsible entity) in respect of a grove (1 hectare) for the period to 30 June 2025;
- entering into an 'Irrigation System Agreement' that relates to the purchase, and installation of an irrigation system on the Growers Grove;
- entering into a 'Grove Management and Harvesting Agreement' that relates to services to be performed in

maintaining and harvesting the Grower's Grove from the date of entering the agreement.

- entering into a 'Crushing and Marketing Agreement' that relates to the crushing of the Grower's produce into olive oil and the marketing of that oil.

Grove Lease Agreement

20. The Grower will lease the Project land from VOOP which will give the Grower full use of one hectare of land planted with no less than 250 olive trees and sufficient water to irrigate the olive trees. The lease will refer to an identifiable area of land and the Grower must maintain their grove to a minimum standard. The Grower may delegate the orchard maintenance to a Manager approved by VOOP.

21. The 'Grove Lease Agreement' will commence after minimum subscription has been achieved and expires on 30 June 2025. The Grower has the option to renew the lease for a further 25 years. The lease fee to be paid under the agreement is \$2,849 per financial year, or part thereof, fixed for the period to 30 June 2010, then increased annually by the proportional increase in the CPI.

22. The first two years rent, \$5,698, relating to the period from application to 30 June 2002, must be paid on application and will be held by the Custodian until minimum subscription is reached.

Irrigation System Agreement

23. The Grower will enter into an agreement with Terrapee Contractors Pty Ltd to purchase and install an irrigation system. Terrapee Contractors will ensure that the irrigation system is installed on the Grower's leased property prior to the olive trees being planted. All future maintenance of the irrigation system is included under the Grove Management and Harvesting Agreement.

24. The Irrigation System Agreement fee is \$9,900, to be paid on application and will be held by the Custodian until minimum subscription is achieved.

Grove Management and Harvesting Agreement

25. The Grower will enter into an agreement appointing Terrapee Contractors Pty Ltd to manage the Grower's interest in the Project. Under this agreement, Terrapee Contractors Pty Ltd specifically undertakes to maintain the Grower's olive grove, with such maintenance to include, but not be limited to, the following activities:

- undertaking of certain measures concerning land degradation;
- establishment of wind breaks;
- operation and maintenance of the irrigation system;
- supply and application of herbicides and fertilisers;
- weed and pest control;
- tying and retying of young trees;
- pruning the trees in a manner to assist with mechanical harvesting;
- harvesting the trees;
- controlling the spread of feral olives; and
- provision of fire control.

26. The Grove Management and Harvesting Agreement will commence on execution of the agreement for an initial period to 30 June 2025. The fee for this Agreement is \$9,460, payable on application, for the period from commencement to 30 June 2004, then \$5,060 per annum payable monthly in advance, increased annually by the proportional increase in the CPI.

Crushing and Marketing Agreement

27. The Grower will enter into an agreement with Victorian Olive Processors Pty Ltd to arrange processing of the Grower's harvest from the Grove with the resulting oil to be marketed for a fee equal to 15% of oil produced by weight.

28. The Crushing and Marketing Agreement will commence upon execution of the agreement, which will not occur before minimum subscription is achieved, and will cease on 30 June 2025.

Income

29. As provided for by the Project's constitution (see below) the gross proceeds from the sale of olive oil under the Crushing and Marketing Agreement will be pooled by VOOP in the Revenue Fund and shared between Growers in proportion to their interest in the fund after deduction of all selling costs.

Application

30. On application to the Project, the Grower must elect what Agreements he or she wishes to enter into. This ruling only applies to

Growers who enter into all of the agreements and pay the following amounts:

Grove Lease Agreement for the period to 30 June 2002	5,698
Irrigation System Agreement	9,900
Grove Management and Harvesting Agreement for the period to 30 June 2004	<u>9,460</u>
	<u>\$25,058</u>

31. The amounts paid by the Grower will be held in trust by the Custodian to the Project until the minimum subscription of 250 allotments have been achieved. The Custodian will make payments to VOOP and Terraptee Contractors Pty Ltd as invoices are presented evidencing work completed, or in annual instalments in the case of the Grove Lease Agreement and Grove Management and Harvesting Agreement.

Management

32. VOOP is the Responsible Entity for the Project. VOOP has the legal responsibility of overseeing the Project in accordance with the Constitution, the Compliance Plan and the Lease Agreement. VOOP will also take a supervisory role in the Irrigation System Agreement, Grove Management and Harvesting Agreement and Crushing and Marketing Agreement. VOOP has applied for a Dealers Licence with the Australian Securities and Investments Commission authorising them to operate the Project.

33. VOOP, as Responsible Entity, will:

- arrange for the Custodian to establish an Application Fund and a Revenue Fund on behalf of the Growers by lodging the first Application Moneys and the first monies received in respect of the project. The money will be held by the Custodian upon the Trust's Constitution. Growers will then have an interest in the relevant Application Fund and Revenue Fund equal to their Proportional Interest but shall not have any interest in any particular part of the fund;
- make application to the Custodian on behalf of the Grower to pay funds from the Application Fund as amounts fall due or to meet approved expenditure;
- lease to the Grower an identifiable hectare of land to be planted with no less than 250 olive trees, and sufficient water to irrigate the Grove;

- execute on behalf of the Grower the Irrigation System Agreement, Grove Management and Harvesting Agreement and Crushing and Marketing Agreement; and
- ensure that all services described under the Irrigation System Agreement, Grove Management and Harvesting Agreement and Crushing and Marketing Agreement are delivered, and report to the Grower on no less than a six monthly basis the performance of the contracting parties under these agreements.

Finance

34. Growers can fund their investment in the Project themselves, or borrow from an independent lender.

35. 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 purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- 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 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, are involved or become involved, in the provision of finance to Growers for the Project.

Growers should be entitled to deductions for interest provided the finance from independent lenders does not have any of the above features.

Other Undertakings

36. The Applicant has provided the Australian Taxation Office with the following undertakings:

- if, in any year of the Project, the income resulting from the sale of product is insufficient to meet the payments under the Grove Lease Agreement, Grove Management Agreement or any other payment then the Members will still be liable to make up the shortfall; and
- there will be no promotional offers involving refunds to Members, donations to charities, or money back guarantees.

Ruling

Assessable Income

37. 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.

Minimum subscription

38. A Grower will not incur the fees shown in the Table(s) 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 250 interests is achieved. Tax deductions are not allowable until these requirements are met.

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

39. A Grower may claim tax deductions using the methods and Tables in paragraphs 44 and 45, where the Grower:

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

Section 8-1 – Prepaid fees

40. Expenditure incurred by a Grower who participates in the Project is subject to the prepayment rules contained in sections 82KZM and 82KZMD. Therefore, a Grower who prepays fees that are otherwise allowable under section 8-1 **cannot** claim a tax deduction for the full amount of the fees in the year in which the expenditure is incurred unless it is ‘excluded expenditure’.

41. The amount and timing of tax deductions allowable each year for such fees must be determined using the formula in subsection 82KZM(1) where a Grower is a ‘small business taxpayer’ and subsection 82KZMD(2) where a Grower is not a ‘small business taxpayer’.

42. Subsection 82KZM(1) enables a Grower, who is a ‘small business taxpayer’, to claim a proportion of the expenditure in each year of the eligible service period. The deductible proportion is ascertained with the formula:

$$\frac{\text{Period in year}}{\text{Eligible Service period}}$$

where:

“Period in year” is the number of days in the whole or the part of the eligible service period that occurs in the year of income;

“Eligible service period” is the number of days in the eligible service period.

43. A Grower, who is not a ‘small business taxpayer’ will calculate their deduction using the formula in subsection 82KZMD(2). In the formula, shown below, the ‘eligible service period’ means, generally, the period over which the services are to be provided.

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

44. In this Project, the tax deductions allowable for the Lease Fees and Management Fees (detailed at paragraph 30 in the Arrangement) must be calculated by applying the relevant formula to the amount incurred each year by the Grower. The application of the formula in paragraph 42 is shown in the Example at paragraph 92.

Fee type	ITAA 1997 section	Year 1 deduction	Year 2 deduction	Year 3 deduction
Management fees	Section 8-1	Amount must be calculated – see note (i) below	Amount must be calculated – see note (i) below	Amount must be calculated – see note (i) below
Lease Fees	Section 8-1	Amount must be calculated – see note (i) below	Amount must be calculated – see note (i) below	\$2,849
Interest	Section 8-1	See note (ii) below	See note (ii) below	see note (ii) below

Notes:

- (i) The Management and Lease fees shown at paragraph 30 above are **NOT** deductible in full in the year incurred. The deduction for each year's fees must be determined using the relevant formula above (see paragraphs 42 and 43). The Project Manager will inform Growers of the number of days in the eligible service period in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred. See Example 2 at paragraph 92.
- (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 paragraphs 61 - 66 below as those rules may be applicable if interest is prepaid.

Tax deductions for capital expenses

45. A Grower who participates in the Project will also be entitled to the following tax deductions:

Fee type	ITAA 1997 section	Year 1 deduction	Year 2 deduction	Year 3 deduction
Irrigation costs	387-125	\$3,300 - see notes (iii) & (iv) below	\$3,300 - see notes (iii) & (iv) below	\$3,300 – see notes (iii) & (iv) below

Notes:

- (iii) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is

calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.

- (iv) A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on landcare operations and/or facilities to conserve or convey water. This is an alternative to claiming deductions under sections 387-55 and 387-125.

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

46. Where a Grower who is registered or 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 paragraph 30; and
- is entitled to an input tax credit for the fees;

then the tax deductions calculated using the methods and Tables in paragraphs 40 to 45 (above) will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 91.

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

47. 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 2006 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.

48. 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 77 in the Explanations part of this ruling, below).

49. 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.

Section 82KL

50. Section 82KL does not apply to deny the deduction otherwise allowable.

Part IVA

51. 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

52. Consideration of whether the management fees and the lease fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds 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 outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer contractually commits 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 has a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

53. A commercial olive growing business 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 olives produced from the Groves (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 include the leasing of land, water and trees, and the tending, maintaining and harvesting of the olive trees.

54. Generally, a Grower will be carrying on a business of olive growing where:

- the Grower has an identifiable interest in specific trees coupled with a right to harvest and sell the olives;
- the growing, tending, harvesting and marketing activities are carried out in a business like way either by the Grower or on behalf of the Grower; and
- overall, the weight and influence of the general indicators used by the Courts point to the person carrying on a business.

55. For this Project Growers have, under the Constitution, Compliance Plan, Grove Lease Agreement and Grove Management and Harvesting Agreement, rights and powers over an identifiable area of land consistent with the intention to carry on a business of producing and selling olives. The Grove Management and Harvesting Agreement indicates that Terrapee Contractors Pty Ltd is to undertake a range of activities consistent with a commercial olive producing business. The Grower, as part of the Crushing and Marketing Agreement, has also entered into an arrangement to have the olives crushed and the oil sold by Victorian Olive Processors Pty Ltd in line with commercial ventures, unless the Grower elects otherwise.

56. The Grove Lease Agreement gives the Grower the right to occupy an identifiable area of land for the purpose of growing, harvesting and marketing olives. The Growers may delegate any of these activities to another party, for example, by entering into the Grove Management and Harvesting Agreement. The Growers' control over the Project is considered sufficient, having regard to the terms of the Grove Management and Harvesting Agreement and the Constitution, and to responses received to specific questions put to the Applicant. Under the terms of the Constitution, a Revenue Fund will be maintained by the Responsible Entity, which will distribute sale proceeds to the Growers. Growers are entitled to receive reports on

the Manager's activities in terms of the Compliance Plan. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default in the performance of the Manager's duties.

57. 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. The Agricultural Report considers the Project is both a low risk venture on horticultural grounds and commercially viable in the long term. 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. This profit does not depend on the fees in question being allowed as a deduction.

58. Terrapee Contractors Pty Ltd, as Manager, will provide services as described in the Prospectus and Grove Management and Harvesting Agreement that are based on accepted horticultural practices and are of the type ordinarily found in commercial olive groves that would commonly be said to be businesses.

59. Growers have a continuing interest in an identifiable allotment within their Grove from the time they enter the Grove Lease Agreement until the termination of the Project. The Applicant has explained how Growers can identify their specific trees. The farming 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.

60. The Grove Management and Harvesting Agreement and Lease Agreement fees associated with the farming activities relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which the income from the sale of olive oil is to be gained from the business. No 'non-income producing' purpose in incurring the fees is identifiable from the arrangement as presented. The fees will, thus, be deductible under the first limb of section 8-1 to the extent they are incurred for the purposes of the provision and are not capital or capital in nature.

Sections 82KZM and 82KZMD – Prepaid fees

61. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible in full under section 8-1. The section applies to an individual or small business taxpayer if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly done within 13 months after the day

on which the expenditure is incurred. If the taxpayer is a large business then section 82KZMD applies instead of section 82KZM with the same effect.

62. The application monies include \$5,698 for the Grove Lease Agreement fee which covers the period from the Grower entering into the project to 30 June 2002 and \$9,460 for the Grove Management and Harvesting Agreement which covers the period from the Grower entering into the project to 30 June 2004. Section 82KZM or section 82KZMD, depending upon the nature of the taxpayer, has application to both of these agreements as the amounts incurred relate to services to be provided over a period of time in excess of 13 months.

63. Accordingly, to determine the proportion of the amount paid on application under these two agreements which is an allowable deduction in the applicable year, the relevant formula in paragraph 42 or 43 must be applied.

Interest deductibility

64. 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.

65. 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.

66. 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. The formula will apply in the same manner as set out in paragraph 43.

Small business taxpayers

67. 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.

68. '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).

69. 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'.

Expenditure of a capital nature

70. Any part of the expenditure of a Grower entering into an olive 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 irrigation are considered to be capital in nature. The fees for this expenditure are not deductible under section 8-1. However, this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

Subdivision 387-B – Irrigation expenditure

71. Section 387-125 allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three-year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed would be covered by this Subdivision.

72. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or licensee who is conducting a primary production business on land in Australia, a deduction would be available to a Grower in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

73. However, a deduction under section 387-125 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Grower can only choose a water facility tax offset where:

- had the Grower chosen a deduction instead of the tax offset, the Grower's taxable income for the income year would have been \$20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Division 35 - Losses from non-commercial business activities

74. 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.

75. 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.

76. 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.

77. 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.

78. 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).

79. 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 2008. Growers who acquire more than one interest in the Project may, however, pass one of the tests in an earlier income year.

80. 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.

81. 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) until 30 June 2006.

82. 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.

83. 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 47), in the manner described in the Arrangement (see paragraphs 15 to 36), 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.

84. 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 expert included in the Prospectus for the Project;
- independent, objective, and generally available information relating to the Australian olive industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity;
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project.

Section 82KL - recouped expenditure

85. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

86. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

87. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Here, there may be a loan provided to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA - general tax avoidance provisions

88. 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).

89. The Victorian Olive Oil 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 paragraphs 44 to 45 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.

1. 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 olives. 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.

Examples

Example 1 – Entitlement to ‘input tax credit’

91. 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).

Example 2 – Prepaid expenditure and the apportionment of fees

92. Murray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$8,000 for management services to be provided from the commencement of the Project until 30 June 2004. From year 4 onwards the management fee will be \$3,000 per annum increased each year by the CPI. The fees on application are payable on execution of the agreements for services to

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be provided up until 30 June 2004. The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year**, using the formula in paragraph 42, as follows:

$$\text{Management fee} \times \frac{\text{period in year}}{\text{Eligible service period}}$$

$$\$8,000 \times \frac{26}{1122}$$

= **\$185** (this is Murray's total tax deduction in 2001 for the prepaid management fees of \$8,000. It represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Murray will be able to claim a tax deduction for management fees calculated as follows:

$$\$8,000 \times \frac{365}{1122}$$

= **\$2603** (this represents the 365 days for which management services were provided in the 2002 income year).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the **2003 and 2004 income years**.

Detailed contents list

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Commissioner of Taxation

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<i>Previous draft:</i>	- ITAA 1936 82KZMA(4)
Not previously issued in draft form	- ITAA 1936 82KZMD
	- ITAA 1936 82KZMD(2)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZME
PR 1999/95; TD 93/34; TD 98/3;	- ITAA 1936 82KZME(4)
TR 92/1; TR 92/20; TR 94/25;	- ITAA 1936 82KZMF
TR 97/11; TR 97/16; TR 98/22	- ITAA 1936 82KZMF(1)
	- ITAA 1936 Pt IVA
<i>Subject references:</i>	- ITAA 1936 177A
- carrying on a business	- ITAA 1936 177C
- commencement of business	- ITAA 1936 177D
- fee expenses	- ITAA 1936 177D(b)
- management fees expenses	- ITAA 1997 6-5
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<i>Legislative references:</i>	- ITAA 1997 Subdiv 387-B
- ITAA 1936 82KH(1)	- ITAA 1997 387-55
- ITAA 1936 82KH(1F)(b)	- ITAA 1997 387-125
- ITAA 1936 82KL	- ITAA 1997 387-130
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