



PR 2000/20 - Income tax: Southern Cross Bamboo Project # 1

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Product Ruling

Income tax: Southern Cross Bamboo Project # 1

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

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Previous Rulings**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

No guarantee of commercial success

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

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

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

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

Potential investors should be aware that the ATO will be undertaking review activities 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 desired in those future years.

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this ruling relates. In this Ruling this arrangement is sometimes referred to as the Southern Cross Bamboo Project # 1, or just simply as 'the Project', or the 'product'.

Tax law(s)

2. The tax law(s) that are dealt with in this Ruling are:

- section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 387-165 of the ITAA 1997;
- section 27-5 of the ITAA 1997;
- section 27-30 of the ITAA 1997;
- Part IVA of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KL of the ITAA 1936; and
- section 82KZM of the ITAA 1936.

3. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of those changes, especially those to do with 'tax shelters', could affect the tax laws dealt with in this Ruling. Some of the changes apply from the date of announcement and others are proposed to apply from nominated dates in the future.

4. Although this Ruling mentions certain of those announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally binding advice in respect of those changes cannot be given until the relevant laws(s) are enacted.

5. However, if the changes become law, the operation of that law will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded. If requested, when the relevant law(s) are enacted, the Commissioner will formalise the non-binding information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

Class of persons

6. 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'.

7. 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

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

9. 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

11. This Ruling applies prospectively from March 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).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely upon the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income

year to which it relates has not yet commenced, the product ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect on 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to the withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Product Ruling application dated 1 November 1999;
- Southern Cross Bamboo Project # 1 Prospectus;
- Southern Cross Bamboo Project # 1 Constitution;
- Southern Cross Bamboo Project # 1 Compliance Plan;
- **Southern Cross Bamboo Project # 1 Management Agreement between Bamboo Plantations of Australia Limited ('BPA' or the 'Responsible Entity') and Growers;**
- **Southern Cross Bamboo Project # 1 Farm Allotment Agreement between Glen Allyn Plantations Ltd (the 'Land Owner') and Growers;**
- Southern Cross Plantations Project # 1 Operations Agreement between BPA and Bamboo Plantations Management Pty Ltd ('BPM' or the 'Manager');
- Lease Agreement between the Land Owner and Australian Rural Group Limited (the 'Custodian');
- Sub-lease Agreement between the Custodian and the Responsible Entity;

- Sub-sub-lease Agreement between the Responsible Entity and the Land Owner;
- Letters from Peter Topperwien to the ATO, dated 8 December 1999, 5 January 2000 and 20 January 2000.

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

15. The documents highlighted are those Growers enter into for the purpose of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate¹ of the Grower will be party to, other than any finance agreement to which paragraphs 38 – 40 applies. The effect of these agreements is summarised as follows.

Overview

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

Location	The Atherton Tablelands district of Northern Queensland
Type of business each participant is carrying on	Commercial growing of bamboo for the production of bamboo shoots and timber
Number of hectares under cultivation	The prospectus provides for 1000 hectares to be planted
Name used to describe the product	Southern Cross Bamboo Project # 1
Size of the leased area	0.25 hectares
Number of plants per hectare	Minimum of 50
Expected production	Between 10,000 and 15,000 kilograms per hectare of edible shoots and 800 culms (bamboo timbers) per hectare
The term of the investment	15 years

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

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Initial cost	\$14,504 if paid by \$1,370 on application and 11 monthly instalments of \$1,194, or \$13,200 if paid in advance
Initial cost on a per hectare basis	\$58,016 or \$52,800
Ongoing costs	\$2,585 for management and administration fees which is increased by the greater of the CPI or Labour Award Rate increases after year 2 and \$165 for licence fees which is increased by the CPI increase after year 2
Other costs	Growers will be charged for the cost of all insurance except Public Liability Insurance as well as harvesting, freight and marketing costs, and performance fees payable to the Responsible Entity
Minimum subscription	80 Farms must be subscribed for before any Farms are allocated to Growers

17. BPA will offer up to 4,000 interests to Growers representing up to 1,000 arable hectares of plantation. Investors taking an interest shall be entitled to subscribe for shares representing up to 40% of the capital of the Land Owner. In total, 10,800,000 shares of \$1.00 each in the Land Owner will be on offer. The Land Owner will carry out any capital works associated with the Project, excluding Plant Establishment works. Acceptance of a Grower into the Project will not occur until applications equating to 80 Farms have been received. **This Ruling does not apply if this number of applications has not been received by 30 June 2000.**

Farm Allotment Agreement

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

19. Licence fees of \$165 pa per Farm (inclusive of GST) are payable for Years 1 and 2 of the Project and are indexed to the CPI

from Year 3 onwards. Licence fees are paid annually in advance. The Growers' interests are terminated upon expiry of the licences.

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

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

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

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

24. The Licences give Growers the right to use the Farm(s) solely for the purpose of establishing, maintaining and harvesting Bamboo and related purposes. The Growers must comply with sound agricultural practices in respect to the Farm.

Management Agreement

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

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

- (a) prepare the Grower's Farm so that it will be suitable for the planting and growing of Bamboo Plants;
- (b) ensure each Grower's Farm has adequate drainage;
- (c) supply at least 50 Bamboo Plants to each Grower selected from high yield stock in healthy condition;
- (d) tend the Plants supplied to each Grower;

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- (e) once the Plants have reached an appropriate stage of development, plant at least 50 Bamboo Plants on each Grower's Farm;
- (f) establish the Plants and each Grower's Farm in a proper and skilful manner;
- (g) comply with the constitution of the Land Owner in so far as it relates to the use of each Grower's Farm (other than the payment of fees); and
- (h) embark on such operations as may be required to prevent or combat land degradation on the Farms.

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

- (a) tend and nurture the bamboo, including periodic slashing and weeding, fertilising, plant inspection, and culm thinning and general husbandry, including training the bamboo towards the necessary plant management system in order to maximise shoot production;
- (b) carry out pest treatment where and when necessary;
- (c) attend to repairs and maintenance as required;
- (d) selectively cull and replace under or non-performing Plants;
- (e) embark on such operations as may be necessary to prevent or combat land degradation on each Grower's Farm or land surrounding each Grower's Farm;
- (f) subject to a Grower's right to harvest its own Plants following at least three months written notice from the Grower to the Responsible Entity prior to a Production Period, harvest the Plants on the Grower's Farm at or around the time estimated by the Responsible Entity to maximise the return of produce from all of the Farms established at or around the same time as the Grower's Farm;
- (g) subject to a Grower's right to take and market produce following at least three month's written notice from the Grower to the Responsible Entity prior to a Production Period, market and sell the Bamboo Attributable to the Grower's Farm, as agent for the Grower, using reasonable endeavours to obtain the maximum price available;
- (h) if the Responsible Entity markets and sells the Bamboo Attributable to a Grower's Farms under clause 4.3(g), account to the Grower and, if relevant, the Custodian for the proceeds of such sale; and

- (i) provide sufficient information to enable each Grower to lodge statements for foods and Service Tax in respect to the Farm.

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

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

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

Fees

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

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

Notes:

1. Management and administration fees are increased after year 2 by the greater of CPI or Labour Award Rate increases.
2. Licence fee is increased after year 2 by the CPI.
3. As stated in the Management and Farm Allotment Agreements respectively, all amounts detailed above are inclusive of Goods and Services Tax.
4. Payment of the Year 1 fees is by \$1,370 on application and 11 monthly instalments of \$1,194.

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5. Year 2 fees are payable on 1 June 2001, regardless of a Grower's date of entry to the Project.

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

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

Note:

As stated in the Management and Farm Allotment Agreements respectively, all amounts detailed above are inclusive of Goods and Services Tax.

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

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

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

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

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

37. BPA's financial projections are based upon its expertise and that of experts it has consulted. Total gross income per Farm for the life of the Project is predicted to exceed a Grower's total expenses of participating in the Project (see page 8 of the Prospectus).

Finance

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

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

40. This Ruling does not apply if a Grower enters into a finance arrangement with any of the following features:

- there are split loan features of the type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project are involved, or become involved, in the provision of finance to Growers for the Project;

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- there are indemnity arrangements, or equivalent collateral agreements, in relation to the loan, designed to limit the borrower's risk;
- 'additional benefits' are granted to a borrower, for the purposes of section 82KL, or the funding arrangements transform the Project into a scheme' to which Part IVA applies;
- repayments of principal and payments of interest are linked to derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project, but are transferred (by any means, and whether directly or indirectly) back to the lender, or any associate of the lender; and
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Goods and Services Tax

41. For a Grower who invests in the Project, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Grower is entitled or, in the case of section 27-5, a decreasing adjustment that a Grower has.

Allowable deductions

42. For a Grower who invests in the Project, the deduction available for the prepaid Management and administration fees will depend upon the date that the investment is made.

IMPORTANT: Paragraph 43 (relating to 'small business taxpayers') and paragraphs 44, 45 and 46 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Growers are advised to carefully examine the information contained in paragraphs 48 and 49 relating to proposed changes to the prepayment rules. Growers who invest in the Project after 11 November 1999 may be affected by these changes.

43. For a Grower who is a 'small business taxpayer' and who invests in the Project before 30 June 2000, the deductions shown in

the Table below will be available for the years ended 30 June 2000 to 30 June 2002.

A. Deductions available - fees paid in instalments

Fee type	1st 12 month period	2nd 12 month period	3rd 12 month period
Management and administration expenses	\$13,083 [See Note (i) below]	\$2,585	\$2,585 (Indexed) [See Note (iii) below]
Licence fees	\$165 [See Note (i) below]	\$165	\$165 (Indexed) [See Note (iii) below]
Plant establishment expenses	Nil [See Note (ii) below]	Nil	Nil
Total	\$13,248	\$2,750	\$2,750

B. Deductions available - fees paid in advance

Fee type	1st 12 month period	2nd 12 month period	3rd 12 month period
Management and administration expenses	\$11,893 [See Note (i) below]	\$2,585	\$2,585 (Indexed) [See Note (iii) below]
Licence fees	\$165 [See Note (i) below]	\$165	\$165 (Indexed) [See Note (iii) below]
Plant establishment expenses	Nil [See Note (ii) below]	Nil	Nil
Total	\$12,058	\$2,750	\$2,750

Notes:

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- (i) Legislative change for Growers who are not ‘small business taxpayers’ means the full deduction will not be allowed in terms of section 8-1 of the ITAA 1997, for the year ended 30 June 2000. See paragraphs 44 to 46 and Example 1. Proposed legislative change for all Growers applying to expenditure incurred after 1 pm, 11 November 1999 means the full deduction will not be allowed for the year ended 30 June 2000. See paragraphs 48 and 49 and Example 2.
- (ii) A deduction under section 387-165 of the ITAA 1997 for bamboo plant establishment expenditure will be allowable, at the rate of 7% per annum, commencing from the time that the bamboo enters its first commercial season (this is expected to be in Year 4 of the Project).
- (iii) Management expenses are to be increased in Year 3 by the greater of the CPI increase or Labour Award Rate increase. Licence fees in Year 3 are to be increased by the CPI increase.

44. For a Grower who invests in the Project before 30 June 2000, who is **not a ‘small business taxpayer’** and is carrying on a business, the deduction available in respect of the Management and administration expenses is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5). (Example 1 at paragraph 85 illustrates the application of this method).

45. In the calculation, the term ‘expenditure’ refers to expenditure otherwise allowable under section 8-1 whose ‘eligible service period’ ends not more than 13 months after it is incurred by the taxpayer. The ‘eligible service period’ (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

Year 1: Expenditure incurred before 30 June 2000

Available deduction = A + B

Where :

A = Expenditure X	<u>Number of days of eligible service period in the expenditure year</u> Total number of days of the eligible service period
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B = (Expenditure *less* A) x 80%

Year 2: Expenditure is incurred after 1 July 2000 and before 30 June 2001

Available deduction = A + B + C

Where :

A = Expenditure X	Number of days of eligible service period in the expenditure year
	<hr/>
	Total number of days of the eligible service period

B = (Expenditure *less* A) x 60%

C = balance of the Year 1 expenditure not previously deducted

Year 3: Expenditure incurred after 1 July 2001 and before 30 June 2002

Available deduction = A + B + C

Where :

A = Expenditure X	Number of days of eligible service period in the expenditure year
	<hr/>
	Total number of days of the eligible service period

B = (Expenditure *less* A) x 40%

C = balance of the Year 2 expenditure not previously deducted.

Note: Growers affected by section 82KZMB will need to be advised by BPA about when their 'eligible service period' begins and ends, in order to perform the calculations described above.

46. For a Grower who invests in the Project before 30 June 2000 who is **not a 'small business taxpayer'**, and is carrying on a business, the deduction available in respect of capital expenditure is in relation to bamboo plant establishment expenditure, which will be available in terms of section 387-165 of the ITAA 1997, at the rate of 7% per annum, commencing from the time that the bamboo enters its first commercial season, which is expected to be in Year 4 of the project.

Sections 82KZM, 82KZMB, 82KL and Part IVA

47. For a Grower who invests in the Project the following provisions have application as indicated:

- expenditure by Growers who are 'small business taxpayers' is not within the scope of section 82KZM (**but see paragraphs 48 and 49**);
- section 82KZMB applies to expenditure by Growers who are not 'small business taxpayers' and are carrying on a business (**but also see paragraphs 48 and 49**);

- 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.

Proposed new laws

Proposed changes to prepayment rules

48. Effective from 11 November 1999, the Government announced a number of changes to the deductibility of certain prepaid expenditure incurred in respect of 'tax shelter arrangements'. Provided the law is enacted as announced, the Project will be a 'tax shelter arrangement' as described and all Growers, including 'small business taxpayers', who invest in the Project after 1pm, 11 November 1999 will be subject to these changes.

49. For these Growers the amount of deduction available in respect of the Management Fee and the Lease Fee is likely to be calculated using the formula shown below (see also Example 2 at paragraph 85). In the calculation, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 of the ITAA 1997, whose 'eligible service period' ends not more than 13 months after it is incurred by the taxpayer. The 'eligible service period' (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

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

The excess remaining after the application of this formula is deductible in the year that the services to which the excess relates are performed.

Note to promoters and advisers -

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 Australian Taxation Office suggests that promoters and advisers ensure that potential investors are fully informed of the announcement requiring prepayments in respect of 'tax shelter' arrangements to be deductible over the period services are provided. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Explanations

Sections 27-5 and 27-30 - Goods and Services Tax

50. Section 27-30 of the ITAA 1997 operates to deny a deduction that would be otherwise available under section 8-1 for the year ended 30 June 2000 to the extent that the loss or outgoing (incurred after 30 November 1999 and before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled after 1 July 2000.

51. Section 27-5 of the ITAA 1997 operates to deny a deduction, that would be otherwise available under section 8-1, to the extent that the loss or outgoing incurred (after 1 July 2000) includes an amount relating to an input tax credit to which a Grower is entitled, or a decreasing adjustment that a Growers has.

Subdivision 960-Q - Small business taxpayers

52. In this product ruling the term 'small business taxpayer' is relevant for the purposes of the discussion relating to certain prepaid expenditure.

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

54. 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 that year is less than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

55. '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).

Section 8-1

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

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoing is not deductible under paragraph 8-1(1)(b) if it is incurred when the business has not commenced; and
- where a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoing in question would have a sufficient connection with activities to produce assessable income.

57. Operating a bamboo plantation can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from shoots and timber from the Project will constitute gross assessable income under section 6-5. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the nurturing, planting, tending, maintaining and harvesting of the shoots and timber.

58. Generally, a Grower will be carrying on a business of a bamboo plantation where:

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

59. For this Project, Growers have under the Farm Allotment Agreement rights over an identifiable area of land consistent with the intention to carry on a business of a commercial bamboo plantation. Under the Management Agreement, Growers appoint BPA, as Manager, to provide services such as nurturing, planting, tending, fertilising, replanting, spraying, maintaining and otherwise caring for the bamboo. BPA is also responsible for the harvesting of the shoots

and timber from the bamboo. The specific cost of these services provided in the first twelve months totals \$14,339 (\$13,035 if paid in advance) per Farm. The Licence fees are \$165 per Farm per annum indexed to CPI from Year 3 of the Project.

60. The Management Agreement and Farm Allotment Agreement combine to give Growers an identifiable interest in specific trees and a legal interest in the land. Growers have the right personally to harvest and market the shoots and timber attributed to their Farm or they can elect to use BPA to harvest and market the produce for them.

61. Growers have the right to use the land in question for the purpose of owning and operating the business of cultivation of bamboo for the production of edible shoots and timber and to have BPA come onto the land to carry out its obligations under the Management Agreement. 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 a twice yearly account for the proceeds of the sale of shoots and timber and report as to plantation activities from the Manager. Growers are able to terminate arrangements with the Manager in certain instances, such as in cases of default or neglect. The activities described in the Management Agreement are carried out on the Growers' behalf.

62. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. The research carried out by BPA and experts on its behalf considers that the Project is realistic and commercially viable. 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 suggests the Project should return a 'before tax' profit to the Growers, i.e, a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

63. Most Growers will engage the professional services of BPA. BPA and its associated companies and personnel have the appropriate credentials to develop and manage a bamboo plantation. The services are based on accepted horticultural practices and are of the type ordinarily found in similar type of businesses such as orchards that would commonly be said to be businesses.

64. Growers have an interest in the bamboo from the time the interest is acquired until the expiration of the term of the Licence on 30 September 2015. The bamboo in which the Growers have an interest can be identified by reference to the surveys forming part of the reference documents of the Farm Allotment Agreement. The bamboo plantation activities, and hence the management and licence fees associated with such are consistent with an intention to commence regular activities that have an "air of permanence" about

them. The Growers' bamboo plantation activities will constitute the carrying on of a business.

65. The fees associated with the bamboo plantation activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the sale of the bamboo shoots and timber) is to be gained from the business. No 'non-income producing' purpose in incurring the fees is identified from the arrangement. That portion of the fees that is not capital, or of a capital nature, will be deductible under section 8-1.

Section 82KZM – Prepaid expenditure for small business taxpayers

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

67. Under the Management Agreement the initial Management Fee will be incurred upon execution of the Agreement. This fee is charged for providing services to Growers for a period of 13 months from the date of execution of the Agreement. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years. The fee is expressly stated to be for a number of specified services. There is evidence this fee is for services to be provided within 13 months of the fee being incurred.

68. Thus, for the purposes of this Ruling, it is accepted that no part of the initial Management and administration Fee is for the Manager to do 'things' that are not to be wholly done within 13 months of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure for the Management and administration fee by Growers who are 'small business taxpayers'.

69. Similar considerations apply to the Licence Fee which is payable on or before 31 May each year for a period from the 1 June of that year to 31 May of the following year. Again, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure for the Licence Fee by Growers who are 'small business taxpayers'.

Sections 82KZMA - 82KZMD - Prepaid expenditure for taxpayers other than small business taxpayers

70. For a Grower who is not a 'small business taxpayer' and is carrying on a business, sections 82 KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the expenditure year). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

71. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Growers investing in the Project, transitional treatment applies to prepayments initially incurred in the 1999-2000 income year. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service period ends more than 13 months after the date the expenditure was occurred, and does not apply to the Project.

72. The deduction available to Growers for the Management and administration Fee will be determined in accordance with the rules contained in section 82KZMB. Because the quantum of both the Management and administration Fee is lower in the second and subsequent years, the capping provisions contained in section 82KZMC will have no practical effect on the deduction available.

73. During the transitional period the amount of the deduction available to Growers is determined using the formula in subsection 82KZMB(3) and the percentages shown in the table in subsection 82KZMB(5).

Proposed changes to prepayment rules

74. The changes announced by the Government to apply from 11 November 1999 but not yet enacted will affect all taxpayers that participate in a 'tax shelter arrangement' and prepay expenditure for up to 13 months. The proposals are for deductions otherwise allowable under section 8-1 of the ITAA 1997 to be spread over the period to which the prepayment relates. However, unlike the law as it is currently enacted, there is no exemption for small business taxpayers and no transitional rules will apply.

75. A tax shelter arrangement is described as existing where:

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- under the arrangement, the taxpayer's allowable deductions exceed the assessable income for that year; and
- all significant aspects of the arrangement during the income year are conducted by people (e.g., a manager) other than the taxpayer; and
- either:
 - more than one taxpayer participates in the arrangement; or
 - the manager, or an associate of the manager, also manages similar arrangements on behalf of others.

76. The arrangement relating to the Project and described at paragraphs 14 to 40 of this Ruling is within the description of a 'tax shelter arrangement'. Therefore, the Management Fee and the Lease Fee incurred by Growers who invest in the Project after 11 November 1999 will be deductible over the period the services are provided. The formula for this apportionment is expected to be the same as that currently shown in subsection 82KZMD(2).

Expenditure of a Capital Nature

77. Any part of the expenditure of Growers entering into a horticultural 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 establishing the bamboo plants are capital in nature. The fees for these expenses are not deductible under section 8-1. However expenditure of this nature can fall for consideration under specific capital write-off provisions of the ITAA 1997.

Subdivision 387-C

78. Subdivision 387-C allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture, to be written off for tax purposes. The exclusive occupant of land carrying on a business of horticulture is taken to own the plants growing on the land rather than the actual owner of the land.

79. Under this Subdivision, if the effective life of the plant is less than three years the expenditure can be written off in full; if the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant is first used to

produce assessable income and BPA will advise the Grower of this date.

Section 82KL

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

Part IVA

81. 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).

82. The Southern Cross Bamboo Project # 1 will be a ‘scheme’. The Growers will obtain a ‘tax benefit’ from entering into the scheme, in the form of the tax deductions per Farm 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.

83. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of bamboo shoots and timber attributable to their Farm(s). Further, there are no features of the Project, for example, such as the Management fees being ‘excessive’, not commercial, and predominantly financed by a non-recourse loan, that might suggest the Project was so ‘tax driven’, and so designed to produce a tax deduction of a certain magnitude that it would attract the operation of Part IVA.

84. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. The Applicant, in the application for this Ruling, states that plants have an estimated commercial life of over 80 years. The write-off rate for horticultural plant is detailed in section 387-185. For a plant with an effective life of 30 or more years, the rate is 7% prime cost.

Examples

85. Example 1: Obligation to prepay expenditure arising on or after 21 September 1999 and before 11 November 1999 – applies to taxpayers who are not small business taxpayers and are carrying on a business:

Joseph Gardener has extensive business interests and his turnover for the 1999/2000 income year exceeds \$1 million. Therefore, he is not a small business taxpayer and is subject to the 21 September 1999 changes to the tax laws relating to prepaid expenditure. Joseph enters into a contract with Pinetree Pty Ltd to manage his one hectare interest in the No 2 Pine Plantation. Joseph's management contract is executed on 20 October 1999 for management services to be provided from 1 June 2000. Under the contract, the first five year's management fees, payable 12 months in advance on 1 June each year, are \$6,000 in the first year and \$1,200 for each of the following four years. Joseph is unable to deduct the whole of his prepaid management fees in the years in which they are incurred. The fees are instead deductible over the eligible service period over which the management services will be provided. However, as the law currently stands, Joseph is able to take advantage of certain transitional rules that 'shade-in' the effect of the changes to the prepayment laws. For 1999/2000 Joseph can claim a deduction of \$4,899 for expenditure incurred before 30 June 2000 on management fees. This amount is calculated as A + B where:

$$\begin{aligned}
 & \text{A = Expenditure} \quad \times \quad \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}} \\
 & = \$6,000 \times \frac{30}{365} = \$493 \\
 & = (\$6,000 - \$493) \times 80\% = \$4,406
 \end{aligned}$$

The balance of the \$6,000 management fees that were prepaid on 1 June 2000 (i.e., \$1,101) is carried forward and can be claimed as a deduction in the 2000/2001 income year. For 2000/2001, Joseph can claim a deduction of \$1,861 for expenditure incurred after 1 July 2000 and before 30 June 2001 on management fees. This amount is calculated as A + B + C where:

$$A = \$1,200 \times \frac{30}{365} = \$99$$

$$B = (\$1,200 - \$99) \times 60\% = \$661$$

$$C = \$1,101$$

Note that the third component (Part C) is the amount carried forward from 1999/2000. As in the first year, the balance of the \$1,200 management fees prepaid on 1 June 2001 (i.e., \$440) is carried forward and can be claimed as a deduction in the 2001/2002 income year. It should also be noted that in certain circumstances, not present in most projects with product rulings, 'capping provisions' will apply in the second and subsequent transitional years. These are complex and are not explained in this example. Similarly, for 2001/2002, Joseph can claim a deduction of \$980 for expenditure incurred after 1 July 2001 and before 30 June 2002 on management fees. This amount is calculated as A + B + C where:

$$A = \$1,200 \times \frac{30}{365} = \$99$$

$$B = (\$1,200 - \$99) \times 40\% = \$441$$

$$C = \$440$$

Note that the third component (Part C) is again the amount carried forward from 2000/2001. As in the first two years, the balance of the \$1,200 management fees prepaid on 1 June 2002 (i.e., \$660) is carried forward and can be claimed as a deduction in the 2002/2003 income year.

86. Example 2: Obligation arising on or after 11 November 1999 to prepay expenditure – applies to all taxpayers investing in 'tax shelter arrangements':

Assume the same facts as above except that the management agreement is executed after 11 November 1999. Assume also that the No 2 Pine Plantation is a 'tax shelter arrangement'. For the Management fee of \$6,000 incurred on 1 June 2000 for management services to be provided between that date and 31 May 2001, Joseph can claim a deduction for the 1999/2000 income year determined in the following way:

Management fee X	Number of days of eligible service period in <u>the expenditure year</u>
	Total number of days of the eligible service period
= \$6,000 X $\frac{30}{365}$ = \$493	

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In the following year the taxpayer can claim the balance of the \$6,000 prepayment (i.e., \$5,507) because that is the year in which the services are to be provided. The second and third year's management fees are calculated using the same method.

Detailed contents list

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Previous draft:

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- ITAA 1936 82KH(1)
- ITAA 1936 82KH(1F)(b)
- ITAA 1936 82KL

Related Rulings/Determinations:
 PR 1999/95; TR 92/1; TR 97/11;
 TR 97/16; TD 93/34; TR 92/20

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

Subject references:

- carrying on a business
- commencement of business
- fee expenses
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- management fees expenses
- primary production
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- producing assessable income
- product rulings
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- schemes and shams
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- ITAA 1936 Pt IVA
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- ITAA 1997 Subdivision 387-C
- ITAA 1997 387-165
- ITAA 1997 387-185
- ITAA 1997 960-335
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- ITAA 1997 960-345
- ITAA 1997 960-350

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