PR 2000/36 - Income tax: Australian Olives Project No 3

Product Ruling
Income tax: Australian Olives Project No 3

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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 derived in those future years.

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of person, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Australian Olives Project No 3', or just simply as 'the Project'.

Tax law(s)

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

- Section 6-10 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 8-1 ('ITAA 1997');
- section 27-5 (ITAA 1997);
- section 27-30 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM (ITAA 1936);
- section 82KZMB (ITAA 1936); and
- Part IVA (ITAA 1936).

1. 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.

1. 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 law(s) are enacted.

1. 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

1. 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'.

1. 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

1. This Ruling provides this specified class of persons with a binding ruling as to the tax consequences of the Product. The Commissioner accepts no responsibility in relation to the commercial viability of this product. A financial (or other) adviser should be consulted for such information. The Commissioner rules on the precise arrangement identified in the Ruling.

1. This Ruling is based on the assumption that minimum subscription will be reached by 30 June 2000.

1. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 46) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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

Date of effect

1. This Ruling applies prospectively from 5 April 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).

1. 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 Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

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

Arrangement

1. 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 a Product Ruling from Australian Olives Limited (AOL) dated 28 January 2000 in respect of the Australian Olives Groves Project No 3;
- Australian Olives Project No 3 Prospectus (Australian Registered Scheme Number 091 051 437, a managed investment scheme under Corporations Law);
- Constitution for Australian Olives Project No 3 ('the Constitution');

- **Grove Licence Agreement** between Collective Olive Groves Limited (COGL) ('the Landowner'), Australian Olives Limited (AOL) ('the Responsible Entity') and the Grower;
- **Grove Agreement** between AOL and the Grower;
- **Finance Agreement** between Australian Agricultural Finance Pty Ltd (AAF) ('the Lender') and the Borrower (the Grower);
- Compliance Plan for the Project;
- Water Supply Agreement between AOL and Australian Olives Holdings Ltd (AOHL) ('the Water Owner');
- Variation Water Supply Agreement between AOL and AOHL;
- Lease and Sublease for Lot 16 on SP113870, Merivale, Tummaville between COGL and ARGL;
- Dealers Licence Number 172740
- Activity Guide
- Newsletter 'Turning Green into Gold'
- Valuation of Stage 2
- Valuation of Stage 3

Note: certain information received from AOL 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.

1. The documents highlighted in paragraph 15 in bold are those that are 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 legally enforceable, to which the Grower, or an associate of the Grower will be a party.

1. All Australian Securities and Investment 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.

The Prospectus

1. The Prospectus will invite Growers to participate in two specific interests. The first is a right to participate in a project called 'Australian Olives Project No 3' ('the Project'), which is a managed

investment scheme under Corporations Law. The second is an offer to purchase shares in COGL, the Project's landowning company. While the Prospectus markets both specific interests as a package, AOL has advised that the Project may be entered without the purchase of shares in COGL.

1. Olive growing projects will be conducted on a series of properties collectively called 'Yallamundi', which is 86 km south west of Toowoomba. This particular Project will involve Lot 16 on SP113870 as well as Lots 12, 79 and 310 on CP ML2152, Parish of Tummaville, and County of Merivale, which will be owned by COGL

1. The offer contained under this prospectus is for six thousand (6,000) Groves. The minimum subscription required for the commencement of the Project is forty (40) Groves.

1. A Grower may participate in the Project by:

- subscribing for 150 shares (one parcel) in COGL at $1 each (total $150). These shares carry with them an entitlement to enter into a Grove Licence Agreement that allows the Grower to licence an area of land ('a Grove');
- if he or she so chooses, entering into a 'Grove Licence Agreement' with the Landowner in respect of a Grove (0.16 hectares) for the period to 30 June, 2023; and
- if he or she so chooses, entering into a 'Grove Agreement' that relates to initial services to be performed in the first 13 months and for ongoing services for the remaining period to 30 June 2023.

1. A Grower purchasing the shares and entering into the Grove Licence Agreement and the Grove Agreement will be liable to pay the following amounts:

- $180 for the purchase of olive seedlings payable on application;
- a Grove Agreement fee of $8,180 payable for the first 13 months services of the Manager;
- a Grove Licence Agreement fee of $20 payable to the Landowner on application. Thereafter, the fee will be payable annually and increased by the proportional increase in the All Groups Consumer Price Index for Brisbane ('the CPI');
- a Grove Agreement fee of $1,300 at the commencement of month 14 after acceptance for services performed until the end of that year. A further fee will be payable on the first day of the next year of

the Agreement and annually thereafter, increased by movements in the CPI; and

- a harvesting fee of $0.27 per kilogram of olives attributable to the Grower's Grove from the first harvest, indexed by the CPI for the remaining years. The first harvest is predicted to occur in Year 4 of the Project.

1. Each Grower's Grove will be allocated by AOL, once and for all, upon acceptance and will be planted with 40 olive trees. There is no variation between individual Growers' Groves within the Project or between rights attached thereto, except that the Manager may plant different varieties of Olive trees on individual Groves based on overall Project objectives.

1. The projected returns from the Grove are outlined on pages 13 and 14 of the Prospectus. Based on a range of assumptions by the Manager (AOL), a Grower could expect to achieve an internal rate of return of 13.72% on a before tax basis for entering the Grove Agreement. There is no assurance or guarantee in respect of the future success of, or financial returns associated with, the Project by the promoter apart from a guarantee that (for whatever reason) the Manager will replace any trees that fail until the first harvest, predicted to be Year 4 of the Project.

Shares in COGL

1. Under the Project, a Grower may purchase a minimum of one parcel of 150 ordinary $1 shares in COGL from AOHL. There are 6,000 parcels of 150 shares in COGL offered in the Prospectus. Growers waive all or any other pre-emptive rights they may hold by virtue of being a Grower in relation to the issue of new shares or the transfer of existing shares. COGL will be deriving income from licence fees and, possibly, from capital gains from the sale of Project land. As a consequence, there is an expectation that this will result in dividends to Growers. The taxation consequences of any subsequent dealing or disposal of shares in COGL does not form part of this Ruling.

Grove Licence Agreement

1. The Landowner intends to lease the Project land to the Custodian, which will subsequently sublease the land back to the Landowner. The Landowner will then be in a position to enter into licence agreements with the Growers.

1. Growers entering the Grove Licence Agreement will pay occupancy fees (clause 6.1) for a licence to use and occupy the Grove

for the limited purposes of planting, growing, harvesting and marketing olives for a period ending on the 30 June 2023. A licence will relate to an identifiable area of land and the Grower may appoint an agent under a Grove Agreement to perform the licensed activities (clause 7.2).

1. The licence fee is payable from the date of acceptance by the Responsible Entity and due on the first day of each year of the Licence Agreement, regardless of the proceeds from the sale of olives from the Grower's Grove.

Grove Agreement

1. The Grower may enter into a Agreement appointing AOL, as Responsible Entity, to manage the Grower's interest in the Project on the terms and conditions set out in the Grove Agreement. A summary of the key aspects of this Agreement is in the Prospectus at pages 35 and 36.

1. Growers enter into the Agreement until the year ended 30 June 2023 unless the Agreement is terminated earlier (clause 3). The Agreement may be terminated by either the Responsible Entity or the Grower under specific conditions (clause 12). Upon termination of the Agreement by the Responsible Entity, the Grower's interest in the Project may be sold to meet any unpaid fees (clause 12.3 of the Grove Agreement and clause 17.5 of the Constitution). The arrangement ruled on does not include the circumstance where the Grove Agreement is terminated or the Responsible Entity is otherwise removed. In such circumstance this Ruling will cease to have effect.

1. The Grove Agreement covers two periods, namely, the first 13 months and the remaining period to 30 June 2023. The duties specific to the first 13 month period to be performed by the Responsible Entity for a Grower's Grove are listed at clause 4.1 of the Agreement and include:

- acquiring 40 olive seedlings for the Grower ;
- installing irrigation works;
- undertaking drainage and soil loss prevention works;
- preplanting preparation and the planting of the olive trees;
- tending the Grower's Grove and, if necessary, tending the olive seedlings;
- supplying water;
- eradicating weeds and repairing damage caused by the Manager; and

- undertaking certain preventive measures concerning land degradation.

1. Under clause 4.3 of the Agreement, the Responsible Entity agrees to provide continuing maintenance of the Grove from month 14 to the end of the Project. Specifically, the Responsible Entity must:

- supply water and irrigate the Grove, including meeting the obligations of the Water Supply Agreement;
- tend and maintain the Grove, including application and supply of herbicides;
- eradicate weeds and repair damage caused by the Manager;
- undertake certain preventive measures concerning land degradation;
- harvest the trees; and
- sell the olives.

1. The Manager has further guaranteed the replacement of olive trees on a Grower's Grove until the first harvest (Year 4 - see page 7 of the Prospectus).

1. A Grower has a right to elect to undertake the maintenance of the Grove and only pay for the services (including water) supplied by the Manager (clause 13). Growers can also elect to receive any olives harvested from their Grove to sell, market or deal with as they determine (clause 5.3). Growers electing to conduct their own harvest and/or maintenance must ensure the work is of a similar standard to that of the work conducted by the Manager of the other Groves (page 6 of the Prospectus). Growers who either elect to maintain or harvest their Grove or who enter into other subcontracting arrangements will be outside the arrangements to which this Ruling relates and will be unable to rely on this Ruling.

1. The Responsible Entity may employ agents, contractors, professional advisers and other consultants to perform its obligations under the Agreement (clause 10.1).

Constitution

1. The Project is governed by the Project's Constitution. The Constitution includes provisions about the legal obligations, rights and limits to the liability of the Growers and details the powers of the parties to the Constitution. This document is registered with ASIC and details a number of procedures, including:

- the payment of application fees;
- the disbursement of proceeds from the Project;
- complaints handling;
- the payment of fees and expenses;
- transmission of Growers' interests;
- meetings; and
- register of Growers.

1. For those Growers who elect AOL to manage their Groves, AOL will pool the olives attributable to the Growers' Groves and then store, market and sell the produce without having regard to the quantity or quality of the particular produce from the particular Groves (clause 25.1(b)). AOL will then pay to the 'Proceeds Fund' the proceeds of the olive sales (or insurance payouts). Amounts for the Grove Agreement, Grove Licence Agreement and other limited outgoings will then be deducted (including taxes) and the result will be distributed proportionately between Growers (clause 25.3(a)).

1. In the case of a Grower's Grove that does not cause a deposit to be made to the Proceeds Fund for a particular production period, the Grower will not be entitled to any part of the Proceeds Fund in respect of the Production Period (clause 25.3(g)). This could occur if the Grower elected to sell his/her own olives or if the Grower's Grove failed to produce any olives for sale.

1. AOL will bear all costs of carrying out its duties under the Grove Agreement (clause 6.5).

1. In return for the services provided, AOL is entitled to receive prepaid Grove Agreement fees upon acceptance, on the first day of month 14 after the commencement of the Agreement, and at the beginning of the following year of the Agreement as prescribed in Clause 6. The Manager has confirmed it is not the intention of AOL to either forgive or roll over any amount of the Grove Agreement fees in any given year, including years in which there are insufficient olive sales from a Grower's Grove to meet the projected Grove Agreement fees.

Compliance plan

1. The Compliance Plan describes how the Responsible Entity will ensure its compliance with the Corporations Law and the Project's Constitution. A Compliance Plan is designed to ensure that the interests of the Growers are protected and is registered with ASIC. The Compliance Plan in this arrangement sets out both details of the compliance procedure and the position within the Responsible Entity,

who will be held responsible for the compliance procedures in areas including:

- naming the Compliance Officer within the Responsible Entity;
- the appointment and monitoring of the Custodian;
- holding Project property;
- marketing the Project;
- conduct of the business, such as the use of qualified contractors;
- application money and commissions payment details;
- compliance committee appointment and function;
- audit functions;
- keeping of records and accounts;
- related party issues;
- fees and expenses;
- complaints handing procedures;
- training and supervision of personnel; and
- review of the compliance level.

Application Form

1. Growers enter into the arrangement through the completion of an Application Form together with the payment of application monies. The Application Form appoints AOL to act as Attorney for the Grower for the purposes of entering into the Grove Agreement and Grove Licence Agreement. The Application Form also provides for the transfer of COGL shares from AOHL to the Grower.

Finance

1. The Ruling application has included details of finance available to investors in the Project. This finance is available from AAF, an associated entity of AOL

1. The finance is covered by a Finance Agreement, provided by the Manager between AAF and the Grower. A Grower may borrow part of the application money due per Grove from AAF. Under each of the options listed below, the Grower must still subscribe a given amount per application. The four options are:

(a) borrow $4,280 on application, having subscribed $4,250 per Grove, and repay $4,330 within 60 days (effective annual interest rate being 7%);

(b) borrow $7,280 on application, having subscribed $1,250 per Grove, and repay $4,000 within 60 days of signing the agreement and 12 monthly instalments of $289.89 commencing 30 days after acceptance of the application (effective annual interest rate being 11%);

(c) borrow $7,280 on application, having subscribed $1,250 per Grove, and repay 12 monthly instalments of $643.42 commencing 30 days after acceptance of the application (effective annual interest rate being 11%); or

(a) borrow $7,280 on application, having subscribed $1,250 per Grove, and repay 24 monthly instalments of $342.69 commencing 30 days after acceptance of the application (effective annual interest rate being 12%).

1. Growers can fund their investment in the Project themselves, borrow from an independent lender or borrow through the finance option offered by AAF ("the Lender").

1. This Ruling does not apply if a Grower enters into a finance agreement that includes any of the following features:

- split loan features of the type described in Taxation Ruling TR 98/22;
- entities associated with the Project, other than AAF, are, or become, involved in provision of the finance;
- indemnity agreements, or equivalent collateral arrangements limiting the borrower's risk;
- non-arms length terms and conditions;
- 'additional benefits', for the purposes of section 82KL are granted to the borrower, or the funding arrangement transforms the Project into a 'scheme' to which Part IVA may be applied;
- repayments of principal and payments of interest are linked to income derived from the Project;
- funds borrowed, in whole or in part, are not available for the conduct of the Project, but are transferred (by any means, and directly, or indirectly) back to the lender, or any associate; or

- 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

1. 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

1. For a Grower who invests in the Project, the deductions available will depend on the date that the investment is made and, in some cases, whether or not the Grower is a 'small business taxpayer'

IMPORTANT: Paragraph 51 (relating to 'small business taxpayers') and paragraphs 52 to 53 (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 69 to 72 relating to proposed changes to the prepayment rules. Growers who invest in the Project after 1pm, AEST, 11 November 1999 may be affected by these changes.

1. For a Grower who is accepted into the Project and who pays the fees of $8,360 payable on application ($180 for the purchase of trees, $8,180 on entering into the Grove Agreement and $20 on entering into the Grove Licence Agreement with AOL), the following deductions will be available in respect of that expenditure:

Payments in respect of services to be performed over thirteen months from the date of application and acceptance which are subject to the current prepayment rules

1. $3,511 of the total fee of $8,360 is incurred by the Grower in respect of services to be provided over the following 13 months and will be an allowable deduction under section 8-1.

Growers who are Small Business Taxpayers

1. For a Grower who is a small business taxpayer this amount is deductible in the year in which it is incurred. Paragraphs 75 to 78 of this Ruling describe what is regarded as a small business taxpayer.

(However, proposed legislative change applying to expenditure incurred after 1.00pm AEST 11 November 1999 means that for all Growers, including small business taxpayers, the full deduction may not be allowed in the year ended 30 June 2000. See non-binding advice in paragraphs 69 to 72 and Example 2.)

Growers who are not Small Business Taxpayers

1. For a Grower who invests in the Project on or before 30 June 2000 who is **not a small business taxpayer** and is carrying on a business, the deduction in respect of this service fee 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 131 illustrates the application of this method).

1. In calculating the deduction available, 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:

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

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:

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

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:

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

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

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

(The formula is repeated until the full amount of expenditure is extinguished).

Payments made on application in respect of services to be provided which are not subject to the prepayment rules and are not dependant on whether the Grower is 'a small business taxpayer'.

Landcare Activities

1. $1,106 of the total fee of $8,360 incurred by the Grower on Landcare operations will be an allowable deduction pursuant to section 387-55, provided the Grower is carrying on a 'primary production business' at the time the expenditure in question is incurred and providing the expenditure is incurred primarily and principally for the relevant purpose. A Grower who applies and is accepted into the Project in the year ended 30 June 2000 but for whom no services are provided in that income year, will not be considered to be carrying on such a business.

Irrigation

1. $985, being one third of $2,953 incurred by the Grower on irrigation and water facilities out of the total fee of $8,360 will be an allowable deduction pursuant to section 387-125, providing the Grower is carrying on a primary production business on the land and the expenditure is incurred primarily and principally for the relevant purpose. Deductibility under section 387-125 is calculated on the basis of one-third of the capital expenditure in the year in which the expenditure is incurred, and one-third in each of the next 2 years of income.

Tree Establishment

1. $790 of the total fee of $8,360 (which includes $180 for olive seedlings) is of a capital nature, being the amounts attributable to the cost of establishing the olive trees, and is not deductible under section 8-1. A deduction under section 387-165 for the cost of establishing olive trees will be allowable to the Grower during the income year that the trees are first used for the purpose of producing assessable income. The total amount is to be written off over a period determined to be the 'effective life' of the trees commencing when the trees enter their first commercial season. The promoter expects the trees to enter their first commercial season in the year ended 30 June 2004.

Grove Licence fee

1. $20 for the annual Grove Licence fee will be an allowable deduction pursuant to section 8-1.

General Deductions which may be subject to the prepayment rules and may be applicable over the period of the Ruling.

Interest, loan repayments and borrowing expenses

1. A Grower who applies for Finance under the arrangements mentioned in this Ruling, will be entitled to claim deductions under section 8-1 for periodical bank fees and interest incurred on borrowed funds used solely to fund the Grower's investment in the Project. If prepaid, refer to paragraphs 69 to 72 for timing of deductibility. Repayments of loan principal are capital in nature and are, therefore, not deductible.

1. Expenses incurred in borrowing these funds will be entitled to a deduction under section 25-25. If the total amount is $100 or less, the full amount can be deducted in the income year. If the total amount is more than $100, the expenditure can be deducted over the period of the loan or 5 years, whichever is the lesser, commencing on the first day on which expenses are incurred. The amount allowable in the first year of income will be the amount of the fee multiplied by the number of days from the first day on which the expenses are incurred until the next 30 June, divided by the number of days in the loan period or five years whichever is the shorter period.

Deductions for fees which are paid in accordance with the prospectus during the second and subsequent years are as follows:

Ongoing Grove Agreement fees

1. Growers who have entered the Grove Agreement will be liable to pay an amount of $1,300 for ongoing fees on the first day of month

14 after entering the Grove Agreement. This fee is in respect of services to be provided to the end of the year in which the 14th month falls. A further fee will be payable on the first day of the following year of the Agreement ($1,300 as increased with movements in the CPI) for services provided in that year.

1. Growers who are small business taxpayers will be entitled to deductions for these amounts pursuant to section 8-1 when the expenditure is incurred. As Growers can enter into the Grove Agreement on different dates, the first day of the month 14 after doing so may fall into different income years.

1. For Growers who are not small business taxpayers, the deduction in respect of this service fee 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 131 illustrates the application of this method). Paragraph 53 sets out the formulas to be used to ascertain the deductions available in each year in respect of these service fees.

Ongoing Grove Licence Agreement fees

1. Growers who have entered the Grove Licence Agreement will be liable to pay an amount of $20 (as increased by the CPI) annually from the commencement date of the Agreement. These fees will be an allowable deduction pursuant to section 8-1.

Irrigation and water facilities

1. Growers will be entitled to an allowable deduction pursuant to section 387-125 for irrigation and water facilities in each of the two subsequent income years after application and acceptance, of $984. The deduction under section 387-125 is calculated on the basis of one-third of the capital expenditure ($2,953) being able to be claimed in the year in which it is incurred, and one-third in each of the next two years.

Harvesting fees

1. In consideration of the Responsible Entity harvesting (or arranging for the harvesting) of the Grower's Grove, a fee is payable to the Responsible Entity in the amount of $0.27 per kilogram of olives. The Grower will be entitled to a deduction pursuant to section 8-1 in the year in which an invoice is presented to the Grower setting out the fee payable. At this stage, a fee of this nature is not expected in the income year of application or in the subsequent two years.

Income

1. Any proceeds from the sale of olives, or insurance recovery regarding the sale of olives or loss of income, will be assessable income to the Grower pursuant to section 6-5.

1. Any dividends received by way of the shareholding in COGL will be assessable income to the Grower pursuant to section 6-10.

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

1. 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 69 to 72);**
- section 82KZMB applies to expenditure by Growers who are not small business taxpayers and are carrying on a business **(but also see paragraphs 69 to 72)**;
- 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

1. On 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 proposed changes are enacted as announced, the Project will be a 'tax shelter arrangement' and all Growers, including 'small business taxpayers', who invest in the Project after 1pm, AEST, 11 November 1999 will be subject to these changes.

1. For these Growers the amount of deduction available in respect of the Services Fee is calculated using the formula shown below (see also Example 2 at paragraph 132). In the calculation, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 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.

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

1. 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

1. **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

1. 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 (on or 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 Grower has.

1. 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 on or before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled on or after 1 July 2000.

Subdivision 960-Q - Small business taxpayers

1. In this product ruling the term 'small business taxpayer' is relevant for the purposes of certain prepaid expenditure.

1. 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 he/she is within the definition of a 'small business taxpayer'.

1. 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 his/her 'average turnover' for the year is less than $1,000,000 or his/her turnover recalculated under section 960-350 is less than $1,000,000.

1. '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 - Initial Grove Agreement and Grove Agreement Licence Fees

1. Consideration of whether the Grove Agreement and Grove Agreement Licence fees are deductible under section 8-1 begins with the first limb of the section.

1. In determining whether an item of expenditure satisfies the wording of the limb, it is necessary to consider whether expenditure has been incurred for the purposes of the section. It is also material to determine the objective purpose for which the expenditure was incurred. As Latham CJ, Rich, Dixon, McTiernan and Webb JJ said in *Ronpibon Tin NL and Tongkah Compound NL v. FC of T* (1949) 78 CLR 47 at 56-57 (Ronpibon Tin):

> 'For expenditure to form an allowable deduction as an outgoing incurred in gaining or producing the assessable income it must be incidental and relevant to that end… In brief substance, to come within the initial part of the sub-section it is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income'.

1. Deductibility of the Grove Agreement and Grove Licence Agreement fees under the first limb depends on 'whether' and, if so, to what 'extent' the expenditure is 'incurred in gaining or producing assessable income' (see *Fletcher & Ors v. FC of T* 91 ATC 4950 at 4957-4958; (1991) 22 ATR 613 at 621-623). To satisfy this test, it is said that, at the time the fees are incurred, the expenditure must have a 'sufficient connection' with the 'operations' which more directly gain or produce the 'assessable income' (*see Ronpibon Tin; Charles Moore & Co (WA) Pty Ltd v. FC of T* (1956) 95 CLR 344; and *FC of T v. DP Smith 81 ATC 4114*; (1981) 11 ATR 538). The existence of a

sufficient connection is determined by looking at the scope of the income producing operations and the relevance of the expenditure to those operations (see *Dixon J in Amalgamated Zinc (de Bavay's) Ltd v. FC of T* (1935) 54 CLR 295 at 309).

1. Where expenditure is incurred prior to the commencement of the actual income producing operations, it may be incurred 'too soon' for it to be incurred 'in' gaining or producing assessable income. That is, the expenditure may be incurred 'too soon' to be characterised as expenditure that is incidental and relevant to the gaining or producing of assessable income. This position was recently restated by the High Court in *Steele v DC of T (1999) HCA 7* where Gleeson CJ, Gaudron and Gummow JJ said at paragraph 44:

> 'There are cases where the necessary connection between the incurring of an outgoing and the gaining or producing of assessable income has been denied upon the ground that the outgoing was entirely preliminary to the gaining or producing of assessable income eg *Softwood Pulp & Paper Ltd v. FCT* (1976) 7 ATR 101 at 113; 76 ATC 4439 at 4450 or was incurred too soon before the commencement of the business or income producing activity *FCT v. Maddalena* (1971) 2 ATR 541; 71 ATC 4161; *Lodge v. FCT* (1972) 128 CLR 171; 3 ATR 254; 72 ATC 4174; *FCT v. Riverside Road Lodge Pty Ltd* (in liq) (1990) 23 FCR 305. The temporal relationship between the incurring of an outgoing and the actual or projected receipt of income may be one of a number of facts relevant to a judgement as to whether the necessary connection might, in a given case, exist, but contemporaneity is not legally essential, and whether it is factually important may depend upon the circumstances of the particular case'.

1. Relevantly, in *FC of T v. Brand 95* ATC 4633 at 4646; (1995) 31 ATR 326, the Full Federal Court (Lee, Lindgren and Tamberlin JJ) allowed prepaid licence fees to a prawn grower investor under the first limb of sub section 51(1) of the ITAA 1936. The Court decided that an outgoing did not have to be contemporaneous with the activity directed to the gaining of income for it to be deductible and that in that case the expenditure was not incurred at a point too soon. It was decided that the outgoing was incidental and relevant to the gaining or producing of assessable income. It was considered that the contractual commitment to the project provided sufficient connection between the expenditure and the operations, which it was expected would gain or produce assessable income, to make the payment deductible under sub section 51(1).

1. Similarly, in this Project at the time the application is accepted, the 'Grove Agreement' executed and monies paid, there is a commitment by the investor to carrying on a business of olive

growing in the near future, such that the expenditure incurred prior to the actual commencement of the income producing operations would ordinarily be incidental and relevant to the gaining or producing of assessable income.

Is the Grower carrying on a business?

1. 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 be the organising of the planting, tending, maintaining, supply of land and harvesting of the olive trees.

1. 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 to determine when a person is carrying on a business are present.

1. For this Project Growers have, under the Constitution, Compliance Plan and Grove and Grove Licence Agreements, 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 Agreement indicates that AOL is to undertake a range of activities consistent with a commercial olive producing business. The Grower, as part of the Grove Agreement, has also entered into an arrangement to have the olives harvested and sold by the Manager in line with commercial ventures, unless the Grower elects otherwise.

1. The Grove Licence Agreement gives the Grower the right to occupy an identifiable area of land for the purpose of planting, growing, harvesting and marketing olives. The Growers may delegate any of these activities to another party, for example, by entering into the Grove Agreement with AOL. The Growers' control over the Project is considered sufficient, having regard to the terms of the Grove Agreement and the Constitution, and to responses received to specific questions put to the Applicant. Under the terms of the

Constitution, a Proceeds Fund will be maintained by the Responsible Entity, which will distribute surplus funds after expenses to the Growers (clause 25 of the Constitution). Growers are entitled to receive reports on the Manager's activities in terms of the Compliance Plan (clause 10.3 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.

1. 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 and Market Reports consider that 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 (pages 14 and 15) 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.

1. AOL, as Manager, will provide services as described in the Prospectus and Grove 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.

1. Growers have a continuing interest in the olive trees within their Grove from the time they are acquired until the termination of the Project. The Manager 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.

1. Growers have a commitment to meet expenses of the activity regardless of the proceeds of sale from olives. Growers, similar to persons in business, are susceptible to a variety of risks associated with a primary production venture.

1. By weighing up all of the attributes of the Project, it is accepted that Growers will be in a business of primary production from the date that 'business operations' are first commenced on their behalf. 'Business operations', in this context, includes such activities as organising the preparation of the land and other pre-planting work, all conducted as part of a coordinated and concerted plan to produce olives for sale.

1. The Grove Agreement fees associated with the farming 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 olives) is to be gained from this business. No

'non-income producing' purpose in incurring the fees is identifiable from the arrangement as presented. They 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.

1. The Grove Licence fees will also relate to the gaining of income from the business and, hence, have a sufficient connection to the income (from the sale of olives) to be deductible under section 8-1.

Section 82KZM - Prepaid expenditure for small business taxpayers

1. 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 wholly done within 13 months after the day on which the expenditure is incurred.

1. Under the Grove Agreement, the initial 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.

1. 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.

1. Thus, for the purposes of this Ruling, it is accepted that no part of the initial Service 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 Service Fee by Growers who are 'small business taxpayers'.

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

1. For a Grower who is not a 'small business taxpayer' and is carrying on a business, sections 82KZMA 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.

1. 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.

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

1. 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

1. 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. It is proposed that deductions otherwise allowable under section 8-1 of the ITAA 1997 be spread over the period to which the prepayment relates. Under the proposed changes, there will be no exemption for small business taxpayers and no transitional rules will apply.

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

- 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.

1. The arrangement relating to the Project and described at paragraph 15 to 46 of this product ruling is within the description of a 'tax shelter arrangement'. Therefore, any service fees 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).

Capital allowance provisions

1. As referred to in the preceding paragraphs, part of the initial Grove Agreement fee for Landcare operations, facilities to conserve or carry water, preparing the ground for planting of the trees, acquiring the trees and the planting of the trees are considered capital or capital in nature. However, some of these capital expenses can fall for consideration under specific deduction provisions relevant to the carrying on of a business of primary production. These are considered below.

Subdivision 387-A: Landcare operations

1. Capital expenditure incurred by a person carrying on a primary production business in respect of various measures primarily and principally for the prevention of land degradation qualifies for a 100% deduction in the year in which the expenditure is incurred, under Subdivision 387-A.

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

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

1. The amount of $1,106 of the initial Grove Agreement fee of $8,180 incurred by a Grower has been identified by the Manager as eligible for Landcare operations. A deduction under section 387-55 for this amount will be allowed in the year in which a participant enters into contractual arrangements with AOL and commences to carry on a primary production business.

Subdivision 387-B: conserving or conveying water

1. Capital expenditure incurred by a person on the construction, acquisition and installation of plant, equipment and structural improvements to be used primarily and principally for the purpose of conserving or conveying water for use in a primary production business, qualifies for a write-off over a three year period (i.e., $33^{1}/_{3}$ % with no pro-rating required). Taxpayers incurring this expenditure need not be the owners of the land to claim the deduction, so long as they are in a business of primary production.

1. In this arrangement there will generally be no delay between the signing of the Agreements and the commencement of 'business operations' on behalf of the Grower. Accordingly, a Grower's business of primary production will generally have commenced at the time the expenditure is incurred. The requirements of Subdivision 387-B have been met in this respect.

1. Expenditure applicable to the conserving or conveying of water for the Groves that meets the requirements of section 387-130 amounts to $2,953. For a Grower entering into the Project by 30 June 2000 and commencing to carry on a primary production business by that date, a deduction of $985 will be allowable under section 387-125 for the income year ending 30 June 2000. Subsequent deductions of $984 will be allowable in each of the income years ending 30 June 2001 and 30 June 2002. For a Grower entering into the Project after 30 June 2000, a deduction will be allowable under section 387-125 for $985 for the income year ending 30 June 2001. Deductions of $984 will be allowable in each of the years ending 30 June 2002 and 30 June 2003.

Subdivision 387-C: horticultural write-off

1. Subdivision 387-C allows capital expenditure incurred in establishing horticultural plants to be written off where the plants are used in a business of 'horticulture'. Under subsection 387-170(3), the definition of 'horticulture' covers the cultivation of olive trees.

1. The write-off commences from the time the trees are used or held ready for use for the purpose of producing assessable income in a horticultural business (see sections 387-165 and 387-170). The write-

off rate will be 7% per year, assuming an effective life of the plants of greater than 30 years, as indicated in the Prospectus (see section 387-185). The Manager has advised that the olive trees will be harvested initially in April 2004, or Year 4 of the Project. The write-off deductions would commence in Year 4, on the basis that this represents the first commercial season and, hence, the time at which the trees are first used for the purpose of producing assessable income in a horticultural business.

1. Costs of establishing horticultural plants may include the cost of acquiring the plants, and the costs of ploughing, contouring, top dressing, fertilising and stone removal, in accordance with Taxation Determination TD 98/3. Expressly excluded is expenditure incurred on draining swamps or clearing the land. The relevant expenditure attributable to the establishment of the olive trees is $790, made up of $610 of the initial Grove Agreement fee and the $180 allocated to the purchase of the trees.

1. The deduction for the establishment expenditure is limited to a proportionate amount based on time. The Manager has agreed to notify Growers of the commencement of the first commercial season and harvest, if different from the estimated time of April 2004.

Interest, loan principal and borrowing expenses

1. Growers may elect to finance their application monies for the Project through a loan facility from AAF. Whether the resulting interest charges are deductible under section 8-1 depends on the same reasoning as that applied in determining whether the Grove Agreement fees are deductible, as discussed above. The interest charged will be in respect of a loan to finance the establishment of an olive grove, which will continue to be directly connected with the gaining of 'business income' from the Project. These fees will, therefore, also have a sufficient connection with the gaining of assessable income. The tests of deductibility under the first limb of section 8-1 are, therefore, met. NOTE: If any interest is prepaid, refer to paragraphs 96 to 106 for an explanation of correct treatment.

1. Repayments of the loan principal are capital in nature and are, therefore, not deductible under section 8-1.

1. Expenses incurred in borrowing these funds will be deductible under section 25-25. Loan application fees may be payable by the Grower on the loans mentioned in the arrangement. Section 25-25 provides that a deduction is available for expenditure incurred for borrowing money, to the extent that the money is used for the purpose of producing assessable income. Whether the borrowing expenses relate to a loan that is used for income producing purposes depends on the same reasoning as that applied in determining whether the Grove

Agreement fees are deductible, as discussed above. If the total amount of the borrowing expenses is $100 or less, the full amount can be deducted in the income year in which it is incurred. If the total amount is more than $100 the expenditure can be deducted over the period of the loan or 5 years, whichever is the shorter period, commencing on the first day on which the expenses are required. The amount allowable in the first year of income will be the amount of the fee multiplied by the number of days from the first day on which the expenses are incurred until the next 30 June, divided by the number of days in the loan period or five years, whichever is the shorter period.

Section 82KL

1. 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'.

1. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received 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.

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

Part IVA

1. 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).

1. The Australian Olives Project No 3 will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the tax deductions per investment (Grove) 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 sale of

olives. There are no facts that would suggest that participants have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. The arrangements do not have:

- non-recourse or limited recourse financing;
- round robin arrangements; or
- an indication that the parties are not dealing with each other at arm's length or, if any parties are not arm's length, that any adverse tax consequences result.

1. Further, having regard to the eight matters to be considered under paragraph 177D(b), based on the arrangement identified it cannot be concluded on the information available that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Income

1. Gross sale proceeds derived from the sale of olives and, in most cases, the proceeds of insurance claims will be assessable income of the Growers, under section 6-5, in the year in which a recoverable debt accrues to them. This will depend on the specific sale contracts entered into by the Manager on behalf of the Grower.

1. Any dividends received by way of the shareholding in COGL will be assessable income to the Grower pursuant to section 6-10.

Examples

1. **Example 1: Obligation to prepay expenditure arising on or after 21 September 1999 and before 1PM AEST 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 on or before 30 June 2000 on management fees. This amount is calculated as A + B where:

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

$$= \$6{,}000 \times \frac{30}{365} = \$493$$

B = (Management fee *less* A) X 80%

= ($6,000 - $493) X 80% = $4,406.

The balance of the $6,000 management fees that were prepaid on 1 June 2000 (i.e. $1,229) 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) X 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) X 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.

1. **Example 2: Obligation arising after 1PM AEST 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:

$$\text{Management fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$\$6{,}000 \times \frac{30}{365} = \$493$$

In the following year Joseph can claim the balance of the $6,000 prepayment (ie $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

1. Below is a detailed contents list for this Product Ruling:

Commissioner of Taxation
5 April 2000

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
PR 98/1; TR 93/34; TR 98/3; TR 92/1; TR 94/25; TR 97/11; TR 97/16

Subject references:
- carrying on a business
- commencement of business
- fee expenses
- management fees expenses
- primary production
- primary production expenses
- producing assessable income

- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance
- schemes
- tax shelters
- tax shelters project

Legislative references:

- ITAA1936 44(1)
- ITAA1936 82KH(1)
- ITAA1936 82KH(1F)(b)
- ITAA1936 82KL
- ITAA1936 82KL(1)
- ITAA1936 82KZM
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1936 177D(b)
- ITAA1997 6-5
- ITAA1997 8-1
- ITAA1997 25-25
- ITAA1997 387-A
- ITAA1997 387-55
- ITAA1997 387-60
- ITAA1997 387-B
- ITAA1997 387-125
- ITAA1997 387-130
- ITAA1997 387-C
- ITAA1997 387-165
- ITAA1997 387-170
- ITAA1997 387-170(3)
- ITAA1997 387-185

Case references:

- Amalgamated Zinc (de Bavay's) Ltd v. FC of T (1935) 54 CLR 295
- Charles Moore & Co (WA) Pty Ltd v. FC of T (1956) 95 CLR 344
- Cliffs International Inc v. FC of T (1979) 9 ATR 507
- Colonial Mutual Life Assurance Society Ltd v. FC of T (1953) 89 CLR 428;
- FC of T v. Brand (1995) 31 ATR 326; 95 ATC 4633;
- FC of T v. Maddalena (1971) 2 ATR 541; 71 ATC 4161;
- FC of T v. Osborne (1990) 21 ATR 888; 90 ATC 4889;
- FC of T v. Raymor (NSW) Pty Ltd (1990) 21 ATR 458; 90 ATC 4461;
- FC of T v. Riverside Road Lodge Pty Ltd (in Liq) (1990) 23 FCR 305; (1990) 21 ATR 499; 90 ATC 4567;
- FC of T v. DP Smith (1981)
- 11 ATR 538; 81 ATC 4114;
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