

PR 2000/47 - Income tax: Brooklyn Park Olive Groves (revised arrangement)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 April 2000*



Product Ruling

Income tax: Brooklyn Park Olive Groves (revised arrangement)

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

Preamble

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

No guarantee of commercial success

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

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

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

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

Potential investors should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

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

What this Product Ruling is about

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

Tax law(s)

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

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 8-1 (ITAA 1997);
- section 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 82KZMA – 82KZMD (ITAA 1936);
- Part IVA (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 the announcement and others are proposed to apply from nominated dates in the future.

4. Although this ruling mentions certain of these 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.

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 formalize 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. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 62) 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.

Note: A material difference may arise in relation to a variation in the facts of the arrangement described in the Ruling. It may also arise in circumstances where the person otherwise included in the class of persons enters into the arrangement as described, but also enters into transactions or arrangements (including financing arrangements) that, when viewed as a whole with the arrangement described in the Ruling, will produce a different taxation consequence for the arrangement. This might include, for example, where the Grower borrows to enter into the arrangement by way of a limited or non-recourse loan and the overall consequence might be that the arrangement is one that would have attracted the application of a tax avoidance provision.

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11. This Ruling is based on the assumption that Minimum Subscription is reached by 18 June, 2000

Date of effect

12. This Ruling applies prospectively from 19 April 2000, the date this Ruling is made. The Promoter has previously obtained two Product Rulings in respect of the Brooklyn Park Olive Grove Project, namely PR 1999/58 and PR 1999/94. Both these Rulings have been withdrawn at the Promoter's request. This Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 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.

Previous Ruling

15. This Ruling applies to the Project that was ruled on in Product Ruling PR 1999/94. PR 1999/94 is withdrawn on and from the date this Ruling is made

Arrangement

16. 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 are:

- Application for Product Ruling dated 20 December 1999;
- The Brooklyn Park Olive Groves Prospectus dated 18 February 2000;
- Supplementary Prospectus dated 10 April, 2000;
- Second Supplementary Prospectus dated 11 April, 2000;
- Constitution of Brooklyn Park Olive Groves Limited ('BPOG');
- Scheme Constitution of Brooklyn Park Olive Groves;
- Draft Compliance Plan for the Brooklyn Park Olive Groves Managed Investment Scheme ;
- Draft Management Agreement between Australian Green and Gold Limited ('AG&G' or 'the Manager'), BPOG and the Grower;
- Draft Licence to Occupy Agreement between BPOG ('the Licensor') and the Grower dated 28 July 1999;
- Option Deed between MJ Shakspeare ('the Grantor') and BPOG ('the Grantee') for the property known as 'Brooklyn Park' (Lot 62 on SP 119592 in the County of Marsh and Parish of Sands);
- Draft Agreement for Sale between MJ Shakspeare ('the Vendor') and BPOG ('the Purchaser') for 'Brooklyn Park';
- Draft Loan Agreement between BPOG ('the Borrower') and the Promoters ('the Lender');

- Draft Head Lease proposed to be between BPOG and Australian Rural Group Limited ('ARG' or 'the Custodian');
- Draft Sublease proposed to be between ARG and BPOG;
- Draft Brooklyn Park Olive Groves Water and Services Agreement dated 28 July 1999;
- Letter dated 6 March 2000 supplied by Australian Green & Gold Limited.
- Letter dated 4 April 2000 supplied by Australian Green & Gold Limited.

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.

17. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal and whether or not legally enforceable, to which a Grower, or any associate of the Grower, will be a party. The arrangement is summarised as follows.

18. The arrangement is called the 'Brooklyn Park Olive Groves Project' and has been registered as a Managed Investment Scheme under the Corporations Law. In the Prospectus, participants are invited to conduct a business of commercially growing olives for domestic and international sale. The Project is to run for a period ending on 30 June 2020.

location	The Darling Downs Region of Queensland
type of business each participant is carrying on	Commercial growing of olives for domestic and international sale
number of hectares under cultivation	This prospectus provides for 200 hectares to be planted, however oversubscriptions may be accepted
name used to describe the product	Brooklyn Park Olive Groves Project
size of the occupied area	0.2 hectares
number of trees per hectare	250

expected production	17500 kg per hectare (70 kg per tree)
term of the investment	20 years
initial cost	\$1,020 for purchase of shares and license fee in relation to applications lodged on or before 18 June 2000 \$6,565 management fee for period to 30 June 2000
initial cost on a per hectare basis	\$32,825 (6,565 x 5)
ongoing costs	Growers will be charged for ongoing management and licence fees and other charges as listed at paragraph 38

19. The Project's olive trees will be located on a property known as 'Brooklyn Park' or 'the Project Land' and identified as Lot 62 on SP 119592 in the County of Marsh, Parish of Sands. 'Brooklyn Park' is 209.2 hectares in size and is located 22 kilometres west of Inglewood in the Darling Downs region of Queensland. 'Brooklyn Park' will be owned by Brooklyn Park Olive Groves Limited ('BPOG').

20. A Grower's minimum investment in the Project will be one parcel of 1,000 A Shares in BPOG, at a cost of \$1,000. Growers can subscribe for one or more parcels. Each parcel of A Shares carries with it an entitlement that the Grower may enter into a Licence to Occupy Agreement with BPOG.

21. Under the Licence to Occupy Agreement, the Grower is given the right to occupy a portion of the Project Land known as an 'Allotment'. Each Allotment will have 50 olive trees planted on an individually identifiable area of 0.20 hectare (a 'Grove').

22. There are 1 million A Shares of \$1 each in BPOG on offer, which equates to 1,000 Allotments. The minimum subscription has been set at 250,000 A Shares (250 Allotments). If the minimum subscription is not reached by 18 June 2000, all subscription monies will be refunded to investors in full without interest.

23. The directors of BPOG have reserved the right to accept oversubscriptions and will then acquire additional land from the property adjoining the Project Land.

24. BPOG has been granted an option to purchase the Project Land for \$1 million. Provided the minimum subscription (250,000 shares) is reached by 18 June 2000, BPOG will enter into a Loan Agreement

with the Financiers who are identified in clause 13.2 of the Prospectus if the maximum subscription (1,000,000 shares) is not reached by that date. The loan will enable BPOG to fund the balance of the purchase price of the Project Land. The Loan Agreement provides that repayments will be funded by any subsequent subscriptions for shares. No interest is payable by BPOG to the Financiers, except in the event that BPOG defaults, in which case the interest rate will be 16%.

25. BPOG will lease the Project Land to ARG who will then sublease the land back to BPOG. BPOG will then be in a position to enter into a Licence to Occupy Agreement with each Grower, granting the Grower occupancy rights over an individual Allotment.

26. Growers can elect to enter into the Management Agreement, whereby they appoint the Manager, Australian Green & Gold Limited ('AG&G'), to establish and maintain their Allotments for the term of the Project. Growers can also elect to conduct the Business themselves or through an approved contractor. Growers who do not use the services of AG&G will be outside the arrangement to which this Ruling applies and will be unable to rely on this Ruling.

Managed Investment Scheme requirements

27. The Project has been registered with ASIC as a Managed Investment Scheme under the Corporations Law. All of the resulting ASIC requirements are, or will be, complied with for the duration of the Project, including the requirements that the Project has a Scheme Constitution, a Responsible Entity and a Compliance Plan.

Scheme Constitution

28. Upon entering into the Management Agreement, Growers become bound by the provisions of the Scheme Constitution. The Constitution primarily sets out the rights, powers, duties and obligations of the Manager. A summary of this document appears at Section 13 of the Prospectus entitled 'Significant Documents'.

Responsible Entity

29. The Manager is the Responsible Entity for the Project and will have the primary responsibility for managing the Project, ensuring compliance with the Corporations Law, the Scheme Constitution and the Management Agreement.

Compliance Plan

30. The Compliance Plan describes how the Responsible Entity will ensure its compliance with the Corporations Law and the Project Scheme Constitution. The Compliance Plan is designed to protect the rights of Growers.

Rights of Shareholders in BPOG

31. As an investor in the Project, a Grower must subscribe for a minimum of 1,000 A Shares in BPOG at a cost of \$1 per share, payable on application. The Grower subscribes by completing the 'Application for Shares' form attached to the Prospectus. Upon acceptance of the Grower's Application by the directors of BPOG, the Grower becomes bound by BPOG's Constitution.

32. As a holder of A Shares, the Grower also consents to, and agrees to be bound by, the terms and conditions of the Licence to Occupy Agreement. The rights, privileges, conditions and other obligations of A Shareholders are set out in Rule 4.3 of the Constitution of BPOG and are summarised in Section 13 of the Prospectus entitled 'Significant Documents'.

33. BPOG also has 250,000 Ordinary Shares on issue to the Promoters at 1 cent each, in consideration of services provided by them. Ordinary Shares rank equally with A Shares with respect to voting rights, dividends and capital. Ordinary Shares differ from A Shares in that Ordinary Shares do not include any rights to occupy the Project Land. The occupancy rights attached to A Shares, by virtue of the Grower's licence to occupy, cease on 30 June 2020. After this date, holders of A Shares will rank *pari passu* with holders of Ordinary Shares. The taxation consequences flowing from the events occurring at that time do not form part of this Ruling.

Licence to Occupy Agreement

34. Each Grower enters into a Licence to Occupy Agreement with BPOG until 30 June 2020 (clause 3.2). Under the Agreement, BPOG grants the Grower a licence to occupy an Allotment on the Project Land for the purpose of conducting the 'Business' (clause 7.1). 'Business' is defined as planting, growing, cultivating, harvesting and marketing olives for domestic and overseas sale (clause 1).

35. Each Allotment is 0.20 hectare in size and will have 50 olive trees planted on it, with row spacings approximately 8 metres by 5 metres (clause 4.2). Each Grower's Allotment will be a distinct area of the Project Land and will be identified on an Allotment Plan to be maintained by BPOG (clause 4.3). Each tree position will be numbered and shown in relation to the boundaries of the Project Land.

This will enable Growers to identify their individual Allotment and tree holding. BPOG will advise Growers of the location of their individual Allotment(s) (clause 4.1).

36. The Agreement places certain obligations on the Grower to maintain the Allotment (clause 5.1). It also permits the Grower to use dams, irrigation systems, roads and other infrastructure located on the Project Land (clause 3.3).

37. The Grower is required to pay an annual Access Fee commencing at \$1,000 to BPOG. Provided the Grower enters into the Management Agreement and is not in default in relation to the Licence to Occupy Agreement and the Management Agreement, BPOG will waive the Access Fee (clause 8.7). As this Ruling only applies to Growers who enter into, and comply with, the Management Agreement, the Access Fee and any waiver of the Fee are outside the arrangement to which this Ruling applies.

38. The Grower is required to pay an annual Licence Fee in advance for each year of the Agreement. The Fee is \$20 per year for the first 4 years (clause 8.1). From the fifth year onwards, the annual Fee will equal the Fee of the preceding year indexed by the All Groups Consumer Price Index for Brisbane ('CPI'), in accordance with the formula in clause 8.2.

39. The Grower will pay all telephone, garbage, waste, electric light and power charges levied against the Land or the Allotment in respect of the Grower's use of the Allotment to conduct the Business. BPOG will pay for all charges and assessments levied on the Allotment, including water and municipal rates (clause 9).

40. The Agreement allows the Grower to delegate the conduct of all or part of the Business to the Manager or an approved contractor (clause 12). As a consequence, the Agreement allows delegates of the Grower to enter upon the Allotment for the purpose of conducting the Grower's Business (clause 10.4).

41. The Agreement may be terminated prior to 30 June 2020, where either party defaults or does not fulfil its obligations (clause 11). Growers are not entitled to assign the licence, except as set out in BPOG's Constitution (clause 10.1).

42. Upon termination of the Agreement, the Grower must remove any item brought onto the Allotment or any improvement constructed on the Allotment (clause 11.5(a)). BPOG will be legally entitled to any trees growing on the Allotment and things brought onto the Allotment by the Grower that are not removed within 14 days following termination of the Agreement (clause 11.5(b)).

Management Agreement

43. Growers may elect to use the services of the Manager, AG&G, by entering into the Management Agreement. The parties to the Management Agreement are the Grower, the Manager and BPOG. The Management Agreement will terminate on 30 June 2020, subject to the valid terminations as set out in clause 16.

44. The Manager must carry out its duties under the Agreement in a manner consistent with best agricultural practice (clause 5.1). Clause 4.2 details the duties to be carried out by the Manager in establishing the Grower's Allotment, whereby the Manager will:

- properly prepare the Allotment, including the performance of soil conservation, irrigation and drainage work on the Land to the benefit of the Allotment;
- cause at least 50 trees to be planted on the Allotment; and
- identify the Grower's trees with appropriate markings.

45. The Manager will also provide additional services to the Grower as set out in clauses 5.2 and 5.3, including:

- procuring, planting and tending the trees on the Allotment;
- minimising soil erosion and maintaining soil quality on the Grove;
- keeping the Grove free from vermin, vegetation, insects and diseases that might inhibit the growth of the trees;
- maintaining and cultivating the trees, including watering, weeding and applying fertilisers, nutrients and herbicides;
- procuring all necessary plant, equipment, machinery and materials;
- maintaining windbreaks, access roads and tracks; and
- harvesting the trees and marketing and selling the olives produced (subject to the Grower's right to make an election regarding these services).

46. In general, the Manager will carry out the above services at or about the same time in respect of all Growers who have entered into the Management Agreement.

47. The Manager guarantees survival of the Grower's trees to the commencement of the fourth year of the term of the Agreement.

Thereafter, the Manager does not guarantee survival of the Grower's trees or that they will produce olives (clause 4.4).

48. Under the Management Agreement, Growers may elect not to use all the services provided by the Manager. Growers may elect to have the Manager harvest the trees on their Allotment separately (clause 6.1) or they may elect to harvest the trees on their Allotment themselves (clause 6.2). Growers may also elect to retain the olives harvested from their Allotment and market, sell or otherwise deal with as they see fit (clause 6.3). Any Grower who makes an election under clause 6.1, 6.2 or 6.3 will be outside the arrangement to which this Ruling applies and will be unable to rely on this Ruling.

49. The Manager is entitled to delegate all or any of the functions to be performed by it under the Agreement (clause 20).

50. The Manager will pool the olives produced by the Grower's trees with those of each other Grower, and market and sell all such olives (clause 7.1). The proceeds of the sale of all olives will be paid to the Custodian, to be divided among all Growers. The allocation of gross sales proceeds to each Grower does not make reference to the quality, volume, prices or any other factor relating to the olives produced by the Grower's Allotment (clause 7.3). The Grower's share of pooled sales is based on the 'Grower's Percentage' as defined in clause 1. The Grower's Percentage is the number of trees on the Grower's Allotment(s) expressed as a percentage of the total number of trees harvested by the Manager.

51. The Custodian will establish an account for each Grower, to which the Grower's share of sale proceeds will be credited (clause 7.4). The Manager will account for the gross sale proceeds received and Management Fees payable and must provide each Grower with certain financial information in respect of the Grower's olives (clause 7.5). The Manager is also required to provide the Grower with various reports, including half yearly reports on the Management Services provided and the progress and condition of the Grove (clause 14).

52. Growers are not entitled to assign their rights or obligations under the Management Agreement, except in certain circumstances (clause 19.2). Where a Grower's interest is assigned, the Grower will no longer be entitled to rely on this Ruling.

53. In consideration of services provided, Growers who invest in the Project on or before 30 June 2000, will pay the Manager Fees as follows:

- in respect of the period from the commencement of the Agreement to 30 June 2000 - \$6,565 payable within 7 days from receipt of an invoice issued by the Manager on 30 June 2000 (clause 12.5).

- in respect of each month following 31 July 2000 up to and including 30 April 2004 - an amount as set out at clause 12.4 of the Agreement payable within 7 days from the end of each invoice period referred to in such invoice. The Manager may issue an invoice either at the commencement of each invoice period or at the commencement of that Financial Year.

and

- in respect of Year 5 and subsequent years, the Fee will be calculated as a percentage of gross sales proceeds of olives harvested in the immediately preceding financial year in accordance with the following table (clause 12.6):

Year	Percentage
5	80%
6	70%
7	60%
8	50%
9-20	40%

54. In order to ensure that the Management Fees are paid by the due date, Growers are required to provide the Manager with letter of credit or such other form of promissory note or financial accommodation from a financial institution. The letter of credit will direct the financial institution to immediately pay the Custodian the full amount of each invoice received from the Manager (clause 12.8).

Water and Services Agreement

55. To supplement the water supply and infrastructure available to the Project, the Manager and the Growers will enter into a Water and Services Agreement with the owner of the property adjoining the Project Land ('the Supplier'). Infrastructure refers to accommodation and administration buildings, machinery service sheds and storage sheds located on the adjoining property. The Agreement will run from the date of commencement of the Project until 30 June 2020. Under the Agreement the Manager will pay the Supplier the following fees:

- **Water Supply Fees:** for the first 4 years the Fee will be \$100 per megalitre of water supplied. For year 5 the Fee will be \$50,000. For years 6 to 20 the Fee in each year will equal the Fee in the previous year indexed by the CPI, in accordance with the formula in the Agreement; and

- **Infrastructure Fees:** for the first year the Fee will be \$30,000. The Fee for each subsequent year will equal the Fee of the previous year indexed by the CPI, in accordance with the formula in the Agreement.

56. If the Management Agreement is terminated, the Supplier will grant the Growers an option to enter into a Water and Services Agreement with the Supplier.

Planting and commercial harvesting

57. Under the Management Agreement, the Manager undertakes to establish the Business of the Grower, including the planting of trees, as soon as is reasonably practicable. The Supplementary Prospectus dated 10 April, 2000 states that for applicants who acquire a grower's interest prior to 30 June 2000, these services will be performed and carried out by ARG on behalf of the grower within two months of the date the expenditure was incurred, that is, within two months of the date of the invoice relating to the initial payment of \$6,565. For an applicant who acquires a grower's interest after 30 June 2000 and before 30 June 2001, these services will be performed and completed by 30 June 2001. It is anticipated that planting will commence soon after the attainment of minimum subscription. The olive trees are expected to be ready for the first commercial harvesting in April 2004.

Fee summary

58. Pursuant to clause 12.4 of the Agreement, the amounts payable per Grove in years 0 to 2, are as follows:

Fee type	Year 0 30/6/2000	Year 1 30/6/2001	Year 2 30/6/2002
Acquisition of 1,000 A Shares in BPOG	\$1,000		
Licence Fee	\$20	\$20	\$20
Supply of 50 olive trees	\$375		
Irrigation	\$3,148		
Landcare	\$1,365		
Management Fee	\$1,677	\$3,304	\$1,779
Total	\$7,585	\$3,324	\$1,799

59. The fees payable for year 3 and onwards, until termination of the Project on 30 June 2020, will consist of the annual Management Fees (see paragraph 52) and Licence Fees (see paragraph 37).

60. The Goods and Services Tax will be applicable to services provided by the Manager after 1 July 2000. The Management Agreement states that any payment by the Grower to the Manager in

connection with any supply of goods or services is a 'primary payment' which is considered to be the 'value' for the purposes of calculating GST i.e., the payment is GST exclusive. The Grower is required to pay GST on the primary payment at the same time and in the same manner as the Grower is required to pay the primary payment in respect of which the GST relates. If a primary payment is to be made from Net Sale Proceeds, the GST is also deducted from that source.

Finance

61. Growers can fund the investment themselves or borrow from an unassociated lending body. No entity involved in the Project is providing any financial support or guarantee to financiers. Independent finance providers may be introduced to Growers by the Project, or its related entities on an arm's length commercial basis.

62. Growers who enter into financing arrangements which do not satisfy the following conditions will be outside the arrangement to which this ruling applies.

- all loan terms are arm's length in nature
- borrowers remain fully liable for the balance of the loan outstanding at any time and lenders will take legal action against defaulting borrowers
- there is no right to assign
- there are no 'round robin' characteristics
- there are no split loan features of a type referred to in Taxation Ruling TR 98/22
- there are no indemnity arrangements or any other collateral agreements in relation to the loan
- repayments of principal and payments of interest are not linked to derivation of income from the Project and are made regularly, starting shortly after the making of the loan.

Undertaking by the Manager

63. The Manager has provided the ATO with an undertaking to contact Growers to provide them with the correct date of commencement of the olive trees' first commercial season, in the event that it differs from the estimated date of 1 April 2004, for the purpose of the horticultural write-off provisions.

Ruling

Goods and Services Tax

64. 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

65. For a Grower who invests in the Project, the deduction available for any prepaid amounts will depend upon the date that the investment is made and, in some cases, whether or not they are 'small business taxpayers'.

IMPORTANT: Paragraph 65 (relating to 'small business taxpayers') and paragraphs 66, 67 and 68 (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 72 and 73 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.

66. For a Grower who is a 'small business taxpayer' and invests in the Project on or before 30 June 2000 and is invoiced on 30 June 2000 for management services to the value of \$6,565, and thereafter as set out at clause 12.4 of the Management Agreement, the following deductions will be available for the years ended 30 June 2000 to 30 June 2002:

Expense type	ITAA 1997 Section	Deductions available each year		
		Year 0 30/6/2000	Year 1 30/6/2001	Year 2 30/6/2002
Management Fee	8-1	\$ 1,677 see note i below	\$ 3,304	\$ 1,779
Licence Fee	8-1	\$20	\$20	\$20
Landcare	387-55	\$ 1,365 see note ii below		

Irrigation	387-125	\$1,050 see note iii below	\$1,049	\$1,049
Olive tree establishment	387-165	see note iv below		

Notes

- (i) Legislative change for Growers means that the full deduction will not be allowed in the year ended 30 June 2000 to Growers who are not small business taxpayers. See paragraphs 66, 67 and 68 and Example 1. Proposed legislative change applying to expenditure incurred after 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 74 and 75 and Example 2. The whole amount of expenditure otherwise allowable under section 8-1 is the 'expenditure' incurred for the purpose of the prepayment rules.
- (ii) A deduction under section 387-55 for capital expenditure on eligible landcare activities will be deductible in full in the year incurred, provided the Grower has commenced a business of primary production at the time the expenditure in question is incurred. A Grower who applies for 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.
- (iii) A deduction under section 387-125 for capital expenditure on irrigation will be an allowable deduction, on the basis of one-third of the total expenditure in the year the expenditure is incurred, and one-third in each of the following two years of income.
- (iv) A deduction under section 387-165 for the cost of establishing olive trees is calculated on the basis of the olive trees, as horticultural plants, entering their first commercial season in the year ended 30 June 2004 and a Grower determining, under section 387-175, that they have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years. This results in a write-off rate of 13%.

67. 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 available in respect of the Management Fee is

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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 128 illustrates the application of this method).

68. In calculating the deductions 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)) commences on the later of:

- (a) the day, or the first day on which services to be done under an agreement are to commence being done or
- (b) the day on which that expenditure is incurred.

69. The whole amount of expenditure otherwise allowable under section 8-1, \$1677, is the expenditure which is subject to the provisions of section 82KZMB. For applicants who acquire a grower's interest prior to 30 June 2000, the eligible service period will commence on 30 June 2000, the date on which the initial fees are incurred. For these Growers, the eligible service period ends 2 months from this date, eg 31 August 2000. For an applicant who acquires a grower's interest after 30 June 2000, the eligible service period will commence on the date that the initial expenditure is incurred and end on 30 June 2001.

Year 1: Expenditure incurred on 30 June 2000

Available deduction = A + B

Where :

		Number of days of eligible service period in the expenditure year
A = Expenditure	X	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 :

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

$$B = (\text{Expenditure less } A) \times 60\%$$

$$C = \text{balance of the Year 1 expenditure not previously deducted}$$

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

$$\text{Available deduction} = A + B + C$$

Where :

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

$$B = (\text{Expenditure less } A) \times 40\%$$

$$C = \text{balance of the Year 2 expenditure not previously deducted.}$$

Example: for a Grower who subscribed on or before 30 June 2000

Year 1: Deduction

$$\text{Available deduction} = A + B$$

$$A = \$1677 \times \frac{1 \text{ day}}{63 \text{ days}} = \$27$$

$$B = (\$1677 \text{ less } A) \times 80\% = \$1320$$

$$\text{Available deduction} = \$27 + \$1320 = \$1347$$

Year 2: Deduction

Available deduction = C = balance of the Year 1 expenditure not previously deducted

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$$C = \$1677 - \$1347 = \$330$$

70. 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 deductions available in respect of capital expenditure are shown in the Table below:

Fee type	ITAA 1997 section	Deductions for capital expenditure for taxpayers who are not small business taxpayers and are carrying on a business		
		Year 0	Year 1	Year 2
Landcare	387-55	\$1,365 see note ii above		
Irrigation	387-125	\$1,050 see note iii above	\$1,049	\$1,049
Olive tree Establishment	387-165	See note iv above		

71. For a Grower who invests in the Project between 1 July 2000 and 30 June 2001 and is invoiced for initial management services to the value of \$6,565, management and licence fees are deductible on the basis that the expenditure is to be incurred and the services are to be wholly provided during the year ended 30 June 2001. Other Fees are deductible in accordance with notes (ii), (iii) and (iv) above as applicable.

72. For a Grower who invests and is accepted into the Project after the date on which the Manager commences work on the Grower's Allotment, individual advice must be sought as to the availability and timing of deductions for income tax purposes relevant to the work completed on the Grower's Allotment. Expenditure incurred in performing work on the Grower's Allotment before the Grower's application is accepted will usually be capital and not allowable as a deduction.

Assessable Income

73. Gross sale proceeds derived from the sale of olives harvested from the Project will constitute assessable income of Growers, pursuant to section 6-5, in the year in which a recoverable debt

accrues to them. This will depend on the terms of the specific sale contracts entered into.

Trading Stock

74. Where a Grower has agreed with AG&G to have their olives “pooled” the Grower will not be in possession of trading stock and will not be required to account for it under the trading stock provisions. For Growers who harvest and/or process their own olives and do not take part in the “pooled” arrangement they will have to account for trading stock

Sections 82KL and Part IVA

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

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions of 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

76. 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.

77. For these Growers the amount of deduction available in respect of the Management Fee (for this project, \$1677) is calculated using the formula shown below (see also Example 2 at paragraph 129). 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.

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

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

78. **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: Good and Services Tax

79. 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 on or after 1 July 2000.

80. 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.

Subdivision 960-Q - Small business taxpayers

81. In this product ruling the term ‘small business taxpayer’ is relevant for the purposes of certain prepaid expenditure.

82. 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'.

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

84. '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: Management and Licence Fees

85. Consideration of whether the Management and Licence Fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where taxpayers merely contractually commit themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether the second limb applies. However, that does not preclude the application of the first limb and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

86. Olive growing activities can constitute the carrying on of a business. A business includes a 'primary production business', which is defined under subsection 995-1(1) to include a business of propagating and cultivating plants. Where there is a business, or a future business, of growing olives for sale at a profit, the gross proceeds from the sale of olives 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 planting, tending and maintaining of olive trees and the harvesting of the olives for sale.

87. A Grower will be considered to be carrying on a business of growing olives where:

- the Grower has an identifiable interest in specific growing trees coupled with a right to harvest and sell the olives produced;
- the olive growing activities are carried out on the Grower's behalf; and
- the weight of the general indicators of a business, as developed by the Courts, point to the Grower carrying on a business.

An identifiable interest and a right to harvest and sell olives

88. By virtue of the Licence to Occupy Agreement and the Management Agreement, the Grower has an occupancy right over an identifiable 0.20 hectare area of land growing 50 olive trees. There is a means to identify trees in which the Grower has an interest. Growers have the right to harvest and sell the olives themselves or have an independent contractor, or the Manager, do so on their behalf.

Olive growing activities carried out on the Grower's behalf

89. Under the Licence to Occupy, Growers have the right to use their Allotments for olive growing purposes and to have AG&G or other contractors enter the land to carry out the management and other services required in the Business.

90. Growers can control AG&G's activities. This control is provided on an individual Grower basis under the Management Agreement and also pursuant to the rules in the Constitution of BPOG in respect of Managed A Shares. Additional control over AG&G is provided under the Corporations Law.

91. Growers are entitled to agricultural, land and financial reports from AG&G. They are able to terminate the Management Agreement with AG&G in certain instances, such as cases of default.

92. The olive growing activities detailed in the Licence to Occupy Agreement and the Management Agreement are carried out on the Grower's behalf. From the information provided, Growers control their investment in the Project.

General indicators of business

93. The general indicators of a business, as developed by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description in this Ruling for all these indicators. The Olive Consultant's Report in the Prospectus considers the Project is feasible and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to cash flow projections in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

94. As detailed above, the Grower's Allotment and the individual trees upon that Allotment can be identified. The Grower bears certain business risks including, from commencement of the fourth year of the Management Agreement, failure of the Grower's trees to survive. The services provided by the Manager are those ordinarily found in olive growing ventures that would commonly be said to be businesses.

95. Growers have a continuing interest in the trees from the time they are acquired until the termination of the Project. The olive growing activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Grower's olive growing activities will constitute the carrying on of a business.

96. The Management Fees and Licence Fees payable by the Grower will relate to the gaining of income from this business. Hence, they have a sufficient connection with the operations by which this income is gained. Further, no 'non-income producing' purpose in incurring the Fees is identifiable from the arrangement. They will, thus, be deductible under the first limb of section 8-1, to the extent that they are not capital or of a capital nature. The Fee payable under the Management Agreement includes separate Fees for the trees, landcare and irrigation establishment costs. These amounts are of a capital nature and not deductible under section 8-1. The Fees, on the basis of the information provided, cannot be said to be grossly excessive. The tests of deductibility under the first limb of section 8-1 are met.

Subdivision 387-A: landcare expenditure

97. 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. The expenditure that qualifies includes, among other things, the eradication of animal and vegetable pests and other

measures, including fencing, to prevent soil erosion, salinity, and preserve natural vegetation (section 387-60).

98. In order to claim a deduction under section 387-55, a business must be being carried on at the time the expenditure was incurred. A taxpayer claiming the deduction need not actually own the land but can be a tenant or a lessee, provided the land is used at that time in carrying on a business of primary production. However, where all that occurs in an income year, is that a person has been accepted into the Project as a Grower but no business operations have been commenced on his/her behalf, he/she 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, year of income.

99. In this Project, a Grower's business of primary production will generally have commenced at the time the expenditure is incurred. The requirements of Subdivision 387-A will have been met in this respect.

100. Under the Management Agreement, the Grower is required to pay an amount of \$1,365 for expenditure attributable to landcare. This amount is eligible expenditure for the purposes of sections 387-55 and 387-60. For a Grower who enters into the Project by 30 June 2000, and commences to carry on a primary production business by that date, a deduction for \$1,365 will be allowable in the year ended 30 June 2000.

Subdivision 387-B: irrigation expenditure

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

102. A taxpayer who is a lessee or licensee of land and who is conducting a primary production business on the land may qualify for a deduction under Subdivision 387-B. Upon entering into the Licence to Occupy Agreement the Grower becomes a licensee of a distinct portion of the Project Land. A deduction will be available to the Growers in this Project at a rate of 33.3% per annum (with no pro-rating required) for the cost of the irrigation system.

103. The expenditure applicable to conserving or conveying water for each olive Grove, as provided for in the Management Agreement, that meets the requirements of section 387-130, amounts to \$3,148.

For a Grower entering into the Project by 30 June 2000 and who incurs the expenditure for use in a primary production business, a deduction will be allowable under section 387-125 for the years ended 30 June 2000 to 30 June 2002, inclusive, as detailed in the table at paragraph 65.

Subdivision 387-C: olive tree establishment expenditure

104. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. Under subsection 387-170(3), the definition of 'horticulture' may include the cultivation of olive trees. For the purpose of this Subdivision, a lessee or licensee of land carrying on a business of horticulture is treated as owning the plants growing on that land rather than the actual owner of the land.

105. The Manager has identified the costs of establishing the horticultural plants, including the costs of acquiring the plants, establishing the plants and preparing the soil (other than costs associated with the clearing of land and the draining of swamps) as \$375 per Grove.

106. For a Grower who determines that the effective life of the olive trees for commercial horticulture is greater than 30 years (section 387-185), the write-off rate is 7% per year on a prime cost basis.

107. The write-off commences from the date the trees are used or held ready for use for the purpose of producing assessable income in a horticultural business (sections 387-165 and 387-170). It is anticipated the trees will enter their first commercial season in April 2004. The Grower's cost of olive tree establishment will be eligible for write-off deductions at a rate of 7% per annum from this date.

108. For a Grower entering into the Project by 30 June 2000, a deduction is expected to be first available in the year ended 30 June 2004. Based on the above assumptions the deduction available in each full production year will be \$26, until the cost is fully written off. This deduction may be reduced pro rata for the year in which the first commercial season commences. The Manager has given an undertaking to the ATO to advise Growers of the actual date of commencement and provide Growers with a calculation of the deductible amount for the year in which the first commercial season commences.

Section 82KZM – Prepaid expenditure for small business taxpayers

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

110. Under the Management Agreement, the portion of the initial fee which is otherwise deductible under section 8-1, \$1677, will be incurred by applicants who acquire a grower's interest prior to 30 June 2000, on 30 June 2000 when the Manager issues the invoice for that amount. The eligible service period will commence on 30 June 2000 in accordance with the definition of 'eligible service period' in section 82KZL(1) "eligible service period", in relation to an amount of expenditure incurred under an agreement, means the period from the beginning of:

- (a) the day, or the first day, on which the thing to be done under the agreement in return for the amount of expenditure is required, or permitted, as the case may be, to commence being done; or
- (b) if the expenditure is incurred on a later day – the day on which the expenditure is incurred;

until the end of:

- (c) the day, or the last day, on which the thing to be done under the agreement in return for the amount of expenditure is required, or permitted, as the case may be, to cease being done; or
- (d) if that day or last day ends more than 10 years after the beginning of the period – 10 years after the beginning of the period;

111. The fee of \$1,677 is charged for providing services to a Grower which may not be wholly performed and completed by 30 June 2000. As the services to which this payment relate will be completed within two months of incurring the expenditure, ie by 31 August 2000, the initial management fees incurred by Growers who invest prior to 30 June 2000 will not relate to a period ending more than 13 months after the expenditure is incurred.

112. For applicants who acquire a grower's interest post 30 June 2000, the initial fee will be incurred and services will be provided wholly within the year ended 30 June 2001. Management fees incurred in relation to subsequent years are also to be completed within the twelve month period.

113. For the purpose of this Ruling, no explicit conclusion can be drawn from the arrangement's description that the fees in the first three years have 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.

114. Thus, for the purposes of this Ruling, no part of the Management Fee incurred in the year ended 30 June 2000 or the fees incurred in subsequent years is for the Manager to do 'things' that are not to be wholly done within 13 months of each 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 expenditures for Management Fees by Growers who are 'small business taxpayers'.

115. Similar considerations apply to the Licence Fee which, under the Licence to Occupy Agreement, is payable in advance each year for a period of one 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

116. 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.

117. 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 incurred, and does not apply to the Project.

118. The deduction available to Growers for the portion of the fees otherwise deductible under section 8-1 will be determined in accordance with the rules contained in section 82KZMB and 82KZMC. For a Grower who invests on or before 30 June 2000, the eligible service period will commence on 30 June 2000 and end two months later, i.e., 31 August 2000. For a Grower who invests after

30 June 2000, the eligible service period will commence on the date the expenditure is incurred and end on 30 June 2001.

119. 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

120. 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.

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

- under the arrangement, the taxpayer's allowable deductions for the income year 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.

122. The arrangement relating to the Project and described at paragraphs 15 to 62 of this product ruling is within the description of a 'tax shelter arrangement'. Therefore, the Management 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 section 82KZMD(2).

Section 82KL

123. 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’.

124. ‘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.

125. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefit(s)’. There are no loans provided to the Grower. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1 of ITAA 1997.

Part IVA

126. 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). The Brooklyn Park Olive Groves Project will be a ‘scheme’. The Growers will obtain a ‘tax benefit’ from entering into the scheme, in the form of deductions for Management Fees and Licence Fees allowable under section 8-1, and deductions allowable under Subdivisions 387-A, 387-B and 387-C, that would not be obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining a tax benefit.

127. 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. The Project does not exhibit any features that might suggest the Project was so ‘tax driven’, and so designed to produce a tax deduction of a certain magnitude, such as being ‘excessive’ or ‘uncommercial’, that would attract the operation of Part IVA.

Trading Stock

128. Taxation Ruling TR 94/13 considers trading stock in relation to various marketing arrangements as they apply to cotton growers. One of the marketing arrangements discussed in that ruling is similar to the arrangement that exists between AG&G and Growers.

129. Under the Management Agreement, raw olives are “pooled” prior to sale and processing. When this pooling occurs, AG&G takes possession of the olives. Given that the arrangement is in effect the

same as the “pooled” arrangements described in TR 94/13, the tax consequences will be the same.

130. Growers who have agreed with AG&G to have their olives “pooled” no longer have dispositive power over the olives and will not be in possession of trading stock.

131. Growers who harvest and/or process their own olives will not take part in the “pooled” arrangement with AG&G. If they retain dispositive power over their produce, they will have to account for trading stock as is the case in TR 94/13.

Examples

Example 1: Obligation to prepay expenditure arising on or after 11:45am AEST 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:

132. Joseph Gardener 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 in advance on 1 June each year for services to be provided for the following 12 months, are \$6,000 in the first year and \$1,200 for each of the following four years. Joseph has been in business for a number of years and has calculated his average turnover for the 1999/2000 income year to be greater than \$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 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:

$$\begin{aligned}
 & \text{A} = \text{Management fee} \quad \times \quad \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}} \\
 & = \$6,000 \times \frac{30}{365} = \$493
 \end{aligned}$$

$$\begin{aligned} B &= (\text{Management fee less A}) \times 80\% \\ &= (\$6,000 - \$493) \times 80\% = \$4,406 \end{aligned}$$

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 expenditure incurred on or after 1 July 2000 and on or 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 on or after 1 July 2001 and on or 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.

Example 2: Obligation arising after 1pm AEST 11 November 1999 to prepay expenditure – applies to all taxpayers investing in 'tax shelter arrangements':

133. 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:

$$\begin{array}{r} \text{Management fee} \quad X \quad \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}} \\ \\ \$6,000 \quad X \quad \frac{30}{365} = \$493 \end{array}$$

In the following year Joseph 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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Commissioner of Taxation

19 April 2000

<i>Previous draft:</i>	- ITAA 1997 8-1
Not previously issued in draft form	- ITAA 1997 8-1(2)(a)
	- ITAA 1997 27-5
<i>Related Rulings/Determinations:</i>	- ITAA 1997 27-30
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1997 70-C
TR 94/13; TR 97/11; TR 97/16;	- ITAA 1997 70-35
PR 1995/95; PR 1999/27;	- ITAA 1887 387-A
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<i>Subject references:</i>	- ITAA 1997 387-60
- carrying on a business	- ITAA 1997 387-B
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