



PR 2001/136 - Income tax: Barkworth Olive Groves Project No. 3

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Product Ruling

Income tax: Barkworth Olive Groves Project No 3

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Preamble

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

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. 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.

Participants must form their own view about the commercial and financial viability of the product. This involves 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 this Product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for participants 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, participants lose the protection of this Product Ruling. Participants may wish to seek assurances from the promoter that the arrangement has been carried out as described in this Product Ruling.

Participants 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.

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Barkworth Olive Groves Project No. 3, or just simply as 'the Project', or the 'product'.

Tax law

2. The tax law dealt with in this Ruling is:
- Division 35 of the *Income Tax Assessment Act 1997* ('ITAA 1997').

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the law

4. The Government is currently evaluating further changes to the tax system in response to the Ralph Review of Business Taxation and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies ('Grower/Processors') is those who entered into the arrangement described below between the date of issue of PR 1999/27 on 19 May 1999 and the date of withdrawal of PR 1999/27 on 9 March 2000. 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.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the 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. The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 19 May 1999 - the date PR 1999/27 was made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law ruled upon, to all persons within the specified class who entered into the specified arrangement between 19 May 1999 and 9 March 2000. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement as outlined. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

14. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Application for Product Ruling dated 22 December 1998;
- Constitution of Barkworth Olive Groves Limited (BOGL);
- Prospectus for Barkworth Olives Project No 3;
- **Management Agreement** between Barkworth Olives Management Limited (BOML) and Grower/Processors;
- Constitution of Barkworth Olives Project No 3, which covers Grower/Processors who enter into a Management Agreement with BOML;
- Compliance Plan of Barkworth Olives Project No 3, which applies to BOML;
- Factory Access Agreement between BOGL and Inglewood Olive Processors Limited;
- Letter dated 28 April 1999 from ATO to the applicant's advisers,
- Letter of reply dated 3 May 1999 from the applicant's advisers to ATO, and

- Additional correspondence received from the applicant dated 7 September 2001.

Note: certain information received from Barkworth Olive Groves Limited and Barkworth Olives Management Limited has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Overview

15. This arrangement is called ‘Barkworth Olive Groves Project No 3’. Under the arrangement an investor may purchase ‘C’ class shares in Barkworth Olive Groves Limited (BOGL). If the participant purchased the minimum number of shares, being 250 \$1 shares, the participant obtained a right to farm an identified area of cleared land of approximately 0.08 hectare owned by BOGL. Such a participant is known as a ‘Grower’. Each farm is suitable for the growing of 20 olive trees. Each Grower also obtained a right to process up to 1.5 tonnes of olives per annum. A Grower paid monies to BOGL on account of the subscription price of shares, farm administration fees and factory access fees.

16. Each Grower appointed Barkworth Olives Management Limited (BOML) to manage that Grower’s farm. A Grower who appointed BOML is known as a ‘Grower/Processor’. As well as the outlays mentioned in paragraph 15, Grower/Processors outlaid monies under the arrangement for the purchase of olive trees, irrigation works, processing and marketing fees, management fees and brand name licence fees.

17. BOGL is the owner of land situated in the northern extreme of the Inverell Shire in New south Wales. The land fronts the Dumaresq River, which forms the border between Queensland and New South Wales. The Project utilised part of this land. The remainder of the land has either been used for earlier projects or has been reserved for future projects.

Rights of shareholders (Growers)

18. The rights of shareholders are set out in BOGL’s Constitution. In particular:

- a Grower shall have a right to occupy a section of the land owned by BOGL and specified in the Company’s Constitution, subject to that Grower paying administration fees to BOGL;

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- a Grower shall have a right to an annual processing allocation of up to 1.5 tonnes of olives, subject to that Grower paying factory access fees to BOGL;
- a Grower shall be entitled to use the agricultural infrastructure necessary for the Grower's business, including but not limited to access to irrigation mains, storage areas and access roads;
- a Grower shall be entitled to use the processing infrastructure necessary for the Grower's business, including but not limited to loading and unloading equipment, storage areas, grading and sampling equipment;
- the 'C' class shares will convert to ordinary shares on 1 July 2019. At that time, the benefit of and the responsibility for the olive trees situated on a Grower's farm will pass to BOGL. The Grower will no longer have a right to farm the land and his/her interest will be the rights attaching to that Grower's ordinary shares in BOGL. The taxation consequences, flowing from the events occurring at that time, do not form part of this Ruling; and
- a Grower may conduct that Grower's business personally, appoint an agent or contractor to manage the business, or appoint BOML to manage the business in accordance with the Management Agreement.

Ruling only applies to Growers who enter into Management Agreements with BOML

19. Most Growers have elected to enter into a Management Agreement with BOML.

20. However, if Growers harvest and process their own olives or appoint other agents to do this, their circumstances may be unique and their tax affairs will likely be different from those Growers who entered into Management Agreements with BOML. Growers who did not enter into Management Agreements with BOML do not fall within the defined 'Class of persons' for the purposes of this Ruling. This Ruling only applies to Grower/Processors who entered into Management Agreements with BOML.

Management Agreement with BOML (Grower/Processors)

21. Under the Management Agreement with BOML, the Manager agreed to carry out duties that relate to:

- soil conditioning, fertilising and drainage of the land, planting, maintaining, processing and marketing on the Grower/Processor's behalf during the first 13 months of the Agreement; and
- ongoing management, harvesting, processing and marketing.

22. Under the Management Agreement, BOML acquired olives produced by Grower/Processors prior to processing. BOML also acquired olives from other sources for processing under the Grower/Processors' processing allocations. BOML must account to the Grower/Processors for the proceeds from the sale of olives attributable to their farms and from the sale of processed olives and olive products attributable to their processing allocations.

23. Grower/Processors who appointed BOML may still elect to take control of the following activities on their farms:

- weeding;
- harvesting trees; and
- marketing olives and olive products.

24. In the event that a Grower/Processor made such an election, the management fees payable to BOML may be reduced. However, tax implications may be different for Grower/Processors who elected to harvest and/or market their own olives and olive products - refer paragraph 31.

Expenditure

25. The expenditure paid by a Grower to BOGL (the land owner) principally relates to the following periods:

Upon Application

10c paid on 250 x \$1 shares	\$25
Farm administration fee	\$88

Year 1 (Year ended 30 June 2000)

Share call by 30 September 1999	\$225
Factory access fee	\$225

PR 2001/136***Year 2 (Year ended 30 June 2001)***

Farm administration fee	\$82.50 (GST inclusive)
Factory access fee	\$247.50 (GST inclusive)

Years 3 to 20 (Years ended 30 June 2002 to 2019)

Farm administration fee	10% of the gross income generated from the sale of raw olive produce from the Grower's farm
Factory access fee	15% of the gross income generated from the sale of olive products processed under the member's processing allocation

26. The expenditure paid under the Management Agreement, by a Grower who appointed BOML as manager, principally relates to the following periods:

Upon Application

Part payment for olive trees	\$20
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Year 1 (Year ended 30 June 2000)

Part payment for olive trees	\$70 (to be paid within 3 months of application)
Irrigation fee	\$1,025
Processing and marketing fee	\$1,175 (this amount reflects a discount for payment within 3 months of application - otherwise the amount is \$1,293)
Management fee	\$3,433 (this amount reflects a discount for payment within 3 months of application - otherwise the amount is \$3,776)
Brand name licence fee	\$500

Year 2 (Year ended 30 June 2001) GST inclusive

Processing and marketing fee	\$1,292.50 (this amount reflects a discount for payment prior to the commencement of Year 2 - otherwise the amount is \$1,422.30)
Management fee	\$962.50 (this amount reflects a discount for payment prior to the commencement of Year 2 - otherwise the amount is \$1,058.20)
Brand name licence fee	the lesser of \$550 and the gross income generated from the sale of the processed olives attributable to the Grower/Processor's allocation

Year 3 (Year ended 30 June 2002)

Processing and marketing fee	70% of gross income generated from the sale of processed olives attributable to the Grower/Processor's allotment
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Years 4 and 5 (Years ended 30 June 2003 to 30 June 2004)

Management fee	90% of gross income generated from the sale of the raw olives attributable to the Grower/Processor's allotment
Processing and marketing fee	70% of gross income generated from the sale of processed olives attributable to the Grower/Processor's processing allocation

PR 2001/136***Year 6 (Year ended 30 June 2005)***

Management fee	60% of gross income generated from the sale of the raw olives attributable to the Grower/Processor's allotment
Processing and marketing fee	70% of the gross income generated from the sale of the processed olives attributable to the Grower/Processor's processing allocation

Year 7 (Year ended 30 June 2006)

Management fee	50% of the gross income generated from the sale of raw olives attributable to the Grower/Processor's allotment
Processing and marketing fee	70% of gross income generated from the sale of the processed olives attributable to the Grower/Processor's processing allocation

Years 8 - 20 (Years ended 30 June 2007 to 30 June 2019)

Management fee	40% of gross income generated from the sale of raw olives attributable to the Grower/Processor's allotment
Processing and marketing fee	70% of gross income generated from the sale and marketing of the processed olives attributable to the Grower/Processor's processing allocation

Finance

27. Grower/Processors could fund their involvement in the Project by borrowing from Barkworth Finance Pty Ltd (BFPL) (a lender associated with the Responsible Entity).

28. Grower/Processors could have entered into a loan arrangement with BFPL with a maximum term of 5 years and an interest rate of 6.5% per annum. A minimum cash deposit of \$1,000 per interest was required. Monthly repayments of principal and interest are required over the term of the loan. The loan was on a full recourse basis and

BFPL has and will pursue recovery action, including legal action if necessary to recover any unpaid amounts.

29. This Ruling does not apply if the finance arrangement entered into by the Grower/Processor includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than BFPL are involved or become involved in the provision of finance to Grower/Processors for the Project.

Income

30. Under the arrangement, income will be received from two types of business. Income from the sale of raw olives is derived from a business of primary production. Income from the sale of processed olives and processed olive products is derived from a business involving non-primary production activities.

31. BOML has undertaken to advise Grower/Processors each year of the apportionment between the two types of income.

Trading stock

32. Where BOML performs all functions on behalf of Grower/Processors, olives to be used for processing will be acquired

by BOML before processing. Under the terms of the arrangement, all olives will be trading stock of BOML.

33. Grower/Processors who elected to do their own harvesting or processing may have trading stock on hand at the end of the financial year.

Ruling

Division 35 – Deferral of losses from non-commercial business activities

Section 35-55 - Commissioner’s discretion

34. For a Grower who is an individual and who entered the Project between 19 May 1999 and 9 March 2000, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b), the Commissioner has decided for the income year ended 30 June 2001 that the rule in section 35-10 does not apply to this business activity, provided that the Project has been, and continues to be, carried on in a manner that is not materially different to the arrangement described in this Ruling.

35. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower’s business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the ‘Exception’ in subsection 35-10(4) applies (see paragraph 41 in the Explanations part of this ruling, below).

36. Where, either the Grower’s business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any ‘loss’ from that activity, to a later year. Instead, this ‘loss’ can be offset against other assessable income for the year in which it arises.

37. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner’s decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be commercially viable. An assessment of the Project or the product from this perspective has not been made.

Explanations

Division 35 – Deferral of losses from non-commercial business activities

38. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual from certain business activities will not be allowable in an income year unless:

- the ‘exception’ in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

39. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer’s allowable deductions attributable to the business activity over that taxpayer’s assessable income from the business activity.

40. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity or, if one of the objective tests is passed, or the Commissioner’s discretion exercised, against other income.

41. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities ‘of a similar kind’. Under subsection 35-10(4), there is an ‘exception’ to the general rule in subsection 35-10(2) where the loss is from a ‘primary production business’ and the individual taxpayer has other assessable income for the income year from sources not related to that activity of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participated in the Project they are beyond the scope of this Product Ruling and are not considered further.

42. In broad terms, the objective tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) that the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);

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- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets is used on a continuing basis in carrying on the business activity in that year (section 35-45).

43. A Grower who was accepted into, and commenced participation in, the Project between 19 May 1999 and 9 March 2000 is carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling and additional information provided since indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2002. Growers who acquired more than one interest in the Project may however, find that their business activity meets one of the tests in an earlier income year.

44. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

45. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

- (i) the business activity has started to be carried on;
- (ii) because of its nature, it has not satisfied one of the objective tests; and
- (iii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

46. A Grower who acquires the minimum allocation of one interest in the Project is expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2002. The Commissioner has decided for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2001. Subsection 35-55(2) prevents the Commissioner exercising the discretion for these Growers beyond the year ended 30 June 2001.

47. Information provided by the applicant states that the business activity comprised by a Grower's involvement in this Project has

started to be carried on, and will continue to be carried on in a manner that is not materially different to that described in the Arrangement in this Product Ruling. If, however, the Project is not carried on during the income year specified above (see paragraph 34), in the manner described in the Arrangement (see paragraphs 14 to 33), this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

48. In deciding to exercise the discretion in paragraph 35-55(1)(b) the Commissioner has relied upon:

- the financial projections and information contained in the Prospectus; and
- independent, objective, and generally available information relating to the olive industry.

Detailed contents list

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

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Commissioner of Taxation

24 October 2001

Previous draft:

Not previously issued in draft form

*Legislative references:**Related Rulings/Determinations:*

PR 1999/27; PR 1999/95; TR 92/1;
TR 92/20; TR 97/16; TR 98/22;
TD 93/34,

- TAA 1953 Part IVAAA
- ITAA 1936 82KL
- ITAA 1936 Part IVA
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 35-55(2)

Subject references:

- NCL provisions
- non commercial losses
- Commissioner's discretion
- product rulings
- schemes and shams
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

ATO references:

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