PR 2001/137 - Income tax: Queensland Olives

Product Ruling
Income tax: Queensland Olives

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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.

Preamble

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

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

No guarantee of commercial success

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.

Potential participants 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 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 potential 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. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential 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.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as Queensland Olives, the Queensland Olives Project, or just simply as 'the Project'.

Tax laws

2. The tax laws dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 8-1 of the ITAA 1997;
- section 17-5 of the ITAA 1997;
- Division 27 (ITAA 1997;
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Division 328 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZL (ITAA 1936);
- section 82KZME (ITAA 1936);
- section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

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

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 who are considering 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 is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified 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. In this Ruling these persons are referred to as 'Growers'.

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

Qualifications

9. The Commissioner rules on the precise arrangement identified in this 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.

Date of effect

11. This Ruling applies prospectively from 24 October 2001, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 & 22 of the taxation ruling TR 92/20).

12. If a taxpayer has a more favourable private Ruling (which is legally binding), the taxpayer can rely on that 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 commenced, 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

13. This Product Ruling is withdrawn on 30 June 2004 and ceases to have effect after this date. 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 specified below. 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 change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Queensland Olives Limited Application for a Product Ruling dated 28 June 2001, and Annexures, including the following;
- Queensland Olives Scheme Replacement Constitution dated 7 February 2001 [Document No 1];
- Deed poll amending the Queensland Olives Scheme Constitution [Document No 2];
- Queensland Olives Scheme Compliance Plan dated 1 February 2001 [Document No 3];

- Compliance Plan Amendment - Queensland Olives [Document No 4];
- Undated lease Form 7 between Queensland Olives Limited and Australian Rural Group Limited [Document No 5];
- Undated sublease Form 7 between Australian Rural Group Limited and Queensland Olives Limited [Document No 6];
- **Draft undated Deed of Licence to Occupy Agreement between the Custodian/Licensor (Australian Rural Group Ltd) and the Manager as agent for the Grower for the scheme property [Document No 7];**
- Draft undated Deed of Licence to Occupy Agreement between the Custodian/Licensor (Australian Rural Group Ltd) and the Manager for the balance of the land [Document No 8];
- **Draft undated Management Agreement between the Manager, the Landowner and the Manager as agent for the Grower [Document No 9];**
- Constitution of Queensland Olives Limited [Document No 10];
- Draft Updated Prospectus for Queensland Olives [ARSN 095 777 503] issued by Queensland Olives Limited [Document No 11];
- Undated Loan Agreement between Queensland Olives Limited and Queensland Olives Management Limited [Document No 12];
- Option Deed for the purchase of the land between the current owners of the land and Queensland Olives Management Limited dated 2 August 1999 [Document No 13];
- Undated Deed of Variation of Option Deed [Document No 14];
- Undated Second Deed of Variation of Option Deed [Document No 15];
- Agency Agreement - Custodian between the Manager and the Custodian dated 25 July 2000 [Document No 16];

- Additional correspondence received from the Applicant's solicitors dated 25 July 2001, and the applicant dated 12 April 2002 and 29 April 2002;
- Queensland Olives – First Supplementary Prospectus, dated 14 March 2002; and
- Land Option extension dated 22 April 2002.

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

15. The documents highlighted are those Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be party to. The effect of these agreements is summarised as follows.

Overview

16. This arrangement is called Queensland Olives.

Names used to describe the product	Queensland Olives
Type of business each participant is carrying on	Establishment and operation of an irrigated olive plantation.
Location	"Severnfields" near Yelarbon, NSW
Number of hectares under cultivation	700 Acres/283 hectares
Number of trees per hectare	318 trees
Size of the licensed grove	0.14 hectares / 0.35 acres
Number of trees per grove	45 olive trees
Minimum subscription	285 groves
Term of the investment	20 years
Initial cost Year 2001/2002 per Grower (Year 1)	$12,950 in cash only which includes the cost of the shares
Shares in QOL	$155 for each grove
Initial cost per Hectare	$90,296
Ongoing costs	Management fees to the Manager and licence fees to QOL.
Other costs	Insurance (on request by the Grower), Harvesting Fees of $0.22 (CPI adjusted) per kg.

17. The Queensland Olives Prospectus offers Growers the opportunity to carry on the business of commercially growing olives for domestic and international sale for a period of twenty years

[cl 1.4]. The olive grove will be established on "Severnfields", a property situated in the southwest Darling Downs area, 40 kilometres west of Texas and 24 kilometres east of Yelarbon [cl 1.1]. Queensland Olives Management Limited has entered into an Option Agreement for the purchase of the Project Land [cl 10.1]. The agreement expires on 31 December 2001. After the Option has been taken up, Queensland Olives Management Limited will then assign its interest in the Project Land to Queensland Olives Limited who will then become the ultimate purchaser and landowner.

18. Under this project, applicants have 2 options. If applicants wish to be responsible for their own preparation, planting, cultivation, harvesting and marketing of their own olives and any outgoings associated with their allotment, then the applicant only subscribes for shares in the landowner and pays the annual licence fee.

19. A Grower subscribes for shares in the landowner, and appoints the Manager to manage his/her olive grove. Growers will execute a Power of Attorney enabling Queensland Olives Management Limited to act on their behalf as required when they make an application for licensed groves. Accordingly Growers pay for shares, licence fee and management services, and for the irrigation system, trees and stakes that will be installed on their grove.

20. Growers, who appoint the Manager to manage their olive grove, are granted a licence to use and occupy areas for growing olive trees. The Growers engage the Manager to establish and maintain the Project. Unless Growers have elected to sell the produce from their licensed grove personally, the Manager will harvest the olives and sell the fruit on behalf of the Growers. This Ruling will only apply where the Grower elects and appoints QOML to be the Manager.

21. The minimum individual holding is one licensed grove of 0.35 acres or 0.142 hectares [cl 1.1]. Overall, it is proposed that approximately 283 hectares will be planted [cl 1.5]. A reference number on a plan of the total grove will identify each licensed grove. Upon acceptance of applications, each Grower will receive a certificate for the licensed grove(s) acquired. The Manager will maintain a register of Growers, identifying the groves held by Growers. Approximately 45 trees will be planted per licensed grove. These trees are expected to produce the first commercial harvest in the year ended 30 June 2005.

22. The establishment of the Project is subject to a minimum subscription of 285 licensed groves. The Prospectus will remain open for 13 months from the date of the Prospectus and interests in this project can be sold up to and including this date provided the project reaches minimum subscription by 20 August 2002. This Ruling does not apply if the minimum subscription requirement is not achieved by 20 August 2002 [First Supplementary Prospectus]. If minimum

subscription is not reached, then all application monies will be returned to Applicants without interest.

23. Possible projected returns for Growers are outlined in the Prospectus [cl 7]. The projected returns depend on a range of assumptions and the Manager does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Project. Moreover as previously indicated the ATO gives 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 reasonable.

Shares

24. Each Grower must subscribe for a minimum of one hundred and fifty five (155) A class shares in Queensland Olives Limited, the ultimate land holder, at $1 per share [cl 1.2]. By acquiring A Class shares, the Growers will enter into a licence to occupy a defined allotment of land with the Custodian of the scheme. Accordingly as the licence is attached to the shares, only Growers can own these shares. At the end of the project, all A class shares revert to Ordinary Shares, and all rights under the Licence to Occupy expire. Queensland Olives Limited will assume responsibility for and benefits of the olive trees at the conclusion of the project.

25. In addition to the A class Shares which are reserved for Growers, the Manager will subscribe for 134,549 B Class shares in Queensland Olives Limited, at $1 per share [cl 1.5] upon the commencement of the project i.e., when minimum subscription has been achieved. The Manager will then purchase the adjoining land which holds the water rights to the project property. The B Class shares are non-voting, and carry no dividend entitlements. On completion of the project the B Class shares also revert to Ordinary Shares. The offer of these B Class shares is outside the scope of this Product Ruling.

26. At the completion of the Project all Ordinary Shares carry an equal entitlement to the capital proceeds of the sale of the property, trees and any fixtures and fittings in accordance with their proportional shareholding.

Constitution

27. The Queensland Olives Scheme Constitution is between the Manager (QOML), the Lessor (QOL) and each Grower. The constitution establishes ‘Queensland Olives’ Scheme for the purpose of conducting a primary production business of planting, cultivating

and harvesting olives and of marketing olives for domestic and overseas sale. It sets out the terms and conditions under which the Manager agrees to act for the Growers and to manage the Project. The Constitution will be executed on behalf of a Grower following them signing the Application and Limited Power of Attorney Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

Lease Agreement

28. QOML will exercise the option to purchase Severnfields and become the owner of the property after minimum subscription has been reached. After the Option has been taken up, QOML will assign its interest in the Project Land to QOL who will then become the ultimate purchaser and landowner. QOL therefore will own the land on which the Olive Groves will be established and will lease the land to the Custodian, who in turn will licence individual allotments to the Growers [cl 10.4].

Deed of Licence to Occupy

29. The Deed of Licence to Occupy gives the Custodian the right to grant each Grower the right to occupy a defined portion of the land [cl 10.5]. A reference number on an allotment plan maintained for that purpose will identify each allotment. The rights granted under the Licence to Occupy Agreement may be exercised by the Grower in his/her own right, by a contractor appointed by the Grower, or by the Grower electing QOML as the Manager for that purpose [cl 10.5].

30. Under the Deed of Licence to Occupy, the Grower must:

- not use or allow his/her allotment to be used for any other purpose than for the business of planting, cultivating and harvesting olives and of marketing olives for domestic and overseas sales,
- at all times during the term of the project keep the allotment free from rubbish and in a condition suitable for the conduct of the business,
- not install or remove any trees, earth, gravel, stones, sand or minerals, or any fixtures from the licensed grove without the consent of the QOL,
- not do anything which would invalidate or increase the premiums of any insurance policies in respect of the licensed area, and

- neither cause nor permit anything on the licensed grove that will cause a nuisance, disturbance, obstruction or damage.

31. In return, Growers have a right of exclusive occupation of the licensed grove including the right to possess the licensed grove without disturbance and to use common areas for purposes incidental to the use of the licensed grove for commercial horticulture purposes. Growers will at all times have full right, title and interest to the trees, fixtures and any olive produce from the licensed grove and the right to have the olive produce from the licensed grove sold for their benefit.

32. Within 14 days of termination or expiry of the Licence to Occupy the Grower must remove any item brought onto the allotment by or on behalf of the Grower or any improvement constructed on the allotment. If not removed by the Grower within 14 days the trees and fixtures and any improvements remaining on the licensed grove shall vest in the landowner QOL. The landowner is not obliged to pay the Grower any compensation in respect of those items that ultimately vest in the landowner.

Management Agreement

33. The Management Agreement is entered into between the Manager and the Grower for each Licensed Grove and sets out the roles and obligations of the parties for the term of the agreement. By entering into the management agreement the Grower engages the Manager to establish and maintain the Olive Grove on his/her behalf until 30 June 2021.

34. Each Grower appoints the Manager to administer, establish, manage and maintain the trees on the licensed grove [cl 10.7]. The Manager accepts the appointment upon the terms and conditions in the Management Agreement and undertakes to provide the services on behalf of each Grower. The Manager must arrange to plant, prune, maintain, supervise and manage all the trees, the groves and the commercial horticultural activities to be carried out by the Growers in accordance with good commercial practice. The Manager is responsible for the day to day running of the Project including, but not limited to the provision of the following services:

- plant olive trees on the Licensed Groves at a rate of not less than 45 trees per grove;
- use best endeavours to minimise soil, erosion and maintain soil quality on the olive groves;
- install and maintain the irrigation system to the trees in the licensed groves;

- cultivate, tend, prune, fertilise, replant, spray and otherwise care for the trees as and when required;
- keep in good repair access laneways within the licensed groves;
- maintain in good repair and condition adequate fire-breaks in and about the licensed groves;
- establish and maintain erosion control banks;
- employ and supervise the requirement of contract labour and service supplies;
- provide administrative support in preparation of annual documents required for Growers;
- obtain and maintain all necessary permits, licences and consents necessary for the conduct of the business on the land;
- replace any trees that fail to establish or that die during the first three years of the Project;
- harvest the olives grown on the licensed groves each year;
- if the Grower directs, make the allotment available to the Grower to harvest on his/her own behalf;
- market and sell the olive produce on behalf of the Growers;
- if the Grower directs, make the olives harvested from the allotment available to the Grower for his/her own market and sale; and
- all other acts or things which the Growers may reasonably instruct the manager to do.

35. Unless a Grower elects to collect and market the produce personally, the Manager is authorised to enter into contracts as agent for the Grower to collect and market the olive produce from the licensed groves. The Manager will sell or market the olive produce on the Growers' behalf, for the best possible commercial price [cl 10.7].

36. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or express or implied undertakings to reverse the transactions if the Commissioner does not allow tax deductions.

37. The Manager will supply sufficient water (to its maximum water allocation) from the Adjacent Land to the Grower to use on the Allotment [cl 11.1].

38. If the manager sells, transfers or disposes of the Adjacent Land, the Manager must obtain a covenant from the transferee of the Adjacent Land that the transferee will comply with the Manager's obligations to supply water and make infrastructure available to Growers. The transferee must also covenant that any future transferee of the Adjacent Land will be similarly obliged to comply with the Manager's obligations to supply water or make infrastructure available as described in this Management Agreement [cl 11.2].

Fees

39. The Growers who participate in the project will make the following payments per licensed grove area for the first three years:

Year	**Y1 $**	**Y2 $**	**Y3 $**
Subscribe 155 Shares QOL	155	-	-
Licence Fee	22	22	22
Management Fee	12,773	1,276	1,386
Total Payable Inc. GST	12,950	1,298	1,408

The management fee includes management services and various capital costs passed to Growers. The management fee has been based on the following estimated expenses:

Year	**Y1 $**	**Y2 $**	**Y3 $**
Establishment Costs			
- Tree Purchase	207.00	-	-
- Tree Establishment	130.00	-	-
- Land Clearing	26.00	-	-
- Land Care	25.00	-	-
Total Tree Establishment	388.00	-	-
Irrigation	610.00	-	-
Management Fee	10,613.82	1,160	1,260
Total Excluding GST	11,611.82	1,160	1,260
GST	1,161.18	116	126
Total Including GST	$12,773.00	$1,276	$1,386

The fees payable by Growers for the first year are payable upon application and are for services to be provided to 30 June 2002 for those Growers accepted into the Project by 15 June 2002. Growers who make application on or after 16 June 2002 will not be accepted into the Project until on or after 1 July 2002. Accordingly the fees

payable on application will be held by the Custodian until the Grower is accepted into the Project. Where a Grower is accepted into the Project on or after 1 July 2002, the fees are for services to be provided to 30 June 2003.

40. The licence fee payable on application and for the first four years of the term of the agreement is $22 per annum for each allotment. The fee is due and payable on 1 July each year excluding the year in which the application monies are paid. For each year thereafter the licence fee will be due on 1 July and will be increased by 4% per annum.

41. The management fees for year 2 are fixed at $1,276 and for years 3 and 4 at $1,386. Each year thereafter the fee will be adjusted for inflation in accordance with the management agreement. The management fees for year 2 onwards will be payable on 1 July.

42. The Manager will not undertake any work on behalf of a Grower on a licensed grove prior to the Grower subscribing for an interest in the Project.

43. Where the Growers appoint the Manager to harvest the olives, a base fee of $0.22 per kilogram will be charged. The charge per kilo is based on current prevailing commercial harvesting rates and this amount will be adjusted each year in line with CPI increases. Using an estimated CPI increase of 4% per annum, the harvest fee is expected to increase to $0.25 per kilo by the first commercial harvest in year 4.

44. The Manager will, at its cost, obtain insurance on behalf of the Grower against damage to the licensed grove caused by fire. Such insurance will not include crop insurance unless specifically agreed between the Manager and the Grower. The Grower will pay insurance premiums for such crop insurance.

45. All Application Monies will be banked into a trust account held by the Custodian. The application monies will only be released to the Manager once Minimum Subscription is reached and the Grower is accepted into the Project.

46. The proceeds of sale of the olive produce will be paid to the Custodian, and the Custodian will deposit those proceeds into the produce fund. Proceeds received by the Custodian are to be distributed in the following order of priority:

- to the Manager for any outstanding Annual Fees and to reimburse the Manager for additional out of pocket expenses incurred on the Grower's behalf, and then
- to Growers pursuant to the Constitution.

Option Agreement for the Purchase of Land

47. This agreement is between the current owners of the land and Queensland Olives Management Limited. The option and agreement provides for Queensland Olives Management Limited to purchase the property being Lot 1, on SP112085 and Lot 3 on RP54066 known as "Severnfields". The option has to be exercised by 30 June 2002. After the Option has been taken up, Queensland Olives Management Limited will assign its interest in the Project Land to Queensland Olives Limited who will then become the ultimate purchaser and landowner.

48. In addition, the Manager will purchase the adjoining property upon the Project reaching minimum subscription in order to secure water rights for the Project property.

Compliance Plan

49. The Manager has prepared a Compliance Plan in accordance with the Corporations Law. Its purpose is to ensure that the Manager meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected. The Compliance Plan also notes the process for the handling of disputes, removal of the Responsible Entity by members, applications, withdrawals and distributions, and the payment of Responsible Entity fees and expenses.

Finance

50. Growers can fund their involvement in the Project themselves or borrow from an independent lender.

51. This Ruling does not apply if the finance arrangement entered into by the Grower includes 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 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) 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
- involves the use of trade dollars for application monies, on-going management fees, or any other fees connected with this project.

52. There is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance to the Grower for any purpose associated with the Project.

Ruling

Application of this Ruling

53. This Ruling applies only to Growers who are accepted to participate in the Project on or before the expiry date of the offer made under this Prospectus and who have executed a Management Agreement and a Licence to Occupy Agreement before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

54. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the Prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 285 interests is achieved by 20 August 2002.

The Simplified Tax System ('STS') - Division 328

55. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

56. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which his/her participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of each individual Grower that cannot be accommodated in this Ruling. Such Growers can ask for a private Ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'

Assessable Income

57. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5. The Grower recognises ordinary income from carrying on the business of growing olives at the time that income is derived.

58. Any dividends received by a Grower from shares held in the Land Owner would be assessable income.

Deductions for Management fees, Licence fees, and Interest - section 8-1

59. A Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses provided the Grower is accepted into the Project by 15 June 2002:

Fee Type	**ITAA 1997 Section**	**Year ended 30 June 2002 Year 1**	**Year ended 30 June 2003 Year 2**	**Year ended 30 June 2004 Year 3**
Management Fee	8-1	$11,675.20 – See Notes (i) & (ii) (below)	$1,276.00 – See Notes (i) & (ii) (below)	$1,386.00 – See Note (i) & (ii) (below)
Licence Fee	8-1	$22.00 – See Notes (i) & (ii) (below)	$22.00 – See Notes (i) & (ii) (below)	$22.00 – See Notes (i) & (ii) (below)

Interest	8-1	As incurred See Note (iii) (below)	As incurred See Note (iii) (below)	As incurred See Note (iii) (below)

A Grower who has made application for participation after 16 June 2002 will not be accepted into the Project until on or after 1 July 2002. Such Growers may claim tax deductions using the same basis as the table above but in a financial year later than that shown in the table. The deductions available to Growers for the year ended 30 June 2003 will be calculated as per Year 1 of the table, and for the year ended 30 June 2004 will be calculated as per Year 2 of the table.

Notes:

(i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 131;

(ii) The Management fees and Licence to Occupy fees as shown in the Management Agreement and the Licence to Occupy Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the licensing of the land) that will not be wholly done in the same income year as the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 102 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000;

(iii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project, should read the discussion of the prepayment rules in paragraphs 96 to 110 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules

apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Deductions for capital expenditure - Division 40

60. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g., irrigation), 'landcare operations' and the establishment of horticultural plants.) All deductions shown in the following table are determined under Division 40 for a Grower who is accepted into the Project by 15 June 2002.

Fee Type	**ITAA 1997 Section**	**Year ended 30 June 2002 Year 1**	**Year ended 30 June 2003 Year 2**	**Year ended 30 June 2004 Year 3**
Water facilities (e.g., irrigation)	40-515	$224.00 - see Notes (iv) & (v) below	$224.00 - see Notes (iv) & (v) below	$223.00 - see Notes (iv) & (v) below
Landcare operations	40-630	$56.10 - see Notes (iv) & (vi) below		
Establishment of horticultural plants - olive trees	40-515	Nil - see Notes (iv) & (vii) below	Nil - see Notes (iv) & (vii) below	Nil - see Notes (iv) & (vii) below

A Grower who has made application for participation after 16 June 2002 will not be accepted into the Project until on or after 1 July 2002. Such Growers may claim tax deductions using the same basis as the table above but in a financial year later than that shown in the table. The deductions available to Growers for the year ended 30 June 2003 will be calculated as per Year 1 of the table, and for the year ended 30 June 2004 will be calculated as per Year 2 of the table.

Notes:

(iv) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 131.

(v) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

(vi) Any capital expenditure incurred for 'landcare operations' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630.

(vii) Olive trees are 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a licence to occupy, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the establishment of the olive trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the olive trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the olive trees enter their first commercial season (section 40-530, item 2). The Project Manager will inform Growers of when the olive trees enter their first commercial season.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

61. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5. The Grower recognises ordinary income from carrying on the business of growing olives at the time the income is received (paragraph 328-105(1)(a)).

62. Any dividends received by a Grower from shares held in the Land Owner would be assessable income.

Deductions for Management fees, Licence fees, and Interest - sections 8-1 and 328-105

63. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses provided the Grower is accepted into the Project by 15 June 2002:

Fee Type	ITAA 1997 Section	Year ended 30 June 2002 Year 1	Year ended 30 June 2003 Year 2	Year ended 30 June 2004 Year 3
Management Fee	8-1 & 328-105	$11,675.20 – See Notes (viii), (ix) & (x) below	$1,276.00 – See Notes (viii), (ix) & (x) below	$1,386.00 – See Notes (viii), (ix) & (x) below
Licence Fee	8-1 & 328-105	$22.00 – See Notes (viii), (ix) & (x) below	$22.00 – See Notes (viii), (ix) & (x) below	$22.00 – See Notes (viii), (ix) & (x) below
Interest	8-1 & 328-105	When paid - See Notes (ix) & (xi) below	When paid - See Notes (ix) & (xi) below	When paid - See Notes (ix) & (xi) below

A Grower who has made application for participation after 16 June 2002 will not be accepted into the Project until on or after 1 July 2002. Such Growers may claim tax deductions using the same basis as the table above but in a financial year later than that shown in the table. The deductions available to Growers for the year ended 30 June 2003 will be calculated as per Year 1 of the table, and for the year ended 30 June 2004 will be calculated as per Year 2 of the table.

Notes:

(viii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 131.

(ix) If, for any reason, an amount shown in the table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of

an amount shown in the table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

(x) Where a Grower who is an 'STS taxpayer', pays the Management fees and the Licence to Occupy fees shown in the Management Agreement and the Licence to Occupy Agreement are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the licensing of the land) that will not be wholly done in the same income year as the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 102, unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

(xi) The deductibility or otherwise of interest arising from loan agreements entered into with financiers is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project, should read the discussion of the prepayment rules in paragraph 96 to 110 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Deductions for capital expenditure - subdivisions 328-D, 40-F and 40-G

64. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g., irrigation), 'landcare operations' and the establishment of olive trees. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F and in relation to 'landcare operations' under Subdivision 40-G. If the 'water facility' or 'landcare operation' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328. Deductions for the establishment of olive trees must be determined under Subdivision 40-F.

65. The deductions shown in the following table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities or 'landcare operations' under Subdivisions 40-F or 40-G and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Notes (xiii) and (xiv) below.

66. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than $1000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

Fee Type	**ITAA 1997 Section**	**Year ended 30 June 2002 Year 1**	**Year ended 30 June 2003 Year 2**	**Year ended 30 June 2004 Year 3**
Water facilities (e.g., irrigation)	40-515	$224.00 - see Notes (xii) & (xiii) below	$224.00 - see Notes (xii) & (xiii) below	$224.00 - see Notes (xii) & (xiii) below
Landcare operations	40-630	$56.10 - see Notes (xiiv & (xiv) below		
Establishment of horticultural plants (olive trees)	40-515	Nil - see Notes (xii) & (xv) below	Nil - see Notes (xii) & (xv) below	Nil - see Notes (xii) & (xv) below

A Grower who has made application for participation after 16 June 2002 will not be accepted into the Project until on or after 1 July 2002. Such Growers may claim tax deductions using the same basis as the table above but in a financial year later than that shown in the table. The deductions available to Growers for the year ended 30 June 2003 will be calculated as per Year 1 of the table, and for the year ended 30 June 2004 will be calculated as per Year 2 of the table.

Notes:

(xii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 131.

(xiii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than $1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2002 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

(xiv) Any capital expenditure incurred for 'landcare operations' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-G (although expenditure on some items of plant can only be deducted under Division 328). For the purposes of

Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than $1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years, the full pool rate will apply. If the expenditure is not on a 'depreciating asset', the expenditure is fully deductible under Subdivision 40-G.

(xv) Olive trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a licence to occupy, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the establishment of olive trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the olive trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the olive trees enter their first commercial season (section 40-530(2)). The Project Manager will inform Growers of when the olive trees enter their first commercial season.

Tax outcomes that apply to all Growers

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

Section 35-55 – Commissioner's discretion

67. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2006 inclusive

that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

68. 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 117 in the Explanations part of this Ruling, below).

69. 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 the Grower's 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.

70. 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.

Sections 82KZME – 82KZMF, 82KL, and Part IVA

71. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Licence to Occupy Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 96 to 110);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Is the Grower carrying on a business?

72. For the amounts set out in the tables above to constitute allowable deductions the Grower's business of olive growing activities as a participant in the Queensland Olives Project must amount to the carrying on of a business of primary production. These olive-growing activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

73. For schemes such as that of the Queensland Olives Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929.

74. Generally, a Grower will be carrying on a business of growing olives, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence to occupy) in the land on which the Grower's olive trees are established;
- the Grower has a right to harvest and sell the olives each year from those olive trees;
- the olive growing activities are carried out on the Grower's behalf; and
- the olive growing activities of the Grower are typical of those associated with a olive growing business; and
- the weight and influence of general indicators point to the carrying on of a business.

75. In this Project, each Grower enters into a Management Agreement and a Licence to Occupy Agreement.

76. Under the Licence to Occupy Agreement each individual Grower will have rights over a specific and identifiable area of 0.14 hectares of land. The Licence to Occupy Agreement provides the Grower with an ongoing interest in the specific olive trees on the licensed area for the term of the Project. Under the licence to occupy, the Grower must use the land in question for the purpose of carrying out olive growing activities, and for no other purpose. The licence to occupy allows the Project Manager come onto the land to carry out its obligations under the Management Agreement.

77. Under the Management Agreement the Project Manager is engaged by the Grower to establish and maintain an olive grove on the

Grower's identifiable area of land during the term of the Project. The Project Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the olive grove on the Grower's behalf.

78. In establishing the olive grove, the Grower engages the Project Manager to purchase and install water facilities (e.g., irrigation), to carry out 'landcare operations' and to acquire and plant cultivars on the Grower's olive grove. During the term of the Project, these assets will be used wholly to carry out the Grower's olive growing activities. The Project Manager is also engaged to harvest and sell, on the Grower's behalf, the olives grown on the Grower's olive grove.

79. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the Project's description for all the indicators.

80. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of the olives that will return a before-tax profit, ie. a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

81. The pooling of olives grown on the Grower's olive grove with the olives of other Growers is consistent with general olive growing practices. Each Grower's proportionate return from the sale of the pooled olives will reflect the proportion of the olives contributed from their olive grove.

82. The Project Manager's services and the installation of these assets on the Grower's behalf are also consistent with general olive growing practices. The assets are of the type ordinarily used in carrying on a business of olive growing. While the size of the olive grove is relatively small, it is of a size and scale that would allow it to be commercially viable. (See Taxation Ruling IT 360).

83. The Growers' degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's olive grove and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

84. 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. For the purposes of this Ruling, the Growers' olive growing activities in the Queensland Olives Project will constitute the carrying on of a business.

The Simplified Tax System - Division 328

85. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

86. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of management fees and licence fees - section 8-1

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

88. The licence to occupy fees and management fees associated with the olive growing activities will relate to the gaining of income from the Grower's business of olive growing (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of olives) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Possible application of prepayment provisions

89. Under the Management Agreement and the Licence to Occupy Agreement neither the management fees nor the licence fees are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

90. However, where a Grower chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 96 to 110) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

Timing of deductions

91. In the absence of any application of the prepayment provisions, the timing of deductions for the management fees or the licence to occupy fees will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

92. If the Grower is not an 'STS taxpayer', the management fees and the licence to occupy fees are deductible in the year in which they are incurred.

93. If the Grower is an 'STS taxpayer' the management fees and the licence to occupy fees are deductible in the income year in which they are paid, or are paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Interest deductibility

Section 8-1 - Growers who use a bank or financier

94. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than a finance provider associated with the Promoter is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

95. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 96 to 110).

Prepayment provisions - sections 82KZL to 82KZMF

96. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (eg. the performance of management services or the licensing of the land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

97. For this Project only section 82KZL (an interpretative provision) and sections 82KZME and 82KZMF are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

98. Where the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

99. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and

- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either:
  a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
  b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

100. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a bank or financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

101. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than $1,000. Such expenditure is immediately deductible.

102. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

103. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Application of the prepayment provisions to this Project

104. In this Project, an initial Management Fee of $12,773 and an initial Licence to Occupy Fee of $22 per olive grove will be incurred on execution of the Management Agreement and the Licence to Occupy Agreement. The Management Fee and the Licence to Occupy Fee are charged for providing management services and licensing the land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

105. In particular, the Management Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the initial management fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

106. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee, and the fees for subsequent years, is for the Project Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Licence to Occupy Agreement, licence fees are payable annually in advance for the licence to occupy of the land during the expenditure year.

107. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 39, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

Growers who <u>choose</u> to pay fees for a period in excess of that required by the Project's agreements

108. Although not required under either the Management Agreement or the Licence to Occupy Agreement, a Grower participating in the Project may **<u>choose</u>** to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use unrelated financiers may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 107 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

109. For these Growers, the amount and timing of deductions for any relevant prepaid Management Fees, prepaid Licence to Occupy Fees, or prepaid interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

110. However, as noted above, prepaid fees of less than $1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

Expenditure of a capital nature - Division 40 and Division 328

111. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to water facilities, landcare operations, and the establishment of the olive trees is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

112. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

113. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 62 and 68 (above) in the tables and the accompanying Notes.

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

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

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

115. 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.

116. 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.

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

118. In broad terms, the objective tests require:

(a) at least $20,000 of assessable income in that year from the business activity (section 35-30);

(b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);

(c) at least $500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or

(d) at least $100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

119. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of one olive grove in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2009. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

120. 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.

121. 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; and

(ii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a

period that is commercially viable for the industry concerned.

122. Information provided with this Product Ruling indicates and a Grower who acquires the minimum allocation of one olive grove 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 2009. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2006. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this latter year.

123. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above, in the manner described in the Arrangement (see paragraphs 14 to 52), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

124. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent Agronomist's report and additional expert evidence provided with the application by the Responsible Entity;
- The possible purchase by a third party of the Project's olives as they become available and/or the projected market in the geographical region where the olive trees are grown;
- independent, objective, and generally available information from State Agricultural Departments relating to the olive industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity; and
- other expert opinion independently obtained by the Commissioner that specifically relates to olive projects.

Section 82KL - recouped expenditure

125. 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'.

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

127. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Here, there is no loan provided to the Grower. However a loan from a bank or other unrelated financier must be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA - general tax avoidance provisions

128. 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).

129. The Queensland Olives Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 59, 60, 63 and 66 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

130. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of their olives. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There are no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Entitlement to GST input tax credits

131. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2002 to 30/6/2002 $4 400*

Carrying out of upgrade of power for your vineyard as quoted $2 200*

Total due and payable by 1 January 2002 $6 600 (includes GST of $600)

*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

1/11 x $4400 = $400.

Hence her outgoing for the management fee is effectively $4400 *less* $400, or $4000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

1/11 x $2200 = $200.

Hence her outgoing for the power upgrade is effectively $2200 *less* $200, or $2000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as $4000 (not $4400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10-year period. She calculates her deduction for the power upgrade as $200 (one tenth of $2000 only, not one tenth of $2200).

Detailed contents list

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

Commissioner of Taxation
24 October 2001

Previous draft:	*Related Rulings/Determinations*:
Not previously issued in draft form	PR 1999/95; TR 2000/8; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TR 98/22; TD 93/34; IT 360

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

Legislative references:

- TAA 1953 Part IVAAA
- ITAA 1936 Subdiv H, Div 3 of Part III
- ITAA 1936 82KH(1)
- ITAA 1936 82KH(1F)(b)
- ITAA 1936 82KL
- ITAA 1936 82KL(1)
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- 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 Div 35
- 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)
- ITAA 1997 Div 40
- ITAA 1997 Subdiv 40-F
- ITAA 1997 Subdiv 40-G
- ITAA 1997 40-515
- ITAA 1997 40-515(1)(a)
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(1)
- ITAA 1997 40-520(2)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530(2)
- ITAA 1997 40-535
- ITAA 1997 40-540
- ITAA 1997 40-545
- ITAA 1997 40-630
- ITAA 1997 40-635
- ITAA 1997 Div 328
- ITAA 1997 Subdiv 328-D
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- ITAA 1997 328-105(1)(b)

Case references:

- FCT v. Lau 84 ATC 4929

ATO references:
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