



# ***PR 2001/31 - Income tax: Tasmanian Truffle Project No. 1***

 This cover sheet is provided for information only. It does not form part of *PR 2001/31 - Income tax: Tasmanian Truffle Project No. 1*

 This document has changed over time. This is a consolidated version of the ruling which was published on *6 June 2001*



# Product Ruling

## Income tax: Tasmanian Truffle Project No. 1

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	27
Explanations	37
Example	83
Detailed contents list	84

### 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

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

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

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

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

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

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

### Terms of Use of this Product Ruling

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

## **What this Product Ruling is about**

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Tasmanian Truffle Project No. 1, or simply as 'the Project'.

### **Tax law(s)**

2. The tax law(s) dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - Section 8-1 (ITAA 1997);
  - Section 17-5 (ITAA 1997)
  - Division 27 (ITAA 1997);
  - Section 42-15 (ITAA 1997);
  - Section 387-165 (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.

### **Business Tax Reform**

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 laws enacted at

the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing 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 investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

### **Class of persons**

7. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires) and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Growers'.

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 arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

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

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## Date of effect

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11. This Ruling applies prospectively from 28 March 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 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, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

## Withdrawal

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

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

- Application for Product Ruling dated 22 December 2000;

- Draft Prospectus for Tasmanian Truffle Project No. 1, received on 6 February 2001;
- **Management Agreement between Tasmanian Truffle Enterprises Ltd and the Grower, undated;**
- Management Agreement between Tasmanian Truffle Enterprises Ltd and The Original Truffle Company Pty Ltd, undated;
- Lease Agreement between Needlesdale Truffles Pty Ltd and Tasmanian Truffle Enterprises Ltd, undated;
- **Sub-Lease Agreement between Tasmanian Truffle Enterprises Ltd and the Grower, undated;**
- **Constitution of Tasmanian Truffle Project No. 1, undated;**
- Option Deed between Needlesdale Truffles Pty Ltd and Truffleland Pty Ltd, undated;
- Additional correspondence dated 25 January 2001, 2 February 2001, 6 February 2001, 16 February 2001, 7 March 2001, 24 May 2001 and 28 May 2001.

**Note: certain information received from Tasmanian Truffle Enterprises Ltd 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 that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows.

### **Overview**

16. This arrangement is called the Tasmanian Truffle Project No. 1.

Location	9 km west of Deloraine in northern Tasmania
Type of business each participant is carrying on	Growing and cultivation of truffle inoculated oak and hazelnut trees for the purpose of harvesting truffles for sale or for processing into truffle products for sale.

**PR 2001/31**

Number of hectares to be under cultivation	50 divided into 500 trufferies
Minimum subscription for Project	85 trufferies
Size of each trufferie	0.1 hectares
Minimum number of trufferies per Grower	1
Minimum number of inoculated trees per trufferie	40
The term of the investment	15 years
Subscription cost per trufferie	\$8,745
Ongoing costs	Lease and Management Fees

17. The Project is located on land 9 km east from Deloraine, northern Tasmania. The land is 79.3 hectares in size, 50 hectares of which has been allocated for the Project.

18. The Project will be registered as a managed investment scheme under the Corporations Law. Investment in the Project is made by applying for one or more trufferies, each of 0.1 hectares in size, for the purpose of growing truffle inoculated oak and hazelnut trees. A minimum of 40 inoculated trees will be grown on each trufferie. There is a minimum subscription for the Project of 85 Trufferies. A maximum of 500 trufferies are available for the Project. There is a right to accept over subscriptions.

19. Trufferies are allocated by the Responsible Entity and plans showing the location of each Trufferie will be provided to each Grower by the Manager and may also be inspected at the Manager's registered office. The Responsible Entity has the right to accept or reject Applications in whole or in part. No applications will be accepted after 16 June 2001.

20. Upon acceptance into the Project, an investor becomes a Grower and enters into the Sub-Lease and Management Agreements. Under the Sub-Lease Agreement the Lessor grants the Grower a lease over their respective Trufferie(s) in return for the annual Lease Fee. Under the Management Agreement the Grower appoints the Manager to manage the Grower's Trufferie(s) by planting, managing, maintaining and collecting Produce from oak and hazelnut trees on the Grower's Trufferie(s) in return for the annual Management Fee.

21. Growers also receive an option to acquire shares in Truffleland Pty Ltd which, in turn, is being granted an option to acquire a direct interest in the Trufferies (comprising the Project land, inoculated trees and other infrastructure and capital works). Growers will have a period of approximately 6 years to monitor the progress of the project

before deciding whether or not to exercise the options and acquire the shares.

### **Management Agreement**

22. The Management Agreement between Tasmanian Truffle Enterprises Ltd as the Manager and each Grower commences to apply from the date of signing and continues until 30 June 2015. Under the Agreement the manager will provide services related to the selection and purchase of inoculated trees, preparation of the land for planting, planting the trees, intense management of the trees in the weeks after planting, ongoing management and maintenance of the trees and harvesting and marketing of the truffles produced. On signing the Agreement, the Grower will pay a fee of \$206.80 for establishment services and \$8,483.20 for initial management services. The Grower will pay ongoing management fees within 14 days of the end of each year of the agreement commencing from the year ended 30 June 2002 for which the fee will be \$880.00. The same fee, indexed annually in accordance with movements in the Consumer Price Index, will be payable for subsequent years of the Agreement.

### **Lease and Sub-Lease Agreements**

23. The Project land will be owned by Needlesdale Truffles Pty Ltd and leased to Tasmanian Truffle Enterprises Ltd from which each Grower will sub-lease their Trufferie(s). The rental will be \$55 from the date of commencement until 30 June 2001, \$220 for the year ended 30 June 2002 and, for subsequent years, the same amount indexed annually in accordance with movements in the Consumer Price Index.

### **Fees**

24. Under the terms of the Management and Sub-Lease Agreements, a Grower will make the following payments per Trufferie:

- \$8,745 payable on application, consisting of \$206.80 for establishment services, \$8,483.20 for initial management fee and \$55 for initial lease fee;
- \$1,100 for the year ended 30 June 2002, consisting of \$880 for annual management fee and \$220 for annual lease fee;
- for each subsequent year until the year ended 30 June 2015, the amounts for annual management fee and annual lease fee in the previous dot point, indexed

annually in accordance with movements in the Consumer Price Index.

## Finance

25. Growers can fund their investment in the Project themselves, or borrow from an independent lender.

26. This Ruling does not apply if a Grower enters into a finance agreement that 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 are involved, or become involved, in the provision of finance to Growers for the Project.

## Ruling

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### Assessable Income

27. A Grower's share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

**Minimum subscription**

28. A Grower will not incur the fees shown in the Table(s) below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted. Under the prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 85 interests is achieved. Tax deductions are not allowable until these requirements are met.

**Section 8-1****Deductions where a Grower is not registered nor required to be registered for GST**

29. A Grower may claim tax deductions in the Tables below where the Grower:

- participates in the Project by 30 June 2001 to carry on the business of growing truffles;
- incurs the fees shown in paragraph 24; and
- is not registered nor required to be registered for GST.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year 1 deductions</b>	<b>Year 2 deductions</b>	<b>Year 3 deductions</b>
<b>Management Fee</b>	8-1	\$7,538.70 – See Note (i) (below)	\$880.00 – See Note (i) (below)	\$880 indexed by CPI – See Note (i) (below)
<b>Lease Fee (Rent)</b>	8-1	\$55 – See Note (i) (below)	\$220 – See Note (i) (below)	\$220 indexed by CPI – See Note (i) (below)
<b>Interest</b>		See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)

**Notes:**

- (i) Where a Grower incurs the management fees and the lease fees as required by the Management Agreement, and the Sub-Lease Agreement those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, then the prepayments 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

**PR 2001/31**

paragraphs 63 to 70 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than \$1,000, is an 'exception' to any prepayment rules that apply and is deductible in full in the year in which it is incurred.

- (ii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraph 74 to 76 below as those rules may be applicable if interest is prepaid.

**Tax deductions for capital expenses**

30. A Grower who participates in the Project will also be entitled to the following tax deductions:

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year 1 deductions</b>	<b>Year 2 deductions</b>	<b>Year 3 deductions</b>
Establishment of horticultural plants	387-165	Nil - see note (iii) below	Nil	Nil
Irrigation Costs	387-125	\$314.83 – see note (iv) (below)	314.83	314.83

**Notes:**

- (iii) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the truffle inoculated oak and hazelnut trees for use in a horticultural business. The deduction is allowable when the truffle inoculated oak and hazelnut trees, as horticultural plants, enter their first commercial season. If the truffle inoculated oak and hazelnut trees have an 'effective life' for the purposes of section 387-185 of greater than '13 but fewer than 30 years', this results in a write-off rate of rate of 13% prime cost. The Project's manager will inform Growers of when the truffle inoculated oak and hazelnut trees enter their first commercial season.
- (iv) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.

A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on facilities to conserve or convey water. This is an alternative to claiming deductions under section 387-125.

### **Deductions where a Grower is registered or is required to be registered for GST**

31. Where a Grower who is registered or is required to be registered for GST:

- participates in the Project by 30 June 2001 to carry on the business of growing truffles;
- incurs the fees shown in paragraph 24; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Table(s) above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 83.

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

#### **Section 35-55 – Commissioner’s discretion**

32. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001, 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 2001 to 30 June 2007 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.

33. 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 55 in the Explanations part of this ruling, below).

34. 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.

35. 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 subsection 35-55(1) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from this perspective has not been made.

### **Sections 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF, 82KL and Part IVA**

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

- expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 60 to 67);
- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 60 to 67);
- expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 60 to 67);
- 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**

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### **Section 8-1**

37. Consideration of whether the management fees and the lease 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 contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether 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.

### **Is the Grower carrying on a business?**

38. A truffle growing scheme can constitute the carrying on of a business. Where there is a business, or a future business, the proceeds from the sale of truffles each year from trufferies comprising the Project will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending and maintaining of the truffle inoculated oak and hazelnut trees and harvesting of the truffles each year from the trufferies. Generally, a Grower will be carrying on a business of trufficulture where:

- the Grower has an identifiable interest in specific truffle inoculated oak and hazelnut trees coupled with a right to harvest and sell the truffles each year from the trees;
- the trufficulture activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

39. For this Project Growers have rights under the Sub-lease Agreement in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing truffles. Under the Management Agreement Growers engage the Project Managers to acquire truffle inoculated oak and hazelnut seedlings and plant out the seedlings on the leased land and to provide ongoing services to care for and maintain the truffle inoculated oak and hazelnut trees. Growers are considered to have control of their operations.

# PR 2001/31

40. The Sub-lease Agreement provides Growers with more than a chattel interest in the oak and hazelnut trees. The Project documentation contemplates Growers will have an ongoing interest in the trees.

41. Growers have the right to use the land in question for trufficulture purposes and to have the Project Manager come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Project Manager's activities. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect. The trufficulture activities described in the Management Agreement are carried out on the Growers' behalf.

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

43. Growers will engage the professional services of a manager with appropriate credentials. These services are of the type ordinarily found in agriculture ventures that would commonly be said to be businesses. There is a means to identify which trees Growers have an interest in.

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

45. The lease fees and management fees associated with the trufficulture activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which income (from the regular sale of truffles) is to be gained from the 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. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

**Expenditure of a capital nature**

46. Any part of the expenditure of a Grower entering into a business of trufficulture that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, the costs of irrigation and the establishment of horticultural plants are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

**Subdivision 387-B – Irrigation expenditure**

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

48. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or licensee who is conducting a primary production business on land in Australia, a deduction would be available to a Grower in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

49. However, a deduction under section 387-125 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Grower can only choose a water facility tax offset where:

- had the Grower chosen a deduction instead of the tax offset, the Grower's taxable income for the income year would have been \$20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

**Subdivision 387-C - Horticultural provisions**

50. Section 387-165 allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. A lessee or licensee of land carrying on a business of horticulture is

taken to own the plants growing on that land rather than the actual owner of the land (section 387-210).

51. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant, such as the truffle inoculated oak and hazelnut trees in this Project, with an effective life of 13 to 30 years, that rate is 13%.

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

52. 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.

53. 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.

54. 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.

55. 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.

56. 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).
57. 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 investment of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2008. Growers who acquire more than one interest in the Project may, however, pass one of the tests in an earlier income year.
58. 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.
59. 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, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the term of this Product Ruling.
60. 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.
61. 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 (see paragraph 32), in the manner described in the Arrangement (see paragraphs 14 to 24), 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.

62. 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 expert and additional evidence provided with the application by the Responsible Entity;
- independent, objective, and generally available information relating to the trufficulture industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

**Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD, and 82KZME – 82KZMF**

63. The prepayments provisions of the ITAA operate to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

64. In this Project, the Management Fee of \$8,483, fee for establishment of horticultural plants of \$207 and a Lease Fee of \$55 per trufferie will be incurred on execution of the Management Agreement and the Lease Agreement. The Management Fee and the Lease Fee are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. 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 Management Fee has been inflated to result in reduced fees being payable for subsequent years.

65. There is also no evidence that might suggest the management services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the

agreements as set out in paragraph 24 then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

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

66. Although not required under either the Management Agreement or the Lease Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 65 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

67. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Lease Fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means, generally, the period over which the services are to be provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and, where the 'eligible service period' exceeds 13 months, whether the Grower is a 'small business taxpayer'.

68. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

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

In the formula, the 'eligible service period' means, generally, the period to which the services are to be provided.

69. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Grower is a 'small business taxpayer' or section 82KZMD if the Grower is not a 'small business taxpayer'. For a 'small business taxpayer' (see paragraphs 71 to 73), the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same, or

effectively the same as that shown in paragraph 68 above, concerning section 82KZMF.

70. A prepaid management fee and/or a prepaid lease fee of less than \$1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(7) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than \$1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of a prepaid management fee or a prepaid lease fee is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

#### **Subdivision 960-Q - Small business taxpayers**

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

72. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

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

#### **Interest deductibility**

74. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier 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.

75. 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. Under the prepayment rules contained in sections 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass

activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

76. Therefore, unless the prepaid interest is ‘excluded expenditure’, where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. Where a prepayment is for more than 13 months, any tax deduction that may be allowable must be determined under section 82KZM (for a ‘small business taxpayer’) or section 82KZMD (for a taxpayer who is not a ‘small business taxpayer’). The relevant formula is the same, or effectively the same as that shown above in paragraph 68 above.

### **Section 82KL - recouped expenditure**

77. 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’.

78. ‘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.

79. Section 82KL’s operation depends, among other things, on the identification of a certain quantum of ‘additional benefits’. Here, there may be a loan provided to the Grower. The loan will 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**

80. 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).

81. The Tasmanian Truffle Project No. 1 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 29

to 30 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.

82. 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 truffles. 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 is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not 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**

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### **Example 1 – Entitlement to ‘input tax credit’**

83. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of \$5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees, however, is reduced by the amount of any ‘input tax credit’ to which she is entitled. The Project Manager provides Margaret with a ‘tax invoice’ showing its ABN and the price of the taxable supply for management services as \$5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 less \$500).

## **Detailed contents list**

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

	<b>Paragraph</b>
<b>What this Product Ruling is about</b>	<b>1</b>
Tax law(s)	2
Goods and Services Tax	3
Business Tax Reform	4
Note to Promoters and Advisers	6
Class of persons	7
Qualifications	9
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Arrangement</b>	<b>14</b>
Overview	16
Management Agreement	22
Lease and Sub-Lease Agreements	23
Fees	24
Finance	25
<b>Ruling</b>	<b>27</b>
Assessable Income	27
Minimum subscription	28
Section 8-1	29
Deductions where a Grower is not registered nor required to be registered for GST	29
Tax deductions for capital expenses	30
Deductions where a Grower is registered or is required to be registered for GST	31
Division 35 – Deferral of losses from non-commercial business activities	32
Section 35-55 – Commissioner’s discretion	32
Sections 82KZM, 82KZMB – 82KZMD, 82KZME–82KZMF, 82KL and Part IVA	36
<b>Explanations</b>	<b>37</b>
Section 8-1	37

**PR 2001/31**

Is the Grower carrying on a business?	38
Expenditure of a capital nature	46
Subdivision 387-B – Irrigation expenditure	47
Subdivision 387-C – Horticultural provisions	50
Division 35 – Deferral of losses from non-commercial business activities	52
Prepayments provisions – sections 82KZM, 82KZMA–82KZMD, and 82KZME–82KZMF	63
Growers who choose to pay fees for a period in excess of that required by the Project’s agreements	66
Subdivision 960-Q – Small business taxpayers	71
Interest deductibility	74
Section 82KL – recouped expenditure	77
Part IVA – general tax avoidance provisions	80
<b>Example</b>	<b>83</b>
Example 1 – Entitlement to ‘input tax credit’	83
<b>Detailed contents list</b>	<b>84</b>

**Commissioner of Taxation**

28 March 2001

<i>Previous draft:</i>	- schemes and shams
Not previously issued in draft form	- tax administration
	- tax avoidance
<i>Related Rulings/Determinations:</i>	- tax benefits under tax avoidance schemes
TR 94/13; TR 97/11; TR 97/16;	- tax shelters
PR 1999/95; PR 1999/27; TR 92/1;	- tax shelters project
TR 92/20; TD 93/34; TR 98/22	
<i>Subject references:</i>	<i>Legislative references:</i>
- carrying on a business	- ITAA 1997 6-5
- commencement of business	- ITAA 1997 8-1
- fee expenses	- ITAA 1997 8-1(1)(a)
- horticulture	- ITAA 1997 8-1(1)(b)
- irrigation expenses	- ITAA 1997 8-1(2)(a)
- management fees expenses	- ITAA 1997 Div 27
- primary production	- ITAA 1997 Div 35
- primary production expenses	- ITAA 1997 35-10
- primary production income	- ITAA 1997 35-10(1)
- producing assessable income	- ITAA 1997 35-10(2)
- product rulings	- ITAA 1997 35-10(3)
- public rulings	- ITAA 1997 35-10(4)
	- ITAA 1997 35-25

- 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 387-B
  - ITAA 1997 387-125
  - ITAA 1997 387-C
  - ITAA 1997 387-125
  - ITAA 1997 387-130
  - ITAA 1997 387-150(3)
  - ITAA 1997 387-165
  - ITAA 1997 387-170(3)
  - ITAA 1997 387-185
  - ITAA 1997 388-55
  - ITAA 1997 Subdiv 960-Q
  - ITAA 1997 960-335
  - ITAA 1997 960-340
  - ITAA 1997 960-345
  - ITAA 1997 960-350
  - ITAA 1997 995-1
  - ITAA 1997 995-1(1)
  - 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 82KZM
  - ITAA 1936 82KZM(1)
  - ITAA 1936 82KZMA
  - ITAA 1936 82KZMA(4)
  - ITAA 1936 82KZMB
  - ITAA 1936 82KZMC
  - ITAA 1936 82KZMD
  - ITAA 1936 82KZMD(2)
  - ITAA 1936 82KZME
  - ITAA 1936 82KZME(4)
  - ITAA 1936 82KZMF
  - ITAA 1936 82KZMF(1)
  - ITAA 1936 Part III
  - ITAA 1936 Part IVA
  - ITAA 1936 177A
  - ITAA 1936 177C
  - ITAA 1936 177D
  - ITAA 1936 177D(b)
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