



PR 2001/45 - Income tax: Black Truffle Project 2001

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 This document has changed over time. This is a consolidated version of the ruling which was published on *23 May 2001*



Product Ruling

Income tax: Black Truffle Project 2001

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Preamble

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

[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

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 Black Truffle Project 2001, 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);
- Division 35 (ITAA 1997);
- Section 42-15 (ITAA 1997);
- Part 2-25 (ITAA 1997);
- Section 387-125 (ITAA 1997);
- Section 387-165 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KZL (ITAA 1936);
- Section 82KZM (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, each of these person, referred to as 'Growers', will have accepted an offer made under subsections 708(1)-(10) of the Corporations Law.

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.

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 44) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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- the Ruling will be withdrawn or modified.

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Date of effect

12. This Ruling applies prospectively from 18 April 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 taxation dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. 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

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

- Application for Product Ruling dated 2 February 2001;
- **Draft Information Memorandum for Black Truffle Project 2001 prepared and issued by Agri Truffle Pty Ltd (“the Manager”), dated 2 April 2001;**
- **Draft Management Agreement between Agri Truffle Pty Ltd and the Grower, dated 3 April 2001;**
- Draft Lease Agreement between Random Nominees Pty Ltd (“the Land Owner”) and Agri Truffle Pty Ltd (“the Tenant”), dated 28 March 2001;
- **Draft Sub-Lease Agreement between Agri Truffle Pty Ltd (“the Lessor”) and the Grower (“the Lessee”), dated 4 January 2001;**
- Technology Supply Agreement between Agri Truffle Pty Ltd and the Truffle Expert, dated 30 December 2000; and
- Additional correspondence dated 14 March 2001, 16 March 2001, 20 March 2001, 21 March 2001, 22 March 2001, 27 March 2001, 28 March 2001, 2 April 2001, 3 April 2001, 4 April 2001, 6 April 2001, 9 April 2001, 2 May 2001, 7 May 2001 and 11 May 2001.

NOTE: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

16. 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

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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 this agreement is summarised as follows.

17. In accordance with the above documents, a Grower who participates in the arrangement must have accepted an offer that was made under section 708 of the Corporations Law. **This Ruling does not apply unless the Grower:**

- has accepted a 'personal offer' under subsections 708(1)-(7) of the Corporations Law ; or
- is a 'sophisticated investor' for the purposes of subsections 708(8)-(9) of the Corporations Law ; or

has accepted an offer made by a licensed dealer where the offer meets the requirements of sub-section 708(10) of the Corporations Law .

18. Each of these categories is explained in paragraph 60 to 66 of the Explanations area of this Product Ruling.

Overview

19. The arrangement is called the Black Truffle Project 2001.

Location	Property situated at Mole Creek Head Road, Deloraine in Tasmania
Type of business each participant is carrying on	Long term commercial cultivation of truffle inoculated oak trees for the purpose of harvesting truffles for sale.
Number of hectares to be under cultivation	This Information Memorandum provides for up to 60 hectares to be planted.
Minimum subscription for Project	40 Trufflelots
Size of each Trufflelot	0.25 hectares
Number of trees per hectare	300 trees per hectare
Expected production	An average of 60 kilograms of Truffles per hectare at full production.
The term of the investment	20 years
Initial Cost	\$10,728
Initial costs per hectare	\$42,912
Ongoing costs	Management Fees payable to the Manager for performing the Trufflelot

	<p>services during the relevant years.</p> <p>Land Rental Fee.</p> <p>Irrigation Fee Instalments to be paid in the second and third year of the Project.</p> <p>Managers Bonus.</p> <p>Sales and Marketing Costs.</p> <p>Rates, taxes, charges or other imposts assessed upon a value of the Land that includes the value of any trees growing on the Land.</p> <p>Additional insurance cover requested by the Grower.</p>
Other costs	Option to purchase shares in Land Company at a cost of \$250

20. Growers applying under this Information Memorandum join as either Year 2001 Growers or Year 2002 Growers depending on their date of application. The date of application also determines the date of execution of the Sub Lease and Management Agreement and the period of provision of Establishment Services to which the Project Subscription Moneys relate. The relevant application periods are summarised as follows:

Application lodged	Grower	Date of Execution	Total Subscription Moneys	Period of provision of Establishment Services
On or before 15/6/2001	Year 2001 Growers	on or before 15/6/2001	\$10,728	From date of execution of Sub-Lease and Management Agreement to 30/6/2001.
On or after 16/6/2001	Year 2002 Growers	at any time between 1/7/2001 and 31/5/2002 (inclusive)	\$10,728	From date of execution of Sub-Lease and Management Agreement to 30/6/2002.

21. The Project is to cultivate a large scale, intensive Trufferie upon land that is held by the Manager. The Project land is located on

Mole Creek Head Road, Deloraine in Tasmania. The Project is for a period of twenty years.

22. Growers participating in the arrangement will enter into a Sub-Lease Agreement between the Lessor and the Grower and a Management Agreement between the Manager and the Grower. The Sub-Lease Agreement gives a Grower a Lease from Agri Truffle Pty Ltd over an identifiable area of land called a Trufflelot until the Project is terminated on 31 May 2021 in relation to a Grower who is a Year 2001 Grower and 31 May 2022 in relation to a Grower who is a Year 2002 Grower.

23. The Project will not be a registered managed investment scheme under the Corporations Law. Under the Information Memorandum the Manager proposes to offer 240 Trufflelots of 0.25 hectares, for the purpose of growing truffle inoculated oak trees. Under the Sub-Lease Agreement the Lessor grants to the Grower a lease over their respective Trufflelot(s) in return for the annual Land Rental Fee. The Lessor will carry out capital works, at its own cost, as required by the Sub-Lease to place the Land in a suitable state for cultivating Truffles. A minimum of 75 inoculated trees will be grown on each Trufflelot. There is a minimum subscription for the Project of 40 Trufflelots. Should minimum subscription not be reached by 15 June 2001 [the project will not proceed and subscription monies will be returned to investors](#). A maximum of 240 Trufflelots are available for the Project. Subject to suitable land being available, further Trufflelots will be issued after 30 June 2001 if more than 240 Trufflelots are subscribed for. Each investor may subscribe for a minimum of one Trufflelot. Subscriptions for the Project will be accepted until 31 May 2002, but Agreements received during the period 16 June 2001 to 30 June 2001 will not be executed until 1 July 2001.

24. Trufflelots are allocated by the Lessor who shall maintain a map of the project identifying each Trufflelot. For each Grower who requests a map the Manager shall provide a copy of the map clearly detailing the location of the Grower's Trufflelot(s).

25. Possible projected returns for Growers are outlined in Appendix 1 of the Information Memorandum. The projected returns are subject to the inherent risks of primary production and the commercial risks of a long term venture of cultivating, growing and harvesting a commercial Trufferie and selling of Truffles. Growers will execute a Power of Attorney enabling the Manager to act on their behalf as required when they make an application for a Trufflelot.

26. Under the Management Agreement the Grower appoints the Manager to manage the Grower's Trufflelot(s) by establishing, managing and maintaining the Trufflelot(s) and collecting and selling Land Produce from truffle inoculated oak trees on the Grower's

Trufflelot(s) in return for the annual Management Fee. The Grower is required to pay the Manager amounts for planting, seedlings and the irrigation system that will be installed on the Trufflelot(s). Unless the Grower has elected to collect the Land Produce from their Trufflelot(s) personally, the Manager will sell the Land Produce on behalf of the Grower (clause 6.1)

27. Growers will obtain an option to acquire shares in the Land Company that holds an option to acquired the Land, upon which the Trufferie is located (comprising the Project Land, inoculated trees and other infrastructure and capital works), from the Land Owner. The option must be exercised within a six month period from the time the Land Company has acquired the Land from the Landowner. The options have an exercise price of \$2,850 indexed by the higher of 3% or CPI per option. The Land Company will require Growers to confirm their intentions of exercising their option prior to acquiring the land. The Growers must confirm their intention to acquire at least 50% of the Land Company for the option to purchase the Land to be exercised.

Lease

28. The Lease Agreement is entered into between the Land Owner and Agri Truffle Pty Ltd. Under the Agreement the Land Owner grants a Lease to the Tenant. The term of the Lease is 20 years. Under the provisions of the Lease the Lessor may use the Land only as a Trufferie. The Lease allows the Lessor to enter into an Agreement with Growers for the purposes of establishing a Trufferie. The Land Owner is to provide access to up to 2 mega litres of water per hectare under management.

Sub-Lease

29. The Sub-Lease sets out the roles and obligations of the parties to the Agreement. The Agreement is entered into between Agri Truffle Pty Ltd as the Lessor and the Grower. Under the terms of the Agreement the Grower may only use the Land for the purpose of cultivating Truffles.

30. The Agreement commences on the date the Sub-Lease is executed by the Manager. The Project is terminated pursuant to the provisions of the Agreement or on the date of completion of the lease of the Land (Clause 8).

31. Growers participating in the Project are granted an interest in land by the Lessor in the form of a lease to use their Trufflelot for the purpose of conducting a long-term business of cultivating truffle inoculated Oak Trees for the production of Truffles for sale.

32. Each Grower must pay a Land Rental Fee to the Lessor being an amount as specified in clause 6 of the Sub-Lease.

33. Under the terms of the Sub-Lease, among other things, the Grower :

- must not use the Trufflelot for illegal or objectionable purposes;
- must ensure that the Trufflelot is managed in accordance with the best practices of Truffle cultivation; and
- must allow reasonable access to adjoining land owners.

34. Under the terms of the Sub-Lease the Lessor must, amongst other things, incur the capital expenditure necessary to place the Land in a suitable state for the conducting of Truffle cultivation, including carrying out activities such as land cleanup, survey costs, road construction, fencing and water storage.

Management Agreement

35. The Management Agreement sets out the roles and obligations of the parties to the Agreement. The Agreement is entered into between the Manager and the Grower. Under the Agreement the Grower appoints the Manager to establish, cultivate, maintain, harvest and sell the Land Produce from the Trufflelots.

36. The Agreement commences on the date the Management Agreement is executed by the Manager. The Project is terminated pursuant to the provisions of the Agreement or on the date of completion of the lease of the Land (Clause 5, 19.1 and 23).

37. The Management Agreement provides that each Grower appoints the Manager to perform services under the agreement. The services to be performed are specified in the definition of 'Establishment Services' and 'Management Services'. The Manager will supervise and manage all activities to be carried out on the Trufflelot on behalf of the Grower including, but not limited to the provision of the following services:

- complete all preparatory work necessary for the planting of seedlings on the land including ploughing, and vermin control;
- supply and plant truffle inoculated oak seedlings;
- replace any Oak Trees that fail to establish or that die due to planting techniques or vermin destruction;
- establish and maintain a trickle irrigation system on the Trufflelot;

- keep the Trufflelot free from vermin, weeds and other pest;
- maintain in good condition and repair all fire breaks, access roads, tracks and fences;
- apply fertiliser in such form and in such quantities so as to maintain satisfactory performance of the trees;
- arrange for the harvesting of the Land Produce; and
- arrange for the sale of produce from the Trufflelot.

38. 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 tax deductions are not allowed by the Commissioner.

Fees

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

- **The Subscription Moneys are** payable by each Grower on Application for the period from the Commencement Date to 30 June in the financial year in which execution of the Agreement takes place, being the First Period (see paragraph 20). The Subscription Moneys are made up of the following Management Fee, Land Rental Fee, Seedling and Planting Fee, first instalment of the Irrigation Fee and Option Fee for both Year 2001 Growers and Year 2002 Growers:
 - Management Fee \$7,887
 - Land Rental Fee \$479
 - Seedling and Planting Fee \$1,565
 - Irrigation Fee \$797
 - Option Fee \$250

The Management Services are to be completed by 30 June 2001 in the case of Year 2001 Growers and 30 June 2002 in the case of Year 2002 Growers.

In all other years:

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- Ongoing **Management Fees** are payable to the Manager for performing the management services during the relevant year. The fees are:

	Year 2001 Growers	Year 2002 Growers
2002	\$4,637	Management Fee paid upon Subscription
2003	\$2,068	\$4,637
2004	Indexed	\$2,068
2005	Indexed	Indexed

From the Financial Year ending 30 June 2004 for Year 2001 Growers and the Financial Year ending 30 June 2005 for Year 2002 Growers, the Management Fee shall be the amount due and payable in the preceding year increased by the greater of 3% or the Consumer Price Index for the 12 months of the preceding Financial Year.

- Following the first year **Land Rental Fees** are payable as follows:

	Year 2001 Growers	Year 2002 Growers
2002	\$495	Land Rental Fee paid upon Subscription
2003	Indexed	\$495
2004	Indexed	Indexed

From the Financial Year ending 30 June 2003 for Year 2001 Growers and the Financial Year ending 30 June 2004 for Year 2002 Growers, the Land Rental Fee shall be the amount due and payable in the preceding year increased by the greater of 3% or the Consumer Price Index for the 12 months of the preceding Financial Year.

- **Irrigation Fee** instalments of \$797 each are to be paid to the Manager in the second and third year of the Project;
- **Managers Bonus** equal to 25% of the surplus operating cashflow over and above forecast cashflows;

- **Sales and Marketing Costs** at cost plus 20% unless the total costs exceed 10% of the sale value of the produce, at which point services are provided at cost.
- Additional **Rates, taxes, charges or other imposts** assessed upon a value of the Land that includes the value of any trees growing on the Land.
- Additional **insurance** cover requested by the Grower.

Harvesting and Sale

40. The Grower has full right, title and interest in the Truffles that are produced by the Grower in the Trufflelot (clause 8). The truffle inoculated Oak Trees will remain the property of the Lessor. Unless the Grower elects to take possession of their harvested Truffles, the Manager will arrange the marketing and sale of the Truffles.

41. The Manager will harvest the Truffles from all Trufflelots subscribed for in different Financial Years separately. In addition, the Manager will keep separate records in respect of Land Produce from Trufflelots subscribed for in different Financial Years. The Gross Proceeds from the sale of Truffles from the previously mentioned Trufflelots will be recorded separately and the Manager will apply the Gross Proceeds of Sale pursuant to clause 9 of the Agreement. The Manager will deduct, from Gross Proceeds of Sale, any unpaid Land Rental Fees, unpaid Annual Management Fees, unpaid irrigation costs, all sales and marketing costs and the Manager's Bonus. The balance of the proceeds will be distributed to the Non-Electing Growers on a proportionate basis.

42. If a Grower is an Electing Grower (clauses 6.1 of the Management Agreement), the Grower must pay any unpaid Land Rental Fees and any unpaid Annual Management Fees at the time the Grower collects their Collectable Land Produce.

Finance

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

44. 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

Assessable Income

45. 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.

46. Once harvested, a Grower’s truffles will be trading stock of the Grower. As a consequence, if truffles are on hand at the end of the income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of ITAA 1997.

47. Each Grower will be notified by the Manager of the respective amounts to be brought to account in proportion to their total holding in the Project, in accordance with Part 2-25 and Taxation Ruling IT 2001.

Minimum subscription

48. 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 Information Memorandum, a Grower’s application will not be accepted and the Project will not proceed until the minimum

subscription of 40 interests is achieved. Tax deductions are not allowable until these requirements are met.

Section 8-1

Deductions where a Grower, who is a Year 2001 Grower, invests in the Project and is not registered nor required to be registered for GST

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

- participates in the Project by 15 June 2001 to carry on the business of growing truffles;
- incurs the fees shown in paragraph 39; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 ending 30/6/2001	Year 2 ending 30/6/2002	Year 3 ending 30/6/2003
Management Fee	8-1	\$7,887	\$4,637 – See Note (i) (below)	\$2,068 – See Note (i) (below)
Land Rental Fees	8-1	\$479	\$495 – See Note (i) (below)	\$495 indexed by the greater of 3% or CPI – See Note (i) (below)
Interest		See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)

Notes:

- (i) Where a Grower incurs the management fees and the land rental 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 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 paragraphs 99 to 106 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.

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- (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 paragraphs 107 to 109 below as those rules may be applicable if interest is prepaid.

Deductions where a Grower, who is a Year 2002 Grower, invests in the Project and is not registered nor required to be registered for GST

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

- participates in the Project on or after 16 June 2001 to carry on the business of growing truffles;
- incurs the fees shown in paragraph 39; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 ending 30/6/2002	Year 2 ending 30/6/2003	Year 3 ending 30/6/2004
Management Fee	8-1	\$7,887	\$4,637 – See Note (i) (below)	\$2,068 – See Note (i) (below)
Land Rental Fees	8-1	\$479	\$495 – See Note (i) (below)	\$495 indexed by the greater of 3% or CPI – See Note (i) (below)
Interest		See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)

Notes:

- (i) Where a Grower incurs the management fees and the land rental 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 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 paragraphs 99 to 106 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 paragraphs 107 to 109 below as those rules may be applicable if interest is prepaid.

Tax deductions for capital expenses

51. A Grower who is a Year 2001 Grower and who participates in the Project will also be entitled to the following tax deductions:

Fee type	ITAA 1997 section	Year 1 ending 30/6/2001	Year 2 ending 30/6/2002	Year 3 ending 30/6/2003
Irrigation Costs	387-125	\$797 – see note (iii) and (iv) below	\$797 – see note (iii) and (iv) below	\$797 – see note (iii) and (iv) below
Seedling and Planting Fees	387-165	Nil - see note (v) below	Nil	Nil

Notes:

- (iii) 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.
- (iv) 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.
- (v) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the truffle inoculated oak trees for use

in a horticultural business. The deduction is allowable when the truffle inoculated oak trees, as horticultural plants, enter their first commercial season. If the truffle inoculated oak trees have an 'effective life' for the purposes of section 387-185 of '13 to 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 trees enter their first commercial season.

52. A Grower who is a Year 2002 Grower and who participates in the Project will also be entitled to the following tax deductions:

Fee type	ITAA 1997 section	Year 1 ending 30/6/2002	Year 2 ending 30/6/2003	Year 3 ending 30/6/2004
Irrigation Costs	387-125	\$797 – see note (vi) below	\$797– see note (vi) below	\$797– see note (vi) below
Seedling and Planting Fees	387-165	Nil - see note (vii) below	Nil	Nil

Notes:

- (vi) 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.
- (vii) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the truffle inoculated oak trees for use in a horticultural business. The deduction is allowable when the truffle inoculated oak trees, as horticultural plants, enter their first commercial season. If the truffle inoculated oak trees have an 'effective life' for the purposes of section 387-185 of '13 to 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 trees enter their first commercial season.

Deductions where a Grower, who is a Year 2001 Grower, invests in the Project and is registered or is required to be registered for GST

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

- participates in the Project on or before 15 June 2001 to carry on the business of growing truffles;
- incurs the fees shown in paragraph 39; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables in paragraphs 49 and 51 above will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). See Example 1 at paragraph 116.

Deductions where a Grower, who is a Year 2002 Grower, invests in the Project and is registered or is required to be registered for GST

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

- participates in the Project on or after 16 June 2001 to carry on the business of growing truffles;
- incurs the fees shown in paragraph 39; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables in paragraphs 50 and 52 above will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). See Example 1 at paragraph 116.

Division 35 – Deferral of losses from non-commercial business activities**Section 35-55 – Commissioner’s discretion**

55. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001 or 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 2001 to 30 June 2007 for Year 2001 Growers and 30 June 2002 to 30 June 2008 for Year 2002 Growers 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.

56. 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).

57. 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 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.

58. 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

59. 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 96 to 103);
- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 96 to 103);
- expenditure by the Grower does not fall within the scope of sections 82KZME and 82KZMF (but see paragraphs 96 to 103);
- 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

Section 708 of the Corporations Law

60. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by the Grower under one of four categories in subsections 708(1)-(10) of the Corporations Law. These provisions set out situations where a prospectus or similar disclosure document is not required.

61. Under subsections 708(1)-(7) a Grower may participate in the project by accepting a 'personal offer' for an interest in the project. Offers under these provisions cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than \$2 million dollars.

62. An offer will be a personal offer only if it can be accepted by the person it is made to, and if the person is likely to be interested in the offer because of any previous contact, professional or other connection to the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 708(2)).

63. Offers made under other exclusions in section 708 (see below) are not counted for the purposes of the 20 investors limit.

64. Alternatively, a Grower who is a 'sophisticated investor' may accept an offer for interests in the project under subsections 708(8)-(10). Under subsection 708(8), an investor in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will be a 'sophisticated investor' where:

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least \$500,000; or
- it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made that the person to whom the offer is made:
 - (i) has net assets of at least \$2.5 million; or

- (ii) has a gross income for each of the last 2 financial years of at least \$250,000 a year.

65. A Grower may also participate in the project where the offer is made by a licensed dealer under subsection 708(10). Under this provision the dealer must be satisfied that the person to whom the offer is made has previous experience in investing which allows them to assess the merits of the offer, the value of the interests in the project, the risks involved in accepting the offer, their own information needs and the adequacy of the information provided.

66. The licensed dealer must provide a written statement of reasons for being so satisfied. Where a Grower is accepted into the project under this provision he or she must sign an acknowledgment that they did not receive a prospectus in relation to the offer.

Assessable income

67. All sales made from Land Produce will be ordinary income of the Grower under the general provisions of section 6-5 of ITAA 1997.

68. Once harvested, a Grower's Truffles will be trading stock of the Grower. As a consequence Truffles on hand at the end of the income year will need to be accounted for in accordance with the trading stock provisions in Part 2-25 of ITAA 1997, and included in assessable income.

69. Each Grower will be notified by the Manager of the respective amounts to be brought to account in proportion to their total holding in the Project, in accordance with Part 2-25 and Taxation Ruling IT 2001.

Section 8-1

70. Consideration of whether the management fees and the land rental 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?

71. 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 Trufflelots 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 trees and harvesting of the truffles each year from the Trufflelot. Generally, a Grower will be carrying on a business of a Trufferie where:

- the Grower has an identifiable interest in the Trufflelot coupled with a right to harvest and sell the truffles each year from the trees;
- the trufferie 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.

72. 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 Manager to acquire truffle inoculated oak seedlings and plant out the seedlings on the leased land. Under the same agreement Growers appoint the Manager to provide services such as cultivating, tending, fertilising, replanting and otherwise caring for the trees as and when required according to good horticultural practice. Growers are considered to have control of their operations. The specific cost of these services provided in the First Year will be \$10,728.

73. The Sub-lease Agreement gives Growers an identifiable interest in specific Truffles and a legal interest in the leased land. Growers have the right to personally market and sell the Truffles attributed to their Trufflelot or they may appoint the Manager to arrange the sale of the Truffles for them. The Project documentation

contemplates that Growers will have a continuing interest in the Land Produce.

74. Growers have the right to use the land in question for trufferie 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 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 trufferie activities described in the Management Agreement are carried out on the Growers' behalf.

75. 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 Information Memorandum 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.

76. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify which Land Produce Growers have an interest in. These services are based on accepted horticultural practices and are of the type ordinarily found in Truffle growing ventures that would commonly be said to be businesses.

77. Growers have a continuing interest in the Land Produce grown on the Truffelots. The Truffle growing activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Grower's horticultural activities will constitute the carrying on of a business.

78. The land rental fees and management fees associated with the Truffle growing 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. 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.

Expenditure of a capital nature

79. Any part of the expenditure of a Grower entering into a business of truffle growing 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

80. 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.

81. 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.

82. 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.

A Grower who invests in the a Year 2002 Grower is not entitled to claim a water facility offset under section 388-55 as the expenditure is not incurred before the end of the 2000-01 income year.

Subdivision 387-C - Horticultural provisions

83. 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).

84. 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 trees in this Project, with an effective life of '13 to fewer than 30 years', that rate is 13%.

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

85. 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.

86. 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.

87. 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.

88. 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.

89. 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).

90. 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 during the years ended 30 June 2001 or 30 June 2002 is unlikely to pass one of the objective tests until the income year ended 30 June 2010. Growers who acquire more than one interest in the Project may, however, pass one of the tests in an earlier income year.

91. 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.

92. 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) until 30 June 2007 for Year 2001 Growers and 30 June 2008 for Year 2002 Growers.

93. 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.

94. 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 55), in the manner described in the Arrangement (see paragraphs 15 to 43), 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.

95. 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 Manager;
- independent, objective, and generally available information relating to the truffle growing industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Manager.

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

96. The prepayments provisions of the ITAA 1936 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.

97. In this Project, the Management Fee of \$7,887 and a Land Rental Fee of \$479 per Trufflelot will be incurred on execution of the Management Agreement and the Sub-Lease Agreement. The Management Fee and Land Rental Fee are charged for providing management services and 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.

98. 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 39 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

99. Although not required under either the Management Agreement or the Sub-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 97 above, the prepayments provisions of the ITAA 1936 will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

100. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Land Rental 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 1936 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'.

101. 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.

102. 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 104 to 106), 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 102 above, concerning section 82KZMF.

103. 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

104. 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.

105. '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).

106. 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

107. 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.

108. 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.

109. 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 101 above.

Section 82KL - recouped expenditure

110. 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’.

111. ‘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.

112. Section 82KL’s operation depends, among other things, on the identification of a certain quantum of ‘additional benefits’. 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

113. 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).

114. The Black Truffle Project 2001 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 49 to 52 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.

115. 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

Example 1 – Entitlement to 'input tax credit'

116. 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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Related Rulings/Determinations:

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 PR 1999/95; PR 1999/27; TR 92/1;
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Subject references:

- carrying on a business
- commencement of business
- fee expenses
- horticulture
- irrigation expenses
- management fees expenses
- primary production
- primary production expenses
- primary production income

- producing assessable income
- product rulings
- public rulings
- schemes and shams
- tax administration
- tax avoidance
- tax benefits under tax avoidance schemes
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