



# ***PR 2001/92 - Income tax: Grampians Olive Project 2001***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *20 June 2001*



# Product Ruling

## Income tax: Grampians Olive 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.

### No guarantee of commercial success

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

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

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

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

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

### Terms of Use of this Product Ruling

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

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.

## 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 2001 Grampians Olives Project, 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 387-125 (ITAA 1997);
  - section 388-55 (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)
  - Division 5 of Part III of the ITAA 1936; and
  - Part IVA (ITAA 1936).

### Business Tax Reform

3. 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.

4. 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**

5. 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**

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

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

#### **Qualifications**

8. The Commissioner rules on the precise arrangement identified in the Ruling. 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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10. This Ruling applies prospectively from 20 June 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).

11. 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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12. 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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13. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Application for a Private Binding Ruling dated 15 December 2000;
- Application for a Product Ruling dated 22 March 2001;
- Draft Private Offer Information Memorandum included with Application for Product Ruling;

- Draft Management Agreement between Agreement between Grampians Olives Pty Ltd and the Partners, received 4 May 2001;
- Draft Partnership Agreement received 4 May 2001;
- Draft Planting Agreement between Tree Maintenance Services Pty Ltd and the Partners received 4 May 2001;
- Draft General Maintenance Services Agreement between Grampians Olives Pty Ltd and the Partners, received 4 May 2001;
- Draft Lease Agreement between Maclary Investments Pty. Ltd and the Partners received 4 May 2001;
- Draft Accounting, Administrative, Secretarial and Other Services Agreement between Mezina Enterprises Pty Ltd and the Partners received 4 May 2001;
- Draft Construction of Watering Facilities Agreement between Tree Maintenance Services Pty Ltd and the Partners received 4 May 2001;
- Letters from the applicant's representative dated 4 May 2001, 14 May 2001, 22 May 2001, 24 May 2001 and 29 May 2001.

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

14. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Partnership will be a party to, that are part of the arrangement to which this Ruling applies, except agreements that come within paragraph 28 below, concerning the provision of finance. The effect of the agreements listed above is summarised as follows.

### Overview

15. The arrangement is called the Grampians Olive Project 2001:

Location:	Property known as "Arizona" situated in the Grampians region of Victoria 5km from the township of Balmoral.
Type of business each Grower is carrying on:	Commercial growing of a number of varieties of olives for sale.
Name used to describe the	Grampians Olive Project 2001.

product:	
Number of hectares under cultivation:	Between 20 and 400 hectares.
Minimum subscription for Project	20 hectares
Minimum subscription per investor	10 hectares
Number of trees per hectare	200 approximately
The term of the investment	24 years.
Initial cost per 10 hectare investment	\$551,850
Initial cost per hectare	\$55,185
Ongoing costs:	\$1168 in the second year increased by 4 per cent in each subsequent year.

16. Under the arrangement an investor will subscribe capital to a partnership. An investor will pay monies to the partnership as capital subscription on account of construction of watering facilities, lease fees, supply and planting of olive trees, accounting, secretarial, administration fees, general maintenance and management fees. No more than 20 partners will constitute the Partnership. The Partnership will enter into several agreements to carry on the business of commercial growing of a number of varieties of olives for sale as either fruit destined for the table olive market or for processing into a variety of olive oils.

17. The property on which the olive growing activities are to be carried out is known as 'Arizona' which is owned by Maclary Investments Pty. Ltd. The property is comprised of 616 hectares and is situated in the Grampians, 5 kilometres from the western Victorian town of Balmoral. The Project will not proceed unless the minimum subscription of 20 hectares is achieved.

### **Agreements**

18. Under the Partnership Agreement, the Partners agree to carry on a business of an olive tree plantation in partnership.

19. Under the Management Agreement between Grampians Olives Pty. Ltd. and the Grower, Grampians Olives Pty. Ltd. is appointed as the Manager responsible for the ongoing management of the business on behalf of the Grower. The Manager agrees to carry out duties that

relate to the management, supervisory, advisory and administrative functions and duties which are relevant and necessary in relation to the carrying on of the business of an olive plantation.

20. The Lease Agreement between Maclary Investments Pty. Ltd and the Partners provides for each Grower to have a right to occupy a section of the land known as "Arizona" situated at Balmoral, Victoria owned by Maclary Investments Pty. Ltd for a period of 23 years.

21. The Planting Agreement between Tree Maintenance Services Pty Ltd and the Partners provides for Tree Maintenance Services Pty Ltd to use appropriately qualified and experienced personnel to plant seedlings by 30 June 2001 at an even density of 200 seedlings per hectare.

22. The Construction of Watering Facilities Agreement between Tree Maintenance Services Pty Ltd and the Partners provides for Tree Maintenance Services Pty Ltd to construct water facilities on the Project land.

23. Under the General Maintenance Services Agreement between Grampians Olives Pty Ltd and the Partners, Grampians Olives Pty Ltd agrees to provide services as listed in a comprehensive list in the Agreement Schedule covering maintenance of the trees and the roads and general maintenance.

24. The Accounting, Administrative, Secretarial and Other Services Agreement between Mezina Enterprises Pty Ltd and the Partners provides for the provision of accounting, secretarial and administrative services and the procurement of marketing services.

### **Fees**

25. The fees payable by a Grower per Hectare is as follows:

#### ***For the year ended 30 June 2001***

Management fees	\$39,980
Accounting & administrative services	\$1,770
Watering facilities	\$5400
Planting	\$1,560
Lease fees	\$300
Marketing	\$150
General	\$6,025

**PR 2001/92*****For the year ended 30 June 2002***

Management fees	\$450
Accounting and secretarial	\$250
Lease fees	\$312
Marketing	\$156

***For the year ended 30 June 2003***

Management fees	\$468
Accounting and secretarial	\$260
Lease fees	\$324.48
Marketing	\$162.24

***For the year ended 30 June 2004 and each subsequent year***

Management fees	The fee for the previous Year increased by 4%
Administration and secretarial fees	The fee for the previous Year increased by 4%

26. In addition to the payment of fees mentioned above, the Grower will contribute further fees to pay for the harvesting of olives in accordance with the following table:

Year	Fee	Year	Fee	Year	Fee
1	Nil	9	\$2,209	17	\$3,024
2	Nil	10	\$2,298	18	\$3,145
3	Nil	11	\$2,389	19	\$3,270
4	Nil	12	\$2,485	20	\$3,401
5	\$629	13	\$2,548	21	\$3,537
6	\$873	14	\$2,688	22	\$3,679
7	\$1,135	15	\$2,796	23	\$3,826
8	\$1,652	16	\$2,907	24	\$3,979

**Finance**

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

28. 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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**Partnership**

29. Under the arrangement, the Partnership will carry on the business of growing olives and each Grower will be in receipt of income jointly from the sale of olives. Therefore, the Partnership is a tax law partnership for the purposes of Division 5 of Part III of the ITAA 1936 (see definition of 'partnership' in section 995-1 of the ITAA 1997. Section 90 of ITAA 1936 provides that the net income of a partnership is calculated as if the partnership were a resident taxpayer, and is the assessable income less all allowable deductions. The Partnership will be required to lodge a partnership return for each year of income, as required by section 91 of the ITAA 1936.

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30. Each Grower will be a partner in the Partnership and in accordance with section 92 of the ITAA 1936, where the Grower is a resident, will be required to include his or her individual interest in the net income of the Partnership in his or her assessable income. Where the Grower is a non-resident, he or she is required to include in his or her assessable income, his or her individual interest in the net income of the Partnership as is derived from a source in Australia.

31. Each Grower will be entitled to a deduction under section 92 of so much of his or her individual interest in any loss of the Partnership as is attributable to a period when he or she was a resident. Where the Grower is a non-resident, he or she will be entitled to a deduction for so much of his or her individual interest in the Partnership loss as is attributable to a period when he or she was a resident.

## **Minimum subscription**

32. A Grower will not incur the fees shown in the Tables below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted (the date the investment is made). Under the Information Memorandum, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 20 hectares is achieved. Tax deductions are not allowable until these requirements are met.

## **Section 8-1**

33. The table below shows the deductions available under section 8-1 of the ITAA 1997 for the Partnership, calculated on a single partner basis, and assuming the Partnership incurs the expenditure set out in the table in paragraph 25.

Fee Type	ITAA 1997 Section	Year ended 30 June 2001 deductions	Year ended 30 June 2002 deductions	Year ended 30 June 2003 deductions
<b>Management Fee</b>	8-1	\$36,346 – See Note (i) (below)	\$409 – See Note (i) (below)	\$425 – See Note (i) (below)
<b>Accounting and secretarial</b>	8-1	\$1,609 – See Note (i) (below)	\$227 – See Note (i) (below)	\$236 – See Note (i) (below)
<b>Marketing</b>	8-1	\$136 – See Note (i) (below)	\$141 – See Note (i) (below)	\$147 – See Note (i) (below)
<b>General Maintenance</b>	8-1	\$5,477 – See Note (i) (below)		
<b>Lease Fee (Rent)</b>	8-1	\$273 – See Note (i) (below)	\$284 – See Note (i) (below)	\$295 – See Note (i) (below)
<b>Interest</b>	8-1	See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)

**Notes:**

- (i) Where a Grower incurs the management, accounting and secretarial services, marketing, general maintenance and lease fees as required by the respective agreements those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (eg, 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 paragraphs 61 to 68 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 72 to 74 below as those rules may be applicable if interest is prepaid.

**PR 2001/92****Tax deductions for capital expenses**

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

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year ended 30 June 2001 deduction</b>	<b>Year ended 30 June 2002 deduction</b>	<b>Year ended 30 June 2003 deduction</b>
Irrigation costs	387-125	\$1636 - see note (iii) and (iv) below	\$1636 - see note (iii) and (iv) below	\$1636 - see note (iii) and (iv) below

**Notes:**

- (i) 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.
- (ii) 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 sections 387-55 and 387-125.

**Goods and Services Tax ('GST')**

35. For simplicity, the figures quoted in the tables in paragraphs 33 and 34 are exclusive of GST. (In general, GST payable would be claimable by the GST registered partnership as part of creditable acquisitions in its Business Activity Statement. The amount of GST would not then be an allowable deduction to the partnership, in accordance with Division 27 of ITAA 1997.)

36. For GST purposes, a Grower will be considered a partner in the tax law partnership, rather than a sole trader. No input tax credit will be available to the Grower for their payment of funds by way of the initial capital contribution and further capital contributions. Relevant input tax credits will be claimed in the Business Activity Statement of the partnership.

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

37. For a Grower who is an individual, either alone or in partnership, 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.

38. Where either the Grower’s business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies (see paragraph 58 in the Explanations part of this ruling, below), section 35-10 will not apply. For the year ended 30 June 2001 and subsequent years at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year. The objective test in section 35-40 will therefore be satisfied.

39. 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.

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

40. 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 61 to 68);
- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 61 to 68);
- expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 61 to 68);
- 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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### **Partnership**

41. Section 90 of ITAA 1936 provides that the net income of a partnership is calculated as if the partnership were a resident taxpayer, and is the assessable income less all allowable deductions. Section 92 provides that the assessable income of a partner includes so much of the individual interest of the partner in the net income of the partnership or, in the case of a partnership loss, a partner is entitled to a deduction under section 92 of so much of his or her individual interest in any loss of the Partnership.

### **Section 8-1**

42. 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 Partnership carrying on a business?**

43. An olive growing scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross proceeds each year from the sale of olives from the groves 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, maintaining and harvesting of the olives each year from the groves. Generally, the Partnership will be carrying on a business of growing olives where:

- the Partnership has an identifiable interest in specific trees coupled with a right to harvest and sell olives from the trees;
- the above activities are carried out in a business like way either by the Partnership or on behalf of the Partnership; 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.

44. For this Project, Partners have rights under the 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 olives. Under the Management Agreement the Partnership engages the Project Manager to supply and plant olive trees on the leased land and to provide ongoing services to care for and maintain the trees. Partners are considered to have control of their operations.

45. The Lease Agreement provides Partners with more than a chattel interest in the trees. The Project documentation contemplates Partners will have an ongoing interest in the trees.

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

47. 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. Partners 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 Partners, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

48. Partners will engage the professional services of a manager with appropriate credentials. There is a means to identify which trees Partners have an interest in. These services are based on accepted viticulture practices and are of the type ordinarily found in olive growing ventures that would commonly be said to be businesses.

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

50. The lease fees and management fees associated with the olive 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 olives) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

## **Expenditure of a capital nature**

51. Any part of the expenditure of a Partnership entering into an olive growing business 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 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**

52. 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.

53. 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 the Partnership at a rate of 33.3 per cent per annum for the cost of the irrigation system.

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

- had the Partnership chosen a deduction instead of the tax offset, the Partnership'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.

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

55. 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.

56. 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.

57. 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.

58. 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.

59. 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).

60. The Partnership will be carrying on a business activity that is subject to these provisions. For the year ended 30 June 2001 and subsequent years, at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year. The objective test in section 35-40 will therefore be satisfied. This means that the Partnership will not be required to defer any excess of deductions attributable to its 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.

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

61. 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.

62. In this Project, the initial fees totalling \$55,185 per hectare will be incurred on execution of the Agreements. The Fees are charged for providing 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.

63. 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 25, 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*

64. 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 63 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.

65. The amount and timing of tax deductions for any prepaid 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’.

66. 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.

67. 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 69 to 71) 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 66 above, concerning section 82KZMF.

68. 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 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**

69. 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.

70. '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).

71. 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**

72. 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.

73. 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.

74. 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 a 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 66 above.

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

75. 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'.

76. '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.

77. 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**

78. 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).

79. The 2001 Grampians Olives Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 33 to 34 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.

80. Grower 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 the olives. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There 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.

**Examples****Example 1 – entitlement to 'input tax credit'**

81. 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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**Commissioner of Taxation**

20 June 2001

<i>Previous draft:</i>	- ITAA 1997 17-5
Not previously issued in draft form	- ITAA 1997 Div 27 - ITAA 1997 Div 35
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-10
PR 1999/95; TR 92/1; TR 97/11;	- ITAA 1997 35-10(2)
TR 97/16; TR 92/20; TR 98/22;	- ITAA 1997 35-10(3)
TD 93/34	- ITAA 1997 35-10(4) - ITAA 1997 35-30 - ITAA 1997 35-35
<i>Subject references:</i>	- ITAA 1997 35-40
- carrying on a business	- ITAA 1997 35-45
- commencement of a business	- ITAA 1997 35-55
- interest expenses	- ITAA 1997 35-55(1)
- harvesting expenses	- ITAA 1997 Subdiv 387-B
- management fees	- ITAA 1997 387-55
- primary production	- ITAA 1997 387-125
- primary production expenses	- ITAA 1997 388-55
- producing assessable income	- ITAA 1997 960-335
- product rulings	- ITAA 1997 960-340
- public rulings	- ITAA 1997 960-345
- schemes	- ITAA 1997 960-350
- tax avoidance	- ITAA 1997 Subdiv 960-Q
- tax benefits	- ITAA 1997 995-1 - ITAA 1936 82KH(1)
<i>Legislative references:</i>	- ITAA 1936 82KH(1F)(b)
- ITAA 1997 6-5	- ITAA 1936 82KL
- ITAA 1997 8-1	- ITAA 1936 82KL(1) - ITAA 1936 82KZL

- ITAA 1936 82KZL(1)
  - ITAA 1936 82KZM
  - ITAA 1936 82KZM(1)
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  - ITAA 1936 Pt IVA
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  - ITAA 1936 177C
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  - ITAA 1936 177D(b)
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