



# ***PR 2002/74 - Income tax: Mediterranean Olives Project 2002***

 This cover sheet is provided for information only. It does not form part of *PR 2002/74 - Income tax: Mediterranean Olives Project 2002*

 This document has changed over time. This is a consolidated version of the ruling which was published on *29 May 2002*



# Product Ruling

## Income tax: Mediterranean Olives Project 2002

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### Preamble

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

### No guarantee of commercial success

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

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

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

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

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

### Terms of Use of this Product Ruling

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

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

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

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the 'Mediterranean Olives Project 2002' or simply as 'the Project'.

### **Tax laws**

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - Section 8-1 (ITAA 1997);
  - Section 17-5 (ITAA 1997);
  - Division 27 (ITAA 1997);
  - Division 35 (ITAA 1997);
  - Division 40 (ITAA 1997);
  - Division 70 (ITAA 1997);
  - Division 328 (ITAA 1997);
  - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
  - Section 82KZL (ITAA 1936);
  - Section 82KZME (ITAA 1936);
  - Section 82KZMF (ITAA 1936); and
  - Part IVA (ITAA 1936).

### **Goods and Services Tax**

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

**Changes in the Law**

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

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

**Note to promoters and advisers**

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

**Class of persons**

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

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion or who otherwise do not intend to derive assessable income from it. This Ruling does not apply to the class of persons whom enter into finance arrangements with the Responsible Entity or any associate of the Responsible Entity.

**Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

## **Date of effect**

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11. This Ruling applies prospectively from 29 May 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

## **Withdrawal**

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2005. 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 arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

## **Arrangement**

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

- Application for a Product Ruling for Mediterranean Olives Project 2002 dated 27 March 2002;
- Draft Product Disclosure Statement for Mediterranean Olives Project 2002, undated;

- **Constitution for the Mediterranean Olives Project 2002 between Mediterranean Olives Estate Limited [“Responsible Entity”] and the Growers, dated 22 February 2002;**
- **Draft Management Agreement for Mediterranean Olives Project 2002 between Mediterranean Olives Estate Limited [“Manager”] and the Grower, undated;**
- **Draft Grove Lease between Mediterranean Olives Estate Limited and the Grower, undated;**
- **Draft Irrigation Sale and Purchase Agreement between Mediterranean Olives Estate Limited [“Vendor”] and the Grower, undated;**
- Draft Head Lease between Mediterranean Olives Land Company Pty Ltd [“Lessor”] and Mediterranean Olives Estate Limited [“Lessee”], undated;
- Scheme Property Custody Agreement between Mediterranean Olives Estate Limited and Sandhurst Trustees Limited [“Custodian”], dated 1 March 2002;
- Draft Olive Oil Purchase Agreement between Mediterranean Olives Estate Limited and O.L.D. Luccisano De Masi Oleificio Srl [“Purchaser”], undated;
- Compliance Plan for the Mediterranean Olives Project 2002, dated 22 February 2002; and
- Additional correspondence from the Applicant dated 9 May 2002 and 13 May 2002.

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

15. The documents highlighted are those that the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

**Overview**

17. This arrangement is called the Mediterranean Olives Project 2002.

Location	Serpentine, near Bendigo, central Victoria.
Type of business each participant is carrying on	Commercial growing, and cultivation of olive trees for the purpose of producing extra virgin olive oil.
Number of hectares under cultivation	700 hectares
Size of each Grove	0.5 hectares
Number of trees per hectare	330
The term of the Project in years	Approximately 23 years.
Initial cost per Grove	\$21,835 per Grove for Growers who are accepted into the Project prior to 30 June 2002; or \$21,901.83 per Grove for Growers who are accepted into the Project on or after 1 July 2002 but before 30 June 2003.
Initial cost per hectare	\$43,670 per hectare for Growers who are accepted into the Project prior to 30 June 2002; or \$43,803.66 per hectare for Growers who are accepted into the Project on or after 1 July 2002 but before 30 June 2003.
Ongoing costs	Management fees, rent, insurance, harvesting fees, transportation fees, and extraction fees.

18. Growers participating in the arrangement will enter into a Management Agreement, a Grove Lease and an Irrigation Sale and Purchase Agreement. The Grove Lease gives a Grower a sub-lease from Mediterranean Olives Estate Limited ('the Manager') over an identifiable area of land called a 'Grove' until 30 June 2025, or the date the Project is terminated under the Constitution, or the date on which the Growers resolve to terminate the Management Agreement, whichever happens first. However, prior to 30 June 2025, the Manager and each Grower may, in writing, agree to extend the term of

the Management Agreement, the Grove Lease and the Irrigation Sale and Purchase Agreement. Each Grove is 0.5 hectares in size.

19. The Project Land is situated in Serpentine, near Bendigo in central Victoria. Mediterranean Olives Land Company Pty Ltd ('the Land Owner') will lease the land to the Manager, who will sub-lease the Groves to the Growers to enable the Growers to carry on a business of cultivating olives for the commercial production of extra virgin olive oil.

20. The Product Disclosure Statement states that the minimum subscription for this Project is 50 Groves which must be reached before 22 June 2002. Under this offer, Growers may enter the Project in either the 2001/2002 income year (defined as '2002 Growers' for the purposes of this Ruling) or 2002/2003 income year (defined as '2003 Growers' for the purposes of this Ruling). For 2002 Growers, applications must be accepted by the Responsible Entity by 30 June 2002. If minimum subscription is reached on or before 4 June 2002, the Responsible Entity will only accept applications from 2002 Growers after 4 June 2002 where the establishment services are able to be completed by 30 June 2002. If minimum subscription is reached during the period from 4 June 2002 to 22 June 2002 applications will only be accepted by the Responsible Entity, after the date minimum subscription is reached, where the establishment services are able to be completed by 30 June 2002. For 2003 Growers applications must be accepted by the Responsible Entity by 30 June 2003. The Responsible Entity will only accept applications from 2003 Growers after 4 June 2003 where the establishment services are able to be completed by 30 June 2003.

21. Each Grower may subscribe for a minimum of one Grove at a cost of \$21,835 for 2002 Growers or \$21,901.83 for 2003 Growers. Growers will execute a Power of Attorney enabling the Responsible Entity to act on their behalf as required when they make an application under the Product Disclosure Statement.

### **Constitution**

22. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Grower and to manage the Project. The Responsible Entity will keep a register of Growers (cl 13.2). The Grove Lease, Management Agreement and Irrigation Sale and Purchase Agreement will be executed on behalf of a Grower following them signing the Application Form in the Product Disclosure Statement. Growers are bound by the Constitution by virtue of their participation in the Project.

**Compliance Plan**

23. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Act 2001. Under the Compliance Plan, a Compliance Committee will monitor to what extent the Responsible Entity meets its obligations as the Responsible Entity of the Project and the rights of the Growers are protected.

**Interest in Land**

24. Growers participating in the arrangement will enter into a Grove Lease between Mediterranean Olives Estate Limited (the 'Manager') and the Grower. Growers are granted an interest in land in the form of a sub-lease to use their Grove for the purpose of conducting their horticultural business (cl 6.1). Growers must pay rent annually to the Manager. The term of a Grower's sub-lease is until 30 June 2025 or such later date as agreed, in writing, with the Manager before 30 June 2025.

**Management Agreement**

25. Each Grower enters into a Management Agreement with Mediterranean Olives Estate Limited (the "Manager") for each Grove. The term of the Project is until the date the Project is wound up pursuant to the Constitution, the date on which the Growers resolve to terminate the Management Agreement or 30 June 2025, whichever happens first, or such later date as agreed, in writing, with the Manager, before 30 June 2025.

26. Growers contract with the Manager to cultivate and care for the olive trees according to quality horticultural practice. Growers pay a management fee on application and annual management fees thereafter.

27. The Manager will carry out the following services under this agreement:

- cultivate, tend, train, prune, fertilise, replant, spray and otherwise care for the Olive Trees as and when required that is consistent with quality horticultural practice;
- use all reasonable measures to keep the Grove free from vermin, noxious weeds, pests and diseases;
- maintain all trellising and fences;
- arrange for harvesting of the Olives; and
- use reasonable endeavours to arrange the processing of the Olives and packaging, marketing and sale of the Olive Products.

28. The Manager will harvest and process the olives and package and market the Olive Products on any such terms as the Manager considers appropriate and advantageous for the Grower (cl 5). The Manager will be responsible for paying for the cost of annual insurance on the Grove in respect of public/occupier's liability up to an amount of \$10 million and the Grower will be responsible for paying for the cost of agricultural insurance against loss or damage caused by fire, lightning, aircraft, hailstorms, windstorms or malicious damage (cl 6 of Schedule 2).

### **Planting**

29. The Manager will plant out on the Groves approximately 165 olive trees per Grove in Spring 2002 for 2002 Growers or Spring 2003 for 2003 Growers. After the planting has been completed, the Manager will maintain the trees in accordance with quality horticultural practice. The services to be provided by the Manager over the term of the Project is outlined in the Management Agreement (Schedule 2 to the Management Agreement).

30. The Manager will be responsible for arranging the marketing and sale of the olive produce. The harvest shall take place in each year of the Term that there is a commercially harvestable crop, at such time or times as in the opinion of the Manager will maximise the return to the Grower.

31. The Gross Proceeds of the sale of the Olive Produce will be paid into the Proceeds Fund Bank Account. Proceeds received by the Responsible Entity are to be distributed in the following order of priority:

- to the Responsible Entity for any amounts it is entitled to under clause 24.3(a) of the Constitution;
- any amounts payable by the Growers under the Grove Lease and Management Agreement and the Constitution (cl 24.3(a) of the Constitution); and
- the Net Proceeds to the Growers.

### **Fees**

32. The initial fee payable under the Agreements on application is \$21,835 for 2002 Growers or \$21,901.83 for 2003 Growers. These fees include an initial management fee of \$13,007.50, a seedling and planting fee of \$3492.50 and \$3,850 for the purchase of irrigation equipment. Also included in these amounts is rent of \$1,485 for 2002 Growers and rent of \$1,551.83 for 2003 Growers. The management services in respect of the initial management fee will be completed

during the period from allotment to 30 June 2002 (2002 Growers) or 30 June 2003 (2003 Growers).

33. For 2002 Growers, a management fee of \$3,916 is payable on 31 October 2002 for services to be provided during the period 1 July 2002 to 30 June 2003. For 2003 Growers, a management fee of \$3,916 is payable on 31 October 2003 for services to be provided during the period 1 July 2003 to 30 June 2004.

34. A management fee of \$2,128.50 is payable on 31 October 2003, for 2002 Growers, or 31 October 2004, for 2003 Growers, for services to be provided during the period 1 July 2003 to 30 June 2004 or 1 July 2004 to 30 June 2005, respectively. For each year thereafter, a management fee is payable on 31 October of the relevant year equal to the previous years management fee indexed by the increase in the Consumer Price Index in June of that year.

35. Under the Management Agreement the Grower is required to pay on application a seedling and planting fee of \$3,492.50 for the purchase and planting of seedlings on the Growers Grove. Growers must also pay harvesting fees, transporting fees, and extraction fees to reimburse the Manager for expenses which have been incurred or will be incurred in respect of these services. The amount of these fees is equal to the Growers proportion of the expenses as the Grower's interest in the Project bears to the total number of interests issued in the Project.

36. Under the Irrigation Sale and Purchase Agreement the Grower will purchase irrigation equipment from the Manager for an amount equal to \$3,850. This amount is also payable on application.

37. Under the Grove Lease, 2002 Growers must pay an amount for rent of \$1,485 on application for the period from allotment to 30 June 2002. Rent of \$1,551.83 is either payable on 31 October 2002 (2002 Growers) or on application (2003 Growers) for the period either from 1 July 2002 (2002 Growers) or date of allotment (2003 Growers) to 30 June 2003. From 1 July 2003 rent is payable annually on 31 October of the relevant year, equal to the amount of the rent which was payable in the previous year indexed by the increase in the Consumer Price Index in June of that year.

38. The Application Monies will be banked in the Application Fund bank account formed under the Constitution (cl. 11.2 of the Constitution).

## **Finance**

39. All Growers are required to fund their involvement in the Project themselves or borrow from an independent lender.

40. This Ruling does not apply if the finance arrangement entered into by the Grower 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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### **Application of this Ruling**

41. This Ruling applies only to Growers who are accepted to participate in the Project either:

- on or before 30 June 2002 and who have executed a Management Agreement, a Grove Lease and an Irrigation Sale and Purchase Agreement on or before that date; and/or
- after 30 June 2002 but on or before 30 June 2003, where the Grower has executed a Management Agreement, a Grove Lease and an Irrigation Sale and Purchase Agreement on or before that date.

The Grower's participation in the Project must constitute the carrying on of a business of primary production. This Ruling does not apply to

those Growers who enter into finance arrangements with the Responsible Entity or an associate of the Responsible Entity.

## **Minimum Subscription**

42. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the Product Disclosure Statement, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 50 interests is achieved before 22 June 2002.

## **The Simplified Tax System ('STS')**

### **Division 328**

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

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

### **Qualification**

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

## **Tax outcomes for Growers who are not 'STS taxpayers'**

### **Assessable Income**

#### **Section 6-5**

45. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

46. The Grower recognises ordinary income from carrying on the business of horticulture at the time that income is derived.

### Trading Stock

#### Section 70-35

47. A Grower who is not an 'STS taxpayer' may, in some years, hold olives and/or olive products that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Grower must include the amount of that excess in assessable income.

48. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Grower may claim the amount of that excess as an allowable deduction.

### Deductions for Management Fees and Rent

#### Section 8-1

49. A Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

#### 2002 Growers

Fee Type	ITAA 1997 Section	Year 1 deduction Year Ended 30 June 2002	Year 2 deduction Year Ended 30 June 2003	Year 3 deduction Year Ended 30 June 2004	Year 4 deduction Year Ended 30 June 2005
<b>Initial Management Fee</b>	8-1	\$13,007.50 – See Note (i) (below)			
<b>Annual Management Fees</b>	8-1		\$3,916 – See Notes (i) & (ii) (below)	\$2,128.50 – See Notes (i) & (ii) (below)	\$2,128.50 (indexed) – See Notes (i) & (ii) (below)
<b>Rent</b>	8-1	\$1,485 – See Note (i) (below)	\$1,551.83 – See Notes (i) & (ii) (below)	\$1,551.83 (indexed)– See Notes (i) & (ii) (below)	*Amount must be calculated – See Notes (i) & (ii) (below)

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year 1 deduction Year Ended 30 June 2003</b>	<b>Year 2 deduction Year Ended 30 June 2004</b>	<b>Year 3 deduction Year Ended 30 June 2005</b>
<b>Initial Management Fee</b>	8-1	\$13,007.50 – See Note (i) (below)		
<b>Annual Management Fees</b>	8-1		\$3,916 – See Notes (i) & (ii) (below)	\$2,128.50 (indexed) – See Notes (i) & (ii) (below)
<b>Rent</b>	8-1	\$1,551.83 – See Note (i) (below)	\$1,551.83 (indexed) – See Notes (i) & (ii) (below)	* Amount must be calculated – See Notes (i) & (ii) (below)

\* From 1 July 2003, rent is payable annually on 31 October of the relevant year, equal to the amount of the rent which was payable in the previous year indexed by the increase in the Consumer Price Index in June of that year.

**Notes:**

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 118;
- (ii) The management fees and the rent shown in the Management Agreement and the Grove Lease are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 92 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

**Deductions for capital expenditure****Division 40**

50. A Grower who is not an “STS taxpayer” will also be entitled to tax deductions relating to the irrigation system (water facilities) and the establishment of the olive trees. All deductions shown in the following table are determined under Division 40.

**2002 Growers**

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
<b>Irrigation Equipment</b>	40-515	\$1,283 - See Notes (iii) & (iv) (below)	\$1,283 - See Notes (iii) & (iv) (below)	\$1,284 - See Notes (iii) & (iv) (below)	
<b>Establishment of olive trees</b>	40-515	Nil - See Notes (iii) & (v) (below)	Nil - See Notes (iii) & (v) (below)	Nil - See Notes (iii) & (v) (below)	Amount must be calculated – See Notes (iii) and (v) (below)

**2003 Growers**

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
<b>Irrigation Equipment</b>	40-515	\$1,283 - See Notes (iii) & (iv) (below)	\$1,283 - See Notes (iii) & (iv) (below)	\$1,283 - See Notes (iii) & (iv) (below)
<b>Establish - ment of olive trees</b>	40-515	Nil - See Notes (iii) & (v) (below)	Nil - See Notes (iii) & (v) (below)	Nil - See Notes (iii) & (v) (below)

**Notes:**

- (iii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 118;
- (iv) Any irrigation system, dam or bore is a ‘water facility’ as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under

Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540);

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

## **Tax outcomes for Growers who are 'STS taxpayers'**

### **Assessable Income**

#### **Section 6-5**

51. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

52. The Grower recognises ordinary income from carrying on the business of afforestation at the time the income is received (paragraph 328-105(1)(a)).

### **Treatment of Trading Stock**

#### **Section 328-285**

53. A Grower who is an 'STS taxpayer' may, in some years, hold olives and/or olive produce that will constitute trading stock on hand. Where, for such a Grower, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than \$5,000, they do not have to

account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

54. Alternatively, a Grower who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

### **Deductions for Management Fees and Rent**

#### **Section 8-1 and section 328-105**

55. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

#### **2002 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year 1 deduction Year Ended 30 June 2002</b>	<b>Year 2 deduction Year Ended 30 June 2003</b>	<b>Year 3 deduction Year Ended 30 June 2004</b>	<b>Year 4 deduction Year Ended 30 June 2005</b>
<b>Initial Management Fee</b>	8-1 & 328-105	\$13,007.50 - See Notes (vi) & (vii) (below)			
<b>Annual Management Fees</b>	8-1 & 328-105		\$3,916 – See Notes (vi), (vii) & (viii) (below)	\$2,128.50 – See Notes (vi), (vii) & (viii) (below)	\$2,128.50 (indexed) – See Notes (vi), (vii) & (viii) (below)
<b>Rent</b>	8-1 & 328-105	\$1,485 – See Notes (vi) & (vii) (below)	\$1,551.83 – See Notes (vi), (vii) & (viii) (below)	\$1,551.83 (indexed) – See Notes (vi), (vii) & (viii) (below)	*Amount must be calculated – See Notes (vi), (vii) & (viii) (below)

#### **2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year 1 deduction Year Ended 30 June 2003</b>	<b>Year 2 deduction Year Ended 30 June 2004</b>	<b>Year 3 deduction Year Ended 30 June 2005</b>
<b>Initial Management Fee</b>	8-1 & 328-105	\$13,007.50 - See Notes (vi) & (vii) (below)		
<b>Annual Management Fees</b>	8-1 & 328-105		\$3,916 – See Notes (vi), (vii) & (viii) (below)	\$2,128.50 – See Notes (vi), (vii) & (viii) (below)
<b>Rent</b>	8-1 & 328-105	\$1,551.83 – See Notes (vi) & (vii) (below)	\$1,551.83 (indexed) – See Notes (vi), (vii) & (viii) (below)	* Amount must be calculated – See Notes (vi), (vii) & (viii) (below)

\* From 1 July 2003, rent is payable annually on 31 October of the relevant year, equal to the amount of the rent which was payable in the previous year indexed by the increase in the Consumer Price Index in June of that year.

**Notes:**

- (vi) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 118;
- (vii) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid;
- (viii) Where a Grower who is an 'STS taxpayer', pays the management fees and the rent in the relevant income years shown in the Management Agreement and the Grove Lease, those fees are deductible in full in the year that they are paid. However, if a Grower chooses to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 92, unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

**Deductions for capital expenditure****Subdivision 328-D and Subdivisions 40-F and 40-G**

56. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g., irrigation) and olive trees. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F. If the 'water facility' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to

claim deductions under Division 328. Deductions for the olive trees must be determined under Subdivision 40-F.

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

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

### 2002 Growers

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
<b>Irrigation Equipment</b>	40-515	\$1,283 - See Notes (ix) & (x) (below)	\$1,283 - See Notes (ix) & (x) (below)	\$1,284 - See Notes (ix) & (x) (below)	Nil
<b>Establishment of olive trees</b>	40-515	Nil - See Notes (ix) & (xi) (below)	Nil - See Notes (ix) & (xi) (below)	Nil - See Notes (ix) & (xi) (below)	Amount must be calculated – See Notes (ix) and (xi) (below)

### 2003 Growers

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
<b>Irrigation Equipment</b>	40-515	\$1,283 - See Notes (ix) & (x) (below)	\$1,283 - See Notes (ix) & (x) (below)	\$1,284 - See Notes (ix) & (x) (below)
<b>Establishment of olive trees</b>	40-515	Nil - See Notes (ix) & (xi) (below)	Nil - See Notes (ix) & (xi) (below)	Nil - See Notes (ix) & (xi) (below)

**Notes:**

- (ix) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 118;
- (x) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the first Financial Year is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540);
- (xi) Olive trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a sub-lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the olive trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the olive trees have an 'effective life' of greater than

30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the olive trees enter their first commercial season (section 40-530, item 2). The Grove Manager will inform Growers of when the olive trees enter their first commercial season.

## **Tax outcomes that apply to all Growers**

### **Interest**

59. The deductibility or otherwise 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. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 87 to 92 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

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

60. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 or 30 June 2003 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. For 2002 Growers under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2006 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. For 2003 Growers, under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2003 to 30 June 2007 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- the 'exception' in subsection 35-10(4) applies (see paragraph 106 in the Explanations part of this ruling, below); or
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45.

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

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

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

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

- expenditure by a Grower who participates in the Project does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 87 to 99);
- 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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### **Is the Grower carrying on a business?**

65. For the amounts set out in the Tables above to constitute allowable deductions the Grower's horticulture activities as a participant in the Mediterranean Olives Project 2002 must amount to the carrying on of a business of primary production. These horticulture activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

66. For schemes such as that of the Mediterranean Olives Project 2002, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the

carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929,(1984) 15 ATR 932.

67. Generally, a Grower will be carrying on a business of horticulture, and hence primary production, if:

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

68. In this Project, each Grower enters into a Management Agreement, a Grove Lease and an Irrigation Sale and Purchase Agreement.

69. Under the Grove Lease each individual Grower will have rights over a specific and identifiable area of land. The Grove Lease provides the Grower with an ongoing interest in the specific olive trees on the leased area for the term of the Project. Under the sub-lease the Grower must use the land in question for the purpose of carrying out horticultural activities and for no other purpose. The sub-lease allows the Project Manager to come onto the land to carry out its obligations under the Management Agreement.

70. Under the Management Agreement the Project Manager is engaged by the Grower to establish and maintain a Grove on the Grower's identifiable area of land during the term of the Project. The Project Manager has provided evidence that it has access to the appropriate professional skills and credentials to provide the management services to establish and maintain the Grove on the Grower's behalf.

71. In establishing the Grove, the Grower engages the Project Manager to install irrigation and to acquire and plant seedlings on the Grower's Grove. During the term of the Project these assets will be used wholly to carry out the Grower's horticulture activities. The Project Manager is also engaged to harvest and sell, on the Grower's behalf, the olives grown on the Grower's Grove.

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

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

74. The pooling of olives grown on the Grower's Grove with the olives of other Growers is consistent with general horticulture practices. Each Grower's proportionate share of the sale proceeds of the pooled olives will reflect the proportion of the olives contributed from their Grove.

75. The Project Manager's services and the installation of assets on the Grower's behalf are also consistent with general horticulture practices. The assets are of the type ordinarily used in carrying on a business of horticulture. While the size of a Grove is relatively small, it is of a size and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

76. The Grower's degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the *Corporations Act (Cth)* 2001, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Grove and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

77. The horticulture activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' horticultural activities in the Mediterranean Olives Project 2002 will constitute the carrying on of a business.

## **The Simplified Tax System**

### **Division 328**

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

79. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore,

any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

## **Deductibility of management fees and rent**

### **Section 8-1**

80. Consideration of whether the initial management fees and rent are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

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

### *Possible application of prepayment provisions*

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

83. However, where a Grower chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 87 to 92) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

#### *Timing of deductions*

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

85. If the Grower is not an 'STS taxpayer', the management fees and the rent are deductible in the year in which they are incurred.

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

### **Prepayment provisions**

#### **Sections 82KZL to 82KZMF**

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

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

exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF.

*Sections 82KZME and 82KZMF*

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

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

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

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

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

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

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

*Application of the prepayment provisions to this Project*

93. In this Project, an initial management fee of \$13,007.50, rent of \$1,485 per Grove for 2002 Growers or \$1,551.83 per Grove for 2003 Growers, seedling and planting fee of \$3,492.50 and \$3,850 for irrigation equipment will be incurred on execution of the Management Agreement, Grove Lease and the Irrigation Sale and Purchase Agreement. The Management Fee and the rent are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

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

95. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee, and the fees for subsequent years, is for the Project Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Grove Lease, rent is payable annually on 31 October for the lease of the land during the expenditure year.

96. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 32 to 37, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

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

97. Although not required under either the Management Agreement or the Grove Lease a Grower participating in the Project may choose to prepay fees for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 96 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

98. For these Growers, the amount and timing of deductions for any relevant prepaid management fees or prepaid rent will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

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

### **Expenditure of a capital nature**

#### **Division 40 and Division 328**

100. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, the amounts summarised in the Tables at paragraphs 51 and 60 above, are considered to be capital in nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

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

102. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 50 and 58 (above), in the Tables and the accompanying Notes.

### **Deferral of losses from non-commercial business activities**

#### **Division 35**

103. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2), a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

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

104. 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.

105. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

106. For the purposes of applying Division 35, 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.

107. In broad terms, the 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, or an interest in real property, (excluding any private dwelling) 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 (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

108. 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 2002 Grower who acquires the minimum allocation of one Grove in the Project is unlikely to have their activity pass one of the tests until

the income year ended 30 June 2009, or 2010 for a 2003 Grower. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

109. 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.

110. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where the business activity has started to be carried on and for that, or those income years;

- because of its nature, it has not yet met one of the tests set out in Division 35; and
- there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

111. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Grove in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2007 for 2002 Growers or 30 June 2008 for 2003 Growers. The Commissioner will decide for 2002 Growers that it would be reasonable to exercise the second arm of the discretion for all income years up to , and including the income year ended 30 June 2006 for 2002 Growers or 30 June 2007 for 2003 Growers.

112. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 60), in the manner described in the Arrangement (see paragraphs 14 to 40). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

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

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

114. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

## **Part IVA - general tax avoidance provisions**

115. 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).

116. The Mediterranean Olives Project 2002 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, 50, 55 and 58, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

117. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of their olives and/or olive produce. 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 at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

## Examples

### Example 1 - Entitlement to GST input tax credits

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

Management fee for period 1/1/2002 to 30/6/2002	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2002 (includes GST of \$600)	<u>\$6,600</u>

\*Taxable supply

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

$$\frac{1}{11} \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4,400 *less* \$400, or \$4,000.

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

$$\frac{1}{11} \times \$2,200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2,200 *less* \$200, or \$2,000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2,000 only, not one tenth of \$2,200).

**Detailed contents list**

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

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**Commissioner of Taxation**

29 May 2002

<i>Previous draft:</i>	- ITAA 1997 35-35
Not previously issued in draft form	- ITAA 1997 35-40
	- ITAA 1997 35-45
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-55
TR 2000/8; PR 2000/93; PR 1999/95;	- ITAA 1997 35-55(1)
PR 2000/114; TR 92/1; TR 92/20;	- ITAA 1997 35-55(1)(a)
TR 97/11; TR 97/16; TD 93/34;	- ITAA 1997 35-55(1)(b)
TR 98/22; IT 360; IT 175; IT 2001	- ITAA 1997 Subdiv 40-F
	- ITAA 1997 40-515
<i>Subject references:</i>	- ITAA 1997 40-515(1)(a)
- carrying on a business	- ITAA 1997 40-515(1)(b)
- commencement of business	- ITAA 1997 40-525(2)
- primary production	- ITAA 1997 40-530
- primary production expenses	- ITAA 1997 40-540
- management fee expenses	- ITAA 1997 40-545
- producing assessable income	- ITAA 1997 Div 70
- product rulings	- ITAA 1997 70-35
- public rulings	- ITAA 1997 Div 328
- schemes and shams	- ITAA 1997 Subdiv 328-F
- taxation administration	- ITAA 1997 Subdiv 328-G
- tax avoidance	- ITAA 1997 328-105
- tax benefits under tax avoidance	- ITAA 1997 328-105(1)(b)
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- tax shelters	- ITAA 1997 328-285(1)
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- ITAA 1997 35-10(4)	- ITAA 1936 177C
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