



# ***PR 2003/24 - Income tax: 2003 Timbercorp Olive Project***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *23 November 2005*



## Product Ruling

### Income tax: 2003 Timbercorp Olive Project

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#### **Preamble**

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

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

#### **No guarantee of commercial success**

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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**

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

## What this Product Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax 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 2003 Timbercorp Olive Project or simply as 'the Project'.

### Tax law(s)

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);
- Section 25-25 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Section 70-35 (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.

**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.

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## Date of effect

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11. This Ruling applies prospectively from 14 May 2003, 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 2006. 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 Product Ruling dated 19 December 2002 as constituted by documents provided on 18 November 2002, 6 December 2002 and 19 December 2002 and additional correspondence dated 19 February 2003, 27 February 2003, 17 March 2003, 18 March 2003, 9 April 2003, 14 April 2003 and 5 May 2003;
- Draft 2003 Timbercorp Olive Project Prospectus ('the Prospectus') prepared for Timbercorp Securities Limited ('TSL' or 'Responsible Entity') dated 5 May 2003;
- Draft **Constitution** of the 2003 Timbercorp Olive Project between TSL and Grovelot Holdings (2003 Project) Limited and each Grower dated 5 May 2003;
- Draft Lease Agreement between TSL and Olivecorp Land Pty Ltd ('Land Owner') dated 5 May 2003;
- Draft **Sub-lease Agreement** between the Land Owner, TSL and each Grower, dated 5 May 2003;
- Draft **Grovelot Management Agreement** between TSL and each Grower, dated 5 May 2003;
- Draft Management Agreement between TSL and Olivecorp Management Limited dated 18 November 2002;
- Put Option Agreement between Olivecorp Management Limited and TSL and the Purchaser;
- Draft Option Agreement between Olivecorp Land Pty Ltd and Grovelot Holdings (2003 Project) Limited dated 18 November 2002;
- Draft Custody Agreement between TSL and Permanent Trustee Company dated 5 May 2003;
- Draft Compliance Plan for the Project, dated 5 May 2003; and
- Draft **finance package** from Timbercorp Finance Pty Ltd.

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

15. The documents highlighted are those Growers enter into or become a party to. A Loan Agreement will be executed where a Grower successfully applies for finance from Timbercorp Finance Pty Ltd. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are part of the arrangements to which this Ruling applies.

16. It should be noted that the term Grower as used in this Ruling means each several person who becomes a party to these documents as a result of the allotment of Grovelot pursuant to an Application in the Prospectus. In these documents, a Grower is referred to as 'Participant Grower'.

17. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

## Overview

18. This arrangement is called the 2003 Timbercorp Olive Project.

Location	Boort (northwest of Bendigo), Victoria
Type of business each participant is carrying on	Cultivating olive trees on their designated 0.25 hectare olive Grovelot and harvesting the olives for production and sale of olive oil
Number of hectares under cultivation	Up to 500 hectares of olive groves with an option to accept oversubscription
Size of each Grovelot	0.25 hectares  Each Grovelot will comprise of an Existing Grovelot (0.05 hectares) and a New Grovelot (0.20 hectares).
Number of olive trees per Grovelot	88 on average
Number of olive trees per hectare	353 trees on average

Minimum number of Grovelots per Grower	Two (2)  The Responsible Entity reserves the right to accept applications for one Grovelot.
The term of the Project in years	Approximately 23 years commencing on acceptance of a Grower's application and ending on 30 June 2026
Subscription amount per Grovelot	\$4,300  This amount is comprised of \$3,500 initial management fee and \$800 rent (see paragraphs 31 & 32 for details of on-going fees).
Subscription amount per hectare	\$17,200
Minimum subscription for Project	None
Option to take up shares in Grovelot Holdings (2003 Project) Limited	Grovelot Holdings (2003 Project) Limited has an option, exercisable between 1 April 2026 and 30 April 2026, to acquire a legal interest in the land on which the olive grove has been established that will not exceed 24.9% of the land. Each Grower will be issued with options to take up shares in the capital of Grovelot Holdings (2003 Project) Limited equal to the number of Grovelots in the Project that the Grower subscribes for. The Growers' options to subscribe for shares are exercisable between 1 March 2026 and 31 March 2026.

19. Applications to participate in the Project are open until the expiry of the Prospectus unless the Responsible Entity closes the offer period earlier. Applicants who make an application and are accepted into the Project in the year ending 30 June 2003 are described as Early Growers. It should be noted that applications will only be accepted by the Responsible Entity during the period 16 June 2003 and 30 June 2003 where the Responsible Entity can wholly provide the services in consideration of the moneys payable on application by 30 June 2003. Applicants who make an application and are accepted



into the Project on or after 1 July 2003 and before the offer period closes are referred to as Post 30 June Growers.

**Interest in land**

20. The land on which the Project will be conducted will be leased by the Land Owner to the Responsible Entity. Growers entering into the Project will enter into a Sub-lease Agreement with the Responsible Entity and the Land Owner as other parties to this agreement. Under this agreement, each Grower will be granted a sub-lease by the Responsible Entity to use and occupy a minimum of two parcels of land for a period of 23 years for the purpose of cultivating the grove for the production of olives for processing into olive oil for sale. The Responsible Entity may however accept an application for only one parcel of land. Each parcel of land, referred to in this Project as a Grovelot, is an allotment of 0.25 hectares of land. Each Grovelot will comprise of an Existing Grovelot which has an area of approximately 0.05 hectares and a New Grovelot with an area of approximately 0.20 hectares. The Existing Grovelot was established by the Land Owner in the 2001 financial year while the establishment of the New Grovelot will be completed by 31 May 2003.

21. Growers will enter into a Grovelot Management Agreement with the Responsible Entity to perform services in relation to the cultivation and management of their Grovelots. Under this agreement, the Responsible Entity will also harvest the olives, procure the processing of olives into olive oil and sell the oil on behalf of the Growers (at market prices). The Responsible Entity will only provide services following the execution of the Sub-lease Agreement. The subscription moneys payable on application are payable in respect of services to be wholly provided by 30 June 2003 (for Early Growers) and 30 June 2004 (for Post 30 June Growers). The fees payable in subsequent financial years are payable in respect of services to be wholly provided in the financial year in which those fees are due and payable.

**Sub-lease Agreement**

22. Under the Sub-lease Agreement, each Grower will be granted a sub-lease to use and occupy Grovelots allotted to the Grower for the sole purpose of cultivating and harvesting olives and producing olive oil.

23. Under the Sub-lease, the Land Owner warrants and represents to the Grower that, at its own cost, in respect of Existing Grovelots, it has carried out and completed all establishment and capital works and in respect of New Grovelots, these works will be completed in full by 31 May 2003. These establishment and capital works include as follows:

- preparation of that part of the Land and each Grovelot which can be used to grow Olive Trees satisfactorily;
- installation of appropriate irrigation equipment and carrying out the necessary irrigation works to ensure proper reticulation of water to the Olive Trees on each Grovelot;
- carrying out drainage work and other works to help prevent soil erosion on all Land;
- eradication as far as reasonably possible any pests and competitive weeds which may affect the growth or yield of the Olive Trees;
- planting Olive Trees on each Grovelot, staking, surveying and erecting stakes approximately 2.3 meters in height and where applicable, construct trellising in accordance with good horticultural practices so that the Olive Trees can be harvested commercially; and
- providing or undertaking, as the case requires, such other capital works, services or things which, in the reasonable opinion of the Land Owner, are incidental or ancillary to the effective establishment and provision of the works referred to above.

24. The Land Owner must purchase and maintain Water Rights up to a maximum of 5.5 megalitres of water per plantable hectare during the Project as required to irrigate the Grovelots and ensure that its Water Rights are fully exploited.

25. The agreement stipulates the rights and obligations of the Responsible Entity which includes allowing the Grower to peacefully and quietly hold the Grovelots. This agreement is subject and conditional on the Grower entering into the Grovelot Management Agreement with the Responsible Entity and the Lease being entered into by the Responsible Entity with the Land Owner on or before the Commencement Date.

26. The Sub-lease Agreement also provides that the Grower must only use the Grovelots for the purpose of the Grovelot Operations and must comply with good horticultural and environmental practices and relevant laws and regulations. The Grower must permit access to the Grovelot(s) for the purposes of the Project under the Sub-lease and the Grovelot Management Agreement. The Grower may engage any person as an agent for the better performance of its obligation under the Sub-lease.

### **Grovelot Management Agreement**

27. Under the Grovelot Management Agreement, each Grower engages the Responsible Entity ('the Manager') to manage and cultivate the grove on behalf of the Grower in accordance with the management plan, harvest the olives, procure the processing of the olives into olive oil and market the oil for sale for the duration of the term. The olives from the relevant Grovelots will be pooled with olives from other Grovelots and Growers will be entitled to their pro rata proportion of the olives and the olive oil produced.

28. The Manager is required to perform the following services in a proper and efficient manner to the extent necessary and in accordance with good horticultural and environmental practices:

- prune the Olive Trees by mechanical or other methods;
- as permitted by law, eradicate vermin which have caused or may cause damage to the Olive Trees or the relevant Grovelots and put in place measures to control such vermin;
- operate the irrigation system;
- at its discretion, conduct tests to ascertain the availability of nutrients in the soil and based on the results, take whatever action is required to maintain the growth rate and productivity of the Olive Trees;
- fertilise as required, in accordance with good horticultural practices, to maintain satisfactory rates of growth and productivity of the Olive Trees;
- destroy any of the Olive Trees or Olives which have contracted an exotic, noxious or incurable disease;
- keep the improvements in good and substantial repair;
- maintain fire breaks in accordance with regulatory and insurance requirements and good horticultural practices;

- maintain the relevant Grovelots in accordance with good horticultural practices including using soil management technique methods to reduce erosion and maintain soil quality;
- protect the Olive Trees from insect infestation and competition from competing growth using good horticultural practices;
- regularly inspect and repair all stakes, fences and irrigation equipment;
- tie and stake all Olive Trees or (where applicable) attach Olive Trees to trellising in accordance with good horticultural practices;
- replant any of the Olive Trees in need of replacement in accordance with the terms of any agreement made with suppliers of the Olive Trees;
- comply with the Grower's obligations under the Sub-lease Agreement (except for those relating to payment of fees);
- do all things necessary to ensure that its rights under the Water Licences are fully exploited to maximise the use and enjoyment of them;
- take all steps to avoid interfering with the supply of water to the relevant Grovelots and to avoid any actions that would prejudice the Grower's rights under this Agreement;
- not discriminate in the supply of water under the Water Licences;
- if additional water in excess of 1.375 mega litres per Grovelot is required from time to time in order to irrigate the Grove and such additional water can be reasonably procured by way of temporary water rights, procure such additional water and supply it to the Grower, at a cost to the Grower to be determined in accordance with this Agreement;
- provide any other service or thing which, in the reasonable opinion of the Responsible Entity, is incidental or ancillary to the ongoing management of the relevant Grovelots; and
- comply with all laws and regulations relating to the use and occupancy of the relevant Grovelots.

29. The Manager will endeavour to arrange insurance on the Growers' behalf. Where this is available, Growers are required to insure their Grovelots against damage or destruction by fire and other insurable risks. The Manager will arrange payment of insurance premiums to the appropriate insurers.

30. Pursuant to the Manager's right to delegate any of its obligations under this Agreement, it has entered into a Management Agreement with Olivecorp Management Limited. Under this Management Agreement, Olivecorp Management Limited agrees to carry out the services detailed in paragraph 28 above.

### **Fees**

31. Having regard to the contractual terms of the Sub-lease Agreement and Grovelot Management Agreement, the fees payable by a Grower per Grovelot will be as follows:

#### ***Fees payable by Early Growers***

- for the period from Commencement Date until 30 June 2003, \$800 rent and \$3,500 initial management fee, payable on application;
- for the period 1 July 2003 to 30 June 2004, \$800 rent and \$2,310 management fee, payable on 31 October 2003; and
- for the period 1 July 2004 to 30 June 2005, \$800 rent and \$2,310 management fee, payable on 31 October 2004.

#### ***Fees payable by Post 30 June Growers***

- for the period from Commencement Date until 30 June 2004, \$800 rent and \$3,500 initial management fee, payable on application; and
- for the period 1 July 2004 to 30 June 2005, \$800 rent and \$3,500 management fee, payable on 31 October 2004.

### ***All Growers***

From and including the Financial Year ending 30 June 2006 all Growers will pay the following fees in each Financial Year:

- management fee in respect of services to be provided in each Financial Year to be estimated in the first instance by the Responsible Entity and adjusted once the actual

costs of managing the Grower's Grovelots are determined, payable on 31 October each year; and

- rent amount being the rent payable on the immediately preceding 31 October, indexed, payable on 31 October each year.

32. All Growers will also pay to the Manager their proportion of the following additional annual fees:

- a management fee based on a percentage of annual gross proceeds from the sale of bulk olive oil less the costs and expenses of processing the olives into olive oil (paragraph 10.3(b) of the Grovelot Management Agreement); and
- an incentive fee of 25% of so much of the annual Net Proceeds in a Financial Year as exceeds the proceeds specified in the Prospectus (paragraphs 10.4 (a) & (b) of the Grovelot Management Agreement).

33. Sub-clause 18.4 of the Constitution sets out the manner in dealing with a Grower's failure to pay by the due date. A Defaulting Grower may be sued by the Responsible Entity for any amount due and assign the Defaulting Grower's interest in the Grovelot to the Land Owner or any other person nominated by the Responsible Entity. This assignment will cause the Call Option to lapse immediately.

## **Finance**

34. Growers can either fund their participation in the Project themselves, borrow from an independent lender, or may elect to use the financing packages offered by Timbercorp Finance Pty Ltd (a lender associated with the Responsible Entity).

35. Under the financing package offered by Timbercorp Finance Pty Ltd ('the Lender'), Growers may enter into the following finance arrangement.

36. A loan application fee of \$250 is payable. The Lender will lend, generally, up to 80% of the fixed fees payable by Early Growers during the first three years of the Project and by Post 30 June Growers during the first two years of their participation in the Project. The minimum loan is \$5,000. There are three loan terms available and the interest rate per annum which applies to the relevant loan term is as follows:

- 3 years – 9%;
- 4 years – 10%;
- 5 years – 11%; and

- 7 years – 11%.

37. The interest rate is fixed for the term of the loan. In the event of default, a higher interest rate will apply. In all instances, the loan is repayable by equal monthly instalments of principal and interest to be deducted from the borrower's bank account under a direct debit authority. All or part of a loan may be repaid at any time without penalty. Corporate borrowers are required to provide guarantees and indemnities. The provision of finance involves full recourse loans and the Lender will pursue legal action against defaulting borrowers.

38. 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, other than Timbercorp Finance Pty Ltd, are involved or become involved in the provision of finance to Growers for the Project.

## **Ruling**

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### **Application of this Ruling**

39. This Product Ruling applies to a Grower who is accepted to participate in the Project:

- on or before 15 June 2003;
- during the period 16 June 2003 to 30 June 2003 (provided that the Responsible Entity can wholly provide the services in consideration of the moneys payable on application by 30 June 2003); or
- on or after 1 July 2003 and before the expiry date of the Prospectus; and

the Grower has executed the Sub-lease Agreement and the Grovelot Management Agreement on or before the date of acceptance.

40. The Grower's participation in the Project must constitute the carrying on of a business of primary production. 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.

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

#### ***Division 328***

41. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. Changes to the STS rules apply from 1 July 2005. From that date, STS taxpayers may use the accruals accounting method. For a Grower participating in the Project, the recognition of income and the timing of tax deductions under the STS where the Grower uses the cash accounting method is different.

### **Qualification**

42. 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***

43. That part of the gross sales proceeds from the Project attributable to the Grower's share of the gross proceeds from the sale



of the product, less any GST payable on the Grower's share of those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

44. The Grower recognises ordinary income from carrying on the business of cultivating olive trees and harvesting the olives for the production and sale of olive oil at the time that income is derived.

### **Trading stock**

#### ***Section 70-35***

45. During the term of the Project a Grower who is not an 'STS taxpayer' may hold olives or olive oil 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.

46. 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.

47. During each year of the Project the Manager will provide the Grower with sufficient information to enable the Grower to determine the value of trading stock on hand at the end of the relevant income year.

### **Deductions for management fees, rent and interest**

#### ***Section 8-1***

48. An Early Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>30/6/2003</b>	<b>30/6/2004</b>	<b>30/6/2005</b>
Management fee	8-1	\$3,500 – See Notes (i) & (ii) below	\$2,310 – See Notes (i) & (ii) below	\$2,310 – See Notes (i) & (ii) below
Rent	8-1	\$800 – See Notes (i) & (ii) below	\$800 – See Notes (i) & (ii) below	\$800 – See Notes (i) & (ii) below

Interest on borrowed funds	8-1	As incurred – See Note (iii) below	As incurred – See Note (iii) below	As incurred – See note (iii) below
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49. A Post 30 June Grower who is not an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>30/6/2004</b>	<b>30/6/2005</b>	<b>30/6/2006</b>
Management fee	8-1	\$3,500 – See Notes (i) & (ii) below	\$3,500 – See Notes (i) & (ii) below	As incurred – See Notes (i) & (ii) below
Rent	8-1	\$800 – See Notes (i) & (ii) below	\$800 – See Notes (i) & (ii) below	\$800, indexed – See Notes (i) & (ii) below
Interest on borrowed funds	8-1	As incurred – See Note (iii) below	As incurred – See Note (iii) below	As incurred – See note (iii) below

**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 128;
- (ii) The management fees and the rent shown in the Grovelot Management Agreement and the Sub-lease Agreement are deductible in full in the year that they are incurred. However, if a Grower chooses to prepay fees for the doing of a thing (e.g. the provision of management services or the 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 101 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; and

- (iii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd, the internal financier, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with Timbercorp Finance Pty Ltd, should read the discussion of the prepayment rules in paragraphs 95 to 102 (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.

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

### **Assessable Income**

#### ***Section 6-5 and section 328-105***

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

51. The Grower recognises ordinary income from carrying on the business of cultivating olive trees and harvesting the olives for the production and sale of olive oil at the time the income is received (paragraph 328-105(1)(a)).

51A. For the 2005-06 income year and later years, a Grower's ordinary income from carrying on a business of cultivating olive trees and harvesting the olives for the production and sale of olive oil will be assessable in the income year in which that income is derived where that Grower uses the accruals accounting method, or in the income year in which that income is received where that Grower uses the cash accounting method.

### **Trading stock**

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

52. During the term of the Project a Grower who is an 'STS taxpayer' may hold olives or olive oil that will constitute trading stock on hand. Where, the difference between the value of all of a Grower's trading stock at the start of an income year and a reasonable

estimate of it at the end of an income year, is less than \$5,000, the Grower does not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

53. 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)).

54. During each year of the Project the Manager will provide the Grower with sufficient information to enable the Grower to determine the value of trading stock on hand at the end of the relevant income year.

### **Deductions for management fees, rent and interest**

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

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

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>30/6/2003</b>	<b>30/6/2004</b>	<b>30/6/2005</b>
Management fee	8-1 & 328-105	\$3,500 – See Notes (iv), (v) & (vi) below	\$2,310 – See Notes (iv), (v) & (vi) below	\$2,310 – See Notes (iv), (v) & (vi) below
Rent	8-1 & 328-105	\$800 – See Notes (iv), (v) & (vi) below	\$800 – See Notes (iv), (v) & (vi) below	\$800 – See Notes (iv), (v) & (vi) below
Interest on borrowed funds	8-1 & 328-105	When paid – See Note (vii) below	When paid – See Note (vii) below	When paid – See note (vii) below

56. A Post 30 June Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses.

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<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>30/6/2004</b>	<b>30/6/2005</b>	<b>30/6/2006</b>
Management fee	8-1 & 328-105	\$3,500 – See Notes (iv), (v) & (vi) below	\$3,500 – See Notes (iv), (v) & (vi) below	As incurred (STS taxpayers using the accruals accounting method) or as paid (STS taxpayers using the cash accounting method) – See Notes (iv), (v) & (vi) below
Rent	8-1 & 328-105	\$800 – See Notes (iv), (v) & (vi) below	\$800 – See Notes (iv), (v) & (vi) below	\$800 – indexed See Notes (iv), (v) & (vi) below
Interest on borrowed funds	8-1 & 328-105	When paid – See Note (vii) below	When paid – See Note (vii) below	As incurred (STS taxpayers using the accruals accounting method) or as paid (STS taxpayers using the cash accounting method) – See Note (vii) below

**Notes:**

- (iv) 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 128;
- (v) For the 2002-03 to 2004-05 income years, an amount shown in the table above is deductible in full in the year in which it is paid where the Grower is an 'STS taxpayer'. For the 2005-06 income year, an amount shown in the table above is deductible in full in the year in which it is incurred where the Grower is an 'STS taxpayer' using the accruals accounting method, or in the year in which it is paid where the Grower is an 'STS taxpayer' using the cash accounting method;
- (vi) 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 same income year as the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 101, 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; and
- (vii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd, the internal financier is outside the scope of this Ruling. However, all Growers, including those who finance their participation in the Project other than with Timbercorp Finance Pty Ltd, should read the discussion of the prepayment rules in paragraph 95 to 102 (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.

**Tax outcomes that apply to all Growers****Deduction for the loan application fee*****Section 25-25***

57. The Loan Application fee of \$250 is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The expense is deductible over the period of the loan specified in the loan agreement, or five years, whichever is the shorter period, beginning with the year in which they were incurred (subsections 25-25(4) and (5)).

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

58. For a Grower who is an individual and who enters the Project during the year ended 30 June 2003 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 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.

59. For a Grower who is an individual and who enters the Project during the year ended 30 June 2004 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2004 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.

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

- a Grower’s business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the ‘Exception’ in subsection 35-10(4) applies (see paragraph 114 in the Explanations part of this ruling, below).

61. Where either the Grower’s business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e. any ‘loss’ from that

activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

62. 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.

### **Deductions for horticultural plant**

#### ***Division 40***

63. A Grower will also be entitled to tax deductions relating to the olive trees on the Grovelot. The deductions shown in the table below are determined under Division 40.

<b>ITAA 1997 Section</b>	<b>30/6/2003</b>	<b>30/6/2004</b>	<b>30/6/2005</b>
<b>Section 40-515</b>	nil - See Note (ix) (below)	\$6.51 - See Notes (viii) & (ix) (below)	\$6.51 - See Notes (viii) & (ix) (below)

#### **Notes:**

- (viii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example at paragraph 128.
- (ix) An olive tree is considered to be a 'horticultural plant' as defined in subsection 40-520(2). As a Grower holds the land under a 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 is determined using the formula in section 40-545. The establishment expenditure that can be written-off by a Grower is limited to the capital expenditure incurred that is attributable to the establishment of the olive trees. As the olive trees have an 'effective life' of 30 years or more, a straight-line write-off rate of 7% will be applied. The deduction is allowable when the olive trees enter their first commercial season (section 40-530, item 2).



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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 95 to 102);
- 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 activities of cultivating olive trees and harvesting the olives for the production and sale of olive oil as a participant in the 2003 Timbercorp Olive Project must amount to the carrying on of a business of primary production.

66. Where there is a business, or a future business, the Gross Proceeds from the sale of olive oil 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.

67. For schemes such as that of the 2003 Timbercorp Olive Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929; 16 ATR 55.

68. Generally, a Grower will be carrying on a business of cultivating olive trees and harvesting the olives for the production and sale of olive oil, and hence primary production, if:

- the Grower has an identifiable interest in the land on which the Grower's trees are established;

- the Grower has a right to harvest and sell the olives and olive oil produce from those trees;
- the cultivating of the olive trees and harvesting the olives for the production and sale of olive oil are carried out on the Grower's behalf;
- the activities of the Grower are typical of those associated with a business of cultivating olive trees and harvesting the olives for the production and sale of olive oil; and
- the weight and influence of general indicators point to the carrying on of a business.

69. In this Project, each Grower enters into a Sub-lease Agreement and a Grovelot Management Agreement.

70. Under the Sub-lease Agreement, each individual Grower will have rights over a specific and identifiable area of 0.25 hectares or more of land. The Sub-lease Agreement provides the Grower with an ongoing interest in the specific 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 activities of cultivating olive trees and harvesting the olives for the production and sale of olive oil and for no other purpose. The Sub-lease allows the Manager to come onto the land to carry out its obligations under the Grovelot Management Agreement.

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

72. The Manager is also engaged to harvest the olives grown on the Grower's Grovelot for the production and sale of olive oil on the Grower's behalf.

73. 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.

74. 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 olive oil 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.

75. The pooling of olives and olive oil produce from trees grown on the Grower's Grovelot with the olives and olive oil produce of

other Growers is consistent with general horticultural practices. Each Grower's proportionate share of the sale proceeds of the pooled olives and olive oil products will reflect the proportion of the trees contributed from their Grovelot.

76. The Manager's services are also consistent with general horticultural practices. They are of the type ordinarily found in horticultural ventures that would commonly be said to be businesses. While the size of a Grovelot is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

78. The activities of cultivating olive trees and harvesting the olives for the production and sale of olive oil, 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 Grower's activities of cultivating olive trees and harvesting the olives for the production and sale of olive oil in the 2003 Timbercorp Olive Project will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

79. 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.

80. 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***

81. 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.

82. The management fee and rent associated with the activities of cultivating olive trees and harvesting the olives for the production and sale of olive oil will relate to the gaining of income from the Grower's business of cultivating olive trees and harvesting the olives for the production and sale of olive oil (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of olives and olive oil produce) 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*

83. Under the Grovelot Management Agreement and the Sub-lease Agreement 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.

84. 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 95 to 102) 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*

85. 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'.

86. If the Grower is not an 'STS taxpayer' or an 'STS taxpayer' using the accruals accounting method, the management fees and the rent are deductible in the year in which they are incurred.

87. If the Grower is an 'STS taxpayer' who uses the cash accounting method, the management fees and the rent are deductible in the income year in which they are paid. 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.

## **Interest deductibility**

### ***Section 8-1***

#### *(i) Growers who use Timbercorp Finance Pty Ltd as the finance provider*

88. Some Growers may finance their participation in the Project through a loan facility with Timbercorp Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of management fee and rent.

89. The interest incurred for the year ended 30 June 2003 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations - the cultivation and growing of olive trees and the lease of the land on which the trees will have been planted - that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

90. As with the management fees and the rent, in the absence of any application of the prepayment provisions (see paragraphs 95 to 102), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

91. If the Grower is not an 'STS taxpayer' or an 'STS taxpayer' using the accruals accounting method, interest is deductible in the year in which it is incurred.

92. If the Grower is an 'STS taxpayer' who uses the cash accounting method, interest is not deductible until it has been both incurred and paid. If interest 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.

*(ii) Growers who DO NOT use Timbercorp Finance Pty Ltd as the finance provider*

93. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than Timbercorp Finance Pty Ltd 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.

94. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 95 to 102).

### **Prepayment provisions**

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

95. 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.

96. For this Project only section 82KZL (an interpretive 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***

97. 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)).

98. 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;
- 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.

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

100. 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.

101. 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.

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

102. 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*

103. In this Project, an initial management fee of \$3,500 and an initial rent of \$800 per Grovelot will be incurred on execution of the Grovelot Management Agreement and the Sub-lease Agreement. The management fee and the rent are charged for providing management services and granting a sub-lease to a Grower by 30 June of the year of execution of those agreements. Under those 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.

104. 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.

105. 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 Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Sub-lease Agreement, rent is payable annually on 31 October for the lease of the land from 1 July to 30 June during the expenditure year. Similarly, under the loan agreements to be executed between Growers and Timbercorp Finance Pty Ltd interest is payable monthly in arrears.



106. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 31 and 32, 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***

107. Although not required under either the Grovelot Management Agreement, the Sub-lease Agreement, or the Loan Agreement with Timbercorp Finance Pty Ltd, a Grower participating in the Project may **choose** to prepay fees/interest for a period beyond the 'expenditure year'. Similarly, Growers who use financiers other than Timbercorp Finance Pty Ltd may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 106 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

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

**Deductibility of the loan application fee**

***Section 25-25***

110. Borrowing expenses are deductible under section 25-25 where the borrowed moneys are used or are to be used during that income year for income producing purposes. The expenses are deductible over the period of the loan specified in the loan agreement, or five years, whichever is the shorter period, beginning with the year in which they were incurred (subsections 25-25(4) and (5)). Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)).

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

111. 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 incurred by an individual 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.

112. 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.

113. 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.

114. 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.

115. In broad terms, the objective tests require:

- at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- 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

- 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).

116. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum participation of two Grovelots (although the Responsible Entity reserves the right to accept applications for one Grovelot) in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2010. Growers who acquire more than the minimum participation in the Project may however, find that their activity meets one of the tests in an earlier income year.

117. 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.

118. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

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

119. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum participation of two Grovelots (although the Responsible Entity reserves the right to accept applications for one Grovelot) in the Project is expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2008. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2007.

120. 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 paragraphs 58 & 59), in the manner described in the Arrangement (see paragraphs 14 to 38). 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.

121. 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 draft report of the independent Olive Expert;
- the Put Option Agreement with the Purchaser; and
- independent, objective, and generally available information relating to the olive industry.

### **Section 82KL – recouped expenditure**

122. 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’.

123. ‘Additional benefit’ (see the definition of ‘additional benefit’ at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received 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.

124. Section 82KL’s operation depends, among other things, on the identification of ‘additional benefit(s)’. 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 anti-avoidance provisions**

125. 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).

126. The 2003 Timbercorp Olive 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 48, 49, 55 and 56, 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.

127. 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 the olives and olive oil 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.

## Example

### Example – Entitlement to GST input tax credits

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

Management fee for period 1/1/2002 to 30/6/2002	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<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:

$$1/11 \times \$4400 = \$400.$$

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

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

$$1/11 \times \$2200 = \$200.$$

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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**Commissioner of Taxation**

14 May 2003

*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*

TR 92/1; TR 92/20; TD 93/34;  
 TR 97/11; TR 97/16; TR 98/22;  
 TR 2000/8; PR 1999/95; IT 360

*Subject references:*

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fee expenses
- producing assessable income
- product rulings
- public rulings



- schemes and shams
- taxation administration
- tax avoidance

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