

PR 2003/28 - Income tax: Loddon Olive Project - 2003 Growers

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Product Ruling

Income tax: Loddon Olive Project – 2003 Growers

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Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

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 Loddon 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);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Division 40 (ITAA 1997);
 - Section 108-5 (ITAA 1997);
 - Section 110-25 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - Section 44 of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KL (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

11. This Ruling applies prospectively from 21 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

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

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 19 December 2002, 29 January 2003, 10 February 2003, and additional correspondence from Applicant's representative dated 18 February 2003, 11 March 2003 and 12 May 2003;
- Draft Loddon Olive Project Product Disclosure Statement;
- Constitution of Loddon Olives Limited ('Loddon' or 'Responsible Entity' or 'Manager');
- **Constitution** of Loddon Olive Project between Loddon Olives Limited and each Grower;
- Constitution of Mysia Holdings Limited ('Mysia' or 'Owner' or Landholding Company);
- Draft **Grove Licence Agreement (Applicants for the 2003 financial year)** between the Landowner (Owner), the Manager, and the Grower;
- Draft **Management Agreement (Applicants for the 2003 financial year)** between the Owner, the Manager and the Grower;
- Copy of Option to Purchase Agreement for up to five hundred and fifty five acres of land by Mysia Holdings Limited from Boort Olives Pty Ltd;
- Olive Purchase and Supply Agreement between the Manager and Inglewood Olive Processors Limited (Inglewood); and
- Draft Compliance Plan for the Project.

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. 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. 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

16. This arrangement is called the Loddon Olive Project. The salient features of the Project are shown in the table below.

Location	Mysia (north west of Bendigo), Victoria
Type of Business each participant is carrying on	Commercial growing and cultivation of an Olive Grove for the purpose of producing olives
Size of each Grove	0.4 hectare
Number of trees per Grove	130
Minimum number of Groves per Grower	1
Number of Groves available	550
Number of Groves for minimum subscription	80
Term of the Project	to 30 June 2023
Subscription amount per Grove	\$13,720 (including GST) for the year ending 30 June 2003, consisting of \$2,500 subscription to 2500 shares in the Landholding company, Olive seedling purchase \$786.50, Irrigation system \$2,090, management fees \$8343.50;
Grove licence fees	\$ 220 (including GST) payable each year by 30 th June commencing 2004 and indexed by CPI thereafter to 2023
Management fees	\$3,520 (including GST) for the year ending 30 June 2004; \$3,608 (including GST) for the year ending 30 June 2005; \$2657.60 (including GST) for the year ending 30 June 2006; For full details on management fees refer to paragraphs 37 to 40.

17. The project involves establishing, planting, cultivating and harvesting olives for sale either as olives or olive oil. A Grower who

participates in the project will do so by acquiring an interest which consist of two components:

- an interest in a 0.4 hectare Olive Grove; and
- a share parcel of 2500 ordinary shares in the landholding company at \$1.00 per share.

18. The second component of an interest in the project can be referred to as stapled securities which can not be subscribed to separately. However, those ordinary shares in the landholding company, being the stapled securities, can be held either directly by the Grower or their nominee, such as a superannuation fund, spouse, trust or company.

19. The Olive Groves and Shares will be issued once minimum subscription of 80 participating interests has been achieved. The Responsible Entity currently has an option over sufficient land which is suitable for the project. It is anticipated that 220 hectares will be developed which corresponds to subscriptions of 550 stapled interests, i.e. 550 Groves and the issue of 1,375,000 ordinary shares. The landholding company will own the land on which the groves will be planted, and also water rights sufficient for the project's needs. The Growers or their nominees will own 100% of shares in the landholding company.

20. Growers may be accepted into the Project on or before 31 May 2003. The supply and planting of the olive seedlings, the establishment of the irrigation system and the provision of initial management services will be completed on or before 30 June 2003.

21. Each Grower will be required to enter into a Grove Licence Agreement with the landholding company in relation to their grove. Each Grower will acquire interest in a minimum of one grove which covers an area of 0.4 of a hectare. The Manager will also be party to the Grove Licence Agreement to ensure the Manager has access to the land for the purposes of carrying out its covenants under the Management Agreement. The Grower enters into the Management Agreement with the Manager under which the Manager will establish Olive plantation on the Grove and cultivate, maintain, harvest and sell the resulting produce at a profit.

22. The Manager has entered into an Olive Purchase and Supply Agreement with Inglewood for the supply to and purchase of olive oil by Inglewood. The period of this contract is 10 years from the date of signing but may thereafter be extended for successive 5 year periods by mutual consent in writing.

23. The fees payable by a Grower on acceptance into the Project are \$13,720 (including GST) in respect of the purchase of shares in the Landholding Company, purchase of olive seedlings, establishment of irrigation system and management fees to 30 June 2003. The

monies will be held by the Custodian, until the minimum subscription is reached, and upon acceptance of the application and the granting of an interest, the amounts will then be paid to the Manager.

Grove Licence Agreement

24. Under the Grove Licence Agreement between the Owner, Grower and the Manager, the Owner agrees to grant a non-exclusive Licence to the Grower to use and occupy the land for the purpose of cultivating and marketing olives. The agreement provides the Manager unlimited access to the Land for the purposes of carrying out its covenants under the Management Agreement. This Agreement will commence on the date signed and shall continue until 30 June 2023 or the termination of the Grower's interest in the Grove. The Grower has requested the Manager to establish an Olive Grove and to cultivate, maintain, harvest and sell the resulting olives at a profit.

25. The Grower is obliged at its own expense to:

- use the Grove for the purpose of cultivating and harvesting olives in such a way as to comply with good agricultural practices and with all laws and regulations relating to such use of the Grove;
- repair any damage caused by the Grower or its employees, agents or contractors to any roads, tracks or fences on the Grove or on any neighbouring land and not to interfere with the activities carried out on any neighbouring land by the owner or occupier of such land;
- take such reasonable measures as to prevent and remedy land degradation in the Grove;
- not use the Grove for any other purpose including residing thereon, except to the extent that such use is reasonably required by the Grower for the cultivation and harvesting of the produce of the Grove;
- not place any chemicals, inflammable or any other substances which may result in environmental damage or damage to surrounding areas including damage to any livestock, crops or water reserves on any such land; and
- allow such rights of way to any occupiers of any other Groves as are necessary for the proper use and enjoyment of their Groves, providing such right of way is confined to any existing roads, tracks or fire breaks on or around the Grove.

26. Pursuant to the terms of the agreement the Grower is not to assign their rights under this Agreement without the consent of the Owner.

27. The Owner is obliged:

- to clear the Land and present the same in a suitable condition for the purposes of this Agreement by the commencement date;
- to pay or cause to be paid all rates, taxes and other charges levied by any government or competent authority on or before their due dates in respect of the Land;
- not to use the Land for the purpose of storage of any chemical, inflammable or any other substances which may result in environmental damage or damage to surrounding areas including damage to any livestock, crops or water reserves on any such land;
- not assign the benefit of this Agreement unless such assignment contains a Covenant by the Assignee to be bound by the terms of this Agreement; and
- to provide the Manager with a maximum of 2 Megalitres of water per grove per annum provided that if the supply is restricted by the Water Supply Authority then the Owner shall supply the Manager with such proportion as the lesser amount bears to the sum of 2 Megalitres.

28. The Manager is obliged prior to the commencement date, to construct a boundary fence on the Land in order to prevent access by livestock and to construct and maintain suitable access roads and pathways onto the Land.

Management Agreement

29. Under the Management Agreement the Grower appoints the Manager to manage the Grower's Grove and to carry out the management services subject to the terms and conditions of this Agreement. This Agreement shall commence on the date signed and shall continue until termination of the Grower's interest or 30 June 2023, whichever is earlier.

30. The Manager is obliged to:

- acquire at least one hundred and thirty (130) olive seedlings for the Grower, selected from the best and highest yield stock and in good condition; prepare the

Grove in order to enable planting and growing of olive trees;

- carry out the necessary irrigation work to ensure proper reticulation of water to the seedlings on the Grower's Grove and to carry out drainage works to help prevent soil erosion;
- cultivate and maintain and replace any seedlings which may fail in the first year of this Agreement at no cost to the Grower;
- enter into a Water Supply Agreement with the Water Owner to arrange for the supply of a maximum of 2 Megalitres of Water provided that if such supply is restricted by the Water Supply Authority, then the Manager shall supply the Grower with the proportion that the lesser amount bears to the sum of 2 Megalitres;
- arrange for the irrigation of the Grower's Grove to comply with the terms and conditions of the Water Supply Agreement;
- cultivate and manage the olive trees so as to maximise the yield thereof and in particular to eradicate all weeds and pests which may affect the trees;
- prune the olive trees as required from time to time in order to promote the growth and production of olives in accordance with good agricultural practice;
- take such reasonable measures as may be required to control the growth of weeds and other vegetable pests on the plantation upon which the olive trees are growing including the cultivation of the plantation between the rows of olive trees;
- take all reasonable measures in accordance with the principles of good husbandry and to the extent reasonably possible to deter and eradicate any insect, bird or animal pest from the plantation which may detract from the health and vigour of the olive trees or the yield of olive fruit there from;
- apply manure fertiliser, mulch and such other material as is necessary in accordance with good agricultural practice to encourage growth and fruiting of the olives;
- take all steps to avoid any actions which may prejudice the Grower's rights under this Agreement and the achievement of the best yields possible for the trees;

- repair any damage to roads, tracks or fences on the Grower's Grove or neighbouring land resulting from the actions of the Manager or its contractors and to take such action to prevent the land degradation on the Grower's Grove or surrounding lands;
- manage the Grove after 30 June 2003 and cultivate the trees in accordance with a manner consistent with professional agricultural managers who manage and maintain other Groves in Australia; and
- arrange for the harvesting annually of the trees in accordance with an Agreement made between the Manger and Inglewood.

31. If the Manager considers that the best interests of the Grower should be served by combining the proceeds of the Grower's Grove with any other neighbouring Groves within the project so as to market the total produce as one or a number of sales, then the Manager shall be at liberty to do so.

Insurance

32. The Manager must insure the Land Owner, the Grower, itself and such other persons, servants and Agents against Public Risk for an amount of not less than twenty million dollars (\$20,000,000.00) at its own cost but shall not be responsible for any other insurance.

33. The Grower may take out any insurance over the Grove, the trees, the crop, against any risks which the Grower may deem to be necessary or desirable at its own cost. If the Grower wishes, the Grower may request the Manager to take out insurance cover on behalf of the Grower.

34. Neither the Manager nor the Grower will permit or suffer to be done, any matter, act or thing whereby any of the insurances previously referred to may be vitiated or rendered void or voidable.

Sales Proceeds

35. All the income and proceeds derived from the Project will be payable to the Responsible Entity who will deposit those amounts into a Proceeds Account. No later than 21 days after those amounts have been deposited into the Proceeds Account, the Responsible Entity will make payments to and on behalf of the Grower on a pro rata basis in respect of the Grower's interest in the Project in the following order:

- i) to reimburse the Responsible Entity for all costs and expenses properly incurred to harvest the olives and any other general administrative expenses incurred in relation to the sale of the olives;
- ii) to the Responsible Entity in respect of any outstanding amount due to it in respect of, insurance premiums paid by it under a Project Agreement;
- iii) to the Owner in relation to any licence fee owing by a Grower; and
- iv) the balance, if any, to the Growers.

Fees

36. A licence fee of \$220 per annum will be payable by a Grower under the terms of the Grove Licence Agreement for the year commencing 1 July 2003 and payable by 30 June 2004. Thereafter the licence fee of \$220 is indexed to CPI and payable by 30 June for each subsequent year.

37. In accordance with the terms of the Management Agreement, the fees payable by the Grower upon the signing of the Agreement for the work to be completed by 30 June 2003 are:

- \$786.50 for the supply and planting of the olive seedlings;
- \$2,090 for the establishment of the irrigation system; and
- \$8,343.50 in management fees.

38. The ongoing management fees payable by the Grower are:

- \$3,520 for the year ending 30 June 2004, and payable in quarterly instalments on 30 September 2003, 31 December 2003, 31 March 2004 and 30 June 2004;
- \$3,608 for the year ending 30 June 2005, and payable in quarterly instalments on 30 September 2004, 31 December 2004, 31 March 2005 and 30 June 2005;
- \$2,657.60 for the year ending 30 June 2006, and payable in quarterly instalments on 30 September 2005, 31 December 2005, 31 March 2006 and 30 June 2006;

- \$2,657.60 indexed to CPI, and payable in quarterly instalments for the year ending 30 June 2007 but not being less than the fee for the year ending 30 June 2006, the quarterly instalments payable on 30 September 2006, 31 December 2006, 31 March 2007 and 30 June 2007;
- \$2,310 for the year ending 30 June 2008, and payable in quarterly instalments on 30 September 2007, 31 December 2007, 31 March 2008 and 30 June 2008; and
- \$2,310 thereafter indexed to CPI annually and payable for the years ending 30 June 2009 until the end of the project but not being less than the fee for the immediately preceding year and payable in quarterly instalments on 30 September, 31 December, 31 March and 30 June.

39. The Manager will harvest the olives and will be paid a fee. The cost of the harvesting of the olives will be advised to Growers in a notice setting out the break-up of the cost. The amount will be payable within 7 days of receipt of the notice. The amount if not paid will be deducted from each Grower's proportion of the sales proceeds.

40. An incentive fee is payable to the Manager where the proceeds of the annual harvest exceed the forecasts as set out in Schedule 2 of the Management Agreement. The fee is 25% of the sum by which the annual net proceeds exceed that forecast.

Option to purchase land

41. Mysia has an irrevocable option to acquire up to 555 acres of land for the project from Boort Olives Pty Ltd (Boort) at a cost of \$500 per acre. The land is situated at Mysia East Road, Mysia. Mysia Holdings Ltd has been incorporated specifically to acquire the land and water rights to be used in the project. The company was incorporated with 1 share being held by Loddon. That share will be transferred under the first allocation to a subscriber therefore the only shareholders of the company will be Growers in the project or their nominee. Under the terms of this option:

- the option shall be exercisable by Mysia giving Boort a notice in writing to exercise the option;
- the option is exercisable between 6 February 2003 and 29 June 2003;
- in the event of this option being exercised in the manner aforesaid there shall be deemed to be

constituted a binding contract between Boort and Mysia for the transfer of land to Mysia;

- Mysia may at any time give to Boort a nomination of its Nominee for the purposes of exercising this option; and
- the Nominee shall be entitled to exercise this option and shall have all the rights which Mysia itself has.

Olive Purchase and Supply Agreement

42. Loddon has entered into an Olive Purchase and Supply Agreement with Inglewood. The period of this Agreement is 10 years from the date of signing but may thereafter be extended for successive 5 year periods by mutual consent in writing. Under the terms of this Agreement:

- Loddon will supply and Inglewood will purchase all oil supplied by it up to the tonnages agreed and specified on an annual basis subject to the satisfactory condition of the oil;
- Inglewood will purchase quantities of oil in excess of the contracted tonnages provided Loddon notifies Inglewood of expected additional production volumes one month prior to delivery;
- in the event that Inglewood is not satisfied with the condition of the delivered oil or with its varietal conformity it will notify Loddon in writing and make every reasonable attempt to reach a mutually acceptable accommodation as to price or other terms or conditions; however Inglewood reserves the ultimate right to reject such oil;
- the weight of the delivered oil will be determined by certified scales after it has been delivered to Inglewood;
- the offer price submitted to Loddon by Inglewood for Extra Virgin grade oil will not be less than 85% of the value of Extra Virgin grade oil sold in bulk on Spanish domestic markets as ascertained from the regular publication *Hoja de Informacion* of the International Olive Oil Council and averaged for the previous 12 months;

- where audits of prevailing supermarket pricing conducted by Inglewood clearly demonstrate by comparison with the domestic prices of bulk oil in the respective countries of origin that oil importers are heavily discounting their brands of extra virgin olive oil for whatever purpose which may include a strategy of preventing the products of Inglewood from winning market share then Inglewood reserves the right to submit evidence of such discounting to Loddon and offer a lesser price for the oil;
- the Pricing Schedule to this agreement provides for a premium to be paid for specific named varieties of oil;
- in the case of oil delivered by Loddon which does not satisfy defined industry standards for extra virgin grade oil Inglewood may elect to still purchase the oil however a lesser price may be paid; and
- the payment for the delivered oil will be made by Inglewood to Loddon within 30 days of its delivery to its factory.

Finance

43. Growers can fund their involvement in the project themselves or borrow from an independent lender. There will be no provision of finance to Growers either by Responsible Entity or other associated entities.

44. 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 Responsible Entity are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

45. This Ruling applies only to Growers who are accepted to participate in the Project on or before 31 May 2003 and who have executed a Management Agreement and a Grove Licence Agreement on or before that date.

46. 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 elect to market their own produce or who enter into finance arrangements with the Manager or an associate of the Manager.

Minimum subscription

47. 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 80 interests is achieved.

The Simplified Tax System ('STS')

Division 328

48. For a Grower participating in the Project, the recognition of income and the timing of tax deductions 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

49. 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***

50. 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.

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 that income is derived.

Deductions for Management and Licence fees***Section 8-1***

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

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Management fee	8-1	\$8,343.50 - See Notes (i) & (ii) below	\$3,520 - See Notes (i) & (ii) below	\$3608 - See Notes (i) & (ii) below
Licence fee	8-1		\$220 - See Notes (i) & (ii) below	Previous year's fee indexed - See Notes (i) & (ii) 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 124.
- (ii) The Management fees and the Licence fees shown in the Management Agreement and the Grove Licence Agreement respectively 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 (see paragraphs 89 to 103). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 95 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***

53. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to irrigation (water facility), and establishment of olive trees (horticultural plant). All deductions shown in the following table are determined under Division 40.

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Water facility (e.g. irrigation, dam, bore, etc)	40-515	\$696.66- See Notes (iii) & (iv) below	\$696.66 - See Notes (iii) & (iv) below	\$696.66 - See Notes (iii) & (iv) below
Establishment of horticultural plants (olive trees)	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 124;
- (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); and
- (v) An olive tree is a 'horticultural plant' as defined in subsection 40-520(2). As a Grower holds the land under a licence, 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. As 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 Responsible Entity 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 and section 328-105***

54. 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.

55. 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)).

Deductions for Management fees and Licence fees***Section 8-1 and section 328-105***

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

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Management fee	8-1 & 328-105	\$8,343.50 - See Notes (vi), (vii) & (viii) below	\$3,520 - See Notes (vi), (vii) & (viii) below	\$3,608 - See Notes (vi), (vii) & (viii) below
Licence fee	8-1 & 328-105		\$220 - See Notes (vi), (vii) & (viii) below	Previous year's fee indexed - See Notes (vi), (vii) & (viii) below

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 124;
- (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; and
- (viii) Where a Grower who is an 'STS taxpayer', pays the Management fees and the Licence fees in the relevant income years shown in the Management Agreement and the Grove Licence Agreement, 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 same income year as the fees are incurred,

the prepayment rules of the ITAA 1936 may apply to apportion those fees (see paragraphs 89 to 103). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 95, 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 Subdivision 40-F

57. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to irrigation (water facility), and establishment of olive trees (horticultural plant). 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.

58. 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 Subdivision 40-F and not under Division 328.

59. 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.

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Water facility (e.g. irrigation, dam, bore, etc)	40-515	\$696.66 - see Notes (ix) & (x) below	\$696.66 - see Notes (ix) & (x) below	\$696.66 - see Notes (ix) & (x) below
Establishment of horticultural plants (olive trees)	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 124;
- (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 year ended 30 June 2003 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); and
- (xi) An olive tree is a 'horticultural plant' as defined in subsection 40-520(2). As a Grower holds the land under a licence, 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. As 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 Responsible Entity will inform Growers of when the olive trees enter their first commercial season.

Tax outcomes that apply to all Growers

Dividends relating to shares

60. The shares in Mysia Holdings Limited are CGT assets (section 108-5 of the ITAA 1997) and the amount paid by a Grower to acquire those assets is an outgoing of capital and not allowable as a deduction. The amount paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)). Any disposal of the shares by a Grower will be a CGT event and may give rise to a capital gain or loss. Dividends paid out of profits by Mysia Holdings Limited are included in the assessable income of shareholders under subsection 44(1) of the ITAA 1936.

Interest

61. 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 89 to 103 (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.

Deferral of losses from non-commercial business activities

Division 35

Section 35-55 – Commissioner's discretion

62. 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 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.

63. 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 110 in the Explanations part of this ruling, below);
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

64. 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.

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

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

66. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Grove Licence 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 89 to 103);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Is the Grower carrying on a business?

67. 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 Loddon Olive Project must amount to the carrying on of a business of primary production. The Grower's activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

68. For schemes such as the Loddon 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.

69. 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 (by lease or by licence) 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.

70. In this Project, each Grower enters into a Management Agreement and a Grove Licence Agreement.

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71. Under the Grove Licence Agreement, each individual Grower will have rights over a specific and identifiable area of 0.4 hectares or more of land. The Grove Licence Agreement provides the Grower with an ongoing interest in the specific trees on the licenced area for the term of the Project. Under the licence, 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 Licence allows the Project Manager to come onto the land to carry out its obligations under the Management Agreement.

72. 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 holds the appropriate professional skills and credentials to provide the management services to maintain the Grove on the Grower's behalf.

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

74. 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.

75. 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 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.

76. The pooling of olives and olive oil produce from trees grown on the Grower's Grove 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 will reflect the proportion contributed from their Grove.

77. The Project Manager's services and the installation of assets on the Grower's behalf are also consistent with general horticultural practices. The assets are of the type ordinarily used in carrying on a business of cultivating olive trees and harvesting the olives for the production and sale of olive oil. 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).

78. The Grower's degree of control over the Project Manager as evidenced by the 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 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.

79. 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 Loddon Olive Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

80. 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.

81. 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 Licence fees

Section 8-1

82. Consideration of whether the initial management fee and licence fee 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.

83. The Management fees and Licence fees 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

84. Under the Management Agreement and the Grove Licence Agreement neither the Management fees nor the Licence fees 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.

85. 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 89 to 103) 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

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

87. If the Grower is not an 'STS taxpayer', the Management fees and the Licence fees are deductible in the year in which they are incurred.

88. If the Grower is an 'STS taxpayer' the Management fees and the Licence fees 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

89. 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.

90. 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

91. 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)).

92. 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.

93. 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 unrelated to Loddon. 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.

94. 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.

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

96. 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

97. In this Project, an initial Management fee of \$8343.50 and no initial Licence fee per Grove will be incurred on execution of the Management Agreement and the Grove Licence Agreement. The Management fee is charged for providing management services 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.

98. 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.

99. 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 Grove Licence Agreement, licence fees are payable annually by 30 June for the licence to use and occupy the land from 1 July to 30 June during the expenditure year.

100. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 36 to 40, 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

101. Although not required under either the Management Agreement, the Grove Licence Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers unrelated to Loddon may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 100 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

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

Expenditure of a capital nature

Division 40 and Division 328

104. 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, expenditure attributable to water facilities, and the establishment of the olive trees is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

105. 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'.

106. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 53 and 59 (above) in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

107. 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 (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 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.

108. 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.

109. 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.

110. 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.

111. In broad terms, the 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, (excluding any private dwelling) 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 (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).

112. 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 one Grove in the Project is unlikely to pass one of the tests until the income year ended 30 June 2009. 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.

113. 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.

114. 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, the business activity has not satisfied, or will not satisfy 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.

115. 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 produce a taxation profit, for the year ended 30 June 2007. The Commissioner will decide for such a Grower 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.

116. 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 62), in the manner described in the Arrangement (see paragraphs 14 to 44). 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.

117. 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 olive expert and additional scientific evidence provided with the application by the Responsible Entity;
- the Soil Survey Reports;
- the Olive Purchase and Supply Agreement that the Responsible Entity has entered into with Inglewood for the purchase by Inglewood of bulk olive oil up to the tonnages agreed and specified on an annual basis subject to the satisfactory condition of the oil;
- independent, objective, and generally available information relating to the olive industry.

Losses and Outgoings incurred under Certain Tax Avoidance Schemes

Section 82KL – recouped expenditure

118. 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’.

119. ‘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.

120. 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.

Schemes to Reduce Income Tax***Part IVA - general tax avoidance provisions***

121. 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).

122. The Loddon 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 52 to 59, that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

123. 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**

124. 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

21 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;
PR 1999/95; TR 2000/8; 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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