

# ***PR 2003/33 - Income tax: Tasmanian Truffle Project No. 2***

 This cover sheet is provided for information only. It does not form part of *PR 2003/33 - Income tax: Tasmanian Truffle Project No. 2*

 This document has changed over time. This is a consolidated version of the ruling which was published on *28 May 2003*



## Product Ruling

### Income tax: Tasmanian Truffle Project No. 2

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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**

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

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

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

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

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

#### **Terms of Use of this Product Ruling**

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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.

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

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

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the 'Tasmanian Truffle Project No.2' 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);
  - Division 70 (ITAA 1997);
  - Division 328 (ITAA 1997);
  - Section 82KL of the *Income Tax Assessment Act 1936* ('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;
- who elect to maintain their own Trufferie;
- who are accepted to participate in the Project between 16 June 2003 and 30 June 2003; or
- who are accepted to participate in the project after 31 January 2004.

## 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 28 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 described below. This description incorporates the following documents:

- Application for a Product Ruling dated 24 March 2003, as constituted by documents provided on 14 March 2003 and additional correspondence (including e-mails) dated 20 March 2003, 21 March 2003, 24 March 2003, 26 March 2003, 3 April 2003, 4 April 2003, 14 April 2003, 15 April 2003, 16 April 2003, 17 April 2003, 22 April 2003, 23 April 2003, 24 April 2003, 27 April 2003, 28 April 2003, 29 April 2003, 2 May 2003, 5 May 2003, 6 May 2003, 9 May 2003, 10 May 2003, 13 May 2003, 14 May 2003, 15 May 2003, 18 May 2003, 19 May 2003 and 20 May 2003;
- Draft Disclosure Document for the Tasmanian Truffle Project No.2 issued by Managed Projects Australia Limited A.C.N. 101 887 638 ('Managed Projects', the 'Responsible Entity' the 'Custodian'), received by the Tax Office on 19 May 2003;
- Draft **Constitution** establishing the Tasmanian Truffle Project No.2 ('the Constitution'), dated on 19 May 2003;
- Draft **Trufferie Management Agreement** ('the Management Agreement') attached as Schedule 2 of the Constitution, to be entered into by each Grower and Managed Projects, received by the Tax Office on 19 May 2003;
- Draft Sub-contract Trufferie Management Agreement between Managed Projects and Tasmanian Truffle Enterprises Limited ('the Manager'), received by the Tax Office on 14 April 2003;
- Draft Lease Agreement between Needlesdale Truffles Pty Ltd ('the Landlord') and Managed Projects ('the Tenant'), received by the Tax Office on 15 April 2003;

- Draft Compliance Plan for Tasmanian Truffle Project No.2 issued by Managed Projects A.C.N. 101 887 638 received by the Tax Office on 15 April 2003;
- Draft **Licence Agreement** attached as Schedule 1 of the Constitution, to be entered into by each Grower and Managed Projects, received by the Tax Office on 19 May 2003;
- Transfer of Lease between Tasmanian Truffle Enterprises Limited A.C.N. 082 081 712 and Managed Projects Australia Limited dated 7 May 2003, received by the Tax Office on 14 May 2003;
- Extension of Lease executed by Tasmanian Truffle Enterprises Limited dated 7 May 2003, received by the Tax Office on 14 May 2003; and
- Draft Deed of Assignment attached as Schedule 3 to the Constitution, received by the Tax Office on 15 April 2003.

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

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

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

### Overview

17. The arrangement is called the Tasmanian Truffle Project No. 2 and is summarised as follows.

Location	Property situated at Trickets Road, Deloraine, in northern Tasmania.
Type of business to be carried on by each participant	Long term commercial cultivation of <i>Melanosporum Sporum</i> ('Black Truffle' or 'Truffle') inoculated Oak and Hazelnut Trees for the purpose of harvesting Truffles for sale.

Number of hectares under cultivation	Up to 38 hectares divided into 380 Trufferies, with an option to accept oversubscriptions.
Size of each Trufferie	0.1 hectare ('one Trufferie').
Minimum allocation per Grower	One Trufferie.
Number of Trees per Trufferie	Minimum of 40 Trees.
Number of Trees per hectare	400 Trees per hectare.
The term of the Project	Approximately 24 years, commencing on acceptance of the participant's application and ending 30 June 2027.
Initial Cost per Trufferie	\$2,783 in initial management fees and \$55 in licence fees on application totalling \$2,838.
Ongoing costs	On-going management fees. Annual licence fees. Harvesting and marketing fee.

18. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The objective of the Project is to establish and manage long term commercial cultivation of Truffle inoculated Oak and Hazelnut trees for the purpose of harvesting Truffles for sale. The Responsible Entity for the Project is Managed Projects Australia Limited ('Managed Projects').

19. The Project is located on Tricketts Road, Deloraine in northern Tasmania being part of the land comprised in Folio 1 of the Register Volume 219540. The land is 79.3 hectares in size, 38 hectares of which has been allocated for the Project.

20. Participation in the Project is made by applying for one or more Trufferie(s), each of 0.1 hectare in size. The Project will be terminated on 30 June 2027, a period of approximately 24 years. A minimum of 40 inoculated Trees will be grown on each Trufferie. A maximum of 380 Trufferies are available for the project.

21. There is a requirement for a minimum subscription of 10 Growers. Under the terms of the Disclosure Document if the minimum subscription is not achieved within 4 months from the date of the Disclosure Document, then all Applicants' monies will be returned in full within 7 days. There is a right to accept over subscriptions, this may increase subject to demand and availability of suitable land.

22. Under the Project, an Applicant whose application is accepted will enter into a Licence Agreement and a Management Agreement with Managed Projects.

23. Under the Management Agreement, in return for the initial management fee and on-going management fee the Grower appoints the Manager as an independent contractor to manage the Grower's Trufferie by establishing and maintaining the Trufferies and harvesting the Truffles.

24. Under the Licence Agreement, in return for the annual licence fee the Licensor grants the Grower a licence over their respective Trufferies to use and occupy an identifiable 0.1 hectare of land suitable for planting Truffle inoculated Oak and Hazelnut trees for the purposes of cultivating, maintaining and harvesting Truffles.

25. When an Applicant becomes a Grower the Responsible Entity must enter in the Register of Growers all relevant details of the Grower and the land allocated to the Grower in the Grower's Licence.

26. The Responsible Entity has the right to accept or reject applications in whole or in part. For the purposes of this Product Ruling the relevant application periods are summarised as follows:

<b>Application accepted</b>	<b>Grower</b>	<b>Total Subscription Moneys</b>	<b>Period of provision of initial management services</b>
On or before 16/6/2003	2003 Grower	\$2,838	From date of application to 30/6/2003.
On or after 1/07/2003 and on or before 31/1/2004	2004 Grower	\$3,938	From date of application to 30/6/2004.

### **Constitution**

27. The Constitution establishes the Project and operates as a deed binding all the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Managed Projects agrees to act as Responsible Entity and Manager of the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

28. Under the terms of the Constitution, all applications and moneys received from applications shall be paid to Managed Projects. Managed Projects shall forward the payment to the Custodian. Managed Projects must ensure that the Custodian deposits the Application Money into an account designated as the Applications Fund Account for Tasmanian Truffle Project No.2.

29. Managed Projects is entitled to be paid for its services in managing the Trufferie (Clause 6). Among other things, the Constitution sets out in detail the following:

- if there is any inconsistency in the Agreements the Constitution prevails (clause 13);
- a process for dealing with complaints (clause 4);
- the winding up of the Project (Clause 5);
- the assignment of Grower's interest (Clause 16);
- powers and duties of the Responsible entity and the appointment of agents (clause 15);
- meetings of Growers (Clause 17); and
- default by Growers (Clause 22).

### **Compliance Plan**

30. As required by the *Corporations Act 2001*, Managed Projects has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that Managed Projects, as the Responsible Entity, complies with obligations and responsibilities under the *Corporations Act 2001* and the Constitution. The Compliance Plan is designed to protect the interests of the Growers.

### **Management Agreement**

31. The Management Agreement between Managed Projects and each Grower commences to apply from the date of signing and continues until the termination of the Grower's interest or the termination or expiration of the Project on 30 June 2027. The Grower engages the Responsible Entity as an independent contractor to manage the licensed Trufferie.

32. Growers that elect to maintain their own Trufferie (clause 19) are outside the scope of this Product Ruling and the taxation consequences of their participation in the Project are not dealt with in this Ruling. Such a Grower may request a private ruling on the taxation consequences of their participation in the Project.

33. The Manager will provide the initial management services. These services, set out in clause 4, involve the selection and overseeing the preparation of the Land for planting, and the management of the environment in which the inoculated trees have been planted. These include, among other things:

- selection and purchase of Oak and Hazelnut trees;
- inoculation of the trees using the certified inoculation process;
- testing of all trees for infection;
- certifying the trees as having been inoculated and infected with Black Truffle;
- the design and layout for the trees to be planted in the licensed land;
- management and care of the trees in the nursery prior to planting;
- overseeing the preparation of the licensed land;
- ensuring the landowner has applied initial quantities of herbicide, lime and fertiliser;
- hand planting the certified trees;
- holding and nurturing the trees in a suitable nursery;
- maintaining drainage;
- eradicating or controlling pests and weeds;
- ensure installation of suitable irrigation system;
- maintaining the irrigation system;
- irrigating the trees in the licensed land or in the nursery;
- maintaining infrastructure; and
- general management.

34. Growers who are accepted into the Project on or before 16 June 2003 will have the initial management services completed by 30 June 2003. For Growers who are accepted into the Project on or after 30 June 2003 but before 1 February 2004 will have the initial management services completed by 28 February 2004.

35. The Manager will also provide for on-going management services which involve the ongoing tending and rearing of the seedlings (clause 6). These include, among other things:

- irrigating the trees;
- maintaining the trees;
- certification and planting of the trees, not completed during initial management services;
- general maintenance (including weed and vermin control);
- maintenance of firebreaks, access roads and tracks;
- monitoring of soil and leaves of the trees;
- application of herbicide, fungicide and fertiliser;
- provision of annual Grower Trufferie progress reports;
- land degradation prevention;
- harvesting of Truffles;
- grading and processing of Truffles;
- marketing and sale of Truffles; and
- accounting to the Grower for the proceeds of the Truffles.

36. The Grower authorises the Manager to decide when it is appropriate to ascertain, by use of its dogs or other animals, whether truffles are growing on the tree roots, and if so to harvest those truffles, and to make all the arrangements for harvesting, freighting and making the Truffles available for sale. The Manager will pay for all costs of harvesting and marketing and will be reimbursed out of the proceeds for its disbursements.

37. In this Agreement, the Grower irrevocably and unconditionally appoints the Manager as its sole agent to market and sell the truffles cultivated on the Land in a proper and competent manner.

38. In consideration of the Manager carrying out its duties under the Management Agreement, the Grower must pay the Manager the fees set out in paragraph 54.

### **Lease Agreement**

39. A Lease Agreement is entered into between Needlesdale Truffles Pty Ltd ('the Landlord') and Managed Projects ('the Tenant') for the leased premises Tricketts Road Deloraine, Tasmania. The term of the Lease is 24 years. Under the provisions of the Lease the Tenant may use the Land only as a Trufferie. The Lease Agreement allows for the provision of management services for the purposes of maintaining each Trufferie.

## **Licence Agreement**

40. The Licence Agreement is granted by Managed Projects ('the Responsible Entity' or the 'Licensee') to Growers named and described in Schedule 1 of the Licence Agreement. Under the terms of the Licence, each Grower is granted a right to use and occupy an identifiable interest in an area of land (as identified under Schedule 2) consisting of a minimum of one Trufferie, of 0.1 hectare, for the purpose of planting, cultivating and nurturing the production of Black Truffles.

41. Under clause 3 the Responsible Entity agrees with the Grower that it:

- has leased the land;
- must ensure that the capital works for the establishment of the Trufferie have been completed; and
- has identified the individual plots.

42. The Licence Agreement sets out the purpose for which the Grower may use the land (clause 2), the term of the Agreement being from the commencement date until 30 June 2027 or the termination of the Grower's interest in the Project (clause 5). This Agreement is subject to and conditional upon the Grower entering into the Management Agreement (clause 7).

43. The Grower may terminate the Licence Agreement if the Responsible Entity commits a breach of the Agreement, or by giving 4 months notice in the event of the whole or substantial part of the Trufferie is destroyed (clause 5). The Responsible Entity may terminate the Agreement if the Grower fails or neglects to pay the licence fee (clause 5 and clause 8). If the Responsible Entity terminates the Licence Agreement it may also terminate the Management Agreement and the Grower will lose all rights and interests in the Project (clause 5). Further, the Agreement terminates immediately if the Management Agreement is terminated for any reason (clause 5).

44. Each Grower must pay the licence fee set out in clause 8 of the Licence Agreement. Under the terms of the Licence Agreement (clause 10), among other things, the Grower must:

- use the Trufferie only for the purpose of the project operations;
- comply with good horticultural and environmental practices;
- maintain the Trufferie;

- permit the landowner, employees, agents or contractors to enter the Trufferie;
- comply or procure compliance with the Management Agreement; and
- give occupiers of other Trufferies the relevant rights as are necessary for access and enjoyment of their land.

45. The Responsible Entity and the Grower may assign their rights in the Project (clause 11).

### **Power of attorney**

46. To be accepted to participate in the Project, Growers must grant Managed Projects an irrevocable power of attorney. This allows Managed Projects to enter into any agreement for the purposes of Truffle processing and sale.

47. Managed Projects as attorney may, where required, stamp and register this instrument at the cost of the Applicant. The power of attorney is irrevocable until the expiration of the Project under the Constitution.

### **Harvesting and sale**

48. Harvesting fees will be deducted from the sale of Truffles. The first commercial Truffle harvest is expected in the year ended 30 June 2009.

49. The Manager must arrange for the harvest of the Truffles from the Truffle inoculated Oak and Hazelnut trees and make all arrangements for the harvesting, processing, grading, freighting and sale of the Truffles (clause 9 (a) of the Management Agreement).

50. Under clause 9 (b) of the Management Agreement the Grower authorises the Manager to pool Truffles harvested from the Trufferie with Truffles harvested from all other Trufferies in the Project that were planted at the same time and which have contributed Truffles to the relevant pool. The net proceeds from the sale of Truffles will be divided equally among those Growers in accordance with number of Trufferies that were planted at the same time and the provisions of the Licence Agreement. Where the produce from a Grower's Trufferie is of sufficient reduced quality or quantity, that Grower's share of the pooled sale proceeds may be reduced.

51. The Grower must reimburse to the Manager the reasonable costs incurred by the Manager in the use of its dogs or other animals in the Trufferie for harvesting purposes (clause 16 of the Management Agreement). Such costs include, but are not limited to, food, board and transport.

52. The remuneration of the Responsible Entity will include the entitlement to a portion of the Truffles produced by the collective Grower's participation in the project, on the basis that minimum levels of production are reached from each stage of planting. The additional entitlement will be calculated as follows (clause 17 of the Management Agreement):

- the Grower is entitled to 100% of the assets that are attributable to the production of up to the equivalent of 60kg per hectare;
- the Responsible Entity is entitled to 100% of the assets that are attributable to the production which are in excess of 60kg of Truffles per Hectare but limited to a production of 70kg of Truffles;
- the Grower and Responsible Entity are entitled to the assets that are attributable to the production of Truffles in excess of 70kg per hectare. The parties are entitled in the proportion of 75% to the Grower and 25% to the Responsible Entity.

53. The net proceeds from the sale of Truffles will be recorded separately and the Manager will apply the net proceeds from the sale to on-going management fees and licence fees.

## Fees

54. Pursuant to clause 8 of the Licence Agreement and clauses 15 and 16 of the Management Agreement, a Grower will make the following payments per Trufferie:

For Applicants who apply and are accepted into the Project **on or before 16 June 2003**:

- the initial management fee of \$2,783, payable on application;
- an initial licence fee of \$55, payable on application;
- on-going management fee of \$1,045, payable on 1 July in Years 1 and 2 of the Project;
- a licence fee of \$55, payable on 1 July in Years 1 and 2 of the Project;

- an on-going management fee of \$1,045, payable on 1 July in all subsequent years, indexed according to CPI; and
- a licence fee of \$55, payable on 1 July in all subsequent years, indexed according to CPI (clause 8 of the Licence Agreement).

For Applicants who apply and are accepted into the Project **on or after 1 July 2003 but on or before 31 January**:

- the initial management fee of \$2,783 and an on-going management fee of \$1,045, payable on application (a total of \$3828);
- an initial licence fee of \$55, payable on application;
- an on-going management fee of \$1,045, payable on 1 July 2004;
- a licence fee of \$55, payable on 1 July 2004;
- an on-going management fee of \$1045, payable on 1 July in all subsequent years, indexed according to CPI; and
- a licence fee of \$55, payable on 1 July in all subsequent years, indexed according to CPI.

### **Timing of Management Services**

55. The initial management services shown in the Management Agreement will be commenced by the Manager after the Grower is accepted into the Project and will continue until the next occurring 30 June.

56. The on-going management services shown in the Management Agreement commence after the initial management services cease. If this is before the end of a financial year, the on-going management fee will be for services to be provided by the following 30 June.

### **Finance**

57. Growers can fund their investment in the Project themselves or borrow from an independent lender. The Responsible Entity and its associates will not offer finance to Growers or introduce Growers to a 'preferred financier'.

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58. Regardless of the source of loan funds, this Ruling will not apply to Growers if the Manager accepts their Application subject to finance approval by a lending institution and the full amount payable at the time of Application is not paid to the Manager by 30 June in the year of Application. Further, the full amount of the Application Money, including any loan funds, must be paid to the Custodian and deposited into the Applications Fund Account on or before 30 June in the year of Application.

59. This Ruling does not apply if the finance arrangement entered into by the Grower includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved in the provision of finance to Growers for the Project.

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## **Ruling**

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### **Application of this Ruling**

60. This Ruling applies only to Growers who are accepted to participate in the Project and who have executed a Trufferie Management Agreement and Licence Agreement:

- on or before 16 June 2003; or
- on or after 1 July 2003 but on or before 31 January 2004.

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

62. This Ruling does **not** apply to Growers who:

- are accepted to participate in the Project on or after 17 June 2003 and on or before 30 June 2003;
- are accepted to participate in the Project on or after 1 February 2004; or
- make an election under clause 19 of the Management Agreement.

### **Minimum subscription**

63. 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 Disclosure Document, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 10 interests is achieved.

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

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

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

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

**Qualification**

65. 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***

66. 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.

67. The Grower recognises ordinary income from carrying on the business of growing Truffles at the time that income is derived.

**Trading stock*****Section 70-35***

68. A Grower who is not an 'STS taxpayer' may, in some years, hold truffles 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.

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

**Deductions for the initial management fee, on-going management fees and licence fees*****Section 8-1***

70. A Grower who is not an 'STS taxpayer' who is accepted into the Project on or before 16 June 2003 may claim, on a per Trufferie basis, 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
<b>Initial management fee</b>	8-1	\$2,124 – See Notes (i) & (ii) (below)		
<b>On-going management fee</b>	8-1		\$1,045 – See Notes (i) & (ii) (below)	\$1,045 – See Notes (i) & (ii) (below)
<b>Licence fee</b>	8-1	\$55 – See Notes (i) & (ii) (below)	\$55 – See Notes (i) & (ii) (below)	\$55 – See Notes (i) & (ii) (below)

71. A Grower who is not an 'STS taxpayer' who is accepted into the Project on or after 1 July 2003 and on or before 31 January 2004 may claim, on a per Trufferie basis, tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
<b>Initial management fee</b>	8-1	\$2,124 – See Notes (i) & (ii) (below)		
<b>On-going management fee</b>	8-1	\$1,045 – See Notes (i) & (ii) (below)	\$1,045– See Notes (i) & (ii) (below)	\$1,045*– See Notes (i) & (ii) (below)
<b>Licence fee</b>	8-1	\$55 – See Notes (i) & (ii) (below)	\$55 – See Notes (i) & (ii) (below)	\$55* – See Notes (i) & (ii) (below)

\* Subject to CPI increase

**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 138;

- (ii) Part of the initial management fee is of a capital nature. An amount totalling \$52 cannot be claimed as a deduction (see paragraph 78 below) and a further amount totalling \$607 is capital expenditure for the establishment of horticultural plants (the Table and notes at paragraph 79 below set out the timing of deductions for this amount). Only that part of the initial management fee shown in the Table above, the on-going management fees, and the licence fees that are each incurred on or before the dates shown in the Management Agreement and the Licence Agreement are deductible in full in the year that they are incurred; and

However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the licence fee) 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 108 to 119). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 114 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.

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

### **Assessable Income**

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

72. 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.

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

**Treatment of Trading Stock*****Section 328-285***

74. A Grower who is an 'STS taxpayer' may, in some years, hold truffles that will constitute trading stock on hand. Where, for such a Grower, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than \$5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

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

**Deductions for initial management fees, on-going management fees and licence fees*****Section 8-1 and section 328-105***

76. A Grower who is an 'STS taxpayer' who is accepted into the Project on or before 16 June 2003 may claim, on a per Trufferie basis, tax deductions for the following revenue expenses:

<b>Fee Type</b>	<b>ITAA 1997 Sections</b>	<b>Year ended 30 June 2003</b>	<b>Year ended 30 June 2004</b>	<b>Year ended 30 June 2005</b>
<b>Initial management fee</b>	8-1 & 328-105	\$2,124 – See Notes (iii), (iv) & (v) (below)		
<b>On-going management fee</b>	8-1 & 328-105		\$1,045 – See Notes (iii), (iv) & (v) (below)	\$1,045 – See Notes (iii), (iv) & (v) (below)
<b>Licence fee</b>	8-1 & 328-105	\$55 – See Notes (iii), (iv) & (v) (below)	\$55 – See Notes (iii), (iv) & (v) (below)	\$55 – See Notes (iii), (iv) & (v) (below)

77. A Grower who is an 'STS taxpayer' who is accepted into the Project on or after 1 July 2003 and on or before 31 January may claim, on a per Trufferie basis, tax deductions for the following revenue expenses:

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Fee Type	ITAA 1997 Sections	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
<b>Initial management fee</b>	8-1 & 328-105	\$2,124 – See Notes (iii), (iv) & (v) (below)		
<b>On-going management fee</b>	8-1 & 328-105	\$1,045.00 – See Notes (iii), (iv) & (v) (below)	\$1,045.00– See Notes (iii), (iv) & (v) (below)	\$1,045.00*– See Notes (iii), (iv) & (v) (below)
<b>Licence fee</b>	8-1 & 328-105	\$55.00 – See Notes (iii), (iv) & (v) (below)	\$55.00 – See Notes (iii), (iv) & (v) (below)	\$55.00* – See Notes (iii), (iv) & (v) (below)

**Notes:**

- (iii) 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 138;
- (iv) 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;
- (v) Part of the initial management fee is of a capital nature. An amount totalling \$52 cannot be claimed as a deduction (see paragraph 78 below) and a further amount totalling \$607 is capital expenditure for the establishment of horticultural plants (the Table and notes at paragraph 79 below set out the timing of deductions for this amount). Only that part of the initial management fee shown in the Table above, the on-going management fees, and the licence fees that are each incurred on or before the dates shown in the Management Agreement and the Licence Agreement are deductible in full in the year that they are paid; and  
  
However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the leasing of land) that will not be wholly

done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 108 to 119). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 114, 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.

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

#### ***Non deductible capital expenditure***

78. Certain amounts that form part of the initial management fee payable by Growers is paid for services performed by the Manager before the Grower is accepted into the Project. These amounts, totalling \$52 per Trufferie, do not constitute allowable deductions under section 8-1 or Division 40.

### **Deductions for capital expenditure**

#### ***Subdivision 40-F***

79. All Growers who are who are accepted into the Project on or before 16 June 2003, or alternatively, on or after 1 July 2003 and on or before 31 January will also be entitled to tax deductions for that part of the initial management fee that relates to the establishment of the inoculated Oak and Hazelnut trees. The amount and timing of these deductions is determined under Subdivision 40-F.

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year ended 30 June 2003</b>	<b>Year ended 30 June 2004</b>	<b>Year ended 30 June 2005</b>
Establishment of horticultural plants	40-515	Nil –  see Notes (vi), (vii) & (viii) below	Nil –  see Notes (vi), (vii) & (viii) below	Nil –  see Notes (vi), (vii) & (viii) below

#### **Notes:**

- (vi) 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 138;

- (vii) Truffle inoculated Oak and Hazelnut Trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a Licence Agreement, once of the conditions of 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 Truffle inoculated Oak and Hazelnut Trees is determined using the formula in section 40-545 and is based on the capital expenditure of \$607 incurred by the Grower that is attributable to their establishment. If the Truffle inoculated Oak and Hazelnut Trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, then the result is a straight-line write off at a rate of 7%. This results in an allowable deduction of \$42.50 per annum from the time when the Truffle inoculated Oak and Hazelnut Trees enter their first commercial season (subsection 40-530(2)). The Manager will inform Growers of when the Truffle inoculated Oak and Hazelnut Trees enter their first commercial season but this is not expected to occur before 2009 for '2003 Growers' and 2010 for '2004 Growers'; and
- (viii) For 2004 Growers the dates shown in the table refer to income years 2004, 2005 and 2006.

### **Interest Deductibility**

80. 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 108 to 119 (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***

81. For a Grower who is an individual that has not made an election under clause 19 of the Management Agreement and who enters the Project:

- on or before 16 June 2003 ('2003 Growers'); or
- on or after 1 July 2003 and on or before 31 January 2004 ('2004 Growers'),

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 2010 for 2003 Growers and 30 June 2004 to 30 June 2011 for 2004 Growers that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling.

82. 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 125 in the Explanations part of this ruling, below); or
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; 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)).

83. 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.

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

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

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

- expenditure by a Grower who participates in the Project does not fall within the scope of sections 82KZME - 82KZMF;
- 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?

86. For the amounts set out in the Tables above to constitute allowable deductions the Grower's Truffle cultivation activities as a participant in the Tasmanian Truffle Project No.2 must amount to the carrying on of a business of primary production. These Truffle cultivation activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

87. For schemes such as that of the Tasmanian Truffle Project No.2, 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.

88. Generally, a Grower will be carrying on a business of Truffle cultivation, and hence primary production, if:

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

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

90. Under the Licence Agreement each individual Grower will have rights over a specific and identifiable area of land. The Licence Agreement provides the Grower with an ongoing interest in the specific inoculated Oak and Hazelnut trees on the licensed area for the term of the Project. Under the Licence Agreement the Grower must use the land in question for the purpose of carrying out Truffle cultivation and for no other purpose. The Licence Agreement allows the Manager to come onto the land to carry out its obligations under the Management Agreement.

91. Under the Management Agreement the Manager is engaged by the Grower to establish and maintain a Trufferie 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 establish and maintain the Trufferie on the Grower's behalf.

92. In establishing the Trufferie, the Grower engages the Manager to acquire and plant Truffle inoculated Oak and Hazelnut trees on the Grower's Trufferie. During the term of the Project, these assets will be used wholly to carry out the Grower's Truffle growing activities. The Manager is also engaged to harvest and sell, on the Grower's behalf, the Truffles grown on the Grower's Trufferie.

93. 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.

94. 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 Truffles 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.

95. The pooling of Truffles grown on the Grower's Trufferie with the Truffles of other Growers is consistent with general Truffle cultivation practices. Each Grower's proportionate share of the sale proceeds of the pooled Truffles will reflect the proportion of the Truffles contributed from their Trufferie.

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

97. The Grower's degree of control over the Manager as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Growers Trufferie 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.

98. The Truffle cultivation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Grower's Truffle growing activities in the Tasmanian Truffle Project No.2 will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

99. 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.

100. 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***

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

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer 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.

102. The management fees and licence fees associated with the Truffle growing activities will relate to the gaining of income from the Grower's business of Truffle growing (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of Truffles) 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' purposes in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. That part of the initial management fee that is of a capital nature has been apportioned and separately dealt with. The remaining part of the initial management fee, the on-going management fee and the licence fee is of a revenue nature. In respect of these amounts the tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply to these amounts.

#### *Possible application of prepayment provisions*

103. For Growers who enter the Project within the periods set out in paragraph 59 above, none of the fees deductible under section 8-1 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.

104. Where a Grower chooses to prepay fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 108 to 119) 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 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 less than \$1,000.

#### *Timing of deductions*

105. 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'.

106. 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.

107. 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***

108. 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 licensing 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.

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

#### ***Sections 82KZME and 82KZMF***

110. 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)).

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

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

112. 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. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deductions 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.

113. 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.

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

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

115. 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*

116. For Growers who enter the Project on or before 16 June 2003, an initial management fee of \$2,783 and an initial licence fee of \$55 per Trufferie will be incurred on execution of the Trufferie Management Agreement and the Licence Agreement. For Growers who enter the Project on or after 1 July 2003 and on or before 31 January 2004, an initial management fee of \$2,783, an on-going management fee of \$1,045, and initial licence fee of \$55 per Trufferie will be incurred on execution of the Trufferie Management Agreement and the Licence Agreement. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of on-going management services and a licence over the land until 30 June in those years.

117. 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 on-going management fees in subsequent years.

118. 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 Licence Agreement, licence fees are payable annually in advance for the licence of the land during the expenditure year.

119. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 54, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

**Expenditure of a capital nature*****Division 40***

120. 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.

121. In this Project, some expenditure incurred by Growers for the initial management fee is for services provided before the Grower is accepted to participate in the Project. This capital expenditure is non-deductible (see paragraph 78). Other expenditure included as part of the initial management fee is attributable to establishment of the inoculated Oak and Hazelnut trees is also of a capital nature. This expenditure falls for consideration under Subdivision 40-F of the ITAA 1997 (see paragraph 79 above).

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

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

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

123. 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.

124. 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.

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125. 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.

126. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);
- (c) at least \$500,000 of real property, or an interest in real property, (excluding any private dwelling) is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

127. 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 allocation of one interest in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2013 (2003 Growers) or 30 June 2014 (2004 Growers). Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

128. 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.

129. 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.

130. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is expected to be carrying on a business activity that will pass one of the tests or will produce a taxation profit in the income year ended 30 June 2011 (2003 Growers), or 30 June 2012 (2004 Growers).

131. The Commissioner will decide for such Growers that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2010 (2003 Growers) and 30 June 2011 (2004 Growers).

132. 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 122), in the manner described in the Arrangement (see paragraphs 14 to 60). If so, this Ruling, and specifically the decision in relation to subsection 35-55(1), 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 subsection 35-55(1) will apply in such changed circumstances.

133. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent expert and additional evidence provided with the application by the Responsible Entity;
- independent, objective, and generally available information relating to the Truffle industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity; and
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project;

**Losses and Outgoings incurred under Certain Tax Avoidance Schemes*****Section 82KL - recouped expenditure***

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

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

135. 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).

136. The Tasmanian Truffle Project No.2 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 70 to 79 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.

137. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of their Truffles. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing 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**

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**Entitlement to GST input tax credits**

138. 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:

$$1/11 \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4400 *less* \$400, or \$4,000.

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

$$1/11 \times \$2,200 = \$200.$$

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

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

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

## **Detailed contents list**

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**Commissioner of Taxation**

28 May 2003

<i>Previous draft:</i>	- ITAA 1997 35-55(1)
Not previously issued in draft form	- ITAA 1997 35-55(1)(a)
	- ITAA 1997 35-55(1)(b)
<i>Related Rulings/Determinations:</i>	- ITAA 1997 Div 40
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1997 40-F
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<i>Subject references:</i>	- ITAA 1997 40-530(2)
- carrying on a business	- ITAA 1997 40-535
- commencement of business	- ITAA 1997 40-540
- fee expenses	- ITAA 1997 40-545
- horticulture	- ITAA 1997 Div 70
- irrigation expenses	- ITAA 1997 70-35
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- tax benefits under tax avoidance	- ITAA 1936 82KZL
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- ITAA 1997 35-10(2)	- ITAA 1936 177A
- ITAA 1997 35-10(3)	- ITAA 1936 177C
- ITAA 1997 35-10(4)	- ITAA 1936 177D
- ITAA 1997 35-30	- ITAA 1936 177D(b)
- ITAA 1997 35-35	- TAA 1953 Part IVAAA
- ITAA 1997 35-40	- Copyright Act 1968
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- FCT v. Lau 84 ATC 4929; (1984) 15  
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