



PR 2003/42 - Income tax: Mediterranean Olives Project 2003

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 This document has changed over time. This is a consolidated version of the ruling which was published on *11 June 2003*



Product Ruling

Income tax: Mediterranean Olives Project 2003

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

Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Mediterranean Olives Project 2003' 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 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 the 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 potential 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 more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires) and deriving assessable income from this involvement. In this Ruling, these persons are referred to as 'Growers'.

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

Qualifications

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

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Date of effect

11. This Ruling applies prospectively from 11 June 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 the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not 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 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 persons' 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 8 April 2003 as constituted by documents received on 26 March 2003 and 28 March 2003 and additional correspondence including e-mails between the Tax Office and the Applicant dated 19 May 2003, 21 May 2003, 23 May 2003, 27 May 2003, 30 May 2003, 2 June 2003, 3 June 2003, 4 June 2003 and 5 June 2003;
- Final Product Disclosure Statement (PDS) dated 31 March 2003;
- Supplementary Product Disclosure Statement, dated 5 June 2003;
- **Constitution for the Mediterranean Olives Project 2003 between Mediterranean Olives Estate Limited ('Responsible Entity') and the Growers, received 3 June 2003;**
- **Draft Grove Lease between Mediterranean Olives Estate Limited and the Grower, received 3 June 2003;**
- **Draft Management Agreement between Mediterranean Olives Estate Limited ('Manager') and the Grower, received 3 June 2003;**
- **Draft Irrigation Sale and Purchase Agreement between Mediterranean Olives Estate Limited ('Vendor') and the Grower, received 8 April 2003;**
- Head Lease between Mediterranean Olives Land Pty Ltd ('Land Owner') and Mediterranean Olives Estate Limited ('Manager'), dated 15 May 2002;
- Scheme Property Custody Agreement between Mediterranean Olives Estate Limited and Sandhurst Trustees Limited ('Custodian'), dated 1 March 2002;
- Olive Oil Purchase Agreement between Mediterranean Olives Estate Limited and O.L.D. Oleificio Luccisano-De Masi Srl ('Purchaser'), dated 26 March 2003;
- Olive Oil Processing Agreement 2003 between Mediterranean Olives Estate Limited and O.L.D. Oleificio Luccisano-De Masi Srl ('Processor'), dated 26 March 2003;

- Project Coordinator Agreement 2003 between Mediterranean Olives Estate Limited and de Fina Nominees Pty Ltd ('de Fina'), dated 26 March 2003;
- Principal Sub-Contractor Agreement 2003 between Mediterranean Olives Estate Limited and De Masi Olive Groves Pty Ltd ('Contractor'), dated 26 March 2003; and
- Compliance Plan for the Mediterranean Olives Project 2003, received 8 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. For the purposes of describing the arrangement to which this Ruling applies, 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 a part of the arrangement. The effect of these agreements is summarised as follows.

16. All Australian Securities and Investment 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

17. The salient features of the Mediterranean Olives Project 2003 are as follows:

Location	Serpentine, near Bendigo, central Victoria
Type of business each participant is carrying on	Commercial growing and cultivation of olive trees for the purpose of producing extra virgin olive oil
Number of hectares offered for cultivation	250 hectares
Size of each grove	0.5 hectare
Number of trees per hectare	330
Term of the Project	Approximately 23 years

Initial cost per grove	\$21,285 per Grove for Growers who are accepted into the Project prior to or on 27 June 2003; and/or \$21,340 per Grove for Growers who are accepted into the Project on or after 1 July 2003 but on or before 30 April 2004
Initial cost per hectare	\$42,570 per hectare for Growers who are accepted into the Project prior to or on 27 June 2003; and/or \$43,680 per hectare for Growers who are accepted into the Project on or after 1 July 2003 but on or before 30 April 2004
Ongoing costs	Management fees, rent, insurance, harvesting fees, transportation fees and extraction fees

18. The Responsible Entity has registered the Mediterranean Olives Project 2003 (the Project) as a managed investment scheme pursuant to the *Corporations Act 2001*.

19. An offer to participate in the scheme will be made through a Product Disclosure Statement ('PDS'). The maximum offer under the PDS is for 250 hectares which is equivalent to 500 Groves. The offer will invite investors to subscribe for at least one 0.5 hectare Grove in the Project.

20. The Project Land is situated in Serpentine, near Bendigo in central Victoria. Mediterranean Olives Land Pty Ltd ('the Land Owner') will lease the land to the Manager, who will sub-lease the Groves to the Growers. Growers participating in the Project will carry on the business of commercial growing and cultivation of olive trees for the purposes of producing extra virgin olive oil.

21. Growers will enter into a Management Agreement, a Grove Lease and an Irrigation Sale and Purchase Agreement. The Grove Lease gives a Grower a sub-lease from Mediterranean Olives Estate Limited ('the Manager') over an identifiable area of land called a 'Grove' until 30 June 2026, or the date the Project is terminated under the Constitution, or the date on which the Growers resolve to terminate the Management Agreement, whichever happens first. However, prior to 30 June 2026, the Manager and each Grower may, in writing, agree to extend the term of the Management Agreement, the Grove Lease and the Irrigation Sale and Purchase Agreement.

22. There is no minimum subscription for the Project. Growers may enter the Project in the 2003 income year (defined as 2003 Growers for the purposes of this Ruling) and/or in the 2004 income year (defined as 2004 Growers for the purposes of this Ruling). For 2003 Growers, applications must be accepted by the Responsible Entity and agreements executed on or before 27 June 2003 to allow for all work and services proposed to be completed by 30 June 2003. For 2004 Growers, applications must be accepted and agreements executed by the Responsible Entity on or before 30 April 2004 to allow for all work and services proposed to be completed by 30 June 2004.

23. Each Grower may subscribe for a minimum of one Grove at a cost of \$21,285 for 2003 Growers or \$21,340 for 2004 Growers. Growers will execute a Power of Attorney enabling the Responsible Entity to act on their behalf as required when they make an application under the Product Disclosure Statement.

Constitution

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

Compliance Plan

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

Project Land

26. The land on which the Project will be conducted is at Serpentine, near Bendigo, in central Victoria and include that part of the properties described as follows:

Judyong property:

- the land described in Certificate of Title Volume 10321, Folio 243;

- the land described in Certificate of Title Volume 10321, Folio 244; and
- the land described in Certificate of Title Volume 10365, Folio 844.

Yarrong property:

- the land described in Certificate of Title Volume 3475, Folio 901; and
- the land described in Certificate of Title Volume 8040, Folio 411.

27. A Head Lease will be entered into between Mediterranean Olives Land Pty Ltd ('Land Owner') and Mediterranean Olives Estate Limited (the 'Manager') under which the Project Land is made available to the Manager. Pursuant to the Head Lease the Manager holds an estate in leasehold in the Project Land, of which the Grove Allotment and the Common Area form part, and is authorised to grant leases of allotments of the Project Land for the purposes of the Project.

Interest in Land

28. Growers participating in the arrangement will enter into a Grove Lease between the Manager and the Grower. Growers are granted an interest in land in the form of a sub-lease to use their Grove for the purpose of conducting their horticultural business (clause 6.1). Growers must pay Rent annually to the Manager. The term of a Grower's sub-lease is until 30 June 2026 or such later date as agreed, in writing, with the Manager before 30 June 2026.

Management Agreement

29. Each Grower enters into a Management Agreement with the Manager for each Grove. The term of the Project is until the date the Project is wound up pursuant to the Constitution, the date on which the Growers resolve to terminate the Management Agreement or 30 June 2026, whichever happens first, or such later date as agreed, in writing, with the Manager, before 30 June 2026.

30. During the Term the Manager will perform all services necessary to establish and maintain an olive grove on the Grower's Grove Allotment and will harvest the Olives, process the Olives into olive oil and sell the Crop on behalf of the Grower. Without limiting the foregoing the Growers contract with the Manager to perform the following:

- the Seedling and Planting Services;

- the Management Services;
- the Harvesting Services;
- the Transportation Services;
- the Extraction Services; and
- any other services as Quality Horticultural Practices reasonably require.

31. If the Manager fails to provide the above services in accordance with or as required by Quality Horticultural Practices, the Grower may engage another person to perform those services.

32. The Manager will carry out the following Management Services under this agreement:

- provide the Grove Allotment with irrigation, fertilisers and nutrients at times, to a standard and in a manner consistent with Quality Horticultural Practice;
- use its best endeavours to minimise soil erosion and maintain soil quality on the Grove Allotment to a standard and in a manner consistent with Quality Horticultural Practices;
- use its best endeavours to maintain any buildings, sheds, fire-breaks, windbreaks, fences, access roads or tracks on the Grove Allotment in the condition required under the Grove Lease and in good repair and condition in all respects;
- use its best endeavours to keep the Grove Allotment free from Vermin and Vegetation to a standard and in a manner consistent with Quality Horticultural Practice;
- use its best endeavours to keep the Trees free from insects and diseases, which might damage or inhibit the growth of the Trees to a standard and in a manner consistent with Quality Horticultural Practice;
- prune the Trees to a standard and in a manner consistent with Quality Horticultural Practice;
- use its best endeavours to do all things required by the terms of the Management Plan to a standard and in a manner consistent with Quality Horticultural Practice;
- use its best endeavours to destroy, abandon or leave to rot any Trees or Olives which a reasonable horticulturalist would destroy, abandon or leave to rot consistent with Quality Horticultural Practice;

- prepare accurate records of all fertilisers, nutrients and other chemicals applied to the Grove Allotment, the Olives or the Trees on the Grove Allotment, which records will detail the types and quantities or concentrations applied and the times at which they were applied; or
- do all other acts or things which the Grower may instruct or which are or may be necessary or desirable to cultivate, maintain and manage the Trees, the Olives and the Grove Allotment in a condition consistent with Quality Horticultural Practice.

33. The Grower will pay to the Manager in respect of Management Services provided in each Financial Year during the Term the Management Fee set out in Item 4 of Schedule 1, payable in accordance with Item 4 of Schedule 1.

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

35. Clause 15.1 provides for the Manager to prepare and forward to the Grower, no later than 4 months after the end of each Financial Year, a report on the Services during the proceeding 12 months.

Planting

36. For 2003 Growers who have been accepted into the Project on or before 27 June 2003, the Manager will undertake the planting of the seedlings in respect of the Seedling and Planting Services, for a Grove in Spring 2003 or Autumn 2004. For 2004 Growers who have been accepted into the Project on or before 30 April 2004, the Manager will undertake the planting of the seedlings in respect of the Seedling and Planting Services, by Autumn 2004. After the planting has been completed, the Manager will maintain the trees in accordance with quality horticultural practice. The services to be provided by the Manager over the term of the Project are outlined in the Management Agreement (Schedule 2 to the Management Agreement).

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

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

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

Fees

2003 Growers

39. An initial Management Fee of \$12,457.50 payable on application for Management Services which will be completed during the period from allotment to 30 June 2003.

40. A Management Fee of \$3,916 is payable on 31 October 2003 for services to be provided during the period 1 July 2003 to 30 June 2004.

41. A Management Fee of \$2,678.50 is payable on 31 October 2004, for services to be provided during the period 1 July 2004 to 30 June 2005. For each year thereafter, the annual Management Fee is payable on 31 October of the relevant year equal to the previous years Management Fee indexed by the increase in the Consumer Price Index in June of that year.

42. Under the Management Agreement the Grower is required to pay on application a Seedling and Planting Fee of \$3,492.50 for the purchase and planting of seedlings on the Grower's Grove. Growers must also pay within 30 days of the date of invoice issued by the Manager the Harvesting Fees, Transporting Fees, and Extraction Fees to reimburse the Manager for expenses which have been incurred or will be incurred in respect of these services. The amount of these fees is equal to the Grower's proportion of the expenses as the Grower's interest in the Project bears to the total number of interests issued in the Project.

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

44. Growers must pay an amount for Rent of \$1,485 on application for the period from allotment to 30 June 2003.

45. Growers must pay an amount for Rent of \$1,540 which is payable on 31 October 2003 for the period from 1 July 2003 to 30 June 2004.

46. From 1 July 2004 Rent is payable annually on 31 October of the relevant year, equal to the amount of the rent which was payable in the previous year indexed by the increase in the Consumer Price Index in June of that year.

2004 Growers

47. An initial Management Fee of \$12,457.50 payable on application for Management Services which will be completed during the period from allotment to 30 June 2004.

48. A Management Fee of \$3,916 is payable on 31 October 2004 for services to be provided during the period 1 July 2004 to 30 June 2005.

49. A Management Fee of \$2,678.50 is payable on 31 October 2005, for services to be provided during the period 1 July 2005 to 30 June 2006. For each year thereafter, the annual Management Fee is payable on 31 October of the relevant year equal to the previous years Management Fee indexed by the increase in the Consumer Price Index in June of that year.

50. Under the Management Agreement the Grower is required to pay on application a Seedling and Planting Fee of \$3,492.50 for the purchase and planting of seedlings on the Grower's Grove. Growers must also pay within 30 days of the date of invoice issued by the Manager the Harvesting Fees, Transporting Fees, and Extraction Fees to reimburse the Manager for expenses which have been incurred or will be incurred in respect of these services. The amount of these fees is equal to the Grower's proportion of the expenses as the Grower's interest in the Project bears to the total number of interests issued in the Project.

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

52. Growers must pay an amount for Rent of \$1,540 on application for the period from allotment to 30 June 2004.

53. From 1 July 2004 Rent is payable annually on 31 October of the relevant year, equal to the amount of the rent which was payable in the previous year indexed by the increase in the Consumer Price Index in June of that year.

Finance

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

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

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

Ruling

Application of this Ruling

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

- on or before 27 June 2003 as a 2003 Grower; and/or
- on or before 30 April 2004 as a 2004 Grower,

who have executed a Management Agreement and a Grove Lease on or before the relevant date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

57. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted, agreements executed and the Project has commenced. **This ruling does not apply to Growers who obtain finance from the Responsible Entity, Mediterranean Olives Estate Limited, or an associate of the Responsible Entity.**

The Simplified Tax System ('STS')

Division 328

58. 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

59. 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

60. 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.

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

Treatment of Trading Stock**Section 70-35**

62. During the term of the Project a Grower who is not an 'STS taxpayer' may, in some years, hold olives 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.

63. 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.

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

Deductions for Management Fees and Rent**Section 8-1**

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

2003 Growers

Fee Type	ITAA 1997 Section	Year Ended 30 June 2003	Year Ended 30 June 2004	Year Ended 30 June 2005
Initial Management Fee	8-1	\$12,457.50 See Note (i) (below)	Nil	Nil
Annual Management Fees	8-1	Nil	\$3,916 See Notes (i) & (ii) (below)	\$2,678.50 See Notes (i) & (ii) (below)
Rent	8-1	\$1,485 See Note (i) (below)	\$1,540 See Notes (i) & (ii) (below)	\$1,540 (indexed) See Notes (i) & (ii) (below)

2004 Growers

Fee Type	ITAA 1997 Section	Year Ended 30 June 2004	Year Ended 30 June 2005	Year Ended 30 June 2006
Initial Management Fee	8-1	\$12,457.50 See Note (i) (below)	Nil	Nil
Annual Management Fee	8-1	Nil	\$3,916 See Notes (i) & (ii) (below)	\$2,678.50 (Indexed) See Notes (i) & (ii) (below)
Rent	8-1	\$1,540 See Note (i) (below)	\$1,540 (indexed) See Notes (i) & (ii) (below)	* Amount must be calculated See Notes (i) & (ii) (below)

* From 1 July 2004, rent is payable annually on 31 October of the relevant year, equal to the amount of the rent which was payable in the previous year indexed by the increase in the Consumer Price Index in June of that year.

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example at paragraph 137.
- (ii) The Annual Management Fees and the Rent shown in the Management Agreement and the Grove Lease are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 109, 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.

PR 2003/42**Deductions for capital expenditure****Division 40**

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

2003 Growers

Fee Type	ITAA 1997 Section	Year Ended 30 June 2003	Year Ended 30 June 2004	Year Ended 30 June 2005
Irrigation Equipment	40-515	\$1,283 See Notes (iii) & (iv) (below)	\$1,283 See Notes (iii) & (iv) (below)	\$1,284 See Notes (iii) & (iv) (below)
Establishment of olive trees	40-515	Nil See Notes (iii) & (v) (below)	Nil See Notes (iii) & (v) (below)	Nil See Notes (iii) & (v) (below)
Stakes and guards	40-25	Must be calculated See Notes (iii) & (vi) below	Must be calculated See Notes (iii) & (vi) below	Must be calculated See Notes (iii) & (vi) below

2004 Growers

Fee Type	ITAA 1997 Section	Year Ended 30 June 2004	Year Ended 30 June 2005	Year Ended 30 June 2006
Irrigation Equipment	40-515	\$1,283 See Notes (iii) & (iv) (below)	\$1,283 See Notes (iii) & (iv) (below)	\$1,284 See Notes (iii) & (iv) (below)
Establishment of olive trees	40-515	Nil See Notes (iii) & (v) (below)	Nil See Notes (iii) & (v) (below)	Nil See Notes (iii) & (v) (below)
Stakes and guards	40-25	Must be calculated See Notes (iii) & (vi) below	Must be calculated See Notes (iii) & (vi) below	Must be calculated See Notes (iii) & (vi) 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 137.
- (iv) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).
- (v) Olive trees are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a sub-lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the olive trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the olive trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the olive trees enter their first commercial season (section 40-530, item 2). The Grove Manager will inform Growers of when the olive trees enter their first commercial season.
- (vi) A stake and guard is a 'depreciating asset'. Each Grower holds an interest in each stake and guard which is a 'low-cost asset' and can be allocated to a 'low-value pool'. Once any 'low-cost asset' of a Grower is allocated to a 'low-value pool', all other 'low-cost assets' the Grower start to 'hold' in that year or a later year must be allocated to that pool. If the Grower has already allocated an asset to a 'low-value pool', the stake and guard assets would also have to be allocated to that pool. Otherwise, the Grower must decide whether to create a 'low-value pool'. If the assets are allocated to a 'low-value pool', the capital expenditure on the stakes and guards will be deducted under the diminishing value methodology of the pool based on a rate of 18.75% in the year the stakes and guards are first used and a rate of 37.5% in subsequent years (section 40-440). If the assets are not allocated to a 'low-value pool', they can be written off based on the 'effective life' of the stakes and guards. As there has been no determination of the 'effective life' of a stake and guard by the Commissioner, Growers must self-assess an 'effective life'. Stakes and guards are not installed until after the olive trees are planted and no deduction for the decline in

value is available until this installation occurs. The Manager will advise Growers of that date to enable them to calculate the deduction.

Tax outcomes for Growers who are ‘STS taxpayers’

Assessable Income

Section 6-5 and section 328-105

67. 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.

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

Treatment of Trading Stock

Section 328-285

69. During the term of the Project a Grower who is an ‘STS taxpayer’ may, in some years, hold olives that will constitute trading stock on hand. Where in an income year, the difference between the value of all 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)).

70. 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)).

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

Deductions for Management Fees and Rent

Section 8-1 and section 328-105

72. A Grower who is an ‘STS taxpayer’ may claim tax deductions for the revenue expenses in the following table.

2003 Growers

Fee Type	ITAA 1997 Section	Year Ended 30 June 2003	Year Ended 30 June 2004	Year Ended 30 June 2005
Initial Management Fee	8-1 & 328-105	\$12,457.50 See Notes (vii) & (viii) (below)	Nil	Nil
Annual Management Fees	8-1 & 328-105	Nil	\$3,916 See Notes (vii), (viii) & (ix) (below)	\$2,678.50 See Notes (vii), (viii) & (ix) (below)
Rent	8-1 & 328-105	\$1,485 See Notes (vii) & (viii) (below)	\$1,540 See Notes (vii), (viii) & (ix) (below)	\$1,540 (indexed) See Notes (vii), (viii) & (ix) (below)

2004 Growers

Fee Type	ITAA 1997 Section	Year Ended 30 June 2004	Year Ended 30 June 2005	Year Ended 30 June 2006
Initial Management Fee	8-1 & 328-105	\$12,457.50 See Notes (vii) & (viii) (below)	Nil	Nil
Annual Management Fees	8-1 & 328-105	Nil	\$3,916 See Notes (vii), (viii) & (ix) (below)	\$2,678.50 (Indexed) See Notes (vii), (viii) & (ix) (below)
Rent	8-1 & 328-105	\$1,540 See Notes (vii) & (viii) (below)	\$1,540 (indexed) See Notes (vii), (viii) & (ix) (below)	* Amount must be calculated See Notes (vii), (viii) & (ix) (below)

* From 1 July 2004, rent is payable annually on 31 October of the relevant year, equal to the amount of the rent which was payable in the previous year indexed by the increase in the Consumer Price Index in June of that year.

Notes:

- (vii) 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 137.
- (viii) 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.
- (ix) Where a Grower who is an 'STS taxpayer', pays the Management Fees and the rent in the relevant income years shown in the Management Agreement and the Grove Lease, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1997 may apply to apportion those fees (see paragraph 104 to 114). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 109, unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

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

73. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g. irrigation) and olive trees. Deductions relating to the 'cost' of stakes and guards must be determined under Division 328. 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.

74. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities under Subdivisions 40-F and not under Division 328. If the expenditure has

been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Note (xiii).

75. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1,000 (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.

2003 Growers

Fee Type	ITAA 1997 Section	Year Ended 30 June 2003	Year Ended 30 June 2004	Year Ended 30 June 2005
Irrigation Equipment	40-515	\$1,283 See Notes (x) & (xi) (below)	\$1,283 See Notes (x) & (xi) (below)	\$1,284 See Notes (x) & (xi) (below)
Establishment of olive trees	40-515	Nil See Notes (x) & (xii) (below)	Nil See Notes (x) & (xii) (below)	Nil See Notes (x) & (xii) (below)
Stakes and guards	40-25	Must be calculated See Notes (x) & (xiii) below	Must be calculated See Notes (x) & (xiii) below	Must be calculated See Notes (x) & (xiii) below

2004 Growers

Fee Type	ITAA 1997 Section	Year Ended 30 June 2004	Year Ended 30 June 2005	Year Ended 30 June 2006
Irrigation Equipment	40-515	\$1,283 See Notes (x) & (xi) (below)	\$1,283 See Notes (x) & (xi) (below)	\$1,284 See Notes (x) & (xi) (below)
Establishment of olive trees	40-515	Nil See Notes (x) & (xii) (below)	Nil See Notes (x) & (xii) (below)	Nil See Notes (x) & (xii) (below)
Stakes and guards	40-25	Must be calculated See Notes (x) & (xiii) below	Must be calculated See Notes (x) & (xiii) below	Must be calculated See Notes (x) & (xiii) below

Notes:

- (x) 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 137.
- (xi) 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 \$1,000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the first Financial Year is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).
- (xii) Olive trees are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a sub-lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the olive trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the olive trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the olive trees enter their first commercial season (section 40-530, item 2). The Grove Manager will inform Growers of when the olive trees enter their first commercial season.

- (xiii) A stake and guard is a 'depreciating asset'. Each Grower holds an interest in each stake and guard which is a 'low-cost asset' as defined in subsection 40-425(2). It cannot be allocated to the 'general STS pool' (section 328-180). A deduction equal to the amount of the Grower's expenditure for the stakes and guards is available in the income year in which they are 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. Stakes and guards are not installed until after the olive trees are planted. The Manager will advise when that has occurred.

Tax outcomes that apply to all Growers

Interest

76. 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 104 to 114 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

77. For a Grower who is an individual and who enters the Project during the year ended 30 June 2003 or 30 June 2004 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for:

- 2003 Growers that for the income years ending 30 June 2003 to 30 June 2007; or
- 2004 Growers that for the income years ending 30 June 2004 to 30 June 2008,

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.

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78. 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 124 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)).

79. 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.

80. 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

81. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Grove Lease 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 104 to 114);
- 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.

Explanation

Is the Grower carrying on a business?

82. For the amounts set out in the Tables above to constitute allowable deductions the Grower's horticultural activities as a participant in the Mediterranean Olives Project 2003 must amount to the carrying on of a business of primary production. These horticultural activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

83. For schemes such as that of the Mediterranean Olives Project 2003, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v Lau* 84 ATC 4929; (1984) 16 ATR 55.

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

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

85. In this Project, each Grower enters into a Management Agreement and a Grove Lease.

86. Under the Grove Lease each individual Grower will have rights over a specific and identifiable area of 0.5 hectares of land. The Grove Lease provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the lease the Grower must use the land in question for the purpose of carrying out horticultural activities, and for no other purpose. The lease allows the Manager to come onto the land to carry out its obligations under the Management Agreement.

87. Under the Management Agreement the 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 Manager has provided evidence that it holds the appropriate professional skills

and credentials to provide the management services to establish and maintain the Grove Allotment on the Grower's behalf.

88. In establishing the Grove, the Grower engages the Manager to purchase and install water facilities (e.g. irrigation) and to acquire and plant olive rootlings on the Grower's Grove. During the term of the Project, these assets will be used wholly to carry out the Grower's horticultural activities. The Manager is also engaged to harvest and sell, on the Grower's behalf, the olives grown on the Grower's Grove.

89. 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.

90. 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 the olives and/or olive produce that will return a before-tax profit, i.e. a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

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

92. The 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 horticulture. While the size of a Grove is relatively small, it is of a size and scale to allow it to be commercially viable. (see *Taxation Ruling* IT 360).

93. The Grower's degree of control over the 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 Allotment 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.

94. The horticultural activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' horticultural activities in the Mediterranean Olives Project 2003 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

95. 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.

96. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Management Fees and Rent

Section 8-1

97. Consideration of whether the Management Fees and Rent are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

98. The Management Fees and Rent associated with the horticultural activities will relate to the gaining of income from the Grower's business of horticulture (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of olive 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

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

100. 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 104 to 117) 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

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

102. If the Grower is not an 'STS taxpayer', the Management Fees and the Rent are deductible in the year in which they are incurred.

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

Prepayment provisions

Sections 82KZL to 82KZMF

104. 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.

105. For this Project, only section 82KZL (an interpretive provision) and sections 82KZME and 82KZMF are relevant. These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

106. 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)).

107. 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.

108. 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.

109. 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.

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

110. 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

111. Under the Management Agreement, a Grower incurs a Year 1 Management Fee of \$12,457.50, and Rent of \$1,485 per Grove Allotment for 2003 Growers or \$1,540 per Grove Allotment for 2004 Growers. A Seedling and Planting Fee of \$3,492.50 and an Irrigation Purchase Price of \$3,850 will be incurred on execution of the Management, Grove Lease and the Irrigation Sale and Purchase Agreement. The Management Fee and the Rent are charged for providing Management Services and leasing land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreements, further annual expenditure is incurred each year during the term of the Project for the provision of Management Services and for the lease of land until 30 June in those years.

112. 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.

113. 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 Lease, Rent is payable annually by 31 October for the lease of the land during the expenditure year.

114. On this basis, the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application to the Management Fees in Years 2 to 23.

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

115. Although not required under either the Management Agreement, or the Grove Lease, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 114 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

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

Expenditure of a capital nature

Division 40 and Division 328

118. 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, the establishment of the olive trees and the installation of the stakes and guards are of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

119. 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'.

120. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 66 and 73 in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

121. 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.

122. 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.

123. 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.

124. 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.

125. 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).

126. 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 0.5 hectare Grove in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2010 for 2003 Growers or 2011 for 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.

127. 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.

128. 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.

129. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one 0.5 hectare Grove Allotment 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, for the income years ended 30 June 2008 for 2003 Growers or 30 June 2009 for 2004 Growers.

130. 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 2007 for 2003 Growers or 2008 for 2004 Growers.

131. 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 77), in the manner described in the Arrangement (see paragraphs 14 to 55). 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.

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

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

Losses and Outgoings incurred under Certain Tax Avoidance Schemes

Section 82KL – recouped expenditure

133. 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

134. 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).

135. The Mediterranean Olives Project 2003 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 65, 66, 72 and 73 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.

136. 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 olive produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm’s length or, if any

parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Entitlement to GST input tax credits

137. 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 \$4,400 *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).

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Commissioner of Taxation

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Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
 TR 97/11; TR 97/16; TR 98/22;
 TR 2000/8; TR 2001/14; TD 93/34;
 IT 360

Subject references:

- carrying on a business
 - commencement of business
 - fee expenses
 - management fees
 - producing assessable income
 - product rulings
 - public rulings
 - taxation administration
 - tax avoidance
 - tax benefits under tax avoidance schemes
 - tax shelters
 - tax shelters project

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