



PR 2003/50 - Income tax: Victorian Olive Oil Project II

 This cover sheet is provided for information only. It does not form part of *PR 2003/50 - Income tax: Victorian Olive Oil Project II*

 This document has changed over time. This is a consolidated version of the ruling which was published on *19 October 2005*



Product Ruling

Income tax: Victorian Olive Oil Project II

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	65
Explanation	87
Examples	132
Detailed contents list	135

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.*

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

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

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

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Victorian Olive Oil Project II 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 328 (ITAA 1997);
 - Section 82KL of the Income Tax Assessment Act 1936 ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Section 82KZME (ITAA 1936);
 - Section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

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

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

Note to promoters and advisers

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

Class of persons

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

8. The class of persons to whom this Ruling applies does not include persons who:

- intend to terminate their involvement in the arrangement prior to its completion;
- do not intend to derive assessable income from it;
- elect to manage their Groves;
- enter into finance arrangements with the Responsible Entity or any associate of the Responsible Entity; or
- enter into this arrangement after 30 May 2005.

Qualifications

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

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

Commonwealth Copyright Administration
Intellectual Property Branch
Department of Communications, Information Technology and
the Arts
GPO Box 2154
Canberra ACT 2601

or by e-mail: commonwealth.copyright@dcita.gov.au.

Date of effect

11. This Ruling applies prospectively from 23 July 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).

Note: The Addendum to this Ruling that issued on 19 October 2005 applies on and from 1 July 2005.

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2007. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who

enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 20 February 2003 as constituted by documents provided on 20 February 2003, 25 March 2003, 18 June 2003, 20 June 2003, 26 June 2003, 30 June 2003, 3 July 2003, 9 July 2003, 16 July 2003 and additional correspondence from Applicant's representative dated 25 March 2003, 2 June 2003, 18 June 2003, 20 June 2003, 26 June 2003, 30 June 2003, 3 July 2003 and 16 July 2003;
- Draft Victorian Olive Oil Project II Product Disclosure Statement ('PDS');
- Constitution of Victorian Olive Oil Project Limited ('VOOPL' or 'Responsible Entity');
- Draft **Constitution** of Victorian Olive Oil Project II;
- Draft Head Lease Agreement between Lanyons Paddock Pty Ltd ('Lanyons' or 'Landlord') and Custodial Limited ('Custodian') as tenant and VOOPL as Responsible Entity on behalf of Grower;
- Draft **Grower's Lease Agreement** between Custodial Limited ('Custodian'), Grower and VOOPL;
- Draft **Management Agreement** between VOOPL on behalf of Grower and Terrapee Contractors Pty Ltd ('Manager');
- Copy of Olive Oil Supply and Purchase Agreement between Victorian Olive Processors Pty Ltd ('Processors') and Inglewood Olive Processors Limited ('Inglewood') dated 30 April 2001;
- Copy of the Orchard Management Plan (OMP);
- Copy of letter from Modern Olives dated 18 March 2003 confirming the OMP is a correct

representation of the nature and extent of operations required to make the orchard commercially viable; and

- Draft Compliance Plan for the Project.

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

15. The documents highlighted are those Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are part of the arrangements to which this Ruling applies. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

Overview

16. This arrangement is called the Victorian Olive Oil Project II. The salient features of the Project are shown in the table

Location	14 kilometres south west of Boort in North Western Victoria
Type of Business to be carried on by each participant	Commercial growing and cultivation of an Olive Grove for the purpose of producing olives for processing and sale
Size of each Olive Grove	One hectare
Number of olive trees per Grove	At least 250, but with an average over the Project of 330
Minimum allotment of Groves per Grower	One Grove
Number of Groves available	118 Groves, each being approximately one hectare
Term of the Project	From Commencement Date to 30 June 2025, with an option for a further 25 years
Initial cost per Grove (Subscription Amount)	\$24,640 consisting of lease fees \$12,540; management fees \$12,100; the initial cost covers lease and management fees for the first two years from the Commencement Date
Ongoing Lease Rentals per Grove after initial two years	\$6,270 per annum, payable monthly in equal instalments to 30 June 2010, and thereafter \$6,270 indexed by CPI each year from 1 July 2010 to 30 June 2025

Ongoing Management fees per grove after initial two years	\$6,050 per annum, payable monthly in equal instalments to 30 June 2010, and thereafter \$6,050 indexed by CPI each year from 1 July 2010 to 30 June 2025
Production Sharing Option	From 1 July 2009 Growers have the option to convert both the annual lease and management fees to 66% of Growers Gross Annual Revenue

17. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. Offers for interests in the Project will be made under a Product Disclosure Statement. For the purposes of this Ruling no Project Interests will be allotted or issued under the PDS after 30 May 2005, although the PDS may be withdrawn sooner.

18. The Landlord has leased the project land to the Custodian under a Head Lease Agreement. Each Grower will execute a Grower's Lease Agreement with the Custodian and may enter into a Management Agreement with the Manager.

19. This Product Ruling does not apply to Growers who do not execute a Management Agreement with the Manager. Such Growers may request a private ruling on the taxation consequences of their participation in the Project.

20. The minimum area of land (referred to as an 'Olive Grove' or a 'Grove') that can be leased by a Grower under the Project is one hectare. Prior to Growers being accepted to participate in the Project the Landlord has installed irrigation infrastructure and planted olive trees on the Groves.

21. Each Grower will use the leased Grove(s) for the purpose of carrying on a business of cultivating and harvesting olives and the sale of olive oil from the harvested produce.

22. Depending upon the date of execution of a Grower's Lease Agreement and, where relevant, a Management Agreement, applicants accepted into the Project will become 2004 Growers or 2005 Growers. For the purposes of this Product Ruling all references to 2004 Growers and 2005 Growers mean:

Growers Lease and Management Agreements executed	Grower
On or before 30/05/2004	2004 Grower
On or after 1/06/2004 and on or before 30/05/2005	2005 Grower

23. A reference in this Product Ruling to the 'Commencement Date' means the first day of the month immediately following the month in which a Grower's Lease Agreement and, if applicable, Management Agreement are executed. For example, if a Grower executes the Agreements on 15 September 2004, the Commencement Date for the purposes of the Agreements will be 1 October 2004.

Constitution

24. The Constitution establishes a Managed Investment Scheme (Scheme) known as 'Victorian Olive Oil Project II' (VOOP II), and operates as a deed binding on all Growers and the Responsible Entity.

25. The Constitution sets out the terms and conditions under which VOOP is appointed and agrees to act as Responsible Entity for the Scheme and act as trustee of the Funds. Among other things, the terms of the Constitution provide that:

- all application monies shall be lodged in the Application Fund (clause 3.4);
- all proceeds from the sale of olive oil shall be lodged in the Revenue Fund (clause 3.5);
- the Application Fund is to be disbursed in accordance with the Growers Lease, the Management Agreement and the Constitution (clause 3.4);
- all Growers who enter into the Management Agreement will have an interest in the Revenue Fund equal to their Proportional Interest (clause 3.7);

26. VOOP may appoint a custodian to hold the Application Fund (clause 3.4) and Revenue Fund (clause 3.5) in accordance with the provisions of the Constitution.

27. The Constitution sets out in detail the following:

- Responsible Entity's liability and indemnity (clause 8);
- register of Growers (clause 11);
- general powers of Responsible Entity (clause 17);
- transfer and transmission of hectares (clause 20);
- meeting of investors (clause 21);
- remuneration of the Responsible Entity (clause 24);
- complaints handling (clause 25);
- compliance committee (clause 27);

- the duration and termination of the Project (clause 28);
- the removal, retirement or resignation of the Responsible Entity (clause 29); and
- replacement of the Responsible Entity (clause 30).

Compliance plan

28. As required by the *Corporations Act 2001*, VOOPL has prepared a Compliance Plan for the Project. The purpose of the Compliance Plan is to have a compliance culture within the Responsible Entity so that it is able to identify, report and address breaches and thereby protect the interests of the Growers. This will ensure that the Responsible Entity complies with obligations and responsibilities under the *Corporation Act 2001* and the Constitution.

Grower's Lease Agreement

29. Each Grower will execute an individual Grower's Lease Agreement. The parties to the Grower's Lease Agreement are the Custodian in its capacity as the Landlord, each Grower as Tenant, and VOOPL in its capacity as Responsible Entity. Under clause 2 of the Agreement, in return for the Rent set out in Item 3a of the Reference Schedule, the Custodian grants and leases the 'Premises' to the Grower.

30. The Premises, being each Grower's Olive Grove(s), consists of the 'Land', as shown in a plan to be attached to each Grower's Lease Agreement, and includes without limitation all olive trees planted on the Grove(s), the produce of harvesting those trees, the right to draw sufficient water from the supply of water made available by the Landlord, and the irrigation system required to irrigate the trees. The Grower's Lease Agreement also grants each Grower the right to use and access the Common Areas for irrigation purposes.

31. The Term of the Agreement will be from the Commencement Date until 30 June 2025 or the termination of the Grower's interest in the Grove. Growers who comply with the conditions of clause 18 are entitled to be granted a Further Term of 25 years less one day.

32. Under the Agreement the Grower undertakes to:

- pay the Rent in the amounts and at the times shown in the Reference Schedule;
- keep the Premises and Common Areas clean;
- not cause a nuisance, or damage to the owners of adjoining properties;

- keep the Land free of vermin and noxious weeds; and
 - obtain and maintain all necessary licences, permits, consents and authorities necessary to use the Grove(s) for growing, cultivating and harvesting olives and related horticultural activities.
33. Under the Agreement the Landlord must:
- ensure that, in accordance with the Orchard Management Plan, there are at least 250 trees planted on each hectare of the Premises (clause 4.2);
 - ensure that the Responsible Entity has insured or procured the insurance of the Premises (clause 4.3); and
 - ensure that each hectare of the Premises is capable of being irrigated by the Irrigation System in accordance with the Orchard Management Plan and must procure the supply of water and provide the Tenant with the means to draw sufficient water to water the Premises in accordance with the Management Plan (clause 4.4).

Production sharing option

34. Under clause 5, a Grower can exercise an option whereby the amount of annual Lease Rentals to be paid will be 33 per cent of Growers Gross Annual Revenue. If this option is exercised, the annual Lease Rental will be determined using this alternative method from the Financial Year commencing 1 July 2009. This amount will be deducted from the Grower's share of the Revenue Fund by the Custodian prior to distribution of income to Growers who exercise this option (clause 5.1).

Management Agreement

35. At the time of Application each Applicant has the option to sign an Authorisation Form authorising the Responsible Entity to enter into a Management Agreement with the Manager on the Applicant's behalf. This Product Ruling only applies to Applicants accepted to participate in the Project where the Responsible Entity has executed such a Management Agreement with the Manager.

36. The Management Agreement will commence on the Commencement Date and continue until 30 June 2025 or until terminated under clause 14.

37. In performing its obligations under the Management Agreement the Manager must have regard to and act in accordance with the Orchard Management Plan (clause 10.1). However, this requirement is subject to an exception where a written direction is received from a Grower that requires the Manager to do something that is inconsistent with the Orchard Management Plan (clause 10.2).

38. The Manager is entitled to subcontract its obligations under the Management Agreement (clause 12.1) although this does not release the Manager from liability under the Agreement (clause 12.2).

39. Under the Management Agreement the Manager agrees to provide Management Services, Crushing Services, and Marketing Services in return for the fees set out in clause 11.

Management Services (clause 4)

40. The Manager will supervise and manage commercial horticultural activities on the Olive Grove, in accordance with the Orchard Management Plan. The Manager undertakes to:

- continually monitor soil condition and take all measures concerning soil preparation and prevention of land degradation;
- cultivate, tend, prune, fertilise, replant, spray and otherwise care for the olive trees as and when required;
- keep in good repair access laneways within the Olive Grove;
- keep the Olive Grove free from vermin, noxious weeds, pests and diseases;
- maintain adequate fire-breaks and make available fire equipment and emergency water points in and around the Olive Groves;
- maintain the Olive Grove in accordance with good olive horticultural practices;
- maintain and repair the irrigation system to supply water to the Grower's Olive Grove;
- replace any of the olive trees in need of replacement within 6 months of the establishment period;
- provide any other service or thing which is incidental or ancillary to the ongoing management of the Olive Grove; and

- arrange for the olives to be harvested at a suitable time and delivered to the crushing site.

Crushing Services (clause 5)

41. The Manager will arrange for crushing services utilising appropriately qualified and skilled staff in accordance with best industry practices, the 'Required Procedures', and the Law. The Required Procedures are set out in clause 5.3. The Olives will be weighed before being crushed to produce Oil.

42. The Oil will be stored in identifiable batches and stainless steel containers and weighed within 40 days of crushing. Any resulting by-products will belong to the Manager.

43. The Crushing Services also include a requirement for the Manager to have finalised plans for, or to have acquired the use of a crushing facility by 31 December 2005.

Marketing Services (clause 6)

44. The Manager will ensure the certainty of sales of the Oil by building relationships with prospective vendors. Towards this end Processors, an associate entity of the Manager, has entered into the Olive Oil Supply and Purchase Agreement with Inglewood. (see paragraphs 50 to 55).

Sales Proceeds

45. The Oil produced from the Crushing Services will be pooled and the proceeds will be paid into a trust account (the Revenue Fund) held on behalf of the Growers by the Custodian.

46. The Custodian will deduct the Selling Costs and any amounts due by any of the Growers and outstanding under this agreement, the Grower's Lease Agreement, and the constitution. On the basis of their 'Proportional Interest' in the Project the Custodian will then pay the balance remaining to those Growers who have contributed to the pool of Oil.

Production sharing option

47. Under clause 11.5 a Grower can exercise an option whereby the amount of annual management fees to be paid will be 33 per cent of the Growers Gross Annual Revenue. If this option is exercised, annual management fees will be determined using this alternative method from the Financial Year commencing 1 July 2009. This

amount will be deducted from the Grower's share of the Revenue Fund by the Custodian and paid to the Manager prior to distribution of income to Growers who exercise this option.

48. However, to exercise this option, the Grower must have also exercised the 'production sharing option' under clause 5 of the Grower's Lease Agreement.

Insurance

49. Under clause 13 the Manager is responsible for procuring with a reputable insurer insurance cover (referred to as the 'Required Insurance') up to a maximum of \$5 million for any loss, and at least \$5 million cover for Manager's performance obligations.

Olive Oil Supply and Purchase Agreement

50. Processors entered into an Olive Oil Supply and Purchase Agreement with Inglewood on 30 April 2001. The period of this Agreement is 10 years but may thereafter be extended for successive 5 year periods.

51. Under this Agreement Inglewood, an entity in the business of packaging and marketing extra virgin grade olive oil, agrees to purchase on an annual basis Oil supplied by the Growers up to the tonnages agreed and specified.

52. Inglewood will purchase quantities of oil in excess of the contracted tonnages provided Processors notifies Inglewood of expected additional production volumes one month prior to delivery.

53. The offer price submitted to Processors by Inglewood for extra virgin grade oil, subject to clause 9(c), will not be less than the value of extra virgin grade oil sold in bulk on Spanish domestic markets and averaged for the previous 12 months.

54. The Pricing Schedule to this agreement provides for a premium to be paid for specific named varieties of Oil.

55. In the case of Oil which does not satisfy defined industry standards for extra virgin grade oil, Inglewood may elect to still purchase the Oil, however, a lesser price may be paid. The payment for Oil will be made by Inglewood to Processors within 30 days of delivery to its factory.

Fees***Subscription and initial period fee***

56. The subscription amount to acquire interest in an Olive Grove is \$24,640. This amount is payable in full upon application. The subscription amount consists of lease rental of \$12,540 and management fees of \$12,100. The subscription amount covers an initial period of two years from the Commencement Date.

Rent after the initial period

57. Subject to paragraph 59 below, the Grower's Lease Rental per Grove after the initial two year period is \$6,270 per annum. The Rent is payable monthly in equal instalments to 30 June 2010. See Example 1 at paragraph 132.

58. From 1 July 2010 the Rent payable per annum by Growers who have not exercised the production sharing option, is \$6,270 indexed by CPI in accordance with Item 9 of the Reference Schedule, and Schedule 2 to the Grower's Lease Agreement, and payable monthly in equal instalments to 30 June 2025.

59. Growers who exercise the production sharing option will pay monthly Lease Rentals (determined as shown in paragraph 57 above) until 30 June 2008. Thereafter, from the Financial Year commencing 1 July 2009, the amount of annual Lease Rentals to be paid will be 33 per cent of the Growers Gross Annual Revenue.

Management fee after the initial period

60. Subject to paragraph 62 below, the Grower's management fee per Grove after the initial two year period is \$6,050 per annum. This fee is payable monthly in equal instalments to 30 June 2010. See Example 1 at paragraph 132.

61. From 1 July 2010 the annual management fee payable per annum by Growers who have not exercised the production sharing option is will be the previous year's annual management fee increased by the CPI for the 12 months ending 30 June of the financial year of review, and payable monthly in equal instalments.

62. Growers who exercise the production sharing option will pay monthly management fees (determined as shown in paragraph 60 above) until 30 June 2008. Thereafter, from the Financial Year commencing 1 July 2009 the amount of annual management fees to be paid will be 33 per cent of the Growers Gross Annual Revenue.

Finance

63. Growers can fund their involvement in the project themselves or borrow from an independent lender. The Responsible Entity and its associates will neither offer finance nor promote any 'preferred financiers' to Growers.

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

- a finance arrangement entered with the Responsible Entity or any associate of the Responsible Entity; or
- 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

65. This Ruling applies only to Growers who are accepted to participate in the Project on or before 30 May 2005 and who have executed a Grower's Lease Agreement and Management Agreement on or before that date.

66. A Grower's participation in the Project must constitute the carrying on of a business of primary production. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced.

67. This Ruling does not apply to Growers who:

- are accepted to participate in the Project before the date this Ruling is made;
- are accepted to participate in the Project after 30 May 2005;
- elect to manage their Olive Grove(s) or do not enter into the Management Agreement with the Manager; or
- enter into finance arrangements with the Responsible Entity or an associate of the Responsible Entity.

The Simplified Tax System ('STS')

Division 328

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

Qualification

69. 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.

Prepaid fees

70. The Management Fees of \$12,100 and the Lease Rentals of \$12,540 incurred for management services and the lease of the Premises to Growers during the first two years of this Project are subject to the prepayment rules in sections 82KZME and 82KZMF. In

this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure'. For the purposes of this ruling 'excluded expenditure' refers to an expenditure of less than \$1000.

71. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

Assessable Income

Section 6-5 and section 328-105

72. That part of the gross sales proceeds from the Project attributable to a 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. Other than Growers referred to in paragraph 74, a Grower is assessable on ordinary income from carrying on their business of cultivating olive trees and harvesting the olives for the production and sale of olive oil in the income year in which that income is derived.

74. A Grower who is an 'STS taxpayer' (for the 2003-04 and 2004-05 income years) or an 'STS taxpayer' using the cash accounting method (for the 2005-06 income year and later years) is assessable on ordinary income from carrying on their business of cultivating olive trees and harvesting the olives for the production and sale of olive oil at the time the income is received.

Deductions for Management Fees and Lease Rentals

Section 8-1 and section 328-105

75. A Grower may claim tax deductions for the revenue expenses set out in the following table. For '**2004 Growers**', deductions shown

PR 2003/50

for years 1, 2 and 3 are those deductions allowable in the income years ended 30 June 2004, 2005 and 2006 respectively. For **'2005 Growers'**, deductions shown for years 1, 2 and 3 are those deductions allowable in the income years ended 30 June 2005, 2006 and 2007 respectively.

Fee type	ITAA 1997 section	Year 1	Year 2	Year 3
Management fee	8-1	Amounts must be calculated – See Notes (i) (ii) & (iii) (below)	Amounts must be calculated – See Notes (i) (ii) & (iii) (below)	Amounts must be calculated – See Notes (i) (ii) & (iii) (below)
Lease fee (Rent)	8-1	Amounts must be calculated – See Notes (i) (ii) & (iii) (below)	Amounts must be calculated – See Notes (i) (ii) & (iii) (below)	Amounts must be calculated – See Notes (i) (ii) & (iii) (below)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example 2 at paragraph 133.
- (ii) The Management fees and the Lease fees (Rent) in paragraph 56 are NOT deductible in full in the year incurred. The deduction for each year's fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 71). The Project Manager will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred. See Example 3 at paragraph 134.

- (iii) For the 2003-04 and 2004-05 income years, the Management fees and the Lease fees (Rent) are NOT deductible in full in the year in which they are paid by, or on behalf of the 'STS taxpayer'. The deduction for each year's fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 71). The Project Manager will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred. (See Example 3 at paragraph 134).

For the 2005-06 and 2006-07 income years, the Management fees and the Lease fees (Rent) payable by a Grower who is an 'STS taxpayer' using the cash accounting method are NOT deductible in full in the year in which they are paid. For a Grower who is an 'STS taxpayer' using the accruals accounting method, these fees are NOT deductible in full in the year incurred. The deduction for each year's fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 71). The Project Manager will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred.

Deductions for capital expenditure

Subdivision 40-F

76. All Growers who are accepted into the Project on or after the date the PDS is registered with ASIC and on or before 30 May 2005, and who have executed the Growers Lease and Management Agreements during these dates, will also be entitled to tax deductions relating to the establishment of the olive trees by the Landlord prior to Growers being accepted to participate in the Project.

77. The amount and timing of these deductions will be determined under Subdivision 40-F but, in general terms, Growers will not be entitled to claim a deduction relating to the olive trees until at least Year 4 of the establishment of the Project.

78. An olive tree is a 'horticultural plant' as defined in subsection 40-520(2). As a Grower holds the land under the Grower's Lease Agreement, 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.

79. The deduction for the olive trees is determined using the formula in section 40-545 and is based on the capital expenditure of \$3499 incurred by the Landlord that is attributable to their establishment. 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 2 at paragraph 133.

80. As olive 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 \$245 per annum commencing from the time when the olive trees enter their first commercial season (section 40-530, item 2). Although the Responsible Entity has estimated that the olive trees will enter their first commercial season in Year 4 of the establishment of the Project, Growers should confirm this with the Responsible Entity at that time before commencing to claim their deductions.

Interest

81. 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 115 (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

82. For a Grower who is an individual and who enters the Project during the income years ended 30 June 2004 or 30 June 2005 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:

- 2004 Growers for the income years ending 30 June 2004 to 30 June 2008; and
- 2005 Growers for the income years ending 30 June 2005 to 30 June 2008.

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.

83. 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 120 in the Explanations part of this ruling, below);
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

84. 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.

85. 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.

Section 82KL, and Part IVA

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

- 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?

87. For the amounts set out in the tables above to constitute allowable deductions the Grower's activities of cultivating olive trees and harvesting the olives for the production and sale of olive oil as a participant in the Victorian Olive Oil Project II must amount to the carrying on of a business of primary production. The Grower's activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

88. For schemes such as the Victorian Olive Oil Project II, 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.

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

- the Grower has an identifiable interest in the land (by lease) or holds rights over the land (under a licence) on which the Grower's trees are established;
- the Grower has a right to harvest and sell the olives and olive oil produce from those trees;
- the cultivating of the olive trees and harvesting the olives for the production and sale of olive oil are carried out on the Grower's behalf;
- the activities of the Grower are typical of those associated with a business of cultivating olive trees and harvesting the olives for the production and sale of olive oil; and
- the weight and influence of general indicators point to the carrying on of a business.

90. In this Project, each Grower who is the subject of this Product Ruling enters into a Management Agreement and a Grower's Lease Agreement.

91. Under the Grower's Lease Agreement, each individual Grower will have rights over a specific and identifiable area of one hectare or more of land. The Grower's Lease Agreement provides the Grower with an ongoing interest in the specific trees and the olives produced by those 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 activities of cultivating olive trees and harvesting the olives for the production and sale of olive oil and for no other purpose. The Lease allows the Manager to come onto the land to carry out its obligations under the Management Agreement.

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

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

94. 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.

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

96. The pooling of olives and olive oil produce from trees grown on the Grower's Grove with the olives and olive oil produce of other Growers participating in the Victorian Olive Oil Project II is consistent with general horticultural practices. Each Grower's proportionate share of the sale proceeds of the pooled olives and olive oil will reflect the proportion contributed from their Grove.

97. The Manager's services on the Grower's behalf are also consistent with general horticultural practices. 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).

98. The Grower's degree of control over the Project 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 Grower's Grove and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

99. The activities of cultivating olive trees and harvesting the olives for the production and sale of olive oil, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Grower's activities of cultivating olive trees and harvesting olives for the production and sale of olive oil in the Victorian Olive Oil Project II will constitute the carrying on of a business.

The Simplified Tax System

Division 328

100. 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.

101. 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 Lease fees

Section 8-1

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

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

about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

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

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. 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 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. 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 that is not associated with the Project. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and any interest incurred are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, any interest deductions allowable will be subject to apportionment under section 82KZMF.

109. 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.

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

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

111. 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

112. The expenditure incurred by a Grower in the Project for the initial management fees and initial lease fees meets the requirements of subsections 82KZME(1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

113. The prepaid lease fees and management fees incurred by Growers for the first two years of their participation in the Project do not fall within any of the 5 exceptions to section 82KZME. Therefore, the deduction for prepaid lease fees and management fees for each year is determined using the formula in subsection 82KZMF(1).

114. In this Project a Grower pays a subscription fee of \$24,640. Of this amount the Grower pays \$12,540 in respect of grove lease rent, and \$12,100 in respect of the management fees for a two year period which may straddle three financial years. Section 82KZMF will apportion the deduction for prepaid Management fees for the provision of management services, and lease fees for leasing the Grove(s) over this period for which the prepayment is made. See Example 3 at paragraph 134.

115. Annual management fees and annual lease fees payable after the first two years of the Growers participation in the Project are payable on a monthly basis and, therefore, are not prepayments for the purposes of Subdivision H. They are, therefore, deductible in the income year in which they are incurred. However, should a Grower choose to prepay these fees (for example to pay annually in advance rather than monthly as required) then the fees will be subject to prepayment provisions and deductions must be determined using the formula in paragraph 110 above.

Expenditure of a capital nature

Division 40 and Division 328

116. 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 the establishment of the olive trees is of a capital nature. This expenditure falls for consideration under Division 40 of the ITAA 1997. The tax treatment of this capital expenditure has been dealt with in a representative way in paragraphs 76 to 80 above.

Deferral of losses from non-commercial business activities

Division 35

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

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

118. 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.

119. 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.

120. 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.

121. In broad terms, the tests require:

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

122. 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 2004 Grower or a 2005 Grower, as relevant, who acquires the minimum participation of one Grove in the Project, is unlikely to pass one of the tests until the income year ended 30 June 2011. Growers who acquire more than the minimum participation in the Project may however, find that their activity meets one of the tests in an earlier income year.

123. 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.

124. 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.

125. Information provided with this Product Ruling indicates that a 2004 Grower or a 2005 Grower, as relevant, who acquires the minimum investment of one Grove in the Project is expected to be carrying on a business activity that will produce a taxation profit, for the year ended 30 June 2009. 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 2008.

126. 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 82), in the manner described in the Arrangement (see paragraphs 14 to 64). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

127. 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 independent expert report relating to suitability of soil and water resources for olive production;
- the horticulturalist report;
- the Olive Oil Supply and Purchase Agreement that Processors has entered into with Inglewood for the purchase by Inglewood of bulk olive oil up to the tonnages agreed and specified on an annual basis subject to the satisfactory condition of the oil; and
- independent, objective, and generally available information relating to the olive industry.

Losses and Outgoings incurred under Certain Tax Avoidance Schemes

Section 82KL – recouped expenditure

128. 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

129. 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).

130. The Victorian Olive Oil Project II 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 75 to 80 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

131. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the olives and olive oil produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm’s length or, if any parties are not dealing at arm’s length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Example 1 - Fees

132. Jack is accepted into the Project and executes the Growers Lease and Management Agreements on 15 September 2003. Jack pays a subscription fee of \$24,640 for the first two years of his participation in the Project. This amount consists of \$12,540 for Grove Lease Rentals, and \$12,100 for the management fees for the period 1 October 2003 to 30 September 2005.

From 1 October 2005 until 30 June 2010 Jack pays \$6,270/12 = \$522.50 per month in Grove Lease Rentals, and \$6,050/12 = \$504.16 per month in management fees.

For each year thereafter Jack will be advised by the Custodian in respect of Grove Lease Rentals, and by the Manager in respect of management fees, that will be payable under the Grower's Lease Agreement and Management Agreement respectively.

Example 2 - Entitlement to GST input tax credits

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

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

*Taxable supply

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

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

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

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

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

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

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

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

Example 3 - Apportionment of Fees

134. Jack decides to participate in the Victorian Olive Oil Project II which is offering 118 interests of 1 hectare Olive Groves. The subscription amount payable upon application to acquire interest in an Olive Grove is \$24,640. The subscription amount covers an initial period of two years from the Commencement Date. The Grower's lease rental per grove after the initial two year period is \$6,270 per annum payable monthly in equal instalments. The management fee per grove after the initial two year period is \$6,050 per annum payable monthly in equal instalments.

Jack authorises VOOPL to execute the Management Agreement on his behalf. On 15 September 2003 VOOPL informs Jack that his application has been accepted. Jack's agreements are duly executed and management services start to be provided from the Commencement Date. The Commencement Date for the purposes of Jack's agreements as per the definition in the Management Agreement will be 1 October 2003. Therefore, the subscription amount covers an initial period of two years from 1 October 2003 to 30 September 2005. There are 731 days in this two year period taking into account that the calendar year 2004 is a leap year with 29 days in the month of February.

Jack is an 'STS taxpayer' who is not registered, nor required to be registered for GST. He calculates his tax deduction for management fees for the **2004 income year** as follows:

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

$$\$12,100 \times \frac{274}{731} \quad \text{There are 274 days between 1 October 2003 to 30 June 2004}$$

= **\$4,535** (this is Jack's total tax deduction in the 2004 Year for prepaid management fees of \$12,100. It represents the 274 days for which management services will be provided in the 2004 income year).

Jack calculates his tax deduction for management fees for the **2005 income year** as follows:

$$\$12,100 \times \frac{365}{731} \quad \text{There are 365 days between 1 July 2004 to 30 June 2005}$$

= **\$6,042** (this is Jack's total tax deduction in the 2005 Year for prepaid management fees of \$12,100. It represents the 365 days for

which management services will be provided in the 2005 income year).

In the **2006 income year** Jack will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\begin{array}{r} \$12,100 \times \frac{92}{731} \end{array} \quad \begin{array}{l} \text{There are 92 days between 1 July 2005 to} \\ \text{30 September 2005} \end{array}$$

= **\$1,523** (this represents the balance of the prepaid fees for services provided to Jack in the 2006 income year).

At the conclusion of the initial two year period Jack is required to pay his annual management fee of \$6,050 on a per month basis in equal monthly instalments of \$504.16. Accordingly, for the balance of the 2006 income year he must pay \$504.16 monthly for 9 months. This equals \$4,538.

Therefore, the amount of Jack's deduction for management fees in the 2006 income year consists of the sum of the two amounts calculated above; **\$1,523 + \$4,538 = \$6,061**.

Jack also calculates his tax deduction for Lease Rentals using the above method.

Detailed contents list

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

	Paragraph
What this Ruling is about	1
Tax law(s)	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	16
Constitution	24
Compliance plan	28
Grower's Lease Agreement	29

<i>Production Sharing Option</i>	34
Management Agreement	35
<i>Management Services (Clause 4)</i>	40
<i>Crushing Services (Clause 5)</i>	41
<i>Marketing Services (Clause 6)</i>	44
<i>Sales Proceeds</i>	45
<i>Production sharing option</i>	47
<i>Insurance</i>	49
Olive Oil Supply and Purchase Agreement	50
Fees	56
<i>Subscription and initial period fee</i>	56
<i>Rent after the initial period</i>	57
<i>Management fee after the initial period</i>	60
Finance	63
Ruling	65
Application of this Ruling	65
The Simplified Tax System ('STS')	68
<i>Division 328</i>	68
Qualification	69
Prepaid fees	70
Assessable Income	72
<i>Section 6-5 and section 328-105</i>	72
Deductions for Management fees and Lease Rentals	75
<i>Section 8-1 and section 328-105</i>	75
Deductions for capital expenditure	76
<i>Subdivision 40-F</i>	76
Interest	81
Deferral of losses from non-commercial business activities	82
Division 35	82
<i>Section 35-55 – Commissioner's discretion</i>	82
<i>Section 82KL, and Part IVA</i>	86
Explanation	87
Is the Grower carrying on a business?	87

The Simplified Tax System	100
<i>Division 328</i>	100
Deductibility of Management fees and Lease Rentals	102
<i>Section 8-1</i>	102
Prepayment provisions	104
<i>Sections 8KZL to 82KZMF</i>	104
<i>Sections 82KZME and 82KZMF</i>	106
<i>Application of the prepayment provisions to this Project</i>	112
Expenditure of a capital nature	116
<i>Division 40 and Division 328</i>	116
Deferral of losses from non-commercial business activities	117
<i>Division 35</i>	117
Losses and Outgoings incurred under Certain Tax Avoidance Schemes	128
<i>Section 82KL - recouped expenditure</i>	128
Schemes to Reduce Income Tax	129
<i>Part IVA - general tax avoidance provisions</i>	129
Example	132
Example 1 – Fees	132
Example 2 – Entitlement to GST input tax credits	133
Example 3 – Apportionment of Fees	134
Detailed contents list	135

Commissioner of Taxation

23 July 2003

<i>Previous draft:</i>	- interest expenses
Not previously issued in draft form	- management fee expenses
	- producing assessable income
<i>Related Rulings/Determinations:</i>	- product rulings
TR 92/1; TR 92/20; TD 93/34;	- public rulings
TR 97/11; TR 97/16; TR 98/22;	- schemes and shams
PR 1999/95; TR 2000/8; IT 360	- taxation administration
	- tax avoidance
<i>Subject references:</i>	<i>Legislative references:</i>
- carrying on a business	- TAA 1953 Pt IVAAA
- commencement of business	- ITAA 1936 Pt III Div 3H
- fee expenses	- ITAA 1936 82KL

- ITAA 1936 82KL(1)
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Div 40
- ITAA 1997 40-F
- ITAA 1997 40-515
- ITAA 1997 40-515(1)(a)
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(1)
- ITAA 1997 40-520(2)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530
- ITAA 1997 40-535
- ITAA 1997 40-540
- ITAA 1997 40-545
- ITAA 1997 108-5
- ITAA 1997 110-25(2)
- ITAA 1997 Div 328
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1997 328-105
- Copyright Act 1968
- Corporations Act 2001

Case references:

- FCT v Lau 84 ATC 4929, (1984)
16 ATR 55

ATO references:

NO: 2002/000528

ISSN: 1441-1172
