PR 2003/57 - Income tax: Northern Rivers Coffee Project No.3 (Supplementary Product Disclosure Statement)

Product Ruling
Income tax: Northern Rivers Coffee Project No.3 (Supplementary Product Disclosure Statement)

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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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Northern Rivers Coffee Project No 3 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 108 (ITAA 1997);
- Division 110 (ITAA 1997);
- Division 328 (ITAA 1997);
- Section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Section 82KL (ITAA 1936);
- Section 82KZL (ITAA 1936);
- Section 82KZME (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

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

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

Note to promoters and advisers

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

Class of persons

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

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

- who intend to terminate their involvement in the arrangement prior to its completion or who otherwise do not intend to derive assessable income from it;
- who elect to weed their own Plantation;
- who are accepted to participate in the Project before 1 February 2004; or
- who are accepted to participate in the Project after 15 June 2004.

Qualifications

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

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*, the Product Ruling cannot be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

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> Canberra ACT 2601
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Date of effect

11. This Ruling applies prospectively from 1 October 2003, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 14 August 2003;
- Product Disclosure Statement (PDS) for Northern Rivers Coffee Project No 3, issued by Managed Projects Australia Limited on 11 July 2003, received 15 August 2003;
- Draft Supplementary Product Disclosure Statement for the issue of interests in Northern Rivers Coffee Project No 3, received 28 August 2003;
- Constitution for Northern Rivers Coffee Project No 3, dated 5 May 2003, received 13 May 2003;
- **Licence Agreement between Managed Projects Australia Limited and each Grower received 13 May 2003**;
- **Plantation Management Agreement between Managed Projects Australia Limited and each Grower received 13 May 2003**;
- Northern Rivers Coffee Project No 3 Compliance Plan received 17 April 2003;
- Lease Agreement between Northern Rivers Coffee Landholding Limited and Managed Projects Australia Limited received 14 March 2003;
- Subcontract Agreement between Managed Projects Australia Limited and Coffee Management Australia Limited received 10 March 2003; and
- Correspondence including e-mails from the applicant to the Tax Office, dated 20 February 2003, 13 March 2003, 14 March 2003, 21 March 2003, 24 March 2003, 31 March 2003, 4 April 2003, 9 April 2003, 10 May 2003, 19 May 2003, 21 May 2003, 14 August 2003 and 28 August 2003.

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

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

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

Overview

17. This arrangement is called the Northern Rivers Coffee Project No 3. The salient features and effect of the arrangement are summarized below:

Location	Bulmers Road, Hogarth Range, near Casino NSW
Type of business to be carried on by each participant	Commercial growing, processing and marketing of coffee beans
Number of plantations on offer	224
Size of each plantation	0.072 hectares
Number of trees per plantation	250
Number of trees per hectare	3472
The term of the project	Until 30 June 2022
Minimum allocation per Grower	1 Plantation
Initial cost per plantation	$3,730.00
Initial cost on a per hectare basis	$52,220.00
Ongoing costs	Ongoing Management Fees, annual licence fees, harvesting fees and processing fees.
Cost of stapled investment being B class shares in Northern Rivers Coffee Landholding Limited	$1,125.00

18. The Northern Rivers Coffee Project No 3 is registered as a Managed Investment Scheme under the *Corporations Act 2001* and is a stapled investment. Under this offer, there are 224 Grower interests in the Northern Rivers Coffee Project No 3 and 224 parcels of shares

in the Landowner, Northern Rivers Coffee Landholding Limited. Only participants who invest in the Project are eligible to purchase shares in the Landowner. Managed Projects Australia Limited will lease land suitable for the establishment of a coffee plantation from Northern Rivers Coffee Landholding Limited for licensing of smaller plots of land to participants in the Project.

19. The Project has been established to enable Growers to become proprietors of their own primary production businesses involving the planting of coffee trees on land leased by Managed Projects Australia Ltd from Northern Rivers Coffee Landholding Limited on a property located at Hogarth Range near Casino, NSW, and the harvesting and processing of coffee to Dried Green Bean for sale. Each Grower will also acquire an interest in Northern Rivers Coffee Landholding Limited (the Landowner) by purchasing a parcel of 1125 B class shares for $1,125.00 when the application to enter the project is accepted.

20. The total land area available for this project is 24 hectares. However, 8 hectares of this land would require clearing and therefore only 16 hectares will be used initially for this project.

21. Each Grower who is accepted into the Project enters into a Licence Agreement and a Plantation Management Agreement with Management Projects Australia Ltd, the Responsible Entity. The Licence Agreement grants to individual Growers a licence to use and occupy an identifiable 0.072 hectares of land suitable for planting 250 coffee trees for the purpose of cultivating, nurturing and harvesting coffee for the term of the agreement. The Plantation Management Agreement between the Grower and the Responsible Entity engages the Responsible Entity as an independent contractor to manage the Grower's business of producing and marketing Dried Green Bean.

Acceptance of Application

22. The Responsible Entity has the right to accept or reject applications in whole or in part. For the purposes of this Product Ruling the relevant application period is on or after 1 February 2004 and on or before 15 June 2004.

Lease Agreement

23. The lease agreement between Northern Rivers Coffee Landholding Limited, the Landowner, and Managed Projects Australia Limited requires the Landowner to undertake at its own cost, preparation of the land, including the provision of all infrastructure to enable the planting and commercial cultivation of coffee. The Landowner will also purchase and maintain water licences during the term of the lease and do all things necessary to ensure that the landowner's rights in relation to the water licences are fully exploited

for the benefit of the lessee or the lessee's licensee. The term of the Lease ends on 30 June 2022. Under the provisions of the Lease the tenant may only use the land as a Coffee Plantation.

Constitution

24. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Licence Agreement and the Plantation Management Agreement are Schedules One and Two to the Constitution respectively. These Agreements will be executed on behalf of each Grower who has signed the 'Application and Power of Attorney Form' attached to the Product Disclosure Document and who is accepted into the project. After acceptance and execution of the Agreements, Growers are bound by the Constitution, the Licence Agreement and the Plantation Management Agreement by virtue of their participation in the Project. The Responsible Entity will keep a register of Growers accepted into the Project.

25. Managed Projects Australia Ltd is entitled to be paid for its services in managing the Coffee Plantation (clause 6). Amongst other things, the Constitution sets out in detail the following:

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

Compliance Plan

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

Licence Agreement

27. Each Grower enters into a Licence Agreement with Managed Projects Australia Limited, the Responsible Entity. The Agreement

sets out the terms of the agreement between the Grower and the Responsible Entity and is subject to and conditional on the Grower entering into the Plantation Management Agreement with the Responsible Entity.

28. In return for the payment of an annual licence fee, the Responsible Entity will grant to a Grower a right to use and occupy a plantation of 0.072 hectares identified in Schedule Two to the Licence Agreement. The licence allows the Grower to use and occupy the land for the purpose of planting, cultivating, nurturing and harvesting coffee for the term of the agreement. The term of the Licence Agreement will be from the commencement date of the Agreement until the earlier of 30 June 2022 or the termination of the Grower's interest in the Project.

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

- has leased the land;
- must ensure that the capital works for the establishment of the Plantation have completed prior to the first occurring 30 June after the commencement of the Agreement; and
- has identified the individual plots.

30. The Licence Agreement sets out the purpose for which the Grower may use the land (clause 2), the term of the agreement being from the commencement date until 30 June 2022 or the termination of the Grower's interest in the Project (clause 5). This agreement is subject to and conditional upon the Grower entering into the Plantation Management Agreement (clause 7).

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

32. Each Grower must pay the licence fee set out in clause 8 of the Licence Agreement. Under the terms of the Licence Agreement (clause 9), among other things, the Grower must:

- use the land only for the purpose of the project operations;

- comply with good horticultural and environmental practices;
- maintain the land;
- permit the landowner, employees, agents or contractors to enter the Plantation;
- comply or procure compliance with the Plantation Management Agreement; and
- give occupiers of other Plantations the relevant rights as are necessary for access and enjoyment of their land.

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

Licence Fees

34. Growers who enter into the Project on or after 1 February 2004 and on or before 15 June 2004 will pay licence fees to the Responsible Entity as follows:

- $60.00 for the period from date of acceptance to 30 June 2004, payable on application;
- $60.00 for period from 1 July 2004 to 30 June 2005, payable on 1July 2004; and
- from 1 July 2005 onwards for each subsequent year until the end of the project, an annual licence fee of $33.00, indexed by All Groups Consumer Price Index (CPI) each year, payable on 1 July in all subsequent years.

Plantation Management Agreement

35. The Grower will enter into a Management Agreement appointing Managed Projects Australia Limited, the Responsible Entity, to manage the Grower's interest in the Project. The Management Agreement terminates on 30 June 2022, or earlier if the Grower ceases to have a right to occupy a plantation or if termination occurs otherwise in accordance with the Project Constitution (clause 5). The Plantation Management Agreement, which is Schedule Two to the Constitution, fully sets out the terms of the agreement between the Grower and the Responsible Entity.

36. The plantation management services to be provided by the Responsible Entity are detailed at clause 4 (Initial Management Services) and clause 6 (Ongoing Management Services).

37. Initial Management Services to be provided include amongst other things:

- ensuring the preparation of the land for planting by the landowner;
- management and care of the coffee trees in the nursery;
- ensure the landowner has applied initial quantities of herbicide, lime, composted poultry manure and mulch to facilitate the planting of coffee trees;
- purchasing of 250 K7 variety coffee trees;
- holding and nurturing the trees in a suitable nursery prior to the appropriate time of planting;
- ensure that the Grower's coffee trees held in the nursery are specifically identified as belonging to that Grower;
- ensure coffee trees are planted at the appropriate time;
- maintain drainage on the licenced land;
- eradication of weeds and pests;
- ensuring the landholder installs an effective and working irrigation system suitable for nurturing coffee trees;
- maintaining irrigation system;
- irrigating the trees; and
- maintaining all other infrastructure.

38. Ongoing Management Services to be provided include amongst other things:

- irrigating trees;
- maintaining the trees;
- general maintenance of the trees including the control of weeds, vermin and other pests;
- maintenance of all firebreaks, access roads and tracks around the plantation;
- application of herbicide, fungicide and fertiliser;
- provision of annual written report to Grower;
- harvesting of coffee cherry;
- processing the coffee cherry to produce Dried Green Bean;
- marketing and sale of the Dried Green Bean; and
- accounting to the Grower for the proceeds of the Dried Green Bean.

39. The Grower's coffee trees will be purchased when the participant is accepted into the project. If necessary, the trees will be held in a nursery on the property until the appropriate time to plant the coffee trees into the Grower's allotment. Whilst in the nursery the Grower's coffee trees will be specifically identified as belonging to that Grower.

40. Growers who enter into the agreement on or after 1 February 2004 and on or before 15 June 2004 will have their trees planted on the Growers' licenced land by 31 December 2004.

41. Growers can elect to carry out their own weed control on their licenced plantations.

42. The Grower authorises the Manager to decide when it is appropriate to harvest the coffee cherries and to make all arrangements for the harvesting, processing, freighting and sale of the coffee.

43. The Grower, appoints the Responsible Entity as its sole agent to market and sell the coffee cultivated on the plantation. The Responsible Entity will pool for sale the harvest of all Growers in Northern Rivers Coffee Project No 3. The net proceeds from the sale of the Dried Green Bean will be divided amongst Growers in accordance with the terms of the Plantation Management Agreement.

44. The Responsible Entity is entitled to delegate all or any of the functions to be performed by it pursuant to the Plantation Management Agreement, subject to clause 15.2 of the Constitution. The Responsible Entity will enter into a subcontract agreement with Coffee Management Australia Limited (Subcontractor) for the subcontractor to manage the licensed plantation.

Management Fee

45. The Management Fee of $3,670.00, payable on application comprises $805.00 for the purchase and establishment of coffee trees, $94.00 for infrastructure costs and $2,771.00 for management services.

Timing of Initial Management Services

46. The Initial Management Services shown in the Plantation Management Agreement will be commenced by the Responsible Entity when the Grower is accepted into the Project and continue until the next occurring 30 June or the trees are planted, whichever occurs the earliest. Accordingly, where the Grower is accepted into the Project on or after 1 February 2004 and on or before 15 June 2004 the Initial Management Services will cover the period to 30 June 2004.

Ongoing Management Fee

47. Growers who enter into the Project on or after 1 February 2004 and on or before 15 June 2004 will pay Ongoing Management Fees to the Responsible Entity as follows:

- $861.00 for the twelve month period from 1 July 2004 to 30 June 2005, payable on 1 July 2004;
- $861.00 for the twelve month period from 1 July 2005 to 30 June 2006, payable on 1 July 2005; and
- $316.00 per Plantation subject to All Groups Consumer Price Index (CPI), payable on 1 July in all subsequent years.

Timing of Ongoing Management Services

48. The Ongoing Management Services shown in the Plantation Management Agreement will commence after the initial services cease. If this is before the end of a financial year, the Ongoing Management Fee will apply to the next 30 June.

Harvesting Fees

49. Harvesting fees will be deducted from the sale of the coffee. Harvesting costs will commence in year 3 of the Project, the 2006 financial year. An initial harvest is expected in that year. However, this will be insignificant in quantity. The first commercial harvest is expected in the 2007 financial year. Harvesting fee payable for the provision of harvesting services is set at $33.00 per pass indexed by the All Groups Consumer Price Index (CPI).

Processing Fees

50. The processing fees will be deducted from the sale of the coffee. The processing fee is calculated at $0.66 per kilogram of processed Dried Green Bean indexed by the All Groups Consumer Price Index (CPI).

Proceeds of Production

51. Proceeds from the sale of Dried Green Bean will be distributed as follows:

- Grower 100% of all net production proceeds up to 0.80 kilogram of Dried Green Bean per tree per year;
- Responsible Entity 100% of all net production proceeds in excess of 0.80 kilogram of Dried Green Bean per

tree up to 1.00 kilogram of Dried Green Bean per tree per year; and

- Grower and Responsible Entity are entitled to share the net production proceeds in excess of 1.00 kilogram of Dried Green Bean per tree per year. The parties are entitled to the proceeds in proportion of 75% to the Grower and 25% to the Responsible Entity.

52. The Responsible Entity will retain from the Grower's proceeds any Licence and Plantation Management fees, which are due and unpaid by the due date.

Finance

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

54. Regardless of the source of loan funds, this Ruling will not apply to Growers if the Responsible Entity accepts their Application subject to finance approval by a lending institution and the full amount payable at the time of Application, are not paid to the Responsible Entity by the 30 June in the year of Application. Such funds are to be paid into the Applications Fund Account in accordance with the terms of clause 12 of the Constitution.

55. This Ruling does not apply if a Grower enters into a finance agreement that 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 and who have executed a Plantation Management Agreement and Licence Agreement on or after 1 February 2004 and on or before 15 June 2004.

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

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

- are accepted to participate in the Project before 1 February 2004;
- are accepted to participate in the Project on or after 16 June 2004; or
- make an election under clause 19 of the Management Agreement.

The Simplified Tax System ('STS')

Division 328

59. 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

60. 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

61. 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.

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

Trading Stock

Section 70-35

63. A Grower who is not an 'STS taxpayer' may, in some years, hold coffee beans 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.

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

Deductions for Initial Management Fee, Ongoing Management Fee and Licence Fees

Section 8-1

65. A Grower who is not an 'STS taxpayer' who is accepted into the Project on or after 1 February 2004 and on or before 15 June 2004 may claim, on a per Plantation basis, tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Initial Management Fee	8-1	$2,771.00 – See Notes (i) & (ii) (below)		
Ongoing Management Fee	8-1		$861.00 – See Notes (i) & (ii) (below)	$861.00 – See Notes (i) & (ii) (below)
Licence Fee	8-1	$60.00– See Notes (i) & (ii) (below)	$60.00– See Notes (i) & (ii) (below)	$33.00* See Notes (i) & (ii) below

***** Subject to CPI increase

Notes:

(i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example at paragraph 134;

(ii) Part of the Initial Management Fee is of a capital nature. An amount totalling $94.00 cannot be claimed as deduction (see paragraph 71 below) and further amount totalling $805.00 is capital expenditure for the establishment of horticultural plants (the Table and notes at paragraph 72 below set out the timing of deduction for this amount). Only that part of the Initial Management Fee shown in the Table above, the Ongoing Management Fee, and the Licence Fees that are each incurred on or before the dates shown in the Management Agreement and the Licence Agreement are deductible in full in the year that they are incurred;

However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the licence fee) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees (see paragraphs 104 to 115). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 110 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling

'excluded expenditure' refers to an amount of expenditure of less than $1,000.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5 and section 328-105

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

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

Trading Stock

Section 328-285

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

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

Deductions for Initial Management Fee, Ongoing Management Fee and Licence Fees

Section 8-1 and section 328-105

70. A Grower who is an 'STS taxpayer' who is accepted into the Project on or after 1 February 2004 and on or before 15 June 2004 may claim, on a per Plantation basis, tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Initial Management Fee	8-1 & 328-105	$2,771.00 – See Notes (iii), (iv) & (v) (below)		
Ongoing Management Fee	8-1 & 328-105		$861.00 – See Notes (iii), (iv) & (v) (below)	$861.00 – See Notes (iii), (iv) & (v) (below)
Licence Fee	8-1 & 328-105	$60.00– See Notes (iii), (iv) & (v) (below)	$60.00– See Notes (iii), (iv) & (v) (below)	$33.00* See Notes (iii),(iv) & (v) below

* Subject to CPI increase

Notes:

(iii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example at paragraph 134;

(iv) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid;

(v) Part of the Initial Management Fee is of a capital nature. An amount totalling $94.00 cannot be claimed as deduction (see paragraph 71 below) and further amount totalling $805.00 is capital expenditure for the establishment of horticultural plants (the Table and notes at paragraph 72 below set out the timing of deduction for this amount). Only that part of the Initial Management Fee shown in the Table above, the Ongoing Management Fee, and the Licence Fees that are each incurred on or before the dates shown in the Management Agreement and the Licence Agreement are deductible in full in the year that they are paid;

However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the licensing of land) that will not be wholly done in the income year the fees are incurred, the

prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 104 to 115). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 110, 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 paid. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

Tax outcomes that apply to all Growers

Non deductible capital expenditure

71. Certain amounts that form part of the Initial Management Fee payable by Growers is for services performed by the Responsible Entity before the Grower is accepted into the Project. These amounts totalling $94.00 per Plantation do not constitute allowable deductions under section 8-1 or Division 40.

Deductions for Capital Expenditure

Division 40

72. All Growers who are accepted into the project, on or after 1 February 2004 and on or before 15 June 2004 will also be entitled to tax deductions for that part of the Initial Management Fee that relates to the establishment of the coffee trees. The amounts and timing of these deductions is determined under Division 40.

Fee Type	**ITAA 1997 Section**	**Year ended 30 June 2004**	**Year ended 30 June 2005**	**Year ended 30 June 2006**
Establish-ment of horticultural plants (coffee trees)	40-515	Nil See Notes (vi) & (vii) (below)	Nil See Notes (vi) & (vii) (below)	Nil See Notes (vi) & (vii) (below)

Notes:

(vi) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example at paragraph 134;

(vii) Coffee trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under

a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the coffee 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 coffee trees have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the coffee trees enter their first commercial season (section 40-530(2)). The Project Manager will inform Growers of when the coffee trees enter their first commercial season.

Interest deductibility

73. 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.

Shares in the Landowner Company

74. The shares in Northern Rivers Landholding Limited are CGT assets (section 108-5 of the ITAA 1997) and the amount of $1,125 payable by a participant for 1125 B Class shares per plantation are outgoings of capital and are not allowable deductions.

75. The amounts paid for each share will represent the first element of the cost base of the share (subsection 110-25(2) of the ITAA 1997). Any disposal of the shares by a Grower will be a CGT event and may give rise to a capital gain or loss.

76. Distributions by the Northern Rivers Landholding Limited are included in the assessable income of a Grower who is a shareholder, in accordance with subsection 44(1) of the ITAA 1936.

Deferral of losses from non-commercial business activities

Division 35

Section 35-55 – Commissioner's discretion

77. For a Grower who is an individual that has not made an election under clause 19 of the Plantation Management Agreement and who enter the Project on or after 1 February 2004 and on or before 15 June 2004 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2004 to 30 June 2006 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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 121 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 paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be commercially viable. An assessment of the Project or the product from this perspective has not been made

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

81. For a Grower who participates in the Project and incurs expenditure as required by the Plantation Management Agreement and

the Licence Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 104 to 115);
- 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 coffee growing activities as a participant in the Northern Rivers Coffee Project No 3 must amount to the carrying on of a business of primary production. These coffee growing 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 Northern Rivers Coffee Project No 3, *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 (by lease or by licence) in the land on which the Grower's coffee trees are established;
- the Grower has a right to harvest and sell the coffee each year from those coffee trees;
- the coffee growing activities are carried out on the Grower's behalf;
- the coffee growing activities of the Grower are typical of those associated with a coffee growing 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 Plantation Management Agreement and a Licence Agreement.

86. Under the Licence Agreement, each individual Grower will have rights over a specific and identifiable area of land. The Licence Agreement provides the Grower with an ongoing interest in the specific coffee trees on the licensed area of land for the term of the Project. Under the licence, the Grower must use the land in question for the purpose of carrying out coffee growing activities and for no other purpose. The licence allows the Responsible Entity to come onto the land to carry out its obligations under the Plantation Management Agreement.

87. Under the Plantation Management Agreement, the Responsible Entity is engaged by the Grower to establish and maintain a coffee plantation on the Grower's identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the plantation on the Grower's behalf.

88. In establishing the plantation, the Grower engages the Responsible Entity to purchase and to plant the coffee trees on the Growers plantation. During the term of the Project, these assets will be used wholly to carry out the Grower's coffee growing activities. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the coffee grown on the Grower's plantation.

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 its coffee 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 coffee grown on the Grower's plantation with the coffee of other Growers is consistent with general coffee practices. Each Grower's proportionate share of the sale proceeds of the pooled coffee will reflect the proportion of the coffee contributed from their plantation.

92. The Responsible Entity's services on the Grower's behalf are also consistent with general horticulture practices. While the size of a plantation 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 Responsible Entity as evidenced by the Plantation Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's Plantation and the activities carried out on the Grower's behalf. Growers are able to

remove the Responsible Entity in accordance with Clause 23.2 of the Constitution.

94. The horticulture 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 the arrangement described in this Ruling, the Growers' horticulture activities in the Northern Rivers Coffee Project No 3 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 Licence Fees

Section 8-1

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

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

98. The management fees and licence fees associated with the coffee growing activities will relate to the gaining of income from the Grower's business of coffee growing (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of coffee) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purposes in incurring the fees is identifiable from the arrangement. The fees appear to be reasonable. That part of the Initial Management Fee that is of a capital nature has been apportioned and separately dealt with. The remaining part of the Initial Management Fee, the Ongoing Management Fee and the Licence Fee is of a revenue nature. In respect of these amounts, the tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply to these amounts.

Possible application of prepayment provisions

99. For Growers who enter the Project within the periods set out in paragraph 56 above, none of the fees deductible under section 8-1 are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

100. Where a Grower chooses to prepay fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 104 to 115) 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 fees payable for the Initial Management Services, Ongoing Management Services and Licence Fees, 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 licence fees are deductible in the year in which they are incurred.

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

Prepayment provisions

Sections 82KZL to 82KZMF

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

Sections 82KZME and 82KZMF

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

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. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

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.

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

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. For Growers who enter the Project on or after 1 February 2004 and on or before 15 June 2004, an Initial Management Fee of $3,670, deductible to the extent of $2,771, and Initial Licence Fee of $60 per plantation will be incurred on execution of the Plantation Management Agreement and Licence Agreement. Under the term of the Agreements, further annual expenditure is required each year during the term of the project for the provision of management services and land until 30 June in those years.

113. In particular, the Initial 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 fee for management services has been inflated to result in reduced fees being payable for management fees in subsequent years.

114. 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 other fees payable in subsequent years under the Plantation Management Agreement, are for the Responsible Entity doing 'things' that are not to be wholly done within the expenditure year. Under the Licence Agreement, licence fees are payable annually in advance for the use of the land during the expenditure year.

115. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 34, paragraph 45 and paragraph 47, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

Expenditure of a capital nature

Division 40 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 coffee trees is of a capital nature. This

expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

117. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 71 and 72 (above) in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

118. 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.

119. 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.

120. 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.

121. 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.

122. 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).

123. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of one interest in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2009. 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.

124. 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.

125. 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.

126. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is expected to be carrying on a business activity that will pass one of the tests in the income year ended 30 June 2009, or will first produce a taxation profit for the income year ended 30 June 2007.

127. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2006.

128. 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.

129. 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 agricultural consultant;
- independent, objective, and generally available information relating to the horticultural industry which substantially supports cash flow projection and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity; and

Losses and Outgoings incurred under Certain Tax Avoidance Schemes

Section 82KL - recouped expenditure

130. 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

131. 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).

132. The Northern Rivers Coffee Project No 3 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

to 72 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.

133. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of their coffee beans. 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 are 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

134. 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	$2,200*
Total due and payable by 1 January 2002 (includes GST of $600)	$6,600

*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).

Detailed contents list

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

Commissioner of Taxation
1 October 2003

Previous draft:
Not previously issued in draft form

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

Subject References:
- carrying on a business
- commencement of business
- horticulture
- management fees expenses
- primary production
- primary production expenses
- primary production income

- producing assessable income
- product rulings
- public rulings
- schemes and shams
- tax administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters

Legislative References:

- 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 40-515
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530(2)
- ITAA 1997 40-535
- ITAA 1997 40-545
- ITAA 1997 Div 70
- ITAA 1997 70-35
- ITAA 1997 108
- ITAA 1997 108-5
- ITAA 1997 110
- ITAA 1997 110-25(2)
- ITAA 1997 Div 328
- ITAA 1997 Subdiv328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- ITAA 1997 328-105(1)(b)
- ITAA 1997 328-285
- ITAA 1997 328-285(1)
- ITAA 1997 328-285(2)
- ITAA 1936 44
- ITAA 1936 44(1)
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- ITAA 1936 82KZL
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