

PR 2003/9 - Income tax: Rewards Group Tropical Fruits Project 3

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 This document has changed over time. This is a consolidated version of the ruling which was published on *15 March 2006*



Product Ruling

Income tax: Rewards Group Tropical Fruits Project 3

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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.

[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. 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 'Rewards Group Tropical Fruits Project 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 of the (ITAA 1997);
- Section 17-5 of the (ITAA 1997);
- Division 27 of the (ITAA 1997);
- Division 35 of the (ITAA 1997);
- Division 40 of the (ITAA 1997);
- Division 70 of the (ITAA 1997);
- Division 328 of the (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KZL of the (ITAA 1936);
- Section 82KZME of the (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA of the (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, each of these persons, referred to as 'Growers', will be wholesale clients for the purpose of the *Corporations Act 2001* or will have accepted an offer which qualifies as a small scale offer for the purpose of the *Corporations Act 2001*.

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. The class of persons to whom this Ruling applies does not include Growers who elect to harvest and market their own fruit from their Grove(s).

Qualifications

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 The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 9 April 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 25 November 2002 and additional correspondence dated 28 November 2002, 15 January 2003, 17 January 2003, 10 February 2003, 11 February 2003, 12 February 2003, 21 February 2003, 6 March 2003, 24 March 2003, and 31 March 2003;
- The Rewards Group Tropical Fruits Project 3 draft Information Memorandum, undated;
- **Draft Constitution** for the Rewards Group Tropical Fruits Project, dated 5 February 2003;
- **Draft Management Agreement for the Rewards Group Tropical Fruits Project**, between Rewards Projects Ltd [the 'Responsible Entity'] and the Grower, undated;
- **Draft Sub-lease for the Rewards Group Tropical Fruits Project** between Rewards Projects Ltd [the 'Responsible Entity' and 'Lessor'] and the Grower, undated;
- Draft Rewards Group Tropical Fruits Project Rules, undated;
- Draft Rewards Group Tropical Fruits Project Standing Offer – Sub-Lease, undated;
- Compliance Plan for the Rewards Group Tropical Fruits Project, undated;
- Draft Management Plan for the Rewards Group Tropical Fruits Project, undated;
- Head Lease Agreements for the Rewards Group Tropical Fruits Project between the Land Owner and Rewards Projects Ltd ['Responsible Entity'], undated;
- Draft Operations Agreement between Rewards Projects Ltd ['Responsible Entity'] and Rewards Management Pty Ltd ['the Manager'], undated;

- Contract for Field Management and Supervisory Services and Supply of Irrigation Infrastructure and Services between Rewards Projects Ltd [‘Responsible Entity’] and the Landowner undated; and
- Draft Deed of Licence for Access to Water between the Landowner and Rewards Projects Ltd.

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. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client or have accepted an offer that is a small scale offering. **This Ruling does not apply unless:**

- the Grower is a wholesale client as defined in section 761G of the Corporations Act 2001; or
- not being a retail client, the Grower has accepted a ‘personal offer’ of a small scale offering for the purpose of the Corporations Act 2001.

17. Each of these categories is explained in paragraphs 67 to 73 in the Explanations area of this Product Ruling.

Overview

18. This arrangement is called the Rewards Group Tropical Fruits Project 3.

Location	15 kilometres west of Kununurra, Western Australia
Type of business each participant is carrying on	Commercial growing and cultivation of fruit trees for producing mango and grapefruit
Number of hectares under cultivation	150 hectares
Size of each Grove	1 hectare
Number of fruit trees per hectare	100 citrus trees and 225 mango trees

The term of the investment	20 years
Initial cost	\$60,000
Initial cost per hectare	\$60,000
Ongoing costs	Management fees and rent

19. The Responsible Entity for this Project is Rewards Projects Ltd. The Project land is situated 15 kilometres west of Kununurra, in the Ord River Irrigation Area of Western Australia.

20. Growers applying under the Information Memorandum will enter into a Sub-Lease Agreement and a Management Agreement. Rewards Projects Ltd will lease the Project land from the Landowner and will sub-lease the Grove to the Grower to enable the Grower to carry on the business of a fruit orchard for the commercial production of red grapefruit and mango. Under the Sub-Lease, Growers lease an area of land called a 'Grove' for a term of approximately 20 years. Each Grove consists of a 'Citrus Grove', which is 0.25 hectares in size, an 'Established Mango Grove', which is 0.08 hectares in size, and a 'New Mango Grove' which is 0.67 hectares in size.

21. Applications must be received by the Responsible Entity by 15 June 2003, although the Responsible Entity may accept late applications for Growers where the services to be provided in the initial period can be completed by 30 June 2003. Services will not be provided prior to the execution of the Management Agreement and the Sub-Lease Agreement.

22. Under the Management Agreement, Growers appoint the Responsible Entity to manage their Grove. The Responsible Entity will enter into an Operations Agreement with Rewards Management Pty Ltd, in respect of the management services required under the Management Agreement. Under the Operations Agreement, Rewards Management Pty Ltd (the 'Manager') will be responsible for the establishment and cultivation of the fruit trees and the harvesting and sale of the fruit. Growers may notify the Responsible Entity that they elect to harvest and sell their own fruit or the Manager will do so on their behalf, under the terms of the Operations Agreement.

23. The Information Memorandum states that the minimum subscription for the Project is 25 Groves. Each participant may subscribe for a minimum of one Grove, at a cost of \$60,000 per Grove. A minimum of 100 citrus trees and 225 mango trees will be planted on each Grove (100 citrus trees and 225 mango trees per hectare).

24. Growers must pay the Subscription Money to the Responsible Entity in full. Growers will execute a Power of Attorney enabling the Responsible Entity to act on their behalf when they make an application for a Grove(s). This will include the execution of the Management Agreement and the Sub-Lease Agreement.

Constitution

25. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to operate the Project. The Responsible Entity will keep a register of Growers. The Sub-Lease Agreement and the Management Agreement will come into effect on acceptance of a Grower's Application by the Responsible Entity. Growers are also bound by the Constitution by virtue of their participation in the Project.

Compliance plan

26. The Responsible Entity has prepared a Compliance Plan in accordance with the *Corporations Act 2001*. Its purpose is to ensure that the Responsible Entity meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

Interest in land

27. Rewards Projects Ltd, the Lessor, grants a sub-lease to the Grower under the terms of the Sub-Lease Agreement (cl. 2.1). Growers are granted an interest in land in the form of a sub-lease to use their Groves for carrying on a business of cultivating fruit trees and harvesting fruit (Recital B). Growers must pay rent annually to the Lessor. Growers must pay rent to the Lessor of \$1,353 per Grove on application and \$1,353 on 1 October each year thereafter (indexed at 2.8% annually commencing in the year ended 30 June 2007). The term of a Grower's sub-lease is for a period of 20 years or such longer term agreed between the parties to allow final harvest.

Management Agreement

28. Each Grower enters into a Management Agreement with the Responsible Entity. The term of the Project is until completion of the final harvest in Year 20, the payment of proceeds from the final harvest is made, and the dispatch of all accounts and reports in relation thereto as provided in the Management Agreement or otherwise required.

29. Growers contract with the Responsible Entity to cultivate and care for the fruit trees in accordance with good horticultural practice. Growers pay a management fee for each Grove on subscription for the 'initial period', being from the commencement date to 30 June 2003. An annual management fee is payable each year thereafter.

30. The Responsible Entity will engage the Manager to provide the following services during the initial period:

- the supply of suitable mango trees and grapefruit seedlings;
- prepare the land for planting mango and grapefruit seedlings;
- supervise the installation of the irrigation system on the citrus grove(s);
- supervising and securing management of all works on the orchard; and
- carry out supervision, monitoring and inspection of irrigation infrastructure and sprinklers as considered necessary for the efficient supply of water.

31. The Responsible Entity will engage the Manager to perform the following ongoing services:

- cultivate and maintain the fruit trees on the Groves in a proper and skilful manner pursuant to the Management Plan;
- install the irrigation system for the New Mango Grove(s) by 30 June 2004;
- take any necessary steps to prevent or combat land degradation in relation to the Groves;
- tend to the fruit trees according to the principles of sound horticulture practice, including such nutrient analysis, pruning, irrigating, fertilising and fumigating as the Manager deems appropriate;
- in the five years following planting, conduct survival counts and where necessary replant trees;
- undertake such operations as may be reasonably required to prevent or combat land degradation in relation to the Groves; and
- do such things as may reasonably be required to eradicate, exterminate and keep the Groves and the land free from disease, vermin, noxious weeds, rabbits, kangaroos, insect pests and all other pests.

32. Growers may elect on or before 30 June 2003 to harvest and sell the fruit from their Groves (cl. 8). However, under the terms of the Operations Agreement, where Growers do not make such an election, the Manager will harvest as and when deemed appropriate with the aim to produce the best overall result for the Grower (cl. 6.1 of the Operations Agreement). The Manager will use its best endeavours to negotiate the sale of fruit for the highest price practicable (cl. 7.2 of the Operations Agreement). The Responsible Entity will be responsible for the cost of public risk insurance and can arrange additional insurance on behalf of the Grower, if requested at the Growers expense.

Fees

33. The fee payable on application for the initial period is \$60,000 per Grove consisting of a management fee of \$52,449, rent of \$1,353, and a planting fee of \$4,701, for services to be performed during the period from the date of allotment until 30 June 2003. The fee payable on application also includes an amount of \$1,497 for irrigation installation on the New Mango Grove(s) which will be completed by 30 June 2004.

34. A management fee of \$3,656 per Grove is payable on or before 1 October 2003 for services to be provided during the period 1 July 2003 until 30 June 2004. Growers must pay a management fee of \$4,547 for services to be provided during the period 1 July 2004 to 30 June 2005, on or before 1 October 2004. For each year thereafter an amount of \$6,251 (indexed at 2.8% commencing in the year ended 30 June 2007) is payable for each year for the term of the Project on or before 1 October in each respective financial year.

35. A planting fee of \$689 is also payable on or before 1 October 2003. This fee is for services to be provided during the period from 1 July 2003 to 30 June 2004.

36. Rent of \$1,353 per Grove is payable on application for the initial period. For each year thereafter rent of \$1,353 is payable on 1 October of the relevant year. This amount will be indexed at 2.8% commencing the year ended 30 June 2007.

37. An amount of \$1,497 per Grove is payable on application for irrigation to be installed on each New Mango Grove. This represents the first instalment payable for these services. Two further instalments are due and payable on or before 1 October 2003 and 1 October 2004 respectively. The irrigation services will be completed prior to 30 June 2004.

38. Each Grower must pay a marketing fee equal to 12.1% of the Grower's share of the net sale proceeds of each harvest after deducting the harvest costs and the costs of sales (Item 4, Schedule to the Management Agreement). The Responsible Entity will also be entitled to a performance fee equal to 22% of the amount (if any) by which the Grower's share of the net sales proceeds received from the sale of fruit from each harvest less harvest costs and costs of sales exceeds the projected sale proceeds from each harvest outlined in the Information Memorandum.

39. The Application Monies will be banked in the Subscription Fund bank account formed under the Project's Constitution (cl. 8.2 of the Constitution).

Planting

40. Under the Management Agreement, the Responsible Entity is required to prepare the land for planting and supply the necessary seedlings. The Responsible Entity will engage the Manager to provide these services and to plant the seedlings on the Groves by 30 June 2004. Each Grove will be planted with seedlings at a rate of 100 citrus trees and 225 mango trees per hectare. The Manager will in the five years following planting, conduct survival counts and where necessary replant trees (Annexure A to the Operations Agreement). The services to be provided by the Responsible Entity over the Term of the Project are outlined in the Management Agreement (Annexures A and B to the Management Agreement). Under the Operations Agreement, the Manager has been contracted by the Responsible Entity to provide these services.

Cultivation and Harvesting

41. Growers may elect, by notice in writing to the Responsible Entity on or before 30 June 2003, to harvest and sell their own fruit (cl 8 of the Management Agreement). This Product Ruling does not apply to Growers who make such an election.

42. If no such election is made, the Grower irrevocably appoints the Responsible Entity to negotiate the sale of harvested fruit (cl 7.1 of the Management Agreement). The Manager has been contracted by the Responsible Entity to perform this service. The Manager will use its best endeavours to negotiate the sale of the fruit for the highest price practicable having regard to the circumstances at the time.

43. The Gross Proceeds from the sale of the fruit by the Manager will be remitted to the Responsible Entity who will place the amount into the Proceeds Fund Bank Account. Proceeds received by the Responsible Entity are to be distributed in the following order of priority:

- to pay the Grower's share of the costs of the harvest and sale as advised by the Responsible Entity (unless the Grower has made an election to sell their fruit under the Management Agreement);
- any amounts due to the Responsible Entity by the Grower under the Constitution;
- any amounts due to the Responsible Entity by the Grower under the Management Agreement;
- any amounts due to the Lessor by the Grower under the Sub-Lease Agreement; and
- the Net Sale Proceeds to the Growers provided that if the aggregate sum to be distributed to all of the Growers is less than \$1,000, then, at the discretion of the Responsible Entity, distribution to Growers may be postponed (cl. 11.1 of the Constitution).

Finance

44. Growers can fund their investment in the Project themselves or borrow from an independent lender.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;

- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

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

- on or before 15 June 2003; or
- during the period 16 June to 30 June 2003 (provided the Responsible Entity can wholly provide the services in consideration of the monies payable on application by 30 June 2003); and

who have executed a Management Agreement and a Sub-Lease Agreement before those dates. This Ruling does not apply to Growers who elect to harvest and market their own fruit from their Grove(s).

Minimum Subscription

47. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the Information Memorandum, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 25 interests is achieved.

The Simplified Tax System ('STS')

Division 328

48. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must elect 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 is

different under the STS where the Grower uses the cash accounting method.

Qualification

49. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'

Assessable Income

Section 6-5

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

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

Trading stock

Section 70-35

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

53. 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 Management Fees, Rent and Interest**Section 8-1**

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

2003 Growers

Fee Type	ITAA 1997 Section	Year 1 deduction Year ended 30/6/2003	Year 2 deduction Year ended 30/6/2004	Year 3 deduction Year ended 30/6/2005	Year 4 deduction Year ended 30/6/2006
Management Fee	8-1	\$52,449 – See Note (i) (below)	\$3,656 – See Notes (i) & (ii) (below)	\$4,547 – See Notes (i) & (ii) (below)	\$6,251 – See Notes (i) & (ii) (below)
Rent	8-1	\$1,353 – See Note (i) (below)	\$1,353 – See Notes (i) & (ii) (below)	\$1,353 – See Notes (i) & (ii) (below)	\$1,353 – See Notes (i) & (ii) (below)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example 1 at paragraph 130.
- (ii) The management fees and the rent shown in the Management Agreement and the Sub-Lease are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees (see paragraphs 96 to 103). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 102 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’ using the cash accounting method

Assessable Income

Section 6-5

55. 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.

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

Treatment of Trading Stock

Section 328-285

57. A Grower who is an ‘STS taxpayer’ may, in some years, hold fruit 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)).

58. 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 Management Fees and Rent

Section 8-1 and section 328-105

59. A Grower who is an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Sections	Year 1 deduction Year ended 30/6/2003	Year 2 deduction Year ended 30/6/2004	Year 3 deduction Year ended 30/6/2005	Year 4 deduction Year ended 30/6/2006
Management Fee	8-1 & 328-105	\$52,449 - See Notes (iii) & (iv) (below)	\$3,656 - See Notes (iii), (iv) & (v) (below)	\$4,547 – See Notes (ii), (iv) & (v) (below)	\$6,251 – See Notes (iii), (iv) & (v) (below)

Rent	8-1 & 328-105	\$1,353 - See Notes (iii) & (iv) (below)	\$1,353 - See Notes (iv), (v) & (v) (below)	\$1,353 - See Notes (iii), (iv) & (v) (below)	\$1,353 - See Notes (iv), (v) & (v) (below)
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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 1 at paragraph 130.
- (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 it is actually paid.
- (v) Where a Grower who is an 'STS taxpayer', pays the management fees and the rent in the relevant income years shown in the Management Agreement and Sub-Lease, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 96 to 103). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 102, 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’ using the accruals accounting method**Assessable income*****Section 6-5***

59A. For the 2005-06 income year and later years, a Grower who is an ‘STS taxpayer’ using the accruals accounting method will be assessable on ordinary income from carrying on their business of horticulture when the income is derived.

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

59B. For the 2005-06 income year and later years, a Grower who is an ‘STS taxpayer’ using the accruals accounting method may in some years, hold fruit 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. Refer to paragraph 57 and 58.

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

59C. For the 2005-06 income year, a Grower who is an ‘STS taxpayer’ using the accruals accounting method may claim tax deductions for the following revenue expenses:

2003 Growers

Fee Type	ITAA 1997 Section	Year 4 deduction Year ended 30 June 2006
Management Fee	8-1	\$6,251 – See Notes (a) & (b)
Rent	8-1	\$1,353 – See Notes (a) & (b)

Notes:

- (a) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27. See Example 1 at paragraph 130.
- (b) The management fees and the rent shown in the Management Agreement and the Sub-Lease are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (for example, the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees (see paragraphs 96 to 103). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 102 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Tax outcomes that apply to all Growers**Deductions for capital expenditure*****Division 40***

60. Growers will also be entitled to tax deductions relating to the establishment of horticultural plants and water facilities (e.g. irrigation). All deductions shown in the following Table are determined under Division 40.

Fee type	ITAA 1997 section	Year 1 Year ended 30 June 2003	Year 2 Year ended 30 June 2004	Year 3 Year ended 30 June 2005	Year 4 Year ended 30 June 2006
Water facility (e.g. irrigation, dam, bore, etc)	40-515	\$1,497 - See Notes (vi), (vii) & (viii) (below)	\$1,497 - See Notes (vi), (vii) & (viii) (below)	\$1,497 - see Notes (vi), (vii) & (viii) (below)	

PR 2003/9

Establishment of horticultural plants (fruit trees)	40-515	Must be calculated – See Notes (vi) & (ix) (below)	Must be calculated – See Notes (vi) & (ix) (below)	Must be calculated – See Notes (vi) & (ix) (below)	Must be calculated – See Notes (vi) & (ix) (below)
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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 130.
- (vii) Any irrigation system, dam or bore is a ‘water facility’ as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the ‘water facility’ in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).
- (viii) The deductions shown in the Table above assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities under Subdivision 40-F and not under Division 328. If the expenditure has been incurred on ‘depreciating assets’ and is claimed under Division 328, the deduction must be calculated. Under Division 328, if the ‘cost’ of a ‘depreciating asset’ at the end of the income year is less than \$1,000 (a ‘low cost asset’), it can be claimed as an immediate deduction when first used or ‘installed ready for use’. This is so, provided the Grower is an ‘STS taxpayer’ for the income year in which it starts to ‘hold’ the asset and the income year in which it first uses the asset or has it ‘installed ready for use’ to produce assessable income.
- (ix) Fruit trees are a ‘horticultural plant’ as defined in subsection 40-525(2). As Growers hold the land under a sub-lease, one of the conditions in subsection 40-525(2) is met and a deduction for ‘horticultural plants’ is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the fruit 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 fruit 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 fruit trees enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the fruit trees enter their first commercial season.

Interest

61. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However, all Growers who borrow funds in order to participate in the Project should read the discussion of the prepayment rules in paragraphs 96 to 103 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

Section 35-55 – Commissioner's discretion

62. For a Grower who is an individual and who enters the Project during the year ended 30 June 2003 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under sub-section 35-55(1)(b) the Commissioner will decide that for the income years ending 30 June 2003 to 30 June 2007 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 the Ruling.

63. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- the 'exception' in subsection 35-10(4) applies (see paragraph 117 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
- the Grower's business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

64. Where, the exception in subsection 35-10(4) applies, the Grower's business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e. any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

65. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in 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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 96 to 103);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Corporations Act 2001

67. For this Ruling to apply, an offer for an interest in the project must:

- have been made to, and accepted by a Grower, who qualifies as a wholesale client as defined in Section 761G of the *Corporations Act 2001*; or
- be an offer which qualifies as a small scale offering as defined in section 1012E of the *Corporations Act 2001*.

Small scale offers and offers to wholesale clients do not require a prospectus or product disclosure statement.

68. A Grower in the Project may be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the persons satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c)); and
- the 'professional investor test' (paragraph 761G(7)(d)).

69. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'product value test' where :

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least \$500,000.

70. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'individual wealth test' where, it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made, that the person to whom the offer is made:

- has net assets of at least \$2.5 million; or
- has a gross income for each of the last 2 financial years of at least \$250,000 a year.

71. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'professional investor test' where:

- the person is a financial services licensee; or
- the person controls at least \$10 million for the purposes of investment in securities.

72. Alternatively, under section 1012E, a Grower may participate in the project by accepting a 'personal offer' for an interest in the project. Offers made under section 1012E cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than \$2 million dollars (subsection 1012E(2)).

73. An offer will be a 'personal offer' where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 1012E(5)).

Is the Grower carrying on a business?

74. For the amounts set out in the Tables above to constitute allowable deductions, the Grower's horticulture activities as a participant in the Rewards Group Tropical Fruits Project 3 must amount to the carrying on of a business of primary production. These horticulture activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

75. For schemes such as that of the Rewards Group Tropical Fruits Project 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 932.

76. 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 fruit trees are established;
- the Grower has a right to harvest and sell the fruit each year from those fruit trees;
- the horticulture activities are carried out on the Grower's behalf;
- the horticulture activities of the Grower are typical of those associated with a horticulture business; and
- the weight and influence of general indicators point to the carrying on of a business.

77. In this Project, each Grower enters into a Management Agreement and a Sub-Lease.

78. Under the Sub-Lease, each individual Grower will have rights over a specific and identifiable area of land (Groves). The Sub-Lease provides the Grower with an ongoing interest in the specific trees on the Groves for the term of the Project. Under the sub-lease the Grower must use the Groves in question for the purpose of carrying out horticultural activities and for no other purpose. The sub-lease

allows the Responsible Entity to come onto the land to carry out its obligations under the Management Agreement.

79. Under the Management Agreement the Responsible Entity is engaged by the Grower to maintain the fruit trees on the Grower's Groves during the term of the Project. The Responsible Entity will subcontract the management services to the Manager, under the Operations Agreement. 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.

80. The Grower engages the Responsible Entity to maintain the fruit trees on the Groves according to the principles of sound horticulture practice which includes irrigation, fertilisation, weed control and pruning. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the fruit grown on the Grower's Grove.

81. 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.

82. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable forecasts, a Grower in the Project may derive assessable income from the sale of its fruit that may 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.

83. The pooling of fruit grown on the Grower's Grove with the fruit of other Growers is consistent with general horticulture practices. Each Grower's proportionate share of the sale proceeds of the pooled fruit will reflect the proportion of the fruit contributed from their Grove.

84. The Responsible Entity's and Manager's services are consistent with general horticulture 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).

85. The Grower's degree of control over the Responsible Entity as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Responsible Entity 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 Responsible Entity in certain instances, such as cases of default or neglect.

86. 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 this Ruling, the Growers' horticulture activities in the Rewards Group Tropical Fruits Project 3 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

87. 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.

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

Deductibility of Management Fees and Rent

Section 8-1

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

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

90. The management fees and rent associated with the horticulture activities will relate to the gaining of income from the Grower's business of horticulture (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of fruit) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no

‘non-income producing’ purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Possible application of prepayment provisions

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

92. However, where a Grower chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 96 to 103) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an ‘STS taxpayer’ or not. These provisions apply to ‘STS taxpayers’ because there is no specific exclusion contained in section 82KZME that excludes ‘STS taxpayers’ from the operation of section 82KZMF. This is subject to the ‘excluded expenditure’ exception. For the purpose of this Ruling ‘excluded expenditure’ refers to an amount of expenditure of less than \$1,000.

Timing of deductions

93. In the absence of any application of the prepayment provisions, the timing of deductions for the management fees or the rent will depend upon whether a Grower is an ‘STS taxpayer’ or is not an ‘STS taxpayer’.

94. If the Grower is not an ‘STS taxpayer’, the management fees and the rent are deductible in the year in which they are incurred.

95. If the Grower is an ‘STS taxpayer’ the management fees and the rent are deductible in the income year in which they are paid, or are paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Prepayment provisions

Sections 82KZL to 82KZMF

96. 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.

97. 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

98. 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)).

99. 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.

100. 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.

101. 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.

102. 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.

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

103. 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

104. In this Project, an initial management fee of \$52,449 per Grove and initial rent of \$1,353 per Grove will be incurred on the execution of the Management Agreement and Sub-Lease. The management fee and rent are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreements further annual expenditure is required each year during the term of the Project for the provision of management services until 30 June in those years.

105. In particular, the management fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the initial management fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

106. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee, and the fees for subsequent years, is for the Responsible Entity doing 'things' that are not to be wholly done within the expenditure year. Under the Sub-Lease, rent is payable annually for the sub-lease of the land during the expenditure year

107. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 33 to 38, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

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

108. Although not required under either the Management Agreement or the Sub-Lease, a Grower participating in the Project may choose to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 107 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

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

Expenditure of a capital nature

111. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to water facilities and the establishment of the fruit trees is of a capital nature.

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

112. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

113. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 60 (above) in the Table and accompanying notes.

Division 35 - deferral of losses from non-commercial business activities

114. 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.

115. 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.

116. 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.

117. For the purposes of applying the tests, 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.

118. 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 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).

119. 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 investment in the Project of one Grove is unlikely to pass one of the tests until the year ended 30 June 2010. Growers who acquire more than one Grove may however, find that their activity meets one of the tests in an earlier income year.

120. 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.

121. 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:

- (i) the business activity has started to be carried on;
- (ii) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) 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.

122. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Grove in the Project is expected to be carrying on a business activity that will pass one of the tests in the income year ended 30 June 2010, or will produce a taxation profit, in the income year ended 30 June 2008.

123. The Commissioner will decide for such Growers that it would be reasonable to exercise the second arm of the discretion until the income year ended 30 June 2007.

124. This Product Ruling is issued on a prospective basis (i.e. before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 62) in the manner described in the Arrangement (see paragraphs 14 to 45). If so, this Ruling, and specifically the decision in relation to paragraph 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 paragraph 35-55(1) will apply in such changed circumstances.

125. 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:

- additional evidence provided with the application by the Responsible Entity; and
- independent, objective and generally available information relating to the horticulture industry which substantially supports cash flow forecasts and other claims, including prices and costs, as described by the independent experts in the Information Memorandum, and in the Product Ruling application submitted by the Responsible Entity.

Section 82KL

126. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(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.

Part IVA

127. 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).

128. The Rewards Group Tropical Fruits Project 3 will be a 'scheme' commencing with the issue of the Information Memorandum. A Grower will obtain a 'tax benefit' from entering

into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 54, 59 and 60 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.

129. 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 fruit. 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 with each other at arm's length, or, if any parties are not 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 - Entitlement to GST input tax credits

130. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her horticulture 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:

$$\frac{1}{11} \times \$4,400 = \$400.$$

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:

$$\frac{1}{11} \times \$2,200 = \$200.$$

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

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

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

Detailed contents list

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Commissioner of Taxation

 9 April 2003

Previous draft:

Not previously issued in draft form

- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters

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

- carrying on a business
- commencement of business
- primary production
- primary production expenses
- management fee expenses
- producing assessable income
- product rulings
- public rulings

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