PR 2004/20 - Income tax: Rewards Group Tropical Fruits Project 4

Product Ruling

Income tax: Rewards Group Tropical Fruits Project 4

Contents Para

What this Product Ruling is about 1
Date of effect 11
Withdrawal 13
Arrangement 14
Ruling 50
Explanation 65
Example 123
Detailed contents list 124

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

Preamble

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

No guarantee of commercial success

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

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

This Product Ruling provides certainty for potential 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 4' or simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- Section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Division 328 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Section 82KZL (ITAA 1936);
- Section 82KZME (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

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

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

Note to promoters and advisers

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

Class of persons

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

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

- are accepted to participate in the Project before the date the Ruling is made;
- have their application conditionally accepted by the Responsible Entity subject to finance for the payment of the initial fee, where the finance has not been approved by the lender by 31 May 2004 and the funds have not been made available to the Responsible Entity by 15 June 2004;
- are accepted to participate in the Project after 31 May 2004;

- intend to terminate their involvement in the arrangement prior to Project's completion;
- elect to harvest and market their own fruit from their Grove(s); or
- do not intend to derive assessable income from the Project.

Qualifications

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

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

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

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

Date of effect

11. This Ruling applies prospectively from 25 February 2004, 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 as constituted by documents provided on 2 December 2003, 8 December 2003, 16 December 2003, 21 January 2004, 23 January 2004, 28 January 2004, 3 February 2004, 10 February 2004, 13 February 2004, 17 February 2004 and 18 February 2004;
- Draft Product Disclosure Statement for the Rewards Group Tropical Fruits Project 2004 Offer to Retail Investors - Project 4, received 18 February 2004;
- Draft **Constitution** of the Rewards Group Tropical Fruits Project between Rewards Projects Limited (as the Responsible Entity) and the Grower, received 18 February 2004;
- Draft **Management Agreement** for the Rewards Group Tropical Fruits Project 2004 between Rewards Projects Ltd (as the Responsible Entity) and the Grower, received 18 February 2004;
- Two Lease agreements for the Rewards Group Tropical Fruits Project 2004 between the Land Owners and Responsible Entity, received on 2 December 2003 and 23 January 2004;
- Draft **Sub-lease** for the Rewards Group Tropical Fruits Project 2004 between Responsible Entity and the Grower, received 18 February 2004;

- Draft Rewards Projects Tropical Fruits Project 2004 **Terms Agreement**, received 2 December 2003;
- Draft Compliance Plan for the Rewards Group Tropical Fruits Project 2004, received 16 December 2003;
- Tropical Fruits Management Plan, dated November 2003; and
- Draft Operations Agreement for the Rewards Group Tropical Fruits Project 2004 between Rewards Projects Ltd (as the Responsible Entity) and Rewards Management Pty Ltd (as the Manager), received 2 December 2003.

Note: Certain information has been provided by the applicant 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 or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are part of the arrangements to which this Ruling applies. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

Overview

16. This arrangement is called the Rewards Group Tropical Fruits Project 4.

Location	Weero Road and Packsaddle Road, 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	45 hectares
Size of each Grove	0.1 hectares
Minimum allocation per Grower	1 Grove
Minimum subscription	When Groves subscribed for in this Project and the Rewards Group Tropical Fruits Project 5 total 35 hectares

Number of fruit trees per Grove	8 grapefruit trees and 24 Mango trees
The term of the investment	20 years
Initial minimum cost	$6,500
Ongoing costs	Management Services Fees, Rent, Planting Fee, Irrigation Fee, Marketing Fee, Harvest Costs, Selling Costs and Insurance

17. The Project involves planting and cultivating grapefruit and Mango trees as well as cultivating established grapefruit and Mango trees. The produce from the trees will be harvested and sold on behalf of the Growers in the Project, however, a Grower can elect to harvest and sell his or her own produce.

18. The Project will be a registered as a Managed Investment Scheme under the *Corporations Act 2001* and has an Australian Financial Services Licence. As such offers for interests in the Project will be made under a Product Disclosure Statement. By completing the application form in the Product Disclosure Statement before 31 May 2004 a Grower can participate in the Project.

19. By signing the application form, the Grower gives Rewards Projects Limited (Rewards) a power of attorney in relation to various aspects of the Project, including entering into the project agreements on behalf of the Grower.

20. When a Grower is accepted into the Project, Rewards will enter into a Sub-Lease agreement and a Management Agreement on behalf of the Grower. Under the Sub-lease, the Grower will lease an identifiable area of land called a 'Grove'. This will enable the Grower to carry on the business of a fruit orchard for the commercial production of grapefruit and Mango. A Grove is 0.1 hectares in size and will consist of:

- 0.018 hectares (7 trees) of new red flesh grapefruit orchard;
- 0.002 hectares (1 tree) of established red flesh grapefruit orchard;
- 0.073 hectares (22 trees) of new Mango orchard; and
- 0.007 hectares (2 trees) of established Mango orchard.

21. Each segment of the Grove will be located in different areas near the township of Kununurra. The new and established segments of the red flesh grapefruit will be located at Weero Road, with the new segment of the Mango located at KL383 Packsaddle Road. The established segment of Mango will be located at either KL383 Packsaddle Road or Weero Road.

22. Under the Management Agreement, which is described in detail below, the Grower engages Rewards to manage the Grove. This includes, supplying and planting the trees, installing the irrigation system and providing the ongoing maintenance of the trees. These services will not be provided prior to the execution of the Management and Sub-Lease agreements.

23. Water for both the grapefruit and Mango plantations will be sourced from the Ord River irrigation system. Through Deeds of Licences for Access to Water with the Land Owners, the Responsible Entity can access 17 megalitres per hectare, per year for the Weero Road property and 15.9 megalitres per hectare, per year for the Packsaddle Road property.

24. The Project can only commence once minimum subscription has been reached. The minimum subscription is reached when the Groves subscribed to in this Project and the Rewards Tropical Fruits Project 5 total 35 hectares. In this Project, each Grower may subscribe for a minimum of one Grove, at a cost of $6,500 per Grove.

25. The Term of the Project is approximately 20 years.

Constitution

26. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers of the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

27. Under the terms of the Constitution, the Responsible Entity must deposit all application moneys received from Growers into a trust account they have established for this purpose. This account is referred to as a Subscription Fund. The application moneys will be released from this fund when the Responsible Entity is satisfied that certain specified criteria in the Constitution have been met (clauses 3.3 and 3.9).

28. The proceeds from the sale of the fruit will be paid into a Proceeds Fund to be established by the Responsible Entity. A Grower is entitled to his or her share from this fund. However, before this share can be distributed to the Grower, it must be reduced by their share of the cost of harvest and sale and other certain amounts (clause 11).

29. If the Grower's Grove is destroyed or partially destroyed, the Grower's proceeds of the sale from the fruit may need to be reduced (clause 18).

30. In addition the Constitution sets out in detail the following:

- Responsible Entity's powers (clause 6);
- complaints handing methods (clause 12.1);
- period and termination of the project (clause 14);
- protections and indemnities (clause 16); and
- insurance (clause 19).

Compliance plan

31. 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.

Lease and Sub-Lease

32. Rewards Projects Limited has leased Project land from Land Owners under the Lease agreements. This land is located at two locations, one being at Weero Road and the other at Packsaddle Road, both locations being near the township of Kununurra. Rewards Projects Limited as Lessor sub-leases the 0.1 hectare portions of this land (Groves) to the Growers, by entering into Sub-Lease Agreements.

33. Under the terms of the Sub-Lease, the Lessor will give the Grower quiet possession of the Groves, use its best endeavours to secure rights to water for irrigation and pay all rates, taxes and other charges in respect of the land (clause 5).

34. The Grower is entitled to the fruit derived from the trees on the Grove(s) allotted (clause 2.2).

Management Agreement

35. Each Grower enters into a Management Agreement with the Responsible Entity to manage their Grove(s). The Responsible Entity then enters into the Operations Agreement to appoint Rewards Management Pty Ltd (the Manager) to perform its obligations under the Management Agreement. Although a manager is appointed, the Responsible Entity remains responsible for all acts and omissions of the Manager pursuant to the Management Agreement, subject to the extent permitted by the law.

36. For the services that will be provided in the initial period Growers pay a Management Services Fee, a Planting Fee and a Irrigation Fee for each Grove on subscription. An annual Management Services Fee is payable each year thereafter. Two more instalments of the Irrigation Fee and one more instalment of the Planting Fee will also be payable in subsequent periods.

37. The services that will be provided in the initial period, which is the date of the Management Agreement to 30 June 2004 includes:

- supply suitable grafted grapefruit and Mango trees;
- prepare the land for the planting of the trees;
- supply the irrigation system for the new grapefruit and Mango grove(s);
- supervise and secure the management of all works on the Orchard;
- ensure the new orchards are being developed in accordance with fruit agents and purchasers requirements and arrange for site inspections of the New and Established Orchards by fruit agents and purchasers;
- carry out supervision, monitoring and inspection of irrigation infrastructure and sprinklers as considered necessary for the efficient supply of water; and
- administration in respect of the above services.

38. The services that will be provided throughout the Project term include:

- plant the grapefruit and Mango trees by 30 August 2004;
- install the irrigation system for the new grapefruit and Mango plantations by 30 August 2004;
- provide an experienced and competent management team to perform the services under the Management Agreement;
- on the established orchards, undertake works such as, pruning, fertilising, pest control, nutrient analysis, repair roads and service machinery;
- undertake such operations as may be reasonably required to prevent or combat land degradation in relation to the Groves;
- in the five years following planting, conduct survival counts and where necessary replant trees;

- undertake periodic site inspections;
- provide periodic reports to the Growers; and
- administration in respect of the above services (annexure A).

39. Growers may elect on or before 30 June 2004 to harvest and sell the fruit from their Groves (clause 8). However, 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 (clause 6). The Manager will use its best endeavours to negotiate the sale of fruit for the highest price practicable (clause 7).

40. The Responsible Entity will be responsible for the cost of public risk insurance (annexure A(u)). The Responsible Entity is also responsible for the cost of crop insurance for the Groves from the date of the Management Agreement to 30 June 2005. After this date any Grower can request the Responsible Entity to arrange appropriate crop insurance. However, the Grower is responsible for the cost of such insurance.

Fees

41. The 'initial fee' payable to Rewards Projects Ltd, on application is $6,500 per Grove. This fee consists of:

- **Management Services Fee** of $5,817, for services to be performed from the Commencement Date to 30 June 2004;
- **Rent** of $33, for the period from the Sub-Lease Commencement Date to 30 June 2004**;**
- **Planting Fee** of $456, to supply trees and prepare the land by 30 June 2004; and
- **Irrigation Fee** of $194, to supply the irrigation system by 30 June 2004.

  (Items 2, 3, and 5 of the Schedule to the Management Agreement and Item 4 of the Schedule to the Sub-Lease).

42. The ongoing fees per Grove are:

- Annual **Management Services Fees**, being $870 payable on or before 1 October 2004 for services to be performed from 1 July 2004 to 30 June 2005. $762 is then payable on or before 1 October 2005 for services to be performed from 1 July 2005 to 30 June 2006. For each year thereafter, an amount of $780 is payable on or before 1 October of the relevant year. Commencing

from 1 July 2007, the amount of $780 will be indexed at 2.8% per annum (Item 2 of the Schedule to the Management Agreement);

- Annual **Rent** of $132, payable on 1 October of each financial year. The first payment is due on 1 October 2004. Commencing from 1 July 2007, the Rent will be indexed at 2.8% per annum (Item 4 of the Schedule to the Sub-Lease);
- **Planting Fee** of $67 payable on or before 1 October 2004 for services to be performed from 1 July 2004 to 30 August 2004 (Item 3 of the Schedule to the Management Agreement);
- **Irrigation Fees**, being, $194 payable on or before 1 October 2004 and $194 payable on or before 1 October 2005 (Item 5 of the Schedule to the Management Agreement);
- **Harvest Costs** , being the Grower's share of all costs of and incidental to the harvest and are payable out of the Grower's share of the proceeds of sale of the relevant harvest (clause 6.2 of the Management Agreement);
- **Costs of Sale**, being the Grower's Share of all costs incidental to the sale of the fruit harvested and are payable out of the Grower's share of the proceeds of sale of the relevant harvest (clause 7.4 of the Management Agreement); and
- **Marketing Fees** 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 sale (Item 4 of the Schedule to the Management Agreement).

Payment of Fees

43. Under the Product Disclosure Statement, the Grower can pay the initial amount of $6,500 by cash on application or by one of the Term Payment Options offered by the Responsible Entity. The following options are available:

1 Year Term Payment Option

- deposit of $650 per Grove payable on application; and
- $5,950.08 per Grove payable in 12 equal monthly instalments (interest free) of $495.84.

2 Year Term Payment Option

- deposit of $650 per Grove payable on application; and
- $6,652.32 per Grove payable in 24 equal monthly instalments (including fixed interest calculated at 10.95% per annum) of $277.18.

3 Year Term Payment Option

- deposit of $650 per Grove payable on application; and
- $7,007.76 per Grove payable in 36 equal monthly instalments (including fixed interest calculated at 10.95% per annum) of $194.66.

5 Year Term Payment Option

- deposit of $650 per Grove payable on application; and
- $7,753.20 per Grove payable in 60 equal monthly instalments (including fixed interest calculated at 10.95% per annum) of $129.22.

7 Year Term Payment Option

- deposit of $650 per Grove payable on application; and
- $8,544.48 per Grove payable in 84 equal monthly instalments (including fixed interest calculated at 10.95% per annum) of $101.72.

7 Year Term Payment Option (3 year interest only and 4 year principal and interest)

- deposit of $650 per Grove payable on application;
- $1,954.44 per Grove payable in 36 equal monthly interest-only instalments (fixed interest calculated at 10.95% per annum) of $54.29; and
- $7,374.72 per Grove payable in 48 equal monthly principal and interest instalments (fixed interest calculated at 10.95% per annum) of $153.64.

44. The total amount payable under each of the Terms Payment Options includes a Term Application Fee of $100 per Grove.

45. If a Grower chooses to pay under one of the Terms Payment Options, they must complete a Terms Application and Direct Debit Request. A Terms Agreement will be executed by the Responsible Entity.

46. The monthly instalments are paid by direct debit commencing on the last business day of July following allotment. If a Grower does not pay the required instalments under the Terms Payment Option, then provided Rewards Projects Ltd has given the Grower 14 days written notice to remedy the default and payment has still not been made, the balance owing under the Terms Payment Option will become immediately due and payable. In addition, Rewards Projects Ltd may take legal proceedings to recover the amount, resume all rights and interest which the Grower has in their Grove(s), or do anything which an owner of the Grove(s) is entitled to do (clause 5.2 of the Terms Agreement).

47. The Responsible Entity will monitor the level of applications received under each of the Terms Payment Options and is not obliged to accept Terms Payment applications. A limit will be imposed on the number of applications that can be accepted under each instalment option.

Finance

48. Growers can fund their investment in the Project themselves, enter into a Term Payment Option with Rewards Projects Limited or borrow from an independent lender.

49. The Ruling applies to a Grower who enters into a Term Payment Option with Rewards Projects Limited, however, it 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

50. This Ruling applies only to Growers who are accepted to participate in the Project on or before 31 May 2004 and who have executed a Management Agreement and a Sub-Lease Agreement on or before that date.

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

52. This Ruling does not apply to Growers who:

- are accepted to participate in the Project before the date the Ruling is made;
- have their application conditionally accepted by the Responsible Entity subject to finance for the payment of the initial fee, where the finance has not been approved by the lender by 31 May 2004 and the funds have not been made available to the Responsible Entity by 15 June 2004;
- are accepted to participate in the Project after 31 May 2004;
- intend to terminate their involvement in the arrangement prior to Project's completion;
- elect to harvest and market their own fruit from their Grove(s); and
- do not intend to derive assessable income from the Project.

The Simplified Tax System ('STS')

Division 328

53. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, 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

54. 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.

Assessable Income

Sections 6-5 and 328-105

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. A Grower who is not an 'STS taxpayer' recognises ordinary income from carrying on the business of horticulture at the time the income is derived.

57. A Grower who is an 'STS taxpayer' recognises ordinary income from carrying on the business of horticulture at the time the income is received (paragraph 328-105(1)(a)).

Deductions for Management Services Fees, Rent and Interest

Section 8-1 and 328-105

58. A Grower may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year 1 ending 30 June 2004	Year 2 ending 30 June 2005	Year 3 ending 30 June 2006
Management Services Fee	8-1 & 328-105	See Notes (i) & (ii) below	$870 See Notes (i), (ii) & (iii) below	$762 See Notes (i), (ii) & (iii) below
Rent	8-1 & 328-105	See Notes (i) & (ii) below	$132 See Notes (i), (ii) & (iii) below	$132 See Notes (i), (ii) & (iii) below
Interest payable to Rewards Projects Ltd under Term Payment Options	8-1 & 328-105	nil	As incurred (**non-STS taxpayers**)or as paid (**STS taxpayers**)See Notes (iv) & (v) below	As incurred (**non-STS taxpayers**)or as paid (**STS taxpayers**)See Notes (iv) & (v) 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 the Example at paragraph 123.

(ii) The Management Services Fees and Rent shown in the Management Agreement and Sub-Lease are deductible in full in the year they are incurred (where the Grower is **not an 'STS taxpayer**') or in the year which they are paid (where the Grower is an '**STS taxpayer**').

For a Grower who is **not an STS taxpayer**, the Management Services Fee of $5,817 and Rent of $33 will be deductible in Year 1, as they will be incurred in this year.

If a Grower who is an '**STS taxpayer**' chooses to pay the Year 1 Management Services Fee and Rent by the cash option, then these amounts will be fully paid in the year in which they are incurred. Therefore, the Management Services Fee of $5,817 and Rent of $33 will be deductible in Year 1 as they are fully paid in the year in which they are incurred.

However, if a Grower who is an '**STS taxpayer**' chooses to pay the Year 1 Management Services Fee and Rent by any of the Terms Payment Options, then the amount described above will not be fully paid in the year in which it is incurred. For STS taxpayers the

Management Services Fee and Rent are only deductible to the extent to which they have been paid, or have been paid for the Grower. Any amount or part of an amount which is not paid in the year, in which it is incurred, will be deductible in the year in which it is actually paid (paragraph 328-105(1)(b)).

(iii) 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 90 to 97). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 96, 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.

(iv) Growers who enter into the Term Payment Options with Rewards Projects Ltd (Rewards) for payment of the initial fee over 2, 3, 5 or either of the two 7 year terms will incur interest monthly. Such interest is deductible in the income year in which it is incurred (where the Grower is **not an 'STS taxpayer'**) or the income year in which it is paid (where the Grower is an **'STS taxpayer'**)(paragraph 328-105(1)(b)).

(v) The deductibility or otherwise of interest arising from loan agreements and other arrangements other than the Term Payment Options with Rewards, is outside the scope of this Ruling. Growers who borrow from lenders other than Rewards may request a private ruling on deductibility of interest incurred. However, all Growers, who finance their participation in the Project, whether with the Term Payment Options or otherwise should read the discussion of the prepayment rules in paragraphs 90 to 97 (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 other arrangement or is at the Grower's choice.

Deductions for capital expenditure

Division 40

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

Fee type	ITAA 1997 section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Water facility (e.g. irrigation, dam, bore, etc)	40-515	$194 See Notes (vi), (vii) & (viii) below	$194 See Notes (vi), (vii) & (viii) below	$194 See Notes (vi), (vii) & (viii) below
Establishment of horticultural plants (fruit trees)	40-515			Must be calculated. See Notes (vi) & (ix) 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 123.

(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. For the new trees planted on a Grower's Grove, the deduction 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.

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

Section 35-55 – Commissioner's discretion

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

61. 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 111 in the Explanation part of this ruling);
- 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)).

62. 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.

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

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

64. 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 90 to 97);
- 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?

65. 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 4 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.

66. For schemes such as that of the Rewards Group Tropical Fruits Project 4, 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* (1984) 6 FCR 202; 84 ATC 4929, (1984) 16 ATR 932.

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

- the Grower has an identifiable interest in the land (by lease) or holds rights over the land (under a licence) 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.

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

69. 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.

70. 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.

71. 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.

72. 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.

73. 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.

74. 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.

75. 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

76. The Grower's degree of control over the Responsible Entity as evidenced by the 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 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.

77. 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 4 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

78. 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.

79. 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 Services Fees and Rent

Section 8-1

80. Consideration of whether the initial Management Services 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.

81. The Management Services Fees and Rent associated with the horticulture activities will relate to the gaining of income from the Grower's business of horticulture, 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

82. 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.

83. 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 90 to 97) 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

84. 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.

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

86. 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.

Interest deductibility

Section 8-1

(i) Growers who pay fees under the Terms Payment Options with Rewards Projects Ltd

87. Some Growers may finance their participation in the Project through a Terms Payment Option with Rewards Projects Limited. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the fees under the Management Agreement.

88. The interest incurred will be in respect of financing the Grower's business operations - the commercial growing and cultivation of fruit trees - that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1 in the income year in which it is incurred (where the Grower is <u>not</u> an STS taxpayer) or the income year in which it is paid (where the Grower is an STS taxpayer) (paragraph 328-105(1)(b)).

(ii) Growers who enter into finance arrangements with other finance providers

89. The deductibility of interest incurred by Growers who finance their participation in the Project through a finance facility with a bank or financier other than Rewards Projects Limited is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

Prepayment provisions

Sections 82KZL to 82KZMF

90. 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.

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

Sections 82KZME and 82KZMF

92. 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)).

93. 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.

94. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier that is not associated with the Project. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and any interest incurred are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, any interest deductions allowable will be subject to apportionment under section 82KZMF.

95. 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.

96. 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.

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

97. 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

98. In this Project, an initial Management Services Fee of $5,817 per Grove and initial Rent of $33 per Grove will be incurred on the execution of the Management Agreement and Sub-Lease. The Management Services Fee and Rent are charged for providing management services and lease of 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.

99. In particular, the Management Services 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 Services Fee has been inflated to result in reduced fees being payable for Management Services Fees in subsequent years.

100. 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.

101. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 14 to 49, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

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

102. Although not required under either the Management Agreement or the Sub-lease, a Grower participating in the Project may **<u>choose</u>** 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 101 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

103. 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.

104. 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

105. 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.

106. 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'.

107. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 59 (above) in the Table and accompanying notes.

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

108. 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 objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

109. 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.

110. 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.

111. 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.

112. 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).

113. 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 where a Grower who acquires the minimum allocation of one Grove in the Project, is unlikely to pass one of the tests until the income year ended 30 June 2010. Growers who acquire more than the minimum allocation in the Project may however, find that their activity meets one of the tests in an earlier income year.

114. 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.

115. 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 satisfy one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

116. Information provided with this Product Ruling indicates that a Grower who acquires the minimum allocation of one Grove in the Project is expected to be carrying on a business activity that will produce a taxation profit, for the year ended 30 June 2008. The Commissioner will decide for such Growers that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2007.

117. 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 60) in the manner described in the Arrangement (see paragraphs 14 to 49). 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) applies, 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.

118. 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 Product Disclosure Statement, and in the Product Ruling application submitted by the Responsible Entity.

Losses and Outgoings incurred under Certain Tax Avoidance Schemes

Section 82KL – recouped expenditure

119. 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.

Schemes to Reduce Income Tax

Part IVA – general tax avoidance provisions

120. 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).

121. The Rewards Group Tropical Fruits Project 4 will be a 'scheme' commencing with the issue of the Product Disclosure Statement. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 58 and 59 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.

122. 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 - Entitlement to GST input tax credits

123. 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	$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:

$^{1}/_{11}$ x $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:

$^{1}/_{11}$ x $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

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

	Paragraph
What this Product Ruling is about	**1**
Tax law(s)	2
Goods and Services Tax	3
Changes in the Law	4

Note to promoters and advisers 6
Class of persons 7
Qualifications 9
Date of effect **11**
Withdrawal **13**
Arrangement **14**
Overview 16
Constitution 26
Compliance Plan 31
Lease and Sub-Lease 32
Management Agreement 35
Fees 41
Payment of Fees 43
Finance 48
Ruling **50**
Application of this Ruling 50
The Simplified Tax System ('STS') 53
Division 328 53
Qualification 54
Assessable Income 55
Sections 6-5 and 328-105 55
Deductions for Management Services Fees, Rent and Interest 58
Sections 8-1 and 328-105 58
Deductions for Capital Expenditure 59
Division 40 59
Division 35 - Deferral of losses from non-commercial business activities 60
Section 35-55 - Commissioner's discretion 60
Sections 82KZME - 82KZMF, 82KL and Part IVA 64
Explanation **65**
Is the Grower carrying on a business? 65
The Simplified Tax System 78
Division 328 78

Deductibility of Management Services Fees and Rent 80
Section 8-1 80
Possible application of prepayment provisions 82
Timing of Deductions 84
Interest deductibility 87
Section 8-1 87
(i) Growers who pay fees under the Terms Payment Options with Rewards Projects Ltd 87
(ii) Growers who enter into finance arrangements with other finance providers 89
Prepayments provisions 90
Sections 82KZL to 82KZMF 90
Sections 82KME to 82KZMF 92
Application of the prepayment provisions to this Project 98
Growers who choose to pay fees for a period in excess of that required by the Project's agreements 102
Expenditure of a capital nature 105
Division 35 - deferral of losses from non-commercial business activities 108
Losses and Outgoings incurred under Certain Tax Avoidance Schemes 119
Section 82KL – recouped expenditure 119
Schemes to Reduce Income Tax 120
Part IVA – general tax avoidance provisions 120
Example **123**
Entitlement to GST input tax credits 123
Detailed contents list **124**

Commissioner of Taxation
25 February 2004

Previous draft:	*Related Rulings/Determinations*:
Not previously issued in draft form	TR 2000/8; PR 1999/95; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TD 93/34; TR 98/22

Subject references:
- carrying on a business
- commencement of business
- primary production
- primary production expenses
- management fee expenses
- non-commercial loss
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters

Legislative references:
- TAA 1953 Pt IVAAA
- 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 Div 40F
- ITAA 1997 40-515
- ITAA 1997 40-515(1)(a)
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(1)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530
- ITAA 1997 40-535
- ITAA 1997 40-540
- ITAA 1997 40-545
- ITAA 1997 Div 328
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1997 328-105(1)(a)
- ITAA 1997 328-105(1)(b)
- ITAA 1936 Div 3 Subdiv H Pt III
- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- Copyright Act 1968
- Corporations Act 2001

Case references:
- FCT v. Lau (1984) 6 FCR 202; 84 ATC 4929, (1984) 16 ATR 932

ATO references:
NO: 2003/16199
ISSN: 1441-1172