Product Ruling

Income tax: Environinvest Beef Cattle Project 2004

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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, ***What this Product Ruling is about*** *(including* ***Tax law****,* ***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 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, who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Environinvest Beef Cattle Project 2004' or simply as 'the Project'.

Tax laws

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);
- Section 25-25 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 328 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Sections 82KZME - 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and services tax

3. All fees and expenditure referred to in this Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a 'Grazier') 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. Although this Ruling deals with the laws 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 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 (ie being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Graziers'.

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;
- persons who are accepted to participate in the Project during the period on or after 16 June 2004; and
- persons who participate in the Project through offers made other than through the Product Disclosure Statement.

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.

Date of effect

11. This Ruling applies prospectively from 19 May 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 the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not commenced and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Note: The Addendum to this Ruling that issued on 11 August 2004, applies on and from 11 August 2004.

Note 2: The Addendum to this Ruling that issued on 16 November 2005, applies on and from 1 July 2005.

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2007. The Ruling continues to apply, in respect of the tax law ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Draft **Product Disclosure Statement (‘PDS’**), for the Environinvest Beef Cattle Project 2004, prepared and issued by Environinvest Ltd A.B.N. 81 080 743 791 (‘Environinvest’), received 2 April 2004;
- Draft **Management Agreement** between Environinvest (‘the Manager’) and the Grazier, received 22 April 2004;
- Draft **Cattle Lease Agreement** between Environinvest (‘the Lessor’) and the Grazier, received 22 April 2004;
- Draft **Agistment Agreement** between Environinvest (‘the Licensor’) and each Grazier, received 22 April 2004;
- Sample Loan Application Form (Annexure 11 to the Application), received 23 December 2003;
- Sample Environinvest Beef Cattle Project 2004 Financial Package for Individual Borrowers, relating to a Principal and Interest Loan, received 3 May 2004;
- Sample Environinvest Beef Cattle Project 2004 Financial Package for Individual Borrowers, relating to a 2nd Year Principal and Interest Loan , received 3 May 2004;
- Sample Environinvest Beef Cattle Project 2004 Financial Package for Individual Borrowers, relating to an Interest Only Loan, received 3 May 2004;
- Sample Environinvest Beef Cattle Project 2004 Financial Package for Individual Borrowers, relating to a 2nd Year Interest Only Loan , received 3 May 2004;
- Draft **Constitution** of the Environinvest Beef Cattle Project 2004, received 22 April 2004;
- Draft Compliance Plan adopted by Environinvest as ‘the Responsible Entity’ (Annexure 16 to the Application), received 23 December 2003; and
- Application for Product Ruling dated 22 December 2003 as constituted by documents received on 23 December 2003 and additional correspondence received from the applicant or the applicant’s representative, dated 15 January 2004, 28 January 2004, 20 February 2004, 24 February 2004, 27 February 2004, 11 March 2004, 24 March 2004, 25 March 2004, 26 March 2004,

30 March 2004, 31 March 2004, 2 April 2004, 21 April 2004, 28 April 2004, 3 May 2004, 6 May 2004 and 7 May 2004.

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

15. The documents highlighted are those Graziers enter into or become a party to. A Loan Agreement will be executed where a Grazier successfully applies for finance from Environinvest. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grazier, or any associate of a Grazier, will be a party to, which are part of the arrangements to which this Ruling applies. In this Ruling the term 'associate' has the meaning given by section 318 of the ITAA 1936. The effect of these agreements is summarised as follows.

16. It should be noted that the term Grazier as used in this Ruling means each several person who becomes a party to these documents as a result of the allotment of 'Droves' pursuant to an Application in the PDS. Graziers whose applications are accepted, Project Agreements are executed and to whom Droves are allocated:

- during the period on or before 15 June 2004 will become '**2004 Graziers**'.

17. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

Overview

18. The salient features of the 'Environinvest Beef Cattle Project 2004' are as follows:

Location	Properties situated New South Wales and Queensland.
Type of business each participant will be carrying on	Medium term commercial leasing, breeding, grazing and sale of beef cattle for profit.
Number of Cows involved in the breeding program	Up to 12,500 cows (3,125 Droves)
Size of each Drove	4 cows
The term of the Project	7 years
Initial Cost	$1,925 per Drove
Ongoing costs	• Management Fees payable to the Manager for performing the services in each Subsequent Year. • Agistment Fees payable to the Licensor to agist the 'Herd' on the Land during the relevant years.

	• Cattle Lease Fee for the Lease of the Stock. • Feedlot Expenses • Transportation Expenses. • Feedlot Management Fees. • Sales Management Fee. • Performance Bonus Fee. • Out of Pocket Expenses (if any). • taxes, levies, excise, charges and duties.

19. The Project will be registered as a managed investment scheme under the *Corporations Act 2001*.

20. The offer to participate in the Project must be made through the Application Form attached to the PDS. There is a minimum subscription of two Graziers for the Project to proceed. The minimum subscription for each Grazier is 10 Droves. Oversubscription will be accepted subject to the availability of suitable land and suitable 'Stock'.

21. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints Environinvest to enter into, on behalf of the Grazier, a Cattle Lease Agreement, Agistment Agreement, Management Agreement and any other documents required to hold an interest in the Project (the 'Project Documents').

Constitution

22. The Constitution establishes the Project and operates as a deed binding all Graziers and Environinvest. The Constitution sets out the terms and conditions under which Environinvest agrees to act as 'Responsible Entity' and thereby manage the Project. Upon acceptance into the Project Graziers are bound by the Constitution by virtue of their participation in the Project.

23. Under clause 7.4 of the Constitution, Environinvest holds the 'Application Money' on bare trust. Environinvest will deposit all 'Application Moneys' received from applicants in a 'Project Account'. Once Environinvest has accepted the application and all of the Project Documents have been executed and remain in force (clause 5.1) the 'Application Money' may be transferred and applied against the fees due to Environinvest (clause 8).

24. In summary, the Constitution also sets out provisions relating to:

- the irrevocable appointment of Environinvest as the Grazier's agent, representative and attorney (clause 3);
- the holding of interests in the Project (clause 5);
- procedures relating to 'Applications' (clause 7);

- the issue of interests in the Project and the transfer of 'Application Money' paid by an applicant from the 'Project Account' to the Responsible Entity (clause 8);
- completion and execution of Project Documents prior to or upon acceptance of an application by the Responsible Entity (clause 9);
- the issue of a numbered 'Certificate' (clause 10);
- the Responsible Entity's powers in relation to investments and borrowings (clause 11);
- the Responsible Entity's powers and duties relating to the management of the Project (clause 14);
- and the keeping and maintenance of a register of Graziers who hold an interest in the Project (clause 15);
- the appointment of agents to perform tasks (clause 16);
- the right of the Responsible Entity to be paid fees and other expenses and the duty to make payments in respect of the Project from its own assets in respect to certain expenses (clause 17);
- the keeping of a 'Project Account' for the holding of 'Proceeds' and any other amounts held by the Responsible Entity on behalf of the Graziers and the manner in which the 'Proceeds' are to be distributed (clause 18);
- resolution of complaints made by the Grazier in relation to the Responsible Entities management of the Project (clause 19);
- the liabilities and indemnities of the Responsible Entity (clause 20) and the Graziers (clause 21);
- the assignment of a Grazier's interest in the Project (clause 22);
- transmission of a Grazier's interest in the Project as a consequence of the death, bankruptcy or mental incapacity of a Grazier (clause 23);
- the retirement and removal of the Responsible Entity (clause 24); and
- termination of the Project (clause 30) and the winding up of the Project and other agreements or arrangements that the Responsible Entity has entered into with the Graziers relating to the Project (clause 31).

Acceptance of Applications

25. The Grazier's participation in the Project commences on the date the Grazier's Project Agreements are executed and Droves are allocated to the Grazier. The Project Documents may be executed upon acceptance of a Grazier's Application for Droves. The Project Documents commence on the day that the conditions in clause 8 of the Constitution are met. Under clause 8, the Responsible Entity will accept an applicant and an applicant will be issued an interest in the Project and become a Grazier where, amongst other things, the following conditions are satisfied:

- the applicant has paid the full amount of 'Application Money' as specified in the PDS upon application for Droves;
- the Responsible Entity has accepted the applicant's application;
- minimum subscription for the Project is reached;
- the Responsible Entity is ready, willing and able to commence performing its duties pursuant to the Project Documents; and
- the Compliance Officer of the Project has not notified the directors of the Responsible Entity that there is an outstanding material breach of any of the provisions of the Constitution or the *Corporations Act 2001* which is detrimental to the interests of the Applicants.

26. The applicant may elect to pay the 'Application Money' in instalments. Clause 7.1 provides that Graziers may pay the 'Application Money' by two or more instalments at the discretion of the Responsible Entity. The full amount of the 'Application Money' will be payable on such terms as specified in the application form, or on such terms as the Responsible Entity may determine, but not later than 12 months following the issue of an interest in the Project.

27. The Responsible Entity may accept applications under the PDS on or before 30 June of each relevant year. However, this Ruling only applies to Graziers who commence to participate in the Project during the period on or before 15 June 2004 **('2004 Graziers')**.

Compliance Plan

28. As required by the *Corporations Act 2001*, Environinvest has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that Environinvest manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Graziers are protected.

Cattle Lease Agreement

29. The Cattle Lease Agreement is entered into between Environinvest, as the Lessor, and the Grazier. The Agreement sets out the roles and obligations of the parties to the Agreement. Under the terms of the Agreement the Grazier will lease the Stock, being a minimum of 10 Droves. Each drove consisting of a 4 cow or heifer ('Female') sub-unit, together with any replacements or additional cows or heifers that may be leased from time to time. Each 'Female' contained in each Drove leased by the Grazier will be identified via a 'Stock Identifier'. The details of each 'Female' contained in each Drove leased to the Grazier will be set out in the Annexure to the Cattle Lease Agreement.

30. The Lessor owns or holds a leasehold interest in the Stock. Graziers participating in the Project are granted an interest in Stock by the Lessor in the form of a lease to use their Stock for the purpose of breeding and to establish the Grazier's 'Herd' to carry on the business of leasing, breeding, grazing and the sale of beef cattle for profit.

31. On the 'Signing Date', being the date on which the Grazier's application for an interest in the Project is accepted and the Cattle Lease Agreement is executed, the Lessor agrees to Lease the Stock to the Grazier on and from the 'Commencement Date'. The Agreement is terminated pursuant to the provisions of the Agreement (clause 13) or on 30 June of the fifth 'Subsequent Year'.

32. Each Grazier must pay a Cattle Lease Fee to the Lessor being an amount as specified in clause 4 and item 5 of the Schedule to the Cattle Lease Agreement. Before the end of the fourth Subsequent Year, 50% of the Stock will be returned to the Lessor and removed from the Lease. The Manager has the discretion to select the retiring Stock. Under the agreement, the Grazier and the Lessor may agree to lease additional Stock or lease Stock for additional periods under the terms and conditions of the Agreement.

33. Under the terms of the Cattle Lease Agreement, among other things, the Grazier agrees to:

- to maintain the Stock and, upon termination or expiry of the Lease, return the Stock to the Lessor;
- that the Grazier is responsible for all costs and expenses of the delivery, maintenance and return of the Stock;
- use the Grazier's best endeavours to ensure that the 'Herd' remains free from any illness, disease or parasite;
- use the Grazier's best endeavours to ensure at all times that the Stock receives all necessary pasture, feeding and supplementary feeding and water supplies to maintain Stock in good condition and health in

accordance with accepted animal husbandry practices for the beef cattle industry; and

- not encumber or in any way deal with the Lessor's interest in the Stock except with the prior written consent of the Lessor.

34. Under the terms of the Cattle Lease Agreement the Lessor agrees, amongst other things:

- to deliver to the Grazier such reasonable breeding information and records of the Stock as requested in a Notice issued by the Grazier;
- that at the Commencement Date the Stock will be pregnancy tested and found to be in calf; and
- prior to the commencement of the next calving season, replace any of the Stock which die or are in the Manager's opinion unsuitable for breeding, with Stock which have been pregnancy tested and found to be in calf.

35. Under clause 6.2 of the Cattle Lease Agreement, the Lessor acknowledges and agrees that the Grazier will lease the Stock for the purpose of producing 'Progeny' that will be used in the Grazier's business of cattle breeding and production. The Grazier is the absolute owner of all the 'Progeny'. The Leased Stock will remain the property of the Lessor.

Agistment Agreement

36. The 'Land' on which the Project will be conducted will be leased by the land owner to Environinvest, who will enter into an Agistment Agreement with the Grazier.

37. Graziers entering into the Project will enter into an Agistment Agreement with Environinvest as the Licensor. Each Grazier will be granted a non exclusive licence to occupy the Land for a period commencing on the 'Commencement Date'. The Agistment Agreement will terminate on 30 June of the 7^{th} Subsequent Year, or subject to earlier termination pursuant to clause 12 of the Agistment Agreement or such later date as the Manager's obligations under the Management Agreement come to an end.

38. Item 5 of the Schedule to the Agistment Agreement between the Licensor and the Grazier provides the particulars of the 'Land' where the Project will be conducted. The 'Land' will comprise of the 'Initial Land' and 'Further Land'. The 'Initial Land' is situated in the southern region of New South Wales. The Manager may seek, on the Grazier's behalf, a licence in respect of 'Further land' in order to conduct the Project. The 'Further Land' will be described at item 6 of the Schedule to the Agistment Agreement.

39. The Agistment Agreement sets out the roles and obligations of the parties to the Agreement. Under the terms of the Agistment

Agreement the Grazier will occupy and use the Land to agist and graze the cows or heifers leased by the Grazier from the Lessor and the Grazier's Progeny ('the Herd') on the Land for the term of the Agreement.

40. Each Grazier must pay an Agistment Fee to the Licensor being an amount as specified in clause 3 of the Agistment Agreement and item 4 of the Schedule to the Agistment Agreement.

Management Agreement

41. The Management Agreement is entered into between Environinvest, as the Manager, and the Grazier. Under the Management Agreement the Grazier appoints the Manager as an independent contractor to oversee and manage the Grazier's 'Business' of leasing, breeding, grazing and selling beef cattle for profit.

42. The Agreement commences on the date the Grazier's application for an interest in the Project is accepted and the Management Agreement is executed. The Agreement is terminated pursuant to the provisions of the Agreement on 30 June of the seventh Subsequent Year or at such time as determined under the Project Agreements (clauses 4 and 21).

43. The Management Agreement provides that each Grazier appoints the Manager to perform services under the Agreement. The services to be performed are specified in the definition of 'Administration Services', 'Breeding Management Services', 'Feedlot Management Services', 'Identification Services', 'Land Management Services', 'Sales Management Services' and 'Stock Management Services'. The Manager will supervise and manage all activities to be carried out with respect to the Grazier's 'Herd' on behalf of the Grazier including, but not limited to the provision of the following services:

(i) Breeding Management Services will be provided in joining the Grazier's 'Herd' in accordance with accepted livestock husbandry practice so as to create the possibility of the 'Herd' being increased, including, without limitation, the following:

- the provision of suitable bulls to stand in the Herd;
- the joining of suitable cows and heifers with suitable bulls to ensure the genetic integrity of the continued breeding process;
- the efficient joining of suitable cows and heifers with suitable bulls to maximise calving rates;
- pregnancy testing;
- bull relocation, rotation and transport activities;

- the identification and segregation of cows and heifers unsuitable for breeding;
- the effective identification of progeny to ensure correct identification of ownership and accurate recording of livestock; and
- the maintenance of standard and necessary breeding information and records.

(ii) Feedlot Management Services will be provided in connection with arranging and monitoring the provision of Feedlot Services for Steers, and include:

- the selection of suitable Feedlots;
- the negotiation of the provision of Feedlot Services; and
- the supervision of the Feedlot Manager, who is appointed by the Manager or its agent to manage the Feedlot, in performing the Feedlot Services.

(iii) Land Management Services:

- fencing, gate and holding pen maintenance and reinstatement activities;
- erosion control, soil degradation control, soil salinity control and soil drainage control activities;
- undertaking soil improvement and fertilising activities;
- undertaking pasture improvement activities;
- vegetation, disease, vermin and other pest reduction and eradication activities;
- fire control and management activities; and
- the identification, selection and procurement of ‘Land’ for the purposes of the ‘Business’.

(iv) Sales Management Services will be provided in relation to the sale of any ‘Progeny’, including:

- receiving, holding and distributing sale proceeds and appointing and managing any agent or contractor carrying out these services;
- pooling the Progeny with progeny of other graziers (of the Class or otherwise) for the purposes of sale;
- assessment of the feasibility of feedlotting of Steers prior to their sale;

- appointing agents, transport contractors and such other persons to assist in providing or provide the services required to effect sales of Progeny;
- advertising;
- negotiation and execution of sale contracts; and
- mustering, droving, and transportation of such of the Progeny as are sold.

(v) Stock Management Services will be provided for the control, tending and rearing of the Grazier's 'Herd' in accordance with accepted animal husbandry practice such as to ensure that the Land is not destroyed or deteriorated, including, without limitation, the following:

- stock care, including disease and parasite control and veterinary treatment activities;
- selecting and acquiring replacement 'Females' for those retired from the Stock;
- carrying out pregnancy testing;
- providing or arranging the provision of 'Feedlot Services';
- providing 'Herd' stock identification;
- stock relocation, rotation and transport activities; and
- stock confinement and protection activities.

44. The Manager will not undertake any work on behalf of a Grazier prior to the Grazier being issued an interest in the Project.

Pooling of 'Progeny' and 'Grazier's Entitlement' to 'Net Sales Proceeds'

45. The Management Agreement (clause 5) set out provisions relating to the 'Grazier's Entitlement' to 'Net Sales Proceeds'. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Graziers who have contributed 'progeny' to the sales pool in a 'Subsequent Year' are entitled to benefit from distributions from those 'Net Sales Proceeds'; and
- any pooled 'Progeny' must consist only of 'progeny', contributed by Graziers the same Project 'Class'.

46. Under the Management Agreement the Grazier agrees to participate in the sales pool at the point of sale of the 'Progeny'.

47. During the term of the Project steers, cows and heifers, which, in the opinion of the Manager, are unsuitable for breeding, will be

contributed to the sales pool. The Manager will provide the 'Sale Management Services' in respect to the Grazier's 'Progeny' together with all 'Progeny' of other Graziers that contribute to the sales pool in each 'Subsequent Year'. The Grazier's 'Progeny' will be contributed to the sales pool during the term of the Project.

48. The 'Grazier's Entitlement' to the 'Net Sales Proceeds' from the sale of the 'Progeny' contributed to the sales pool will be determined as follows:

Grazier's Entitlement = the amount of Net Sales Proceeds x Grazier's Interest

49. The 'Net Sales Proceeds' are the 'Sales Proceeds', being the gross proceeds from the sale of al or part of the 'Progeny' and the sale of progeny of the other Graziers of the 'Class', less the costs and expenses of sale reimbursed to the Manager. The Manager will deduct from 'Sales Proceeds' the costs incurred in transporting the 'Herd' for the purpose of sale and all other reasonable expenses incurred in the sales process which include advertising and marketing expenses and fees charged by sale agents. The Manager will deduct from 'Net Sales Proceeds' any Feedlot Expenses and Transportation Expenses payable, the Feedlot Management Fee, the Sales Management Fee, the Performance Bonus and any other amount payable by the Grazier under the Project Documents.

50. The 'Grazier's Interest' is determined in accordance with the following formula:

A/B x 100

Where:

'A' is the number of Grazier's Droves as at the first Subsequent year;

'B' is the total number of Droves of all Graziers holding an interest in the Project of the Class as at 30 June in the Application Year.

51. If any of the 'Progeny' are destroyed or damaged and the Grazier or another Grazier receives insurance proceeds from an insurance claim made under an insurance policy taken out under clause 13 of the Management Agreement in respect of the Progeny, the Grazier's Interest shall be adjusted to reflect the changed composition of the Total Herd. Where a Grazier receives insurance proceeds, the calculation of Grazier's Interest will be adjusted to reflect the reduction of the Total Herd.

52. Graziers who do not contribute to a sales pool in a Subsequent Year will not be included in the calculation of 'Graziers Interest'. The Manager will pay the Grazier's Share of the Sales Proceeds into the Graziers' Account. Upon execution of the Management Agreement, the Grazier will authorise the Manager to set aside out of the Grazier's Share any sums due and payable under a Contribution Notice and any other sum payable in accordance with the Constitution of the Project.

Fees

53. Under the terms of the Management Agreement, the Cattle Lease Agreement and the Agistment Agreement a Grazier will make payments per Drove as described below.

54. **The Application Money** is to be paid in full by each Grazier on application for the provision of 'Application Services' in the 'Application Year'. The 'Application Services' are to be provided in the period commencing on the Commencement Date and expiring on 30 June of 2004 for '2004 Graziers'. The 'Application Moneys' comprise of the following:

- $1,870 per Drove being the Initial Management Fee;
- $33 per Drove being the Cattle Lease Fee; and
- $22 per Drove being the Agistment Fee.

55. Following the Application Year on or before 30 June of each Subsequent Year ongoing **Management Fees** are payable in arrears to the Manager for performing the 'Administration Services', 'Breeding Management Services', 'Land Management Services' and 'Stock Management Services' during the continuation of the Management Agreement. The fees will be calculated under a formula set out in the Management Agreement.

56. Following the Application Year on or before 30 June of each Subsequent Year a **Cattle Lease Fee** is payable in arrears during the continuation of the Cattle Lease Agreement. The Cattle Lease Fee is payable to the Manager on the Lessor's behalf. The fees will be calculated in accordance with a formula set out in the Cattle Lease Agreement.

57. Following the Application Year on or before 30 June of each Subsequent Year ongoing **Agistment Fees** are payable in arrears to the Manager on the Licensor's behalf for the agistment of the Grazier's 'Herd' during the continuation of the Agistment Agreement. The fees will be calculated under a formula set out in the Agistment Agreement.

58. **Out of Pocket Expenses**, if any, are payable by the Grazier to the Manager. The Manager shall notify the Grazier of any Out of Pocket Expenses incurred or to be incurred by the Manager. The Out of Pocket Expenses will be due and payable to the Manager within 15 days of the date of a 'Notice' outlining the Grazier's share of any Out of Pocket Expenses.

59. **Feedlot Expenses** are payable to the Manager for the expenses charged by the Feedlot Manager during the continuation of the Management Agreement. The fees will be calculated under a formula set out in the Management Agreement.

60. **Transportation Expenses** are payable to the Manager in respect to the cost incurred by the Manager in transporting all or part

of the 'Herd' to the Feedlot. The fees will be calculated under a formula set out in the Management Agreement.

61. **Feedlot Management Fees** are payable to the Manager for the provision of Feedlot Management Services during the continuation of the Management Agreement. The fees will be calculated under a formula set out in the Management Agreement.

62. **Sales Management Fees** are payable by the Grazier to the Manager from the Net Sale Proceeds for the provision of the Sales Management Services. The Sales Management Fee is an amount of 4.5% of the 'Grazier's Entitlement' to the 'Net Sale Proceeds'.

63. **Performance Bonus Fees** are payable by the Grazier to the Manager where the average price per animal net of sales costs and Feedlot Expenses is greater than the 'Benchmark Price'. The Performance Bonus Fee is an amount of 15% of the excess of the weighted average net price per animal over the weighted average 'Benchmark Price'.

64. The Lessor and the Licensor are entitled to be paid by the Grazier **any tax, levy, excise, charge or duty** imposed on the Lessor and the Licensor in respect of the Stock or by reason of the lease of the Stock and in respect to the grazing activities carried out on the 'Land'. The taxes, levies, excise, charges or duties are to be paid upon demand and from time to time in addition to the Cattle Lease Fee and the Agistment Fee.

Finance

65. Graziers can fund their involvement in the Project by borrowing from independent sources or from Environinvest ('the Lender'), acting in the capacity of finance provider.

66. The Lender will provide Graziers with loans on a full recourse basis and will pursue legal action against any defaulting borrowers. Details of the loans that will be offered to Graziers by the Lender are set out in the Loan Application Form and Loan Agreement. The Lender will offer four finance options to Graziers. These options are summarised as follows:

(i) A **Principal and Interest Loan** with the following features:

- the Grazier must provide Environinvest with a deposit of <u>not less</u> than 10% of the 'Application Fee', being the amount payable by the Grazier in the 'Application Year' of the Project;
- the term of the loan may be up to 6 years;
- from the Commencement Date the principal and interest is repayable in equal monthly instalments, in arrears;

- the rate of interest is fixed over the term of the loan;
- the fixed rate of interest per annum will be not more than 15%;
- the monthly instalments are payable monthly in arrears, commencing one month after the 'Commencement Date';
- a loan establishment fee of no more than $100 is payable; and
- at least, minimum security by mortgage over the Grazier's present and future interest in the Project.

(ii) A **Principal and Interest 2nd Year Loan** with the following features:

- the Grazier must provide Environinvest with a deposit of not less than 10% of the 'Application Fee', being the amount payable by the Grazier on 30 June in the first Subsequent Year of the Project;
- the term of the loan may be up to 5 years;
- from the Commencement Date the principal and interest is repayable in equal monthly instalments, in arrears;
- the rate of interest is fixed over the term of the loan;
- the fixed rate of interest per annum will be not more than 15%;
- the monthly instalments are payable monthly in arrears, commencing one month after the 'Commencement Date';
- a loan establishment fee of no more than $100 is payable; and
- at least, minimum security by mortgage over the Grazier's present and future interest in the Project.

(iii) An **Interest Only Loan** with the following features:

- the Grazier must provide Environinvest with a deposit of not less than 10% of the 'Application Fee', being the amount payable by the Grazier in the 'Application Year' of the Project;
- the term of the loan may be up to 6 years;

- the rate of interest is fixed over the term of the loan;
- the fixed rate of interest per annum will be not more than 15%;
- interest is payable annually in advance in equal amounts, beginning on the 'Commencement Date' and thereafter, annually in advance on the 'Date of Interest Payment' specified in Item 11 of the Schedule;
- the principal is payable on the Final Repayment Date as set out in Item 10 of the Schedule;
- there is no loan establishment fee; and
- at least, minimum security by mortgage over the Grazier's present and future interest in the Project.

(iv) An **Interest Only 2nd Year Loan** with the following features:

- the Grazier must provide Environinvest with a deposit of not less than 10% of the 'Application Fee', being the amount payable by the Grazier on 30 June in the first Subsequent Year of the Project;
- the term of the loan may be up to 5 years;
- the rate of interest is fixed over the term of the loan;
- the fixed rate of interest per annum will be not more than 15%;
- interest is payable annually in advance in equal amounts, beginning on the 'Commencement Date' and thereafter, annually in advance on the 'Date of Interest Payment' specified in Item 11 of the Schedule;
- the principal is payable on the Final Repayment Date as set out in Item 10 of the Schedule;
- there is no loan establishment fee; and
- at least, minimum security by mortgage over the Grazier's present and future interest in the Project.

67. Graziers cannot rely on this Product Ruling if they enter into a finance agreement with the Lender that materially differs from that set out in the Loan Application Form and Loan Agreements provided to the Tax Office by Environinvest.

68. Furthermore, '2004 Graziers' cannot rely on this Product Ruling if 'Application Money' otherwise remains unpaid by 15 June 2004. Where an application is accepted subject to finance approval by any lending institution, '2004 Graziers' cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by 15 June 2004.

69. [Omitted.]

70. This Ruling does not apply if the finance arrangement entered into by the Grazier with the Lender or any other lender 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, other than Environinvest, are involved or become involved in the provision of finance to Graziers for the Project.

Ruling

Application of this Ruling

71. This Ruling applies only to Graziers who are accepted to participate in the Project, whose Project Agreements have been executed and who have had Droves allocated to them on or before 15 June 2004 ('2004 Graziers').

72. The Grazier's participation in the Project must constitute the carrying on of a business of primary production. A Grazier is not eligible to claim any tax deductions until the Grazier's application to

enter the Project is accepted, Doves are allocated to the Grazier and the Project has commenced.

The Simplified Tax System ('STS')

Division 328

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

Qualification

74. This Product Ruling assumes that a Grazier who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grazier may become an 'STS taxpayer' at a later point in time. Also, a Grazier 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 Graziers that cannot be accommodated in this Ruling. Such Graziers can ask for a private ruling on how the taxation legislation applies to them.

Assessable Income

Section 6-5 and section 328-105

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

76. Other than Graziers referred to in paragraph 77, a Grazier is assessable on ordinary income from carrying on their business of leasing, breeding, grazing and sale of beef cattle for profit in the income year in which that income is derived.

77. A Grazier who is an 'STS taxpayer' (for the 2003-04 and 2004-05 income years) or an 'STS taxpayer' using the cash accounting method (for the 2005-06 income year and later years) is assessable on ordinary income from carrying on their business of leasing, breeding, grazing and sale of beef cattle for profit in the income year in which that income is received.

Deductions for the Initial Management Fee, Agistment Fees, Cattle Lease Fees, Management Fees, Feedlot Expenses, Transportation Expenses, Feedlot Management Fees, Sales Management Fees, Performance Bonus Fees, Out of Pocket Expenses, Interest and Borrowing Expenses

Section 8-1, section 328-105 and section 25-25

78. A Grazier may claim tax deductions for the following revenue expenses for each of the Grazier's Droves.

Fee Type	**Year ended 30 June 2004**	**Year ended 30 June 2005**	**Year ended 30 June 2006**
Initial Management Fee	$1,870- See Notes (i) & (ii)		
Cattle Lease Fee	$33- See Notes (i), (ii) & (vii)	As incurred- See Notes (i), (ii) & (vii)	As incurred- See Notes (i), (ii) & (vii)
Agistment Fee	$22- See Notes (i), (ii) & (vii)	As incurred- See Notes (i), (ii) & (vii)	As incurred- See Notes (i), (ii) & (vii)
Management Fee		As incurred- See Notes (i), (ii) & (vii)	As incurred- See Notes (i), (ii) & (vii)
Feedlot Expenses		As incurred- See Notes (i), (ii) & (vii)	As incurred- See Notes (i), (ii) & (vii)
Transportation Expenses		As incurred- See Notes (i), (ii) & (vii)	As incurred- See Notes (i), (ii) & (vii)
Feedlot Management Fees		As incurred- See Notes (i), (ii) & (vii)	As incurred- See Notes (i), (ii) & (vii)
Sales Management Fee		As incurred- See Notes (i), (ii) & (vii)	As incurred- See Notes (i), (ii) & (vii)
Performance Bonus Fee		As incurred- See Notes (i) & (ii)	As incurred- See Notes (i) & (ii)

Out of Pocket Expenses		As incurred- See Notes (i), (ii), (iii) & (vii)	As incurred- See Notes (i) (ii), (iii) & (vii)
Interest (Principal and interest loan from Environinvest)	As incurred- See Notes (iv), (vii) & (viii)	As incurred- See Notes (iv), (vii) & (viii)	As incurred- See Notes (iv). (vii) & (viii)
Interest (Interest only loan from Environinvest)	Must be calculated- See Notes (v), (vii) & (viii)	Must be calculated- See Notes (v), (vii) & (viii)	Must be calculated- See Notes (v), (vii) & (viii)
Loan Establishment Fee on Principle and Interest Loans	$100- See Note (vi)		

Notes:

(i) If the Grazier is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (eg input tax credits): Division 27. See the Example at paragraph 122.

(ii) Where the Grazier is not an 'STS taxpayer', the amount of the fee payable is deductible in full in the year that it is incurred.

For the 2003-04 and 2004-05 income years, the amount of the fee payable is deductible in full in the year that it is paid where the Grazier is an 'STS taxpayer'.

For the 2005-06 and 2006-07 income years, the amount of fee payable is deductible in full in the year that it is incurred where the Grazier is an 'STS taxpayer' using the accruals accounting method, or in the year that it is paid where the Grazier is an STS taxpayer' using the cash accounting method.

(iii) This Ruling does not rule on the deductibility of any portion of the Out of Pocket Expenses that relate to the cost of bringing or defending any third party legal proceedings for and on behalf of Graziers.

(iv) Graziers who enter into a **Principal and Interest Loan** and/or **a Principal and Interest 2nd Year Loan** with Environinvest incur interest monthly, in arrears. Such interest is deductible in full in the year that it is incurred where the Grazier is not an 'STS taxpayer'.

For the 2003-04 and 2004-05 income years, such interest is deductible in full in the year that it is paid where the Grazier is an 'STS taxpayer'.

For the 2005-06 and 2006-07 income years, such interest is deductible in full in the year that it is incurred where the Grazier is an 'STS taxpayer' using the accruals accounting method or in the year that it is paid where the Grazier is an 'STS taxpayer' using the cash accounting method.

(v) Graziers who enter into an **Interest Only Loan** and/or an **Interest Only 2nd Year Loan** with Environinvest incur interest annually in advance, beginning from the Commencement Date. Unless the amount of the interest is 'excluded expenditure' (see paragraph 112):

- such interest is **NOT** deductible in full in the year that it is incurred where a Grazier is not an 'STS taxpayer';
- for the 2003-04 and 2004-05 income years, such interest is **NOT** deductible in full in the year that it is paid where the Grazier is an 'STS taxpayer'; or
- for the 2005-06 and 2006-07 income years, such interest is **NOT** deductible in full in the year that it is incurred where the Grazier is an 'STS taxpayer' using the accruals accounting method or in the year that it is paid where the Grazier is an 'STS taxpayer' using the cash accounting method.

Where the amount of interest is not 'excluded expenditure' the deduction for the interest paid in advance each year must be determined using the formula in subsection 82KZMF(1) (see paragraph 109). The Commencement Date will be the date the loan is entered into and the number of days in the 'eligible service period' in the first expenditure year (ie the Application Year) will be the number of days from that date until 30 June of the relevant year.

(vi) Borrowing expenses are deductible under section 25-25 where the borrowed moneys are used or will be used during that income year for income producing purposes. Borrowing expenses of $100 or less are deductible in the year in which they are incurred (subsection 25-25(6)).

(vii) This Ruling does not apply to Graziers who choose to prepay fees or, who choose, or who are required to prepay interest under a loan agreement other than as discussed in Note (v), (see paragraph 106). Amounts that are prepaid for a period that extends beyond the income year in which the expenditure is incurred may be subject to the prepayment provisions in sections 82KZME to 82KZMF of the ITAA 1936. Any Grazier who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.

(viii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Environinvest is outside the scope of this Ruling. Graziers who borrow from lenders other than Environinvest may request a private ruling on the deductibility of the interest incurred.

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

Section 35-55 - Exercise of Commissioner's discretion

79. A Grazier, who is an individual, with the minimum allocation of 10 Droves and is a '2004 Grazier' may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Graziers for the income years ending **30 June 2004 to 30 June 2006**. This conditional exercise of the discretion will allow those losses to be offset against the Grazier's other assessable income in the income year in which the losses arise.

80. While Graziers may still incur losses after the years shown above, financial projections by the Responsible Entity indicate that in these later years of the Project the assessable income test in section 35-30 will be met. The assessable income test requires that a Grazier derives at least $20,000 of assessable income in an income year from their business of breeding and selling beef cattle.

81. Where a Grazier satisfies the assessable income test in an income year the Grower will not be required to defer any loss attributable to their business activity, to a later year. Instead, this loss can be offset against other assessable income of the Grower for the year in which the loss arises. However, if a Grower fails to pass the assessable income test in an income year, and fails to pass one of the other tests in Division 35, they should seek a private ruling on how Division 35 will apply to their business activity for that income year.

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

82. For a Grazier who participates in the Arrangement described above and incurs expenditure as required by the Project Agreements and any loan agreement with the Financier, the following provisions of the ITAA 1936 have application as indicated:

- Expenditure, by a Grazier who participates in the Project, on the Initial Management Fee, Cattle Lease Fees, Agistment Fees, Management Fees, Feedlot Expenses, Transportation Expenses, Feedlot Management Fees, Sales Management Fees, Performance Bonus Fees, Out of Pocket Expenses, and interest expenses incurred under the Principal and Interest Loan or the Principal and Interest 2^{nd} Year Loan **does not** fall within the scope of sections 82KZME to 82KZMF;
- Expenditure, by a Grazier who participates in the Project, on interest incurred under the Interest Only Loan or the Principal and Interest Only 2^{nd} Year Loan **does** fall within the scope of section 82KZME to 82KZMF;
- 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 Grazier carrying on a business?

83. For the amounts set out in the tables above to constitute allowable deductions the Grazier's activities of leasing, breeding, grazing and sale of beef cattle as a participant in the Environinvest Beef Cattle Project 2004 must amount to the carrying on of a business of primary production.

84. Where there is a business, or a future business, the 'Sale Proceeds' from the sale of cattle will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

85. For schemes such as the Environinvest Beef Cattle Project 2004, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grazier'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 *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

86. Generally, a Grazier will be carrying on a business of breeding and selling beef cattle, and hence primary production, if:

- the Grazier has an identifiable interest (by lease) or rights over (by licence) cattle held for breeding purposes;
- the Grazier has a right to take and sell the progeny of those leased or licensed cattle;
- the breeding of the cattle and sale of their progeny are carried out on the Grazier's behalf;
- the activities of the Grazier are typical of those associated with a business of leasing, breeding, grazing and sale of beef cattle; and
- the weight and influence of general indicators point to the carrying on of a business.

87. In this Project, each Grazier enters into a Management Agreement, Cattle Lease Agreement, and an Agistment Agreement.

88. Under the Cattle Lease Agreement, each individual Grazier will have rights over a number of specific and identifiable cattle held for breeding purposes. During the term of the Cattle Lease Agreement the Grazier will have an ongoing interest in the individual cows and heifers that make up the Grazier's Droves and the Cattle Lease Agreement acknowledges that the Grazier is the absolute owner of the 'Progeny' that is the offspring of the leased stock and any offspring of the leased stock that forms the Grazier's 'Herd'. The progeny of the Grazier's 'Herd' will be identified via the use of tags to ensure correct identification of ownership and accurate recording of livestock. Under the Cattle Lease Agreement, the Grazier must use the stock in question for the purpose of breeding and establishing the Grazier's 'Herd' to carrying on the business of leasing, breeding, grazing and sale of beef cattle for profit and for no other purpose. The Cattle Lease Agreement allows Environinvest to carry out its obligations under the Management Agreement.

89. Under the Agistment Agreement, each individual Grazier will have rights over a specific and identifiable area of land. The Agistment Agreement provides the Grazier with an ongoing interest in the 'Land' in the form of a non-exclusive licence to occupy and use the 'Land' to agist and graze the 'Herd' for the term of the Project. The licence allows the Manager to come onto the Land to carry out its obligations under the Management Agreement.

90. Under the Management Agreement Environinvest is engaged by the Grazier to establish and maintain the Grazier's 'Herd' agisted on the 'Land' during the term of the Project. Environinvest has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to maintain the cattle on the Grazier's behalf.

91. In establishing the 'Herd', the Grazier engages the Manager to oversee the Grazier's business of leasing, breeding, grazing and selling beef cattle for profit and appoints the Manager as an independent contractor to provide 'Administration Services', 'Breeding

Management Services', 'Feedlot Management Services', 'Identification Services', 'Land Management Services', 'Sales Management Services' and 'Stock Management Services' and various other services in respect to the Grazier's Herd.

92. 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.

93. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grazier in the Project will derive assessable income from the sale of cattle that will return a before-tax profit, that is a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

94. The pooling of the Grazier's cattle with cattle of other Graziers is not inconsistent with general pastoral practices. Each Grazier's proportionate share of the sale proceeds of the pooled cattle will reflect the proportion of the cattle contributed by the Grazier. Graziers who do not contribute cattle to a pool are excluded from sharing in the proceeds of that pool.

95. Environinvest's services are also consistent with general pastoral practices. They are of the type ordinarily found in pastoral ventures that would commonly be said to be businesses. While the size of a 'Herd' is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

96. The Grazier's degree of control over Environinvest as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, Environinvest will provide the Grazier with regular progress reports on the Grazier's 'Herd' and the activities carried out on the Grazier's behalf. Graziers are able to terminate arrangements with Environinvest in certain instances, such as cases of default or neglect.

97. The activities of leasing, breeding, grazing and selling beef cattle, 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 Grazier's activities of breeding and selling beef cattle in the Environinvest Beef Cattle Project 2004 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

98. Subdivision 328-F sets out the eligibility requirements that a Grazier must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

99. The question of whether a Grazier is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grazier 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'.

Initial Management Fee, Agistment Fees, Cattle Lease Fees, Management Fees, Feedlot Expenses, Transportation Expenses, Feedlot Management Fees, Sales Management Fees, Performance Bonus Fees and Out of Pocket Expenses

Section 8-1

100. Consideration of whether the fees payable under the Management Agreement, Cattle Lease Agreement, and an Agistment Agreement 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.

101. Any part of the expenditure of a Grazier entering into a pastoral business 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, a portion of the Out of Pocket Expenses may be paid in relation to the cost of the Manager bringing or defending any third party legal proceedings for an on behalf of Graziers. In some instances the bringing and defending of third party legal proceedings may be properly characterised as capital expenditure and cannot be deducted under section 8-1.

102. The fees payable under the Management Agreement, Cattle Lease Agreement and Agistment Agreement, other than any possible cost of bringing and defending a third party legal proceeding that is properly characterised as capital expenditure, are associated with the Grazier's leasing, breeding and grazing activities and the sale of the progeny and will relate to the gaining of income from the Grazier's business (see above), and hence have a sufficient connection to the

operations by which income (from the sale of cattle) 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 fees is identifiable from the arrangement. The fees appear to be reasonable and the fees have no capital component. The tests of deductibility under the first limb of section 8-1 are met and the exclusions do not apply.

Interest deductibility

Section 8-1

(i) Graziers who use Environinvest as the finance provider

103. Some Graziers may finance their participation in the Project through a loan facility with Environinvest. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of fees payable under Management Agreement, Cattle Lease Agreement, and an Agistment Agreement.

104. The interest incurred by Graziers from the Commencement Date and in subsequent years of income will be in respect of a loan to finance the Grazier's business operations – the leasing, breeding, grazing and selling of beef cattle - 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.

(ii) Graziers who DO NOT use Environinvest as the finance provider

105. The deductibility of interest incurred by Graziers who finance their participation in the Project through a loan facility with a bank or financier other than Environinvest 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

106. 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 (eg 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 income year, then it is not expenditure to which the prepayment rules apply.

Application of the prepayment provisions to this Project

107. Under the Arrangement to which this Product Ruling applies fees payable under the Management Agreement, Cattle Lease Agreement and Agistment Agreement are incurred annually and interest payable to Environinvest under all loans, except the Interest Only Loan and the Interest Only 2nd Year Loan, is incurred monthly. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this expenditure. A Grazier who is an 'STS taxpayer' who uses the cash accounting method can, therefore, claim a deduction for each of the relevant amounts in the income year in which the amount is paid. A Grazier who is not an 'STS taxpayer' or an 'STS taxpayer' who uses the accruals accounting method (for the 2005-06 and 2006-07 income years) can claim a deduction for each of the relevant amounts in the income year in which the fee is incurred.

108. However, sections 82KZME and 82KZMF may have relevance if a Grazier in this Project enters into the Interest Only Loan and/or and the Interest Only 2nd Year Loan facility. Under the Interest Only Loan and the Interest Only 2nd Year Loan facilities interest is payable annually in advance and, therefore, may need to be apportioned under section 82KZMF.

109. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure, such as the interest incurred under the Interest Only Loan and the Interest Only 2nd Year Loan. Section 82KZMF uses the formula below, to apportion the prepaid interest and allow a deduction over the period that the interest relates to.

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

110. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years. Under the Interest Only Loan and the Interest Only 2nd Year Loan the eligible service period will be 365 days.

111. Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

112. There are a number of exceptions to these rules, but for Graziers 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 Graziers in this Project, 'excluded expenditure' is prepaid

expenditure incurred under the arrangement that is less than $1,000. Such expenditure is immediately deductible.

113. As noted in the Ruling section above, Graziers who prepay fees or interest, other than interest under the Interest Only Loan or the Interest Only 2nd Year Loan discussed above, are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

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

Section 35-55 – Exercise of Commissioner's discretion

114. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2004 to 30 June 2006** the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 *Income tax: Division 35 - non commercial business losses*. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years:

- it is because of its nature the business activity of a Grazier will not satisfy one of the four tests in Division 35;
- there is an objective expectation that within a period that is commercially viable for the cattle industry, a Grazier's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grazier who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

115. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) is conditional on the Project being carried on in the manner described in this Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Ruling a Grazier will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

116. Financial projections provided with the application for this Product Ruling indicate that Graziers may continue to make taxation losses beyond the commercially viable period for the cattle industry. However, in each of those loss years, the financial projections provided by the Responsible Entity show that Graziers are expected to derive assessable income of at least $20,000. Where a Grazier derives assessable income of at least $20,000 in an income year they will meet the assessable income test in section 35-30 of Division 35. Graziers who meet the assessable income test, or one of the other

tests in Division 35, will not be required to defer losses arising from the business of breeding and selling beef cattle.

117. If a Grazier fails to meet the assessable income test in those years, or fails to meet one of the other tests set out in sections 35-35, 35-40 or 35-45, the losses may be deferred under section 35-10 of Division 35. In such circumstances Graziers may apply for a private ruling on how Division 35 will apply to their business activity for that income year.

Section 82KL – recouped expenditure

118. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits'. 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 - general tax avoidance provisions

119. 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).

120. The Environinvest Beef Cattle Project 2004 will be a 'scheme'. A Grazier will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 78 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

Example

Entitlement to GST input tax credits

122. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every

six months in advance. On 1 December 2003, 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 1/1/2004 to 30/6/2004	$4,400*
Carrying out of upgrade of power for your vineyard as quoted	$2,200*
Total due and payable by 1 January 2004 (includes GST of $600)	$6,600

*Taxable supply

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

$$^{1}/_{11} \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively $4,400 *less* $400, or $4,000.

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

$$^{1}/_{11} \times \$2,200 = \$200.$$

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

In preparing her income tax return for the year ended 30 June 2004, 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

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

Commissioner of Taxation
19 May 2004

Previous draft:

Not previously released in draft form

Related Rulings/Determinations:

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

Other Rulings/Determinations:

TR 2001/14

Subject references:

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

Legislative references:

- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)

- ITAA 1936 82KZME
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1936 318
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 25-25
- ITAA 1997 25-25(6)
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- 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)(b)
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- TAA 1953 Pt IVAAA
- Copyright Act 1968
- Corporations Act 2001

Case references:

- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

ATO references

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