



PR 2004/85 - Income tax: Northern Rivers Coffee Project No. 3 (Second Supplementary Product Disclosure Statement) - Post 31 January 2005 Growers

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 This document has changed over time. This is a consolidated version of the ruling which was published on *8 September 2004*



Product Ruling

Income tax: Northern Rivers Coffee Project No. 3 (Second Supplementary Product Disclosure Statement) – Post 31 January 2005 Growers

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	55
Explanation	73
Example	103
Detailed contents list	104

Preamble

*The number, subject heading, **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 Tax Office **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 and how the product fits an existing portfolio. 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 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, 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 Tax Office 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.

Potential participants may wish to refer to the Tax Office website at www.ato.gov.au or contact the Tax Office directly to confirm the currency of this Product Ruling or any other Product Ruling that the Tax Office has issued.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' 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 referred to as the Northern Rivers Coffee Project No 3 (2nd Supplementary Product Disclosure Statement) or simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 8-1 of the ITAA 1997;
 - section 17-5 of the ITAA 1997;
 - Division 27 of the ITAA 1997;
 - Division 35 of the ITAA 1997;
 - Division 40 of the ITAA 1997;
 - Division 328 of the ITAA 1997;
 - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KZL of the ITAA 1936;
 - sections 82KZME to 82KZMF of the ITAA 1936; and
 - Part IVA of the 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 '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. 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 (that is, 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 'Growers'.

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

- who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it;
- who elect to weed their own Plantations;
- who are accepted to participate in the Project before 1 February 2005;
- who are accepted to participate in the Project after 15 June 2005.

Qualifications

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

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Date of effect

11. This Ruling applies prospectively from 8 September 2004. 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).

Withdrawal

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

- Application for a Product Ruling dated 24 June 2004 as constituted by documents provided on 12 July 2004, 13 August 2004 and additional correspondence dated 8 July 2004 and 31 August 2004 as well as earlier correspondence received on 19 May 2003, 9 April 2003, 4 April 2003, 31 March 2003, 14 March 2003 and 13 March 2003;

- Product Disclosure Statement (PDS) for Northern Rivers Coffee Project No 3, issued by Managed Projects Australia Limited on 11 July 2003;
- Draft 2nd Supplementary Product Disclosure Statement (2nd SPDS) for the issue of interests in Northern River Coffee Project No 3, received 13 August 2004;
- **Constitution** for Northern Rivers Coffee Project No 3, dated 5 May 2003, received 12 July 2004;
- **Licence Agreement** between Managed Projects Australia Limited and each Grower, received 13 August 2004;
- **Plantation Management Agreement** between Managed Projects Australia Limited and each Grower, received 13 August 2004;
- Northern Rivers Coffee Project No 3 Compliance Plan, received 17 April 2003;
- Lease Agreement between Northern Rivers Coffee Landholding Limited and Managed Projects Australia Limited, received 14 March 2003; and
- Subcontract Agreement between Managed Projects Australia Limited and Coffee Management Australia Limited, received 10 March 2003.

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 that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, 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 a part of the arrangement. The effect of these agreements is summarised as follows.

16. All Australian Securities and Investment 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

17. The salient features of the Northern Rivers Coffee Project No 3 are as follows:

Location	Bulmers Road, Hogarth Range, near Casino NSW
Type of business to be carried on by each participant	Commercial growing and cultivation of coffee trees for the purpose of harvesting and selling coffee beans
Number of plantations currently on offer	138
Size of each interest	0.072 hectares
Minimum allocation	1 Plantation
Number of trees per plantation	250
Number of trees per hectare	3472
Term of the Project	Until 30 June 2022
Initial cost	\$3,730.00
Initial cost per hectare	\$52,220.00
Ongoing costs	Ongoing management fees, annual licence fees, harvesting fees and processing fees

18. The Northern Rivers Coffee Project No 3 is registered as a Managed Investment Scheme under the *Corporations Act 2001*. Under this offer, there are currently 138 Grower interests in the Northern Rivers Coffee Project No 3 still available. No shares will be offered to Growers in the Landowner, Northern Rivers Coffee Landholding Limited as the prospectus for these stapled securities expired on 12 June 2004. Managed Projects Australia Limited has leased land suitable for the establishment of a coffee plantation from Northern Rivers Coffee Landholding Limited for licensing of smaller plots of land to participants in the Project.

19. The Project has been established to enable Growers to become proprietors of their own primary production businesses involving the planting of coffee trees on land leased by Managed Projects Australia Limited from Northern Rivers Coffee Landholding Limited on a property located at Hogarth Range near Casino, NSW, and the harvesting and processing of coffee cherry to Dried Green Bean for sale.

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

Lease Agreement

21. The lease agreement between Northern Rivers Coffee Landholding Limited, the Landowner, and Managed Projects Australia Limited requires the Landowner to undertake at its own cost, preparation of the land, including the provision of all infrastructure to enable the planting and commercial cultivation of coffee. The Landowner will also purchase and maintain water licences during the term of the lease and do all things necessary to ensure that the landowner's rights in relation to the water licences are fully exploited for the benefit of the lessee or the lessee's licensee. The term of the Lease ends on 30 June 2022. Under the provisions of the Lease, the tenant may only use the land as a Coffee Plantation.

Constitution

22. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Licence Agreement and the Plantation Management Agreement are Schedules One and Two to the Constitution respectively. These Agreements will be executed on behalf of each Grower who has signed the 'Application and Power of Attorney Form' attached to the 2nd Supplementary Product Disclosure Statement and who is accepted into the Project. After acceptance and execution of the Agreements, Growers are bound by the Constitution, the Licence Agreement and the Plantation Management Agreement by virtue of their participation in the Project. The Responsible Entity will keep a register of Growers accepted into the Project.

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

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

Compliance Plan

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

The Compliance Plan is designed to protect the interests of the Growers.

Licence Agreement

25. Each Grower enters into a Licence Agreement with Managed Projects Australia Limited, the Responsible Entity. The Agreement sets out the terms of the agreement between the Grower and the Responsible Entity and is subject to and conditional on the Grower entering into the Plantation Management Agreement with the Responsible Entity (clause 7).

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

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

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

28. The Licence Agreement sets out the purpose for which the Grower may use the land (clause 2), the term of the agreement being from the commencement date until 30 June 2022 or the termination of the Grower's interest in the Project (clause 5).

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

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

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

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

Licence Fees

32. Growers who enter the Project on or after 1 February 2005 and on or before 15 June 2005 will pay licence fees to the Responsible Entity as follows:

- \$60.00 for the period from the date of acceptance to 30 June 2005, payable on application;
- \$60.00 for period from 1 July 2005 to 30 June 2006, payable on 1 July 2005; and
- from 1 July 2006 onwards for each subsequent year until the end of the project, an annual licence fee of \$33.00, indexed by All Groups Consumer Price index (CPI) each year, payable on 1 July in all subsequent years.

Plantation Management Agreement

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

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

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

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

36. Growers who are accepted into the Project on or after 1 February 2005 and on or before 15 June 2005 will have their initial management services completed by 30 June 2005.

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

- irrigating the trees;
- maintaining the trees;
- general maintenance of the trees including the control of weeds, vermin and other pests;
- maintenance of all firebreaks, access roads and tracks around the plantation;
- application of herbicide, fungicide and fertiliser;
- provision of annual written report to grower;

- harvesting of coffee cherry;
- processing the coffee cherry to produce Dried Green Bean;
- marketing and sale of the Dried Green Bean; and
- accounting to the Grower for the proceeds of the Dried Green Bean.

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

39. Growers who enter into the agreement on or after 1 February 2005 and on or before 15 June 2005 will have their trees planted on the Growers' licenced land by 31 December 2005.

40. Growers can elect under clause 19 of the Plantation Management Agreement to carry out their own weed control on their licenced plantations.

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

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

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

Initial Management Fee

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

Timing of Initial Management Services

45. The Initial Management Services shown in the Plantation Management Agreement will be commenced by the Responsible Entity when the Grower is accepted into the Project and continue until the next occurring 30 June or the trees are planted, whichever occurs the earliest. Accordingly, where the Grower is accepted into the Project on or after 1 February 2005 and on or before 15 June 2005, the Initial Management Services will cover the period from the date of acceptance to 30 June 2005.

Ongoing Management Fees

46. Growers who enter into the Project on or after 1 February 2005 and on or before 15 June 2005 will pay Ongoing Management Fees to the Responsible Entity as follows:

- \$861.00 for the twelve month period from 1 July 2005 to 30 June 2006, payable on 1 July 2005;
- \$861.00 for the twelve month period from 1 July 2006 to 30 June 2007, payable on the 1 July 2006; and
- \$316.00 per Plantation subject to All Groups Consumer Price Index (CPI), payable on 1 July in all subsequent years.

Timing of Ongoing Management Services

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

Harvesting Fees

48. Harvesting Fees will be deducted from the sale of the coffee. Harvesting costs will commence in the first year of production, the 2009 financial year. The Harvesting Fee payable for the provision of harvesting services is set at \$33.00 per pass of the mechanical harvester on the Grower's plantation. The harvest fee will be indexed each year by the All Groups Price Index (CPI).

Processing Fees

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

Proceeds of Production

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

- Grower 100% of all net production proceeds up to 0.80 kilogram of Dried Green Bean per tree per year;
- Responsible Entity 100% of all net production proceeds in excess of 0.80 kilogram of Dried Green Bean per tree up to 1.00 kilogram of Dried Green Bean per tree per year; and
- Grower and Responsible Entity are entitled to share the net production proceeds in excess of 1.00 kilogram of Dried Green Bean per tree per year. The parties are entitled to the proceeds in proportion of 75% to the Grower and 25% to the Responsible Entity.

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

Finance

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

53. Regardless of the source of loan funds, this Ruling will not apply to Growers if the 'Responsible Entity' accepts their Application subject to finance approval by a lending institution and the full amount payable at the time of Application, including any loan funds, is not paid to the 'Responsible Entity' by 30 June 2005.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be

transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, are involved or become involved in the provision of finance to Growers for the Project

Ruling

Application of this Ruling

55. This Ruling applies only to Growers who are accepted to participate in the Project and who have executed a Plantation Management Agreement and a Licence Agreement on or after 1 February 2005 and on or before 15 June 2005.

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

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

- are accepted to participate in the project before 1 February 2005;
- are accepted to participate in the Project after 15 June 2005;
- make an election under clause 19 of the Management Agreement.

58. 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.

The Simplified Tax System ('STS')

Division 328

59. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

60. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a

later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Assessable income

Section 6-5 and section 328-105

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

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

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

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

Section 8-1 and section 328-105

64. A Grower may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the Table below.

65. However, if for any reason, an amount shown or referred to in the Table below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

Fee Type	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Initial Management Fee	\$2771.00 See Notes (i), (ii) & (iii)		
Ongoing Maintenance Fees		\$861.00 See Notes (i), (iv) & (v)	\$861.00 See Notes (i), (iv) & (v)
Licence Fee	\$60.00 See Notes (i), (iv) & (v)	\$60.00 See Notes (i), (iv) & (v)	\$33.00* See Notes (i), (iv) & (v)

*Subject to CPI increase

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27. See Example at paragraph 103.
- (ii) Only that part of the Initial Management Fee shown in the Table above is deductible in full in the year that it is incurred (where the Grower is **not an 'STS taxpayer'**) or the year in which it is paid (where the Grower is an **'STS taxpayer'**).
- (iii) Part of the Initial Management Fee shown in the Plantation Management Agreement is of a capital nature. An amount totalling \$94.00 cannot be claimed as deduction (see paragraph 66) and a further amount totalling \$805.00 is capital expenditure for the establishment of horticultural plants (paragraph 68 sets out the timing of deductions for this amount).
- (iv) Where a Grower pays the Ongoing Management Fee and the Licence Fee in the relevant income years shown in the Plantation Management Agreement and the Licence Agreement, those fees are deductible in full in the year that they are incurred (where the Grower is **not an 'STS taxpayer'**) or the year in which they are paid (where the Grower is an **'STS taxpayer'**).
- (v) This Ruling does not apply to Growers who choose to prepay the Licence Fees or Ongoing Management Fees. 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 Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.

Tax outcomes that apply to all Growers***Non deductible capital expenditure***

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

Deductions for horticultural plant***Subdivision 40-F***

67. Subject to paragraph 69, Growers will be entitled to tax deductions for that part of the Initial Management Fee, which relates to the establishment of the coffee trees. The amount and timing of these deductions is determined under Subdivision 40-F.

68. Coffee trees are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the coffee trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the coffee trees have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the coffee trees enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the coffee trees enter their first commercial season.

69. If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27. See Example at paragraph 103.

Interest

70. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 90 to 93 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Division 35 – deferral of losses from non-commercial business activities***Section 35-55 – exercise of Commissioner's discretion***

71. A Grower who is an individual accepted into the Project on or before 15 June 2005 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 Growers for the income years ending **30 June 2005 to 30 June 2007**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

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

72. For a Grower who participates in the Project and incurs expenditure as required by the Plantation Management Agreement and the Licence Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME to 82KZMF (but see paragraphs 90 to 93);
- 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?

73. For the amounts set out in the Table above to constitute allowable deductions the Grower's coffee growing activities as a participant in the Northern Rivers Coffee Project No 3 must amount to the carrying on of a business of primary production. These coffee growing activities will fall within the definition of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

74. Where there is a business, or a future business, the gross proceeds from the sale of the Dried Green Bean 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.

75. For schemes such as that of the Northern Rivers Coffee Project No 3, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

76. Generally, a Grower will be carrying on a business of coffee cultivation, and hence primary production, if:

- the Grower has an identifiable interest (by licence) in the land on which the Grower's coffee trees are established;
- the Grower has a right to harvest and sell the coffee from those coffee trees;
- the coffee growing activities are carried out on the Grower's behalf;

- the coffee growing activities of the Grower are typical of those associated with a coffee growing business; and
- the weight and influence of general indicators point to the carrying on of a business.

77. Under the Licence Agreement, each individual Grower will have rights over a specific and identifiable area of 0.072 hectares of land. The Licence Agreement provides the Grower with an ongoing interest in the specific coffee trees on the licensed area for the term of the Project. Under the licence, the Grower must use the land in question for the purpose of carrying out coffee growing activities, and for no other purpose. The licence allows the Responsible Entity to come onto the land to carry out its obligations under the Plantation Management Agreement.

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

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

80. 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.

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

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

83. The Responsible Entity's services are also consistent with general horticultural practices. They are of the type ordinarily found in coffee growing ventures that would commonly be said to be businesses. While the size of a plantation is relatively small, it is of a size and scale to allow it to be commercially viable.

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

85. The coffee growing 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' coffee growing activities in the Northern Rivers Coffee Project No 3 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

86. 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.

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

Deductibility of Management Fees and Licence Fees

Section 8-1

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

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

89. The Management Fees and Licence Fees associated with the coffee growing activities will relate to the gaining of income from the Grower's business of coffee growing (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of Dried Green Bean) 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. That part of the Initial Management Fee that is of a capital nature has been apportioned and separately dealt with. The remaining part of the Initial Management Fee is of a revenue nature. In respect of these amounts, the tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply to these amounts.

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 (for example, 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.

Application of the prepayment provisions to this Project

91. Under the Arrangement to which this Product Ruling applies Management and Licence Fees are incurred annually. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this Arrangement. A Grower who is an 'STS taxpayer' can, therefore, claim a deduction for each of the relevant amounts in the income year in which the amount is paid, or paid on their behalf. A Grower who is not an 'STS taxpayer' can claim a deduction for each of the relevant amounts in the income year in which the fee is incurred.

92. However, sections 82KZME and 82KZMF may have relevance if a Grower in this Project prepays all or some of the expenditure payable under the Plantation Management Agreement and the Licence Agreement or prepays interest under a loan agreement. 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.

93. As noted in the Ruling section above, Growers who prepay fees or interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

Expenditure of a capital nature

Division 40 and Division 328

94. 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 establishment of the coffee trees is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

95. 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'.

96. The tax treatment of capital expenditure has been dealt with in paragraphs 66, 67, 68 and 69.

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

Section 35-55 – exercise of Commissioner's discretion

97. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2005 to 30 June 2007** 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 ended 30 June 2005 up to and including 30 June 2007:

- it is because of its nature the business activity of a Grower 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 coffee industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grower 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.

98. 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 Grower will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL – recouped expenditure

99. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefits(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA – general tax avoidance provisions

100. 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).

101. The Northern Rivers Coffee Project No 3 will be a ‘scheme’. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 65 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.

102. 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 Dried Green Bean. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm’s length or, if any parties are not dealing at arm’s length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Entitlement to GST input tax credits

103. 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	<u>\$2,200*</u>
Total due and payable by 1 January 2004 (includes GST of \$600)	<u>\$6,600</u>

*Taxable supply

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

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

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

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

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

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

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

104. 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 advisors	6
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	17

Lease Agreement	21
Constitution	22
Compliance Plan	24
Licence Agreement	25
Licence Fees	32
Plantation Management Agreement	33
Initial Management Fee	44
Timing of Initial Management Services	45
Ongoing Management Fees	46
Timing of Ongoing Management Services	47
Harvesting Fees	48
Processing Fees	49
Proceeds of Production	50
Finance	52
Ruling	55
Application of this Ruling	55
The Simplified Tax System ('STS')	59
<i>Division 328</i>	59
Qualification	60
Assessable income	61
<i>Section 6-5 and section 328-105</i>	61
Deductions for Initial Management Fee, Ongoing Management Fees and Licence Fees	64
<i>Section 8-1 and section 328-105</i>	64
Tax outcomes that apply to all Growers	66
<i>Non deductible capital expenditure</i>	66
Deductions for horticultural plant	67
<i>Subdivision 40-F</i>	67
Interest	70
Division 35 – deferral of losses from non-commercial business activities	71
<i>Section 35-55 – exercise of Commissioner's discretion</i>	71
Section 82 KZME to 82 KZMF, 82KL and Part IVA	72
Explanation	73
Is the Grower carrying on a business?	73
The Simplified Tax System	86

<i>Division 328</i>	86
Deductibility of Management Fees and Licence Fees	88
<i>Section 8-1</i>	88
Prepayment provisions	90
<i>Sections 82KZL to 82KZMF</i>	90
Application of the prepayment provisions to this Project	91
Expenditure of a capital nature	94
Division 40 and Division 328	94
Division 35 – deferral of losses from non-commercial business activities	97
<i>Section 35-55 – exercise of Commissioner's discretion</i>	97
Section 82KL – recouped expenditure	99
Part IVA – general tax avoidance provisions	100
Example	103
Entitlement to GST input tax credits	103
Detailed contents list	104

Commissioner of Taxation

8 September 2004

<i>Previous draft:</i>	- tax avoidance
Not previously released in draft form	- tax benefits under tax avoidance schemes
	- tax shelters
<i>Related Rulings/Determinations:</i>	- tax shelters project
PR 1999/95; TD 93/34; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TR 98/22; TR 2000/8; TR 2001/14	<i>Legislative references:</i>
<i>Subject references:</i>	- ITAA 1936 82KL
- carrying on a business	- ITAA 1936 Pt 3 Div 3 Subdiv H
- commencement of business	- ITAA 1936 82KZL
- fee expenses	- ITAA 1936 82KZM
- horticulture	- ITAA 1936 82KZMA
- interest expenses	- ITAA 1936 82KZMB
- management fees	- ITAA 1936 82KZMC
- non commercial losses	- ITAA 1936 82KZMD
- primary production	- ITAA 1936 82KZME
- primary production expenses	- ITAA 1936 82KZMF
- primary production income	- ITAA 1936 Pt IVA
- producing assessable income	- ITAA 1936 177A
- product rulings	- ITAA 1936 177C
- public rulings	- ITAA 1936 177D
- schemes and shams	- ITAA 1936 177D(b)
- taxation administration	- ITAA 1997 6-5
	- TAA 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 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Div 40
- ITAA 1997 Subdiv 40-F
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(2)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530 item 2
- ITAA 1997 40-535
- ITAA 1997 40-545
- ITAA 1997 Div 328

- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- 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

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