

PR 2005/30 - Income tax: Western Tiers Truffiere Project - 2005 Growers

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *16 March 2005*



Product Ruling

Income tax: Western Tiers Truffiere Project – 2005 Growers

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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.

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.

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 'Western Tiers Truffiere Project' 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;
- Part 3-1 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 and 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;
- persons not carrying on a business of primary production;
- persons who participate in the Project through offers made other than through the Information Memorandum and its Addendum;
- persons who elect to opt out of the marketing arrangement with Agri Truffle Pty Ltd to organise the sale of 'Truffles' from their 'Trufflelot' ('Electing Growers');
- persons accepted to participate in the Project and execute a Management Agreement and Lease after 31 May 2005;
- persons who do not pay their 'Application Fees' in full by 31 May 2005 other than person's whose application is accepted subject to finance approval with any lending institution and written evidence of that approval has not been given to Agri Truffle Pty Ltd by 31 May 2005;
- persons who enter into finance arrangements with lenders that include any of the features described in paragraph 54 of this Ruling;

- persons who prepay interest with any lender;
- persons who prepay 'Annual Management Fees' or 'the rent' to Agri Truffle Pty Ltd; and
- Agri Truffle Pty Ltd or its associates.

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 16 March 2005, 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).

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 21 October 2004 as constituted by documents received 21 October 2004, 19 November 2004, 25 November 2004, 10 December 2004, 13 December 2004, 4 February 2005, 14 February 2005, 22 February 2005 and 1 March 2005 and additional correspondence including emails dated 16 November 2004, 25 January 2005, 22 February 2005 and 2 March 2005;
- Information Memorandum for Western Tiers Truffiere (the 'Information Memorandum'); received 21 October 2004;
- Information Memorandum – Addendum for Western Tiers Truffiere (the 'Information Memorandum – Addendum') received 4 February 2005;
- Draft **Lease** between Agri Truffle Pty Ltd (as Lessor) and the Grower (as Lessee) received 4 February 2005;
- Draft **Management Agreement** between Agri Truffle Pty Ltd (as Manager) and the Grower received 22 February 2005;
- Lease Agreement (the 'Head Lease') between Random Nominees Pty Ltd (as Lessor), Agri Truffle Pty Ltd (as Lessee) and Mark Ranicar (as Land Owner) dated 1 July 2001;
- Letters of Variation to the 'Head Lease' received 4 February 2005 and 1 March 2005;
- Draft **Share Option Agreement** between Mark Ranicar and Charles Black (as Vendors), Agri Truffle Land Company Pty Ltd and the Grower received 21 October 2004; and

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- Call Option Deed between Mark Ranicar and Agri Truffle Land Company Pty Limited received on 14 February 2005.

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. In this Ruling the term 'associate' has the meaning given by section 318 of the ITAA 1936.

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.

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

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

Overview

18. The salient features of the Western Tiers Truffiere Project are as follows:

| | |
|---|--|
| Location | Deloraine, Tasmania |
| Type of business to be carried on by each participant | Commercial growing and cultivation of truffle inoculated oak trees for the purpose of harvesting truffles for sale |
| Number of hectares offered for cultivation | 20 hectares |
| Size of each interest | 0.25 hectares |
| Minimum allocation | 1 |
| Number of trees per hectare | 300 |
| Term of the Project | 20 years |
| Initial cost | \$10,728 |

| | |
|---------------|---|
| Ongoing costs | <p>Annual Management Fee payable to the Manager for performing the Management Services during the relevant years.</p> <p>Irrigation Fees instalments payable to the Manager in the second and third year of the Project.</p> <p>The rent to the Lessor.</p> <p>Harvesting charges.</p> <p>Sales and marketing costs.</p> <p>Bonus.</p> <p>Rates and taxes levied attributable to the improvements made to the Land.</p> |
| Other costs | Options to purchase shares in Land Company at a cost of \$250 |

19. The Project land is located on Mole Creek Head Road, Deloraine in Tasmania, comprised in Folios of the Register Volume 36989 Folio 4. The Project is to cultivate a Truffiere on the Project land for a period of twenty years.

20. An offer to participate in the Project will be made through an 'Information Memorandum' and 'Information Memorandum – Addendum'. To participate in the Project participants must complete an 'Application' containing a Power of Attorney Form in the 'Information Memorandum' and pay the 'Application Fees'. Payment of the 'Application Fees' constitutes full payment of the initial fees in the Lease and the Management Agreement.

21. Under the 'Information Memorandum', the Manager proposes to offer up to 80 'Trufflelots' (or 'a truffle lot' as defined in the Lease) of 0.25 hectares and will invite participants to subscribe for at least one 'Trufflelot'. The 'Trufflelots' will be planted with two varieties of oak trees (*Quercus pubescens* and *Quercus ilex*) inoculated with *Tuber melanosporum* to produce black truffles. A minimum of 75 truffle inoculated trees will be planted on each 'Trufflelot'. There is no minimum subscription for this Project.

22. The 'Information Memorandum – Addendum' to the Project provides that applications to participate in the Project will be accepted to 31 May 2005. It is proposed that trees for '2005 Growers' will be planted by 7 June 2005.

23. Growers will enter into a Lease with Agri Truffle Pty Ltd (as Lessor). The Lease will comprise contractual rights in relation to an identifiable area of land called 'a truffle lot'. The Lease will enable Growers to access the land to establish, maintain and harvest 'a truffle lot'. Growers will also contract with Agri Truffle Pty Ltd (as Manager), under a Management Agreement to have truffle inoculated trees planted on their 'Trufflelot' for the purpose of harvesting truffles over the period of the Project.

24. Growers entering the Project will pay an 'Option Fee' of \$250 per 'Trufflelot'. The 'Option Fee' grants the Grower an option to purchase shares in Agri Truffle Land Company Pty Ltd which holds an option from the Land Owner to acquire the 'Property' on which the Project is located. The share option must be exercised between the period commencing 1 December 2007 and ending 1 February 2008. The options have an exercise price of \$2,850 indexed by the greater of 4% or a formula based on a Consumer Price Index ('CPI') contained in the Share Option Agreement. Agri Truffle Land Company Pty Ltd will only exercise its option to purchase the 'Property' where the exercised options are sufficient to hold at least 50% of its shares. This Ruling deals only briefly with shares acquired in Agri Truffle Land Company Pty Ltd but Growers should note the tax implications set out in paragraph 69 of this Ruling.

Head Lease

25. The 'Head Lease' is entered into between Random Nominees Pty Ltd (as Lessor), Agri Truffle Pty Ltd (as Lessee) and Mark Ranicar (as Land Owner). The term of the lease is twenty-four years, a period covering the term of the Project. Under the provisions of the 'Head Lease', 'the Lessee' must use 'the Land' as a trufflelot. 'The Lessor' is to provide 'the Lessee' with access to two megalitres of water per hectare under management for this Project and earlier projects on the property or 120 megalitres of water, whichever is the lesser, in each 'Lease Year' (clause 13).

Lease

26. The Lease sets out the roles and obligations of Agri Truffle Pty Ltd (as Lessor) and the Grower (as Lessee). Under the terms of the Lease the Grower may only use 'the Land' as 'a truffiere'.

27. Growers participating in the Project are granted an interest in 'the Land' (a specific and identifiable area of land within the Project land) by the Lessor in the form of a lease to possess and use 'a truffle lot' for the purpose of cultivating truffle inoculated trees for growing and harvesting truffles for sale (clause 3.1).

28. The Lease commences on the date that it is executed by the Manager. The Project is terminated pursuant to the provisions of the Lease or on the date of completion of 'the lease' of 'the Land' (clauses 2 and 5). Growers are granted an option to renew the Lease (clause 3.4). The new lease will commence at the end of the Lease and continue for a period of one year. The new lease may not be renewed more than five times.

29. Each Grower must pay 'the rent' to the Lessor being an amount set out in clause 6.

30. Under the terms of the Lease, the Grower, among other things:

- must cultivate, manage and maintain 'the Land' in accordance with the best practices of truffle cultivation;
- must pay any 'rates or taxes' levied in respect of 'the Land' to the extent that they are attributable to the improvements made to 'the Land' by the Grower; and
- must allow reasonable access to the Lessor and/or any of its agents at any time for any reasonable purpose (clause 7).

Management Agreement

31. The Management Agreement sets out the roles and obligations of Agri Truffle Pty Ltd (as Manager) and the Grower. Under the Management Agreement, the Grower engages the Manager to establish, manage and maintain the 'Trufflelot'.

32. The Management Agreement commences on the date of commencement of the 'Lease'. The 'Termination Date' of the Management Agreement is determined pursuant to the provisions of the agreement or on the date of termination of the 'Lease' (clauses 6, 25, 30.1 and 31.2).

33. The Management Agreement provides that each Grower appoints the Manager to perform services under the Management Agreement. The Manager will supervise and manage all activities to be carried out on the 'Trufflelot' on behalf of the Grower including 'Establishment Services' and 'Management Services'.

34. 'Establishment Services' must be commenced as soon as practicable after the date of the Management Agreement and the Manager must use its best endeavours to complete the 'Establishment Services' between the date when the Grower enters the Project and 7 June 2005 (clause 4). 'Establishment Services' include the provision of the following services:

- complete all preparatory work necessary for the planting of seedlings on 'the Land' including installation of all irrigation, all ploughing and vermin control; and
- supply and plant healthy seedlings inoculated with *Tubor melanosporum* on 'the Land' (clause 3).

35. The Grower must pay an 'Irrigation Fee' to the Manager in consideration for the installation of the irrigation system on the Grower's 'Trufflelot' in the initial year of the Project. The 'Irrigation Fee' is payable upon acceptance of the 'Application' for each Grower. However, the Manager will accept the 'Irrigation Fee' payable by way of three annual instalments (clauses 20 and 21).

36. 'Management Services' provide the Grower with tending and rearing of the 'Trees' and management and maintenance of the 'Trufflelot' in accordance with proper horticultural and agricultural practices and include, but are not limited to, the provision of the following services:

- replanting any seedlings that the Grower requires to be replaced, that fail to establish or that die due to planting techniques or vermin destruction;
- controlling weeds, suckers, vermin or other pests which may impede the performance of the 'Trees';
- maintaining in good condition and repair all fire breaks, access roads, tracks and fences;
- testing of soils and tree roots to monitor soil elements and infection levels of the 'Tree' roots with the fungi;
- applying fertiliser in such form and in such quantities so as to maintain satisfactory performance of the 'Trees';
- providing written annual reports to Growers on the progress of the 'Trufflelot' no later than 30 May in each year;
- maintaining the irrigation system to ensure the 'Trees' are properly watered and that the irrigation system is working satisfactorily at all times;
- general management and supervision; and
- developing a marketing plan and marketing of the 'Produce' on behalf of the Grower (clause 5).

Fees

37. Under the terms of the Management Agreement and Lease, a Grower will make payments per 'Trufflelot' as described below.

38. The 'Application Fees' are payable by each Grower when the 'Application' is made. However, the Manager may accept Growers and allot 'Trufflelots' where 'Applications' have been received by 31 May 2005 from Growers who are waiting on finance to be finalised (clause 25). Applications accepted on this basis must provide written evidence to the Manager by 31 May 2005 that a loan application has been approved.

39. The 'Application Fees' are made up of 'Annual Management Fees', 'the rent', 'Seedling and Planting Fee', first instalment of the 'Irrigation Fee' and 'Option Fee' as follows:

| | |
|---------------------------|---------|
| Management Fee | \$8,286 |
| The rent | \$80 |
| Seedling and Planting Fee | \$1,565 |
| Irrigation Fee | \$797 |
| Option Fee | \$250 |

40. Ongoing 'Annual Management Fees' are payable to the Manager for performing the 'Management Services' during the relevant year (clause 23). The 'Annual Management Fees' are:

| Year | |
|------|---------|
| 2006 | \$4,637 |
| 2007 | \$2,063 |
| 2008 | Indexed |

From the 'Financial Year' ending 30 June 2008 the 'Annual Management Fee' shall be the amount due and payable in the preceding year indexed by the greater of 2.75% or a formula based on a 'CPI' contained in the Management Agreement (clause 24).

41. Following the first year, 'the rent' is payable as follows:

| Year | |
|------|---------|
| 2006 | \$495 |
| 2007 | \$509 |
| 2008 | Indexed |

From the 'Financial Year' ending 30 June 2008 'the rent' shall be the amount due and payable in the preceding year indexed by the greater of 2.75% or a formula based on a 'CPI' contained in the Lease (clauses 6.2 and 6.3)

42. 'Irrigation Fee' instalments of \$797 each are to be paid to the Manager in the second and third years of the Project (clause 21).

43. A bonus equal to 25% of the excess of the operating cashflow over the forecast cashflow as provided by Lonsec Research is payable to the Manager. The Manager must appoint an independent auditor to calculate the bonus (clause 14).

44. Where the Grower is a 'Non-Electing Grower', the Manager is entitled to sales and marketing costs at cost plus a margin of 20% unless the total costs exceed 10% of the 'Gross Proceeds of Sale', in which case, the sales and marketing services are provided at cost (clause 10).

45. The Grower must pay 'rates and taxes' levied in respect of 'the Land' to the extent that they are attributable to the improvements made to 'the Land' by the Grower (clause 7.2).

46. Where the Grower is a 'Non-Electing Grower', harvesting charges will be based upon a commercially established rate after benchmarking where possible against French charges as well as charges on similar projects in New Zealand and Australia. These costs will be reviewed by a Growers' representative as nominated by the Manager (clause 7.4).

Harvesting and sale

47. The Grower has full right, title and interest in the truffles (the 'Produce') that are produced by the Grower on the 'Trufflelot' (clause 11). For 'Non-Electing Growers' the Manager must arrange for the harvest of the 'Produce' (clause 7) and the marketing and sale of the truffles (clause 10).

48. Growers may elect on or before 30 June 2006 to be an 'Electing Grower' and to collect their 'Grower's Produce' by giving written notice to the Manager (clause 8.1). This Ruling does not apply to Growers who make such an election.

49. The Manager will ensure that 'Produce' harvested from land leased by '2005 Growers' who are 'Non-Electing Growers' will be stored and pooled separately to produce harvested from land leased by other growers in earlier projects (clause 7.3).

50. The Manager will harvest, process and sell the 'Produce' on behalf of 'Non-Electing Growers' for the maximum practicable price (clause 9.1).

51. Upon sale of the 'Produce', 'Non-Electing Growers' will receive the balance of the 'Gross Proceeds of Sale'. This amount is determined by the 'Growers Proportional Interest' in the proceeds of 'Produce' harvested from the land leased by '2005 Growers' who are 'Non-Electing Growers' less any unpaid 'Rent', unpaid 'Annual Management Fees', unpaid 'Irrigation Fees', sales and marketing costs and any bonus (clause 12).

Finance

52. Growers can fund their involvement in the Project themselves or borrow from an independent lender.

53. Growers cannot rely on this Product Ruling if 'Application Fees' remain unpaid by 31 May 2005. However, where an application is accepted subject to finance approval by any lending institution, Growers cannot rely on this Ruling if written evidence of that approval has not been given to Agri Truffle Pty Ltd by 31 May 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 on or before 31 May 2005 and who have executed a Management Agreement and Lease on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

56. 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

57. 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

58. 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**

59. That part of the 'Gross Proceeds of Sale' from the Project attributable to the Grower's 'Produce', less any GST payable on those proceeds (section 17-5 of the ITAA 1997), will be assessable income of the Grower under section 6-5 of the ITAA 1997.

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

61. A 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) of the ITAA 1997).

Deductions for Annual Management Fees and Lease Fees (rent)**Section 8-1 and section 328-105**

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

63. However, if for any reason, an amount shown or referred to in the Tables 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 |
|--------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Annual Management Fee | \$8,286 See Notes (i) & (ii) | \$4,637 See Notes (i) & (ii) | \$2,063 See Notes (i) & (ii) |
| Lease Fee (‘the rent’) | \$80 See Notes (i) & (ii) | \$495 See Notes (i) & (ii) | \$509 See Notes (i) & (ii) |

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 of the ITAA 1997. See Example 1 at paragraph 104 of this Ruling.
- (ii) The 'Annual Management Fees' and 'the rent' shown in the Management Agreement and the Lease are deductible in full in the year that they are incurred (where the Grower is not an '**STS taxpayer**') or the year in which it is paid (where the Grower is an '**STS taxpayer**'). This Ruling does not apply to Growers who choose to prepay 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 and 82KZMF of the ITAA 1936 (see paragraphs 90 to 93 of this Ruling). Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.

Deductions for capital expenditure (Non-'STS taxpayers')***Division 40***

64. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (for example irrigation system) and establishment of horticultural plant (for example truffle inoculated oak trees). All deductions shown in the following Table are determined under Division 40 of the ITAA 1997.

| Fee Type | ITAA 1997 Section | Year ended 30 June 2005 | Year ended 30 June 2006 | Year ended 30 June 2007 |
|---|--------------------------|--------------------------------|--------------------------------|--------------------------------|
| Water facility (irrigation system) | 40-515 | \$797 See Notes (i) & (iii) | \$797 See Notes (i) & (iii) | \$797 See Notes (i) & (iii) |
| Establishment of horticultural plant (trees) | 40-515 | Nil See Note (iv) | Nil See Note (iv) | Nil See Note (iv) |

Notes:

- (iii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one-third of the capital expenditure incurred by each Grower on the installation of the 'water

facility' in the year in which it is incurred and one-third in each of the next 2 years of income (section 40-540).

- (iv) Truffle inoculated oak trees are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the trees is determined using the formula in section 40-545 and is based on the capital expenditure of \$1,565 incurred by the Grower that is attributable to their establishment. If the trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the truffle inoculated oak trees enter their first commercial season (section 40-530, item 2). The Project Manager will inform Growers of when the trees enter their first commercial season.

Deductions for capital expenditure ('STS taxpayers')

Subdivision 328-D and Subdivisions 40-F and 40-G

65. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (for example irrigation system) and establishment of horticultural plant (for example truffle inoculated oak trees). An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F of the ITAA 1997. If the 'water facility' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328 of the ITAA 1997. Deductions for the trees must be determined under Subdivision 40-F.

66. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities under Subdivision 40-F and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Note (v).

67. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1,000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is the case provided that the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

| Fee Type | ITAA 1997 Section | Year ended 30 June 2005 | Year ended 30 June 2006 | Year ended 30 June 2007 |
|---|-------------------|-------------------------------|------------------------------|------------------------------|
| Water facility (irrigation system) | 40-515 | \$797 See Notes (i) & (v) | \$797 See Notes (i) & (v) | \$797 See Notes (i) & (v) |
| Establishment of horticultural plant (Seedling and Planting Fee) | 40-515 | Nil See Notes (i) and (iv) | Nil See Note (iv) | Nil See Note (iv) |

Notes:

- (v) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1,000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is the case provided that the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2005 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under paragraph 40-515(1)(a). This deduction is equal to one-third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one-third in each of the next 2 years of income (section 40-540).

Interest

68. 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 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. Growers may request a private ruling on the tax consequences of financing their participation in this Project through a loan facility.

Shares in Agri Truffle Land Company Pty Ltd***Capital Gains Tax – Part 3-1***

69. Shares in Agri Truffle Land Company Pty Ltd acquired by Growers through the exercise of the share option are CGT assets (section 108-5 of the ITAA 1997) and the 'Option Fee' payable for the share option or the 'Purchase Price' constitute an outgoing of capital and are not allowable deductions. Any disposal of CGT assets will be a CGT event and may give rise to a capital gain or loss.

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

70. A Grower who is an individual accepted into the Project by 31 May 2005 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10 of the ITAA 1997. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) of the ITAA 1997 for these Growers for the income years ending **30 June 2005 to 30 June 2011**. 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, 82KZMF and 82KL and Part IVA

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

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

- 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?

72. For the amounts set out in the Tables above to constitute allowable deductions the Grower's truffle cultivation activities as a participant in the Western Tiers Truffiere Project must amount to the carrying on of a business of primary production.

73. Where there is a business, or a future business, the gross proceeds from the sale of the 'Produce' 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.

74. For schemes such as the Western Tiers Truffiere Project, 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.

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

- the Grower has an identifiable interest in land (by lease) or rights over the land (by licence) on which the Grower's truffle inoculated oak trees are established;
- the Grower has a right to harvest and sell the 'Produce' from those trees;
- the truffle cultivation activities are carried out on the Grower's behalf;
- the truffle cultivation activities of the Grower are typical of those associated with a truffle cultivation business; and
- the weight and influence of general indicators point to the carrying on of a business.

76. In this Project, each Grower enters into a Management Agreement and a Lease.

77. Under the Lease each individual Grower will have rights over a specific and identifiable area of 0.25 hectares of land. The Lease provides the Grower with an ongoing interest in the specific trees on 'the Land' for the term of the Project. Under the Lease the Grower must use the land in question for the purpose of carrying out truffle cultivation and for no other purpose. The Lease allows the Manager to come onto to the land to carry out its obligations under the Management Agreement.

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

79. The Manager is also engaged to harvest and sell, where the Grower is a 'Non-Electing Grower', on the Grower's behalf, the 'Produce' grown on the Grower's 'Trufflelot'.

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 the 'Produce' 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 'Produce' from truffle inoculated oak trees grown on the Grower's 'Trufflelot' with the truffles of other Growers is consistent with general truffle cultivation practices. Each Grower's proportionate share of the sale proceeds of the pooled 'Produce' will reflect the proportion of the truffle inoculated oak trees contributed from their 'Trufflelot'.

83. The Manager's services are also consistent with general truffle cultivation practices. They are of the type ordinarily found in truffiere ventures that would commonly be said to be businesses. While the size of a 'Trufflelot' 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 Manager as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's 'Trufflelot' and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

85. The truffle cultivation 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' truffle cultivation activities in the Western Tiers Truffiere Project 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 Annual Management Fees and lease fees (rent)

Section 8-1

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

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

89. The 'Annual Management Fee' and 'the rent' associated with the truffle cultivation activities will relate to the gaining of income from the Grower's business of truffle cultivation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of 'Produce') is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the 'Annual Management Fee'. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

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 'Annual Management Fees' and 'the rent' 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 chooses to prepay all or some of the expenditure payable under the Management Agreement and/or the Lease or chooses or is required to prepay 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 water facilities and the establishment of horticultural plant 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 a representative way in paragraphs 64 to 67 in the Table(s) and accompanying notes.

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 2011** 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 2011:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35; and
- there is an objective expectation that within a period that is commercially viable for the truffle cultivation industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

98. Therefore, 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.

99. 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

100. 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

101. 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).

102. The Western Tiers Truffiere Project will be a ‘scheme’. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 37 to 46 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.

103. 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 the ‘Produce’. 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

104. 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).

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Commissioner of Taxation

16 March 2005

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| <i>Previous draft:</i> | - ITAA 1936 82KZMC |
| Not previously issued as a draft | - ITAA 1936 82KZMD |
| | - ITAA 1936 82KZME |
| <i>Related Rulings/Determinations:</i> | - ITAA 1936 82KZMF |
| PR 1999/95; TR 92/1; TR 92/20; | - ITAA 1936 Pt IVA |
| TR 97/11; TR 97/16; TR 98/22; | - ITAA 1936 177A |
| TR 2000/8; TR 2001/14; TD 93/34 | - ITAA 1936 177C |
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| <i>Subject references:</i> | - ITAA 1936 318 |
| - carrying on a business | - ITAA 1997 6-5 |
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| - fee expenses | - ITAA 1997 17-5 |
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