PR 2006/27 - Income tax: 2006 Grain Co-Production Project

Product Ruling

Income tax: 2006 Grain Co-Production Project

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This Ruling provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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 scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document.

If the scheme 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 scheme 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 scheme has been implemented as described below and to ensure that the participants in the scheme 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 entity(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 Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'taxation provision(s)' identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Ruling this scheme is referred to as the '2006 Grain Co-Production Project' or simply as 'the Project'.

Relevant taxation provision(s)

2. The relevant tax provisions 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;
- section 25-5 of the ITAA 1997;
- Division 27 of the ITAA 1997;
- Division 35 of the ITAA 1997;
- Subdivision 61-J of the ITAA 1997;
- Division 328 of the ITAA 1997;
- Division 328 of the *Income Tax (Transitional Provisions) Act 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.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

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 entities

7. The class of entities to whom this Ruling applies is the entities more specifically identified in the Ruling part of this Product Ruling and who enter into the scheme specified below on or after the date this Ruling is made. They will have a purpose of staying in the scheme 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 scheme. In this Ruling, these entities are referred to as 'Growers'.

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

- entities who intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- entities who participate in the Project through offers made other than through the Product Disclosure Statement;
- entities who finance their participation in the Project through loans with entities associated with the Responsible Entity other than those described at paragraphs 74 to 75; and
- entities who are accepted to participate in the Project after 31 May 2006.

Qualifications

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 15 to 78.

10. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

Date of effect

12. This Ruling applies prospectively from 29 March 2006, 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).

13. 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 scheme 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

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2008. 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 scheme specified below. Thus, the Ruling continues to apply to those entities, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entities' involvement in the scheme.

Scheme

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

- Application for a Product Ruling as constituted by documents received on 15 November 2005, 14 December 2005, 17 January 2006, 25 January 2006, 10 February 2006, 13 February 2006, 14 February 2006 16 February 2006, 24 February 2006, 8 March 2006, 13 March 2006 and additional correspondence received, 17 January 2006, 23 January 2006, 3 February 2006, 6 February 2006, 10 February 2006, 13 February 2006, 21 February 2006, 8 March 2006, 10 March 2006 and 14 March 2006;
- Draft Product Disclosure Statement for the 2006 Grain Co-Production Project, received 14 March 2006;
- Draft Constitution of the 2006 Grain Co-Production Project, received 14 March 2006;
- Draft Compliance Plan for the 2006 Grain Co-Production Project, received 14 February 2006;
- Draft **Grower Sub-Lease Agreement** between Macro Funds Ltd (as 'Responsible Entity') and the Grower, received 13 March 2006;
- Draft **Grower Management Agreement** between Macro Funds Ltd (as 'Responsible Entity') and the Grower, received 14 March 2006;
- Draft Farmer Management Agreement between Australian Agricultural Contracts Ltd ('AACL') and the Farmer received 13 February 2006;
- Draft Service Agreement between Macro Funds Ltd and AACL, received 13 February 2006;
- Draft Farm Lease Agreement between the Farm Lessor and AACL, received 16 November 2005;
- Draft Head Lease Agreement between Macro Funds Ltd and AACL, received 13 February 2006;
- Expert Agronomist Report, dated 9 December 2005;
- Expert Price Risk Management Report, dated 10 January 2006; and
- **Finance Application and Terms of Loan** between Financier 1 and Financier 2 and each Grower received 24 January 2006 and 13 February 2006.

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

16. The documents highlighted are those that Growers may enter into. For the purposes of describing the scheme 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 scheme. The effect of these agreements is summarised below.

17. 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

18. The salient features of The 2006 Grain Co-Production Project are as follows:

Location	The Wheatbelt, Western Australia
Type of business to be carried on by each participant	Wheat Farming
Number of hectares offered for cultivation	Up to 50,000 hectares
Size of each Co-Production Unit	Between 12 and 34 hectares (depending on productivity)
Minimum interest	4 Co-Production Units
Term of the Project	Approximately 52 months
Initial cost per Co-Production Unit (2006 Season)	$4,609
Initial cost per Interest (4 Co-Production Units -2006 Season)	$18,436
Ongoing costs	• Initial Period Fees; • Rent; • Subsequent Period Fee; • Harvest Period Costs; • Project Pool Finalisation Fee; • Management Production Bonus; • Rent Bonus; • Project Pool Performance Bonus; • Management Price Bonus; • Crop insurance; and • Multi peril insurance (subject to availability and market conditions).

19. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. Macro Funds Ltd ('Macro') has been issued with an Australian Financial Service Licence and will be the Responsible Entity for the Project.

20. An offer to participate in the Project will be made through a Product Disclosure Statement ('PDS'). The offer under the PDS is for up to 50,000 hectares. There is no minimum subscription.

21. Growers must apply for a minimum of 4 Co-Production Units ('CPU'). Applicants may increase the size of their interest in the Project by increments of 1 CPU. Each CPU is a parcel of land which is expected to yield 40 Tonnes of Australian Premium White wheat per season. The size of a CPU will range from 12 to 34 hectares based on productivity of between 1.2 and 3.5 tonnes of wheat per hectare. However, the actual size could be higher or lower depending on the expected yield.

22. Upon application, Growers will execute a Power of Attorney enabling Macro to act on their behalf as required.

23. The land on which the Project will be conducted is situated on various wheat properties spread across the Western Australian Wheat belt. Australian Agricultural Contracts Ltd ('AACL') will enter into Farm Lease Agreements with various Farm Lessors for the provision of land for the purpose of growing wheat. Under a Head Lease Agreement, AACL will then lease the land to Macro who in turn will sub-lease the land to Growers in the form of allocated CPUs.

24. The Grower will enter into a Grower Management Agreement with Macro to plant, manage, harvest, transport, market and sell the wheat grown on the Grower's CPUs. Under a Service Agreement Macro will appoint AACL to manage the CPUs. AACL in turn will enter into a Farmer Management Agreement with the Contract Farmers to perform the wheat farming services required under the Grower Management Agreement on behalf of the Growers.

Constitution

25. The Constitution establishes the Project and operates as a deed binding on all of the Project's Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Macro agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 16 of the Constitution, the Responsible Entity will keep a register of Growers.

26. Under the terms of the Constitution, all moneys received from applications shall be paid to the Responsible Entity, who will deposit those moneys in the Project Fund. The application monies will be released by the Responsible Entity when it is reasonably satisfied that criteria in the Constitution have been met (clause 11).

Compliance Plan

27. As required by the Corporations Act, a Compliance Plan has been adopted by Macro for the Project. The purpose of the Compliance Plan is to ensure that Macro manages the Project in accordance with the obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Head Lease Agreement

28. Macro will enter into a Head Lease Agreement with AACL each Season to lease the land for the Project. The Term of the Head Lease Agreement is from the Commencement Date (on or before 31 May 2006) until Harvest but no later than 10 months from the Commencement Date. The Head Lease Agreement is conditional on execution of the Service Agreement (see paragraph 24).

Sub-Lease Agreement

29. Each year the Grower will enter into a Grower Sub-Lease Agreement with Macro for the sub-lease of the CPUs. The Grower Sub-Lease Agreement is conditional on the Grower executing a Grower Management Agreement with Macro.

30. The Term of each Grower Sub-Lease Agreement reflects the wheat growing season, being the period each year in which the crop is planted, grown and harvested. In the first Season, the Term is from the Commencement Date (on or before 31 May 2006) to the day after the wheat has been harvested from the CPUs. The Commencement Date for the Sub-Lease Agreements in the two subsequent Seasons will be prior to planting but before 31 May of the relevant year and the agreements will terminate at Harvest.

Grower Management Agreement

31. Under the Grower Management Agreement, Macro agrees to manage the production of wheat on the Grower's CPUs. The Grower Management Agreement is conditional on the Grower entering into a Grower Sub-Lease Agreement for the use of the CPUs to plant and farm wheat.

32. The Term of the Grower Management Agreement shall be approximately 52 months from the Commencement Date (on or before 31 May 2006). The Term may vary depending on the date on which all funds in each Season are distributed to Growers from the Project Fund.

33. Each year the Grower pays an Initial Period Fee in consideration for the Responsible Entity performing the following services during the Initial Period:

- supply, propagate and husband the Seed for the CPU;
- carry out the planting and sowing of the Seed;
- supply and maintain a pest and weed control programme including spraying;
- supply and spread fertiliser on the CPU;
- provide general care and maintenance as required;
- maintain firebreaks;
- conduct regular checks on the progress of the Crop on each of the CPUs; and
- conduct all other duties as are reasonably required and considered good farming practice for a Project of this type.

34. For the 2006 Season the Initial Period is from the Commencement Date to 30 June 2006. In the two subsequent Seasons, the Initial Period is from the date the new crop planting is commenced, being no later than 15 June each year, until the end of each respective financial year.

35. If the weather conditions are such that there is no good reason for the Wheat to be planted on the land, and the Responsible Entity is unable to find any other suitable land by 15 June each year, the Responsible Entity must repay the Initial Period Fee on or before 30 June of that financial year.

36. In the Subsequent Period, from 1 July to the date on which the Crop is harvested each Season, the Responsible Entity will perform the following services for the Grower:

- maintain suitable access to each of the individual CPUs;
- maintain firebreaks;
- maintain a pest and weed control programme including spraying as required;
- supply and spread fertiliser on the CPU as required;
- provide general care and maintenance as required;
- conduct regular checks on the progress of the Crop on each of the CPUs;
- arrange compulsory crop insurance for the Grower;
- arrange compulsory multi-peril insurance (if available) for the Grower;

- conduct all other duties as are reasonably required and considered good farming practice for a Project of this type;
- harvest the Crop from the CPU by such means as the Manager in its absolute discretion shall deem reasonably necessary;
- transport, store, stock or handle the Crop in such manner so as to ensure the Crop is preserved and protected until such time as it can be sold;
- undertake by marketing or other means the sale of the Crop as soon as practically possible after its harvest; and
- account to the Grower for profits generated from the sale of the Crop.

37. The Grower is entitled to terminate the Grower Management Agreement should the Responsible Entity breach any term of the Agreement or become insolvent.

Pooling and Sale of the Crop

38. The Crop harvested from a Grower's CPU is referred to as 'Gross Farm Produce'. The 'Gross Pool Produce' is all the Gross Farm Produce derived from all the CPUs in the Project and pooled in the Project Pool, prior to the deduction of the Management Production Bonus and Rent Bonus.

39. After the Management Production Bonus and Rent Bonus are deducted from the Gross Pool Produce, the balance of the Crop in the Project Pool is called the 'Net Pool Produce'.

40. The Responsible Entity will market and sell the Net Pool Produce and the Grower will be entitled to a distribution of the sale proceeds pro rata to the number of CPUs held by the Grower in the Project Pool.

41. Where part of a Grower's CPU is destroyed or damaged during the Term, the Grower will be entitled to receive a distribution in relation to the CPU where Gross Farm Produce, including any insurance proceeds, from the CPU has been contributed to the Project Pool. If the Grower's entire Crop on a CPU is destroyed, the Grower will not be entitled to a distribution of sale proceeds in relation to that CPU.

Distribution of proceeds

42. The Responsible Entity will hold the proceeds from the sale of the Net Pool Produce in the Project Fund. Each Grower will have an interest in the Project Fund in proportion to the number of CPUs held by the Grower compared to the total number of CPUs held by all Growers in the Project Pool each Season.

43. The Responsible Entity is entitled to deduct certain fees and outgoings from the sale proceeds of the Net Pool Produce (clause 8.2). The Responsible Entity will provide a statement to the Grower for each financial year showing the Grower's proportional entitlement in the Project Fund and the Initial Period Costs or Initial Period Fees paid by the Grower for the year.

44. The Responsible Entity, at its discretion, will distribute the balance from each Season's Project Pool, after any authorised deductions, from the Project Fund.

Fees

45. In consideration for the services to be performed under the Grower Management Agreement, the following fees are payable by the Grower each season:

- Initial Period Fee;
- Subsequent Period Fee;
- Harvest Period Costs;
- Management Production Bonus;
- Project Pool Performance Bonus;
- Management Price Bonus; and
- Crop Insurance and Multi Peril Insurance (if available).

46. Under the Grower Management Agreement the Project Pool Finalisation Fee is payable at the finalisation of the Project.

47. Under the Grower Sub-Lease Agreement, the following fees are payable by the Grower:

- Initial Period Rent;
- Subsequent Period Rent; and
- Rent Bonus.

Initial Period Fee

48. For the 2006 Season, the Initial Period Fee is $4,554 per CPU. The Initial Period Fee is paid for services from the Commencement Date to 30 June 2006. For the minimum interest of 4 CPUs, the total of the Initial Period Fees payable on application is $18,216.

49. For each of the 2007 and 2008 Seasons the Initial Period Fee is $3,850 per CPU (indexed for CPI). The Responsible Entity may recover the Initial Period Fees from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient, the Grower must pay the shortfall to the Responsible Entity by 31 March 2007 and 31 March 2008, respectively.

Subsequent Period Fee

50. The Subsequent Period Fee of $445.50 per CPU (indexed for CPI) is payable in each year of the Project for services performed by the Responsible Entity in the Subsequent Period. The Subsequent Period Fee is payable prior to 30 June of the year immediately following Harvest from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall.

Harvest Period Costs

51. In each Season, the Responsible Entity is entitled to charge the Grower the costs and disbursements incurred relating to transportation, marketing and sale of the Crop. Harvest Period Costs are payable prior to 30 June of the year immediately following Harvest from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall.

Management Production Bonus

52. In consideration for the performance by the Responsible Entity of Initial Period Services and Subsequent Period Services the Responsible Entity is entitled to be paid a Management Production Bonus where the Grower's CPU achieves a Harvest Surplus. A Harvest Surplus will arise where the value of the Crop harvested from the Grower's CPU is greater than the Target Value of $6,688.

53. The Management Production Bonus is based on 50% of the Harvest Surplus and is payable in each Season of the Project. The calculation of the Management Production Bonus is set out in Item 14 of the Schedule to the Grower Management Agreement.

54. In calculating the Management Production Bonus the Responsible Entity must determine the Deemed Delivery Price. If the Responsible Entity determines that the method for calculating the Deemed Delivery Price as set out in Item 11 of the Schedule to the Grower Management Agreement does not provide an appropriate benchmark for the prices of Wheat the Responsible Entity must select another method which it considers is an appropriate benchmark.

55. The Management Production Bonus is deducted from the Gross Pool Produce and is paid in the form of Wheat.

Project Pool Performance Bonus

56. In consideration of the Responsible Entity marketing the Crop the Responsible Entity is entitled to be paid a Project Pool Performance Bonus based on 25% of the Final Project Pool Surplus. A Final Project Pool Surplus will arise where the Final Project Pool Value exceeds the sum of the Expected Net Pool Proceeds and the Project Pool Management Price Bonus.

57. The calculation of the Project Pool Performance Bonus is set out in Item 19 to the Schedule of the Grower Management Agreement.

58. The Project Pool Performance Bonus is payable in each Season of the Project and is paid from the Project Fund on the Determination Date. The Determination Date means the earliest of:

(a) the date that all proceeds from the sale of the Net Pool Produce have been received as determined by the Responsible Entity; or

(b) in respect of each season the following dates:

- Season 2006 – 31 May 2008
- Season 2007 – 31 May 2009
- Season 2008 – 31 May 2010.

Management Price Bonus

59. In consideration of the Responsible Entity harvesting and selling the Crop the Responsible Entity is entitled to be paid a Management Price Bonus where the Grower's CPU achieves Target Value, and where the Deemed Average Final Price at the Determination Date exceeds the AWB No 1 Pool Nominated Estimated Pool Return.

60. The calculation of the Project Pool Management Price Bonus is set out in Item 18 of the Schedule to the Grower Management Agreement.

61. In calculating the Management Price Bonus the Responsible Entity must determine the Deemed Final Price. If the Responsible Entity determines that the method for calculating the Deemed Final Price as set out in Item 17 of the Schedule to the Grower Management Agreement does not provide an appropriate benchmark for the prices of Wheat the Responsible Entity must select another method which it considers is an appropriate benchmark.

62. The Management Price Bonus is payable in each year of the Project and is paid from the proceeds in the Project Fund on the Determination Date.

Project Pool Finalisation Fee

63. The Responsible Entity is entitled to be paid the Project Pool Finalisation Fee of $385 per CPU at the Project Pool Finalisation Date. The Project Pool Finalisation date is the date all Project Pool Proceeds for each Season have been received and all Project Outgoings, with the exclusion of the Management Price Bonus and the Project Pool Performance Bonus have been paid.

64. The Project Pool Finalisation Fee is paid from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall.

Crop Insurance and Multi Peril Insurance

65. The Responsible Entity will arrange compulsory crop insurance and multi peril Insurance (subject to availability and market conditions) for each CPU. Crop insurance will cover the Grower against risks such as fire and hail. Multi peril insurance, if arranged, will provide cover for all perils outside of those covered by the crop insurance policy for all CPUs in the project up to a value of approximately 90% of each CPU's Initial Period Fees each Season.

66. The cost of the crop insurance and multi peril insurance will be at the expense of the Grower and will be payable prior to 30 June of the year immediately following Harvest from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall. The cost of the crop insurance and multi peril insurance is estimated to be approximately $1.65 each per tonne.

Rent

67. The Grower will pay the Responsible Entity rent of $247.50 for the 2006 Season of the Project consisting of:

- $55 payable on application, for the Initial Period from Commencement date to 30 June 2006; and
- $192.50 for the Subsequent Period, from 1 July 2006 until the completion of Harvest. The Subsequent Period Rent is payable prior to 30 June 2007 from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall.

68. For the 2007 and 2008 Seasons the amount of $247.50 will be increased by CPI and will be payable prior to 30 June of the year immediately following Harvest from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall.

Rent Bonus

69. In consideration of the performance by the Responsible Entity in the selection of the land, the Responsible Entity will be entitled to a Rent Bonus. The Rent Bonus will be calculated as 40% of the Harvest Surplus and will be deducted from the Gross Pool Produce of the Project Pool and paid in the form of wheat.

70. The payment of any Rent Bonus is subject to the Grower's CPU achieving the Target Value of $6,688. The calculation of the Management Production Bonus is set out in Item 12 of the Schedule to the Grower Sub-Lease Agreement.

Service Agreement

71. Macro will enter into a Service Agreement with AACL engaging AACL as Project Manager to provide the services necessary to plant, manage and harvest the Crop on the land described in the Head Lease Agreement. In the Initial Period of each season AACL must plant, spray and fertilise the Crop. In the Subsequent Period AACL must spray and fertilise (as required), harvest, transport and market the Crop.

72. The Service Agreement is conditional on execution of a Head Lease Agreement.

Finance

73. Growers can fund their involvement in the Project themselves, borrow from Financier 1 or Financier 2 (Preferred Financiers), or borrow from an independent lender.

74. Finance will be provided by Financier 1 on a full recourse commercial basis under the following finance arrangements:

- payment of the Initial Period Costs, including GST, by 10 months interest only plus 31 months principal and interest instalments payable monthly in arrears;
- an Application Fee of $250 plus 0.5% of the loan amount is payable on application. This fee may be added to the loan;
- the interest rate payable for the loan is 10.50% per annum, based on current interest rates (this is an indicative term only). Interest will accrue on the unpaid balance of the loan on the date each scheduled payment is due and is charged monthly in arrears;
- the maximum amount of finance that can be received by a Grower is $250,000; and
- all loans are secured by a registered charge over the Grower's interest in the Project. Normal debt recovery procedures, including legal action will be taken in the case of defaulting borrowers.

75. Finance will be provided by Financier 2 on a full recourse commercial basis under the following finance arrangement:

- payment of the Initial Period Costs, including GST, 10 months interest only plus 31 months principal and interest instalments payable monthly in arrears;
- an Establishment Fee of $250 plus 0.10% of the amount financed is payable on application. This fee may be added to the loan amount;
- stamp duty at the rate of 0.40% is payable on the loan amount and establishment fee;

- the interest rate payable for the loan is fixed at 10.75% per annum, based on current interest rates. Interest will accrue on the unpaid balance of the loan on the date each scheduled payment is due and is charged monthly in arrears; and
- all loans are secured by a registered charge over the Grower's interest in the Project. Normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers.

76. This Ruling will not apply to Growers if the Responsible Entity accepts their application subject to finance approval by the Preferred Financiers or any other lending institution and the full amount payable at the time of Application is not paid to the Responsible Entity by 30 June 2006. 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 the Responsible Entity by 30 June 2006.

77. Growers cannot rely on this Ruling if they enter into a finance arrangement with the Preferred Financiers that differs in terms from those outlined at paragraphs 74 to 75.

78. 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 of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than the Preferred Financiers are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

79. This Ruling applies only to Growers who:

- are accepted to participate in the Project on or before 31 May 2006;
- have executed a Grower Management Agreement and a Grower Sub-Lease Agreement on or before that date;
- finance their participation in the Project through loans with entities associated with the Responsible Entity other than those described at paragraphs 74 to 75; and
- have paid the application fee.

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

81. 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

82. To be an 'STS' taxpayer a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer' (Division 328). For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different under the STS where a Grower who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

83. For such Growers, a reference in this Ruling to an amount being deductible when 'incurred' will mean that amount is deductible when paid and a reference to an amount being included in assessable income when 'derived' will mean that amount is included in assessable income when received.

25% entrepreneurs tax offset

Subdivision 61-J

84. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides a 25% tax offset of income tax liability related to the business income of a business in the STS with annual group turnover of less than $75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

Assessable income

Section 6-5

85. 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.

86. The Grower recognises ordinary income from carrying on the business of wheat farming at the time that income is derived.

Deductions for Initial Period Fee, Subsequent Period Fee, Harvest Period Costs, Management Production Bonus, Project Pool Performance Bonus, Management Price Bonus, Crop and Multi Peril Insurance, Rent, Rent Bonus, Interest and Borrowings.

Sections 8-1 and 25-25

87. A Grower may claim tax deductions under section 8-1 or section 25-25, for the revenue expenses in the Table below, on a CPU basis.

Fee Type	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
Initial Period Fee	$4,554 See Notes (i) and (ii)	$3,850 (plus CPI) See Notes (i) and (ii)	$3,850 (plus CPI) See Notes (i) and (ii)
Subsequent Period Fee		$445.50 See Notes (i) and (ii)	$445.50 (plus CPI) See Notes (i) and (ii)
Harvest Period Costs		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Management Production Bonus		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Project Pool Performance Bonus		As incurred See Notes (i), (ii) and (iii)	As incurred See Notes (i), (ii) and (iii)
Management Price Bonus		As incurred See Notes (i), (ii) and (iii)	As incurred See Notes (i), (ii) and (iii)

Crop & Multi Peril Insurance		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Rent	$55 See Notes (i) and (ii)	$192.50 See Notes (i) and (ii)	$247.50 (plus CPI) See Notes (i) and (ii)
Rent Bonus		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Interest on loans with Preferred Financiers	As incurred See Note (iv)	As incurred See Note (iv)	As incurred See Note (iv)
Borrowing Expenses for loans with Preferred Financiers	Must be calculated See Note (v)	Must be calculated See Note (v)	Must be calculated See Note (v)

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.

(ii) The Initial Period Fee, Subsequent Period Fee, Harvest Period Costs, Management Production Bonus, Project Pool Performance Bonus, Management Price Bonus, Project Pool Finalisation Fee, Crop and Multi Peril Insurance, Rent and Rent Bonus shown in the Grower Management Agreement and the Grower Sub-Lease Agreement, are deductible in full in the year they are incurred.

(iii) The Responsible Entity will inform the Grower each Season of the amount of any Management Price Bonus and Project Pool Performance Bonus and in which financial year the amounts are paid and therefore incurred.

(iv) Interest paid under a loan agreement with the Preferred Financiers (as described in paragraphs 74 to 75) is deductible in the year in which it is incurred. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than the Preferred Financiers is outside the scope of this Ruling. Growers who borrow from lenders other than the Preferred Financiers may request a private ruling on the deductibility of the interest incurred. All Growers who finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 111 to 114 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.

(v) The Loan Application Fee and Stamp Duty are borrowing costs and are deductible under section 25-5. They are incurred for borrowing funds that are used or are to be used during the income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than the Preferred Financiers is outside the scope of this Ruling.

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

Section 35-55 – exercise of Commissioner's discretion

88. A Grower who is an individual accepted into the Project by 31 May 2006 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 year ending **30 June 2006**. 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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME and 82KZMF;
- section 82KL does not apply to deny the deductions otherwise allowable; and

the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Commissioner of Taxation
29 March 2006

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Is the Grower carrying on a business?

90. For the amounts set out in the Table at paragraph 87 to constitute allowable deductions the Grower's wheat growing activities as a participant in the 2006 Grain Co-Production Project must amount to the carrying on of a business of primary production.

91. Where there is a business, or a future business, the gross proceeds from the sale of the Crop 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.

92. For schemes such as that of the 2006 Grain Co-Production 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.

93. Generally, a Grower will be carrying on a business of wheat growing, and hence primary production, if:

- the Grower has an identifiable interest (by sub-lease) in the land on which the Grower's Crop is planted, grown and harvested;
- the Grower has a right to harvest and sell the Crop;
- the wheat farming activities are carried out on the Grower's behalf;
- the wheat farming activities of the Grower are typical of those associated with a wheat farming business; and
- the weight and influence of general indicators point to the carrying on of a business.

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

95. Under the Grower Sub-Lease Agreement each individual Grower will have rights over a specific and identifiable area of land known as a CPU. The Grower Sub-Lease Agreement provides the Grower with an interest in the Crop growing on the leased CPU for the term of the Grower Sub-Lease Agreement. Under the Grower Sub-Lease the Grower must use the land in question for the purpose of carrying out wheat farming activities, and for no other purpose. The Grower Sub-Lease allows the Responsible Entity to come on to the land to carry out its obligations under the Grower Management Agreement.

96. Under the Grower Management Agreement the Responsible Entity is engaged by the Grower for the purpose of managing and producing wheat on the Grower's CPUs 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 on the Grower's behalf.

97. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the Crop grown on the Grower's CPUs.

98. 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.

99. 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 Crop 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.

100. The pooling of Crop grown on the Grower's CPUs with the Crop of other Growers is consistent with general wheat farming practices. Each Grower's proportionate share of the sale proceeds of the pooled Crop will reflect the proportion of the Grower's CPUs contributing to the Project Pool.

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

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

103. The wheat farming 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' wheat farming activities in the 2006 Grain Co-Production Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

104. 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.

105. Changes to the STS rules apply from 1 July 2005. 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 Initial Period Fees, Subsequent Period Fees, Harvest Period Costs, Management Production Bonus, Project Pool Performance Bonus, Management Price Bonus, Project Pool Finalisation Fee, Crop and Multi Peril Insurance, Rent and Rent Bonus

Section 8-1

106. Consideration of whether the Fees payable under the Grower Management Agreement and Grower Sub-Lease Agreement are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

107. The Fees payable under the Grower Management Agreement and the Grower Sub-Lease Agreement associated with the wheat farming activities will relate to the gaining of income from the Grower's business of wheat farming (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of the Crop) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the Fees is identifiable from the scheme. The Fees appear to be reasonable. There is no capital component of the Fees payable under the Grower Management Agreement. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Interest deductibility

Section 8-1

(i) Growers who use a Preferred Financier as the finance provider

108. Some Growers may finance their participation in the Project through a loan facility with a Preferred Financier. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of Fees payable under the Grower Management Agreement and the Grower Sub-Lease Agreement.

109. The interest incurred for the year ended 30 June 2006 and subsequent years of income will be in respect of a loan to finance the Grower's business operations – wheat growing and the lease of the land on which the wheat will have been planted – that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

(ii) Growers who DO NOT use a Preferred Financier as the finance provider

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

Prepayment provisions

Sections 82KZL to 82KZMF

111. 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

112. Under the Scheme to which this Product Ruling applies the Fees are incurred annually and interest payable to the Preferred Financiers is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this Scheme.

113. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower 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.

114. Growers who choose to prepay 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.

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

Section 35-55 – exercise of Commissioner's discretion

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

- 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 wheat farming 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.

116. 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

117. The operation of section 82KL of the ITAA 1936 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

118. For Part IVA of the ITAA 1936 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).

119. The 2006 Grain Co-Production 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 paragraph 87 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.

120. 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 Crop. 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) of the ITAA 1936 it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Appendix 2 – Detailed Contents List

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 93/34; TR 92/20; TR 97/11; TR 98/22; TR 2000/8; TR 2001/14

Subject references:

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 25-5
- ITAA 1997 25-25
- 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 Subdiv 61-J
- ITAA 1997 Div 328
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- IT(TP)A 1997 Div 328
- IT(TP)A 1997 328-120
- IT(TP)A 1997 328-125
- TAA 1953
- Copyright Act 1968
- Corporations Act 2001

Case references:

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

ATO references

NO: 2006/516
ISSN: 1441-1172
ATOlaw topic: Income Tax ~~ Product ~~ crops - other