



PR 2007/42 - Income tax: real Dairy Project No. 1

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 This document has changed over time. This is a consolidated version of the ruling which was published on *16 May 2007*



Product Ruling

Income tax: real Dairy Project No. 1

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ⓘ This publication 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. 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.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product 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 Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. In this Product Ruling this scheme is referred to as the real Dairy Project No. 1 or simply as 'the Project'.

Class of entities

2. This part of the Product Ruling specifies which entities can rely on the tax benefits set out in the Ruling section of this Product Ruling and which entities cannot rely on those tax benefits.

3. The class of entities who can rely on those tax benefits are referred to as Farmers. Farmers will be those entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and who have executed the relevant Project Agreements set out in paragraph 39 of this Ruling on or before 15 June 2007. They must 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.

4. The class of entities who can rely on the tax benefits set out in the Ruling section of this Product Ruling 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;
- are accepted into this Project before the date of this Ruling or after 15 June 2007;
- do not pay the Application Fee in full on or before 30 June 2007;
- participate in the scheme through offers made other than through the Product Disclosure Statement (PDS);
or
- enter into finance arrangements with real Agribusiness Limited or entities associated with this Project (the word 'associate' has the meaning given in section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936)).

Superannuation Industry (Supervision) Act 1993

5. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product Ruling as to whether investment in this product may contravene the provisions of SISA 1993.

Qualifications

6. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 39 to 93 of this Ruling.

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

- this Product 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 Product Ruling may be withdrawn or modified.

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Date of effect

9. This Product Ruling applies prospectively from 1 June 2007, the earliest date a Farmer can be accepted for the purposes of this Product Ruling. It therefore applies only to the specified class of entities that enter into the scheme from 1 June 2007 until 15 June 2007, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities for the income years up to 30 June 2010.

10. However the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

11. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

12. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

13. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Changes in the law

14. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments to the law may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to the extent of those amendments this Product Ruling will be superseded.

15. Entities who are considering participating in the scheme 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

16. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes 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 Product Ruling is issued.

Goods and Services Tax

17. All fees and expenditure referred to in this Product Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a Farmer) 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.

Ruling

Application of this Ruling

18. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Farmer in the defined class of entities who enters into the scheme described at paragraphs 39 to 93 of this Ruling.

19. The Farmer's participation in the Project must constitute the carrying on of a business of primary production. Provided the Project is carried out as described below, the Farmer's business of primary production will commence at the time of execution of their Dairy Cow Lease Management and Agistment Agreement (DCLMAA), on or before 15 June 2007.

Minimum subscription

20. A Farmer is not eligible to claim any tax deductions until the Farmer's application to enter the Project is accepted and the Project has commenced. Under the terms of the PDS, a Farmer's application will not be accepted and the Project will not proceed until the minimum subscription of 1,000 Leased Dairy Cows is achieved.

The Simplified Tax System (STS)

Division 328

21. To be an 'STS taxpayer' a Farmer must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer' (Division 328 of the ITAA 1997). For a Farmer participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Farmer was an 'STS taxpayer' prior to 1 July 2005 and 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*.

22. For such Farmers, 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

23. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides for a tax offset of up to 25% 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

Sections 6-5 and 17-5

24. That part of the Gross Dairy Proceeds from the Project attributable to the Farmer's produce, less any GST payable on those Gross Dairy Proceeds (section 17-5), will be assessable income of the Farmer under section 6-5.

25. The Farmer recognises ordinary income from carrying on the business of dairy farming at the time that income is derived.

Trading stock

Sections 70-35, 70-45 and 70-55

26. A Farmer who is not an 'STS taxpayer' may, in some years, hold livestock or milk that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the end of an income year exceeds the value of trading stock on hand at the start of an income year a Farmer must include the amount of that excess in assessable income.

27. Alternatively, where the value of trading stock on hand at the start of an income year exceeds the value of trading stock on hand at the end of an income year, a Farmer may claim the amount of that excess as an allowable deduction.

28. Under section 70-45, the Farmer can elect to value trading stock on hand at the end of the income year at cost, market selling value or replacement value. Where the Farmer elects to value the trading stock at the end of the income year at cost, 'cost' would include only those expenses incurred until the livestock or milk became trading stock of the Farmer.

29. Under section 70-55, where the Farmer holds trading stock, being livestock, that the Farmer acquired by natural increase, the Farmer can elect to value the cost of that livestock at the actual cost of each animal or the cost prescribed by the regulations for each animal in the applicable class of livestock.

Section 328-285

30. A Farmer who is an 'STS taxpayer' may, in some years, hold livestock or milk that will constitute trading stock on hand. Where, for such a Farmer, for an income year, the difference between the value of all their trading stock at the start of an income year and a reasonable estimate of it at the end of the income year, is less than \$5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

31. Alternatively, a Farmer who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

Deduction for Application Fees, Ongoing Dairy Cow Lease Management and Agistment Fees, Dairy Production Costs, Performance Fees, insurance premiums and insurance costs

Section 8-1 and Division 27 of the ITAA 1997 and sections 82KZME and 82KZMF of the ITAA 1936

32. A Farmer may claim tax deductions for the fees and expenses on a per Leased Dairy Cow basis, as set out in the Table below.

| Fee Type | Year ending 30 June 2007 | Year ending 30 June 2008 | Year ending 30 June 2009 | Year ending 30 June 2010 |
|--|---|---|---|---|
| Application Fee | \$1,540 See Notes (i) & (ii) | \$220 See Notes (i) & (ii) | Nil | Nil |
| Ongoing Dairy Cow Lease Management and Agistment Fees | Nil | \$1,711.60 See Notes (i), (iii) & (iv) | \$1,785.30 See Notes (i), (iii) & (iv) | \$1,859.00 See Notes (i), (iii) & (iv) |
| Dairy Production Costs | As incurred See Notes (i) & (iii) | As incurred See Notes (i) & (iii) | As incurred See Notes (i) & (iii) | As incurred See Notes (i) & (iii) |
| Performance Fee | Nil | As incurred See Notes (i) & (iii) | As incurred See Notes (i) & (iii) | As incurred See Notes (i) & (iii) |
| Annual insurance premium | Nil | As incurred See Notes (i), (iii) & (iv) | As incurred See Notes (i), (iii) & (iv) | As incurred See Notes (i), (iii) & (iv) |
| Insurance costs | Nil | As incurred See Notes (i), (iii) & (iv) | As incurred See Notes (i), (iii) & (iv) | As incurred See Notes (i), (iii) & (iv) |

Notes:

- (i) If the Farmer 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 Application Fee of \$1,760 per Leased Dairy Cow consists of a Fee for Initial Management Services, to be provided during the period from the Commencement date to 29 June 2007, totalling \$1,540 and a prepayment of the Fee for Initial Management Services to be provided during the period 1 July 2007 to 30 June 2008, totalling \$220. The Application Fee must be paid by 30 June 2007.

The Fee of \$1,540, for the Initial Management Services to be provided during the period from the Commencement Date to 29 June 2007 is deductible under section 8-1 in the income year ending 30 June 2007.

However, the amount of \$220 per Leased Dairy Cow prepaid in respect of the portion of the Initial Management Services to be provided during the period 1 July 2007 to 30 June 2008 is **NOT** deductible in the year in which it is incurred. Deductions for this amount **must** be determined using the formula in subsection 82KZMF(1) of the ITAA 1936 (see paragraphs 103 to 111 of this Ruling). This section operates to apportion expenditure over the eligible service period or ten years, whichever is the lesser. The 'eligible service period' commences on 1 July 2007 and ends on 30 June 2008. Accordingly, an amount of \$220 per Leased Dairy Cow is deductible in the year ending 30 June 2008. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred, however as the Farmer is required to acquire a minimum interest of 10 Leased Dairy Cows the prepaid Fee will be greater than \$1,000 and does not fall within the definition of excluded expenditure.

- (iii) Where the Farmer pays the Ongoing Dairy Cow Lease Management and Agistment Fees, Dairy Production Costs, Performance Fee, annual insurance premium and insurance costs, consisting of reasonable interest and administration expenses, in the relevant income years shown in the above table and set out in the DCLMAA, those fees are deductible in full under section 8-1 in the year that they are incurred.

- (iv) This Ruling does not apply to Farmers who choose to prepay fees (see paragraphs 103 to 111 of this Ruling), other than the prepaid Fee in respect to Initial Management Services to be provided during the period 1 July 2007 to 30 June 2008. Subject to certain exclusions, 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. Any Farmer who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.

Interest

33. The deductibility or otherwise of interest incurred by Farmers who finance their participation in the Project through a loan facility with an independent lender external to the Project is outside the scope of this Ruling. Such Farmers may request a private ruling on the deductibility or otherwise of interest under such finance arrangements.

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

Section 35-55 – exercise of Commissioner’s discretion

34. A Farmer who is an individual accepted into the Project by 15 June 2007 may have losses arising from their participation in the Project that must be deferred to a later income year under section 35-10.

35. Under paragraph 35-55(1)(b) the Commissioner may decide that the rule in section 35-10 does not apply to this activity provided that it is because of the nature of the business activity that it has not yet satisfied one of the tests set out in sections 35-30, 35-35, 35-40 or 35-45. For this Project, the dairy farming activity covered by this Ruling is capable of producing assessable income from the time the business commences. **Therefore, the Commissioner will not exercise the discretion under paragraph 35-55(1)(b) in relation to this Project for the 2006-07 and later income years.**

36. **Accordingly, should a Farmer have losses arising from their participation in the Project and the activity does not pass one of the tests and the Farmer does not come within one of the exceptions referred to in paragraph 112 of this Ruling, a deduction for a loss made by an individual from this Project will not be taken into account in the 2006-07 and later income years. The loss is required to be deferred until the activity satisfies one of those tests or the Farmer comes within one of the exceptions (see Explanation at paragraphs 112 to 118 of this Ruling).**

37. A Farmer who is an individual accepted into the Project on or before 15 June 2007 should have assessable income arising from their participation in the Project for the 2006-07 income year. real Agribusiness Limited (the Manager) will inform Farmers of the reasonable estimate of what would have been the amount of the assessable income if the Farmer had carried on the business activity throughout the year.

Anti-avoidance provisions

Section 82KL and Part IVA

38. For a Farmer who commences participation in the Project and incurs expenditure as required by the DCLMAA, the following provisions of the ITAA 1936 have application as indicated:

- 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.

Scheme

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

- Application for Product Ruling as constituted by documents received on 3 and 18 January 2007 and 1 March 2007 and additional correspondence received on 31 January 2007, 1, 2, 9, 28, 29 and 30 March 2007, 13, 17, 20, 26 and 27 April 2007 and 1, 2 and 3 May 2007;
- Draft **Product Disclosure Statement** for the real Dairy Project No. 1 to be issued by real Agribusiness Limited (the Manager), received 27 April 2007 and updated 2 May 2007;
- Draft **Constitution** of the real Dairy Project No. 1 between real Agribusiness Limited (the Manager) and the Farmer, received 20 April 2007;
- Draft **Dairy Cow Lease Management and Agistment Agreement** for the real Dairy Project No. 1 between real Agribusiness Limited (the Manager) and the Farmer, received 3 May 2007;
- Draft Herd Lease between Lomaria Pty Ltd (the Lessor) and real Agribusiness Limited (Lessee), received on 27 April 2007;

- Draft Memorandum of Lease between the Trustee of real Agribusiness Land Trust No. 2 (Lessor) and real Agribusiness Limited (Lessee), received 18 January 2007;
- Draft Agreement to Lease between the Trustee of real Agribusiness Land Trust No. 2 (Lessor) and real Agribusiness Limited (Lessee), received 1 May 2007;
- Draft Compliance Plan for the real Dairy Project No. 1, received 4 May 2007;
- Draft indicative Farmgate Milk Supply Agreement, received 28 March 2007;
- Draft Dairy Management Agreement for the real Dairy Project No. 1 between the real Agribusiness Limited and real Dairy Management Pty Ltd (as Manager), received 26 April 2007; and
- Draft **Power of Attorney** and **Application Form** for the real Dairy Project No. 1, received 2 May 2007.

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

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

41. The documents highlighted are those that a Farmer 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 Farmer, or any associate of a Farmer, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows.

Overview

42. The main features of the real Dairy Project No. 1 are as follows:

| | |
|--|--|
| Location | Carilla Property in Tintinara, South Australia |
| Type of business to be carried on by each Farmer | Long term commercial milk production from dairy cattle |
| Term of the Project | 8 years |
| Number of cows offered for milk production | 2,000 |
| Minimum allocation per Farmer | 10 Leased Dairy Cows |
| Minimum subscription | 1,000 Leased Dairy Cows |

| | |
|-----------------------------------|---|
| Initial cost per project interest | \$17,600 (includes an amount for prepaid fees) |
| Ongoing costs | Ongoing Dairy Cow Lease Management and Agistment Fees, Performance Fees, Dairy Production Costs, annual insurance premiums and insurance costs. |
| Other costs | All losses, damages and Costs incurred in the course of the Manager's office or in the administration and management of the Project. |

43. The Project will be a registered managed investment scheme under the *Corporations Act 2001*. real Agribusiness Limited has been issued with an Australian Financial Service Licence 309304 and will be the Manager for the Project.

44. The Project will involve the commercial agistment and milking of Dairy Cows and the operation of a dairy farming business.

45. An offer to participate in the Project will be made through a PDS. The offer under the PDS is for 2,000 Dairy Cows, which corresponds to a maximum of 200 Dairy Herds in the Project.

46. A Farmer that participates in the Project will do so by acquiring an interest in the Project which will consist, initially, of a Dairy Herd with a minimum of 10 Leased Dairy Cows, at a cost of \$1,760 per Leased Dairy Cow.

47. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints real Agribusiness Limited to enter into, on behalf of the Farmer, a DCLMAA and any other documents required to hold an interest in the Project.

48. For the purposes of this Ruling, Applicants who are accepted to participate in the Project and who execute the DCLMAA on or before 15 June 2007 will become Farmers.

49. Under the terms of the PDS, the interests in the Farmer's Dairy Herd will be issued after a minimum subscription of 1,000 Leased Dairy Cows has been achieved by 15 June 2007.

50. The Manager will lease Land from the landowner, being the Trustee of real Agribusiness Land Trust No. 2 (the Trustee), for the Project within the Tintinara region of South Australia. Specifically, it is described as the whole of sections 109 and 110 in the Hundred of Coombe Certificate of Title Volume 5958, Folio 821. The Commencement Date of the Lease is 1 June 2007. Subject to minimum subscription being achieved, the Manager will issue interests in the Project following the Commencement Date of the Lease.

51. The Manager will grant an Agistment Licence to each of the Farmers accepted in the Project, to occupy and use the Agistment Land.

52. Each Farmer will use their Dairy Herd for the purpose of carrying on a business of commercial agistment and milking of Dairy Cows and the operation of a dairy farming business for commercial profit.

Constitution

53. The Constitution establishes the Project and operates as a deed binding all Farmers and real Agribusiness Limited. The Constitution sets out the terms and conditions under which real Agribusiness Limited agrees to act as Manager and thereby manage the Project. Upon acceptance into the Project, Farmers are bound by the Constitution by virtue of their participation in the Project.

54. In order to acquire an interest in the Project, the Farmer must make an application for Leased Dairy Cows in accordance with clause 3 of the Constitution. Among other things, the application must be completed in a form approved by the Manager, signed by or on behalf of the Applicant, lodged at the registered office of the Manager and accompanied by payment of the Application Fee in a form acceptable to the Manager.

55. Under clause 2 of the Constitution, real Agribusiness Limited holds the Application Fee on bare trust. real Agribusiness Limited will deposit all Application Moneys received from applicants in an Application Fund (clause 4.1).

56. Once real Agribusiness Limited has accepted the application and all of the DCLMAAs have been executed and remain in force (clause 6) the Application Money may be transferred and applied against the fees due to real Agribusiness Limited (clauses 4.1 and 7).

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

- the appointment of real Agribusiness Limited as the Manager for the Project, the vesting of the Assets of the Project, the establishment of the Project, the creation of the Application Fund and the Proceeds Fund and the interest of the Applicants and Farmers in those funds (clause 2);
- the Manager's powers in relation to acceptance and refusal of applications and procedures relating to applications (clause 3);
- procedures relating to Application Money (clauses 3 and 4);
- completion and execution of DCLMAAs upon acceptance of an application by the Manager and the issue of interests in the Project (clause 5);
- the transfer of Application Money paid by an Applicant from the Application Fund to the Manager (clauses 6 and 7);

- the Manager's responsibilities relating to the retention of the Applicant's DCLMAAs and Powers of Attorney and the procedures to be taken by Farmers to obtain a copy of the DCLMAAs (clause 8);
- the Manager's powers and duties relating to the management of the Project, the appointment of agents to perform tasks and in relation to investments (clause 9);
- the right of the Manager to collect proceeds from the sale of the Project Milk and the sale of Progeny, recover costs from the Assets of the Project, to be paid fees from the Proceeds Fund and the manner in which amounts held in the Proceeds Fund are to be distributed (clauses 10, 11, 12 and 13);
- the liabilities and indemnities of the Manager (clause 14);
- the appointment of an Independent Dairy Cow Expert and the provision of Independent Dairy Cow Expert's Reports to Farmers (clause 16);
- the keeping and maintenance of a Register of Applicants and of Farmers who hold an interest in the Project (clause 17);
- the assignment of a Farmer's interest in the Project (clause 18);
- transmission of a Farmer's interest in the Project as a consequence of the death, bankruptcy or mental incapacity of a Farmer (clause 19);
- the retirement and removal of the Manager (clause 20);
- the liabilities and indemnities of Applicants and the Farmers (clause 21);
- the Farmers' and the Manager's power to amend the Constitution (clause 22);
- the term and termination of the Project and winding up procedures (clause 23); and
- resolution of complaints made by the Farmer in relation to the Manager's management of the Project (clause 25).

Compliance Plan

58. As required by the Corporations Act, real Agribusiness Limited has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that real Agribusiness Limited manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Farmers are protected.

Land Lease

59. The Manager will enter into a Lease with the Trustee of real Agribusiness Land Trust No. 2, in respect of Land required for the Project.

60. The parties will enter into the Lease subject to the Manager, on or before 1 June 2007, successfully registering the Scheme with ASIC. Upon satisfaction of this Condition, the Trustee will exercise its right to terminate any existing lease over the Land between the Trustee and Lomaria Pty Ltd. The Lease in respect to the Land will commence on 1 June 2007.

61. The Manager must use the Land only for dairy farming.

62. The Manager may also sub-lease the land, or any part of the land, to Farmers in the real Dairy Project No. 1 for a term equivalent to the term of the Lease.

Herd Lease

63. The Manager will enter into a Herd Lease with Lomaria Pty Ltd in respect of all the livestock required for the Project.

64. The Manager must use the Herd solely as productive milking cows and milk the Herd.

65. The Manager may also sub-lease the Herd to Farmers in the real Dairy Project No. 1 for a term equivalent to the term of the Lease.

Dairy Management Agreement

66. real Agribusiness Limited has entered into a Dairy Management Agreement with real Dairy Management Pty Ltd. Under the Dairy Management Agreement, the Manager has agreed to appoint real Dairy Management Pty Ltd to perform the Manager's obligations with respect to the Initial Management Services and Ongoing Management Services under the terms and conditions set out in the Dairy Management Agreement.

Dairy Cow Lease Management and Agistment Agreement

67. Farmers will enter into a Dairy Cow Lease Management and Agistment Agreement with the Manager to licence part of the Agistment Land and lease or sub-lease Dairy Cows to carry on the business of commercial agistment and milking of Dairy Cows and the operation of a dairy farming business until completion of the Project.

Dairy Cow lease

68. The Manager will hold a leasehold interest in the Leased Dairy Cows. On the Milking Date, being 29 June 2007, until termination, the Manager agrees to Lease the Leased Dairy Cows to the Farmer (clause 2.1). The Lease of the Leased Dairy Cows will terminate on the termination date of the Project in accordance with the Constitution, or subject to earlier termination pursuant to clause 9 of the DCLMAA.

69. Each Farmer will initially lease a minimum of 10 Leased Dairy Cows for the purpose of milking the Dairy Cows and producing the Farmer's Progeny. The Farmer's Progeny will be used in the Farmer's business of dairy farming (clause 2.2). Leased Dairy Cows will remain the property of Lomaria Pty Ltd.

70. The Farmer's Dairy Herd will comprise of the Leased Dairy Cows held by the Farmer and also includes any Progeny derived from the Leased Dairy Cows, including any replacements thereof. Each Leased Dairy Cow contained in the Farmer's Dairy Herd will be identified via an Identifier Code. The details of each Leased Dairy Cow contained in a Farmer's Dairy Herd will be set out in item 4 of Schedule 1 to the DCLMAA.

71. Among other things, the Manager and the Farmer agree that:

- the Farmer is the absolute owner of all the Farmer's Progeny;
- the Manager will maintain the Farmer's Progeny provided that the Manager may sell such Progeny that the Manager determines to be unsuitable for the purposes of the Project;
- if any or all of the Leased Dairy Cows are pregnant upon retirement, the Farmer shall not have any interest in any calves subsequently born to those Leased Dairy Cows;
- the Manager will identify the Progeny of a Farmer's Dairy Herd as being the Farmer's Progeny and will assign an Identifier Code to each of the Farmer's Progeny and record the Identifier Code against the name of the Farmer in the register;
- the Manager may substitute or retire any of the Dairy Cows, as required, provided any replacement Dairy Cows are of milk production age and have the capacity to produce milk on a commercial basis;
- the Manager must retire the Progeny Herd at the end of the Project; and
- the Farmer must retire and return the remaining Leased Dairy Cows on or before the end of the Project.

72. In addition, the Manager guarantees that, the Manager will replace any of the Leased Dairy Cows that have died or are determined by the Manager to be unsuitable for the business of dairy farming with replacements, to ensure that the Farmer's Dairy Herd will remain the same from the Milking Date until the second anniversary of the Milking Date (clause 2.4).

73. The Manager acknowledges that the milk and Progeny produced by the Farmer's Dairy Herd will remain the property of the Farmer during the term of the DCLMAA. In addition, the Farmer has the right to have the milk produced by the Farmer's Dairy Herd and the Progeny sold for the benefit of the Farmer in accordance with the provisions of the DCLMAA (clause 6).

Agistment Licence

74. Under the terms of the DCLMAA the Farmer will agist the Farmer's Dairy Herd on the Agistment Land. The Agistment Land on which the Project will be conducted will be leased by the Trustee to real Agribusiness Limited, who will grant an Agistment Licence to the Farmer to occupy and use the Agistment Land for the purpose of agisting and milking of the Farmer's Dairy Herd and the operation of a dairy farming business.

75. Each Farmer will be granted a non exclusive licence to occupy the Agistment Land for a period commencing on the Commencement Date, being no earlier than 1 June 2007. The Agistment Licence will terminate on the termination date of the Project in accordance with the Constitution, or subject to earlier termination pursuant to clause 9 of the DCLMAA.

76. Item 3 of Schedule 1 to the DCLMAA provides the particulars of the Agistment Land on which the Project will be conducted.

77. The Manager warrants to the Farmer that, amongst other things:

- on the Commencement Date, the Manager has entered into such legally binding agreements necessary to facilitate the granting of the Agistment Licence to the Farmer (clause 3.2); and
- the Project Herd on the Agistment Land will not exceed the carrying capacity of the Agistment Land (clause 3.3).

78. The Farmer's obligations are set out in detail in clause 4 under which the Farmer agrees to use and maintain the Agistment Land and its carrying capacity for the purpose of long term commercial agistment and milking of the Farmer's Dairy Herd and the operation of a dairy farming business in accordance with established industry practices of the dairy farming industry.

Management of the Farmer's business

79. Under the DCLMAA the Farmer appoints the Manager to manage the Farmer's Dairy Herd and to carry out the management services subject to the terms and conditions of the Agreement. The Agreement will commence on the date of execution of the DCLMAA and shall continue until its termination under clause 9.

80. The Manager will commence the provision of the Initial Management Services on or after the Commencement Date and will use all reasonable endeavours to complete the Initial Management Services before 30 June 2008.

81. The Initial Management Services include, amongst other things:

- source suitable cows for the purposes of the Project;
- procure the Leased Dairy Cows by way of purchase or lease;
- transport the Leased Dairy Cows onto the Agistment Land;
- ear tagging of the Leased Dairy Cows within the Dairy Herd, and to record the Identifier Code against the name of the Farmer in the register;
- assess the health of the Leased Dairy Cows within the Dairy Herd and take any remedial action as may be required;
- pregnancy testing of the Leased Dairy Cows within the Dairy Herd, as necessary, from the Commencement Date;
- negotiate and maintain a Milk Supply Agreement for the sale of milk produced by the Dairy Herd; and
- all administrative services required in respect of providing the services.

82. The Manager will commence the provision of the Ongoing Management Services on 29 June 2007 and shall continue to provide the Ongoing Management Services until the termination of this Agreement.

83. The Ongoing Management Services include, amongst other things:

- the agisting and milking of the Farmer's Dairy Herd and the production of pasture for consumption by the Farmer's Dairy Herd;
- the ear tagging of Progeny with an Identifier Code and to record the Identifier Code against the name of the relevant Farmer in the register;

- to care for the Farmer's Dairy Herd including disease and parasite control, veterinary treatment activities, confinement and protection activities and relocation and rotation activities;
- to maintain the Agistment Land upon on which the Farmer's Dairy Herd is agisted;
- maintenance of the Dairy to ensure that the daily milking of the Farmer's Dairy Herd can be maintained for the Term;
- maintain a Milk Supply Agreement;
- to monitor the ongoing milk production of the Farmer's Dairy Herd and to substitute or retire any cow in the Farmer's Dairy Herd;
- to sell Progeny deemed unsuitable for the Project;
- obtaining a Report from the Independent Dairy Cow Expert by no later than 31 October 2007 and thereafter annually, to be provided to the Farmer;
- all administrative services required in respect of providing the services.

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

85. The Manager will enter into the Dairy Management Agreement to appoint real Dairy Management Pty Ltd to carry out its obligations with respect to the Initial Management Services and the Ongoing Management Services to the Farmer under the DCLMAA.

Pooling of milk and proceeds and Farmer's entitlement to Gross Dairy Proceeds

86. The DCLMAA sets out provisions relating to the Farmer's entitlement to participate in the sale of the Project milk and the sale of Progeny from the Milking Date. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Farmers whose dairy farming activities have contributed Gross Dairy Proceeds into the Proceeds Fund are entitled to benefit from distributions from the pool; and
- any pooled milk or Progeny must consist only of milk or Progeny contributed by Farmers of real Dairy Project No. 1.

Fees

87. Under the terms of the DCLMAA, a Farmer will make payments as described below on a per Leased Dairy Cow basis.

88. For the Initial Management Period, being from the Commencement Date and up to and including 30 June 2008 the following **Fees** are to be paid:

- the **Application Fee** payable to the Manager on application is \$1,760 per Leased Dairy Cow. This fee consists of:
 - **Initial Management Period Fee** of \$1,540, for Initial Management Services to be performed during the period from the Commencement Date to 29 June 2007 (item 5.1 of Schedule 1); and
 - prepaid **Initial Management Period Fee** of \$220, for the portion of the Initial Management Services to be performed during the period from 1 July 2007 to 30 June 2008 (item 5.1 of Schedule 1); and
- the Farmer's Proportional Share of **Dairy Production Costs**, being all costs of whatsoever nature relating to the production and sale of milk in respect of the Project Herd, for the period from 29 June 2007 to 30 June 2007 (clause 13.2).

89. In each Financial Year commencing on 1 July 2007 and up to and including the Termination Year the following **Fees** are to be paid:

- **Ongoing Dairy Cow Lease Management and Agistment Fees**, payable for Ongoing Management Services, Lease of Leased Dairy Cows and the Agistment Licence. The following amount, per annum for each Leased Dairy Cow, is payable monthly in arrears on the last Business Day of each month:

| Income year | Fee |
|--------------------|------------|
| 2007-08 | \$1,711.60 |
| 2008-09 | \$1,785.30 |
| 2009-10 | \$1,859.00 |
| 2010-11 | \$1,933.80 |
| 2011-12 | \$2,008.60 |
| 2012-13 | \$2,048.20 |
| 2013-14 | \$2,088.90 |
| 2014-15 | \$2,130.70 |

- **Performance Fees**, being the Farmer's Proportional Share of the Performance Fee Amount. The Performance Fee Amount is defined as being 35% of the amount by which Farmers' Net Proceeds exceed \$300,000 in respect to the relevant Financial Year (item 5.3 of Schedule 1);
- the Farmer's Proportional Share of **Dairy Production Costs** (clause 13.2);
- annual **insurance premiums**; and
- in respect to **annual insurance premiums**, insurance costs consisting of reasonable **interest and administration expenses**, up to an amount not exceeding 10% of the premium as determined by the Manager (clauses 4.5 and 13.3.2).

90. If in any of the Financial Years, not including the Termination Year, the Net Dairy Proceeds are not sufficient to pay the amounts payable under the DCLMAA the Manager will invoice the Farmer for the outstanding amount. The Farmer will be required to pay any outstanding amounts upon delivery of an invoice.

Finance

91. A Farmer who does not pay the Application Fee in full upon application can borrow from an independent lender external to the Project. A Farmer who enters into a finance arrangement with an independent lender external to the Project may request a private ruling on the deductibility or otherwise of interest incurred under that finance arrangement.

92. Farmers cannot rely on any part of this Ruling if the Application Fee is not paid in full on or before 30 June 2007 by the Farmer or, on the Farmer's behalf, by a lending institution. Where an application is accepted subject to finance approval by any lending institution, Farmers cannot rely on this Ruling if written evidence of that approval has not been given to the Manager by the lending institution by 15 June 2007.

93. This Ruling does not apply if the finance arrangement entered into by the Farmer 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 of the ITAA 1936 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 Farmers for the Project.

Commissioner of Taxation

16 May 2007

Appendix 1 – Explanation

❶ *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 Farmer carrying on a business?

94. For the amounts set out in paragraphs 32 of this Ruling to constitute allowable deductions the Farmer's dairy farming activities as a participant in the real Dairy Project No. 1 must amount to the carrying on of a business of primary production.

95. Two Taxation Rulings are relevant in determining whether a Farmer will be carrying on of a business of primary production.

96. The general indicators used by the Courts are set out in Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production?

97. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the real Dairy Project No. 1. As Taxation Ruling TR 2000/8 sets out, the relevant principles have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

98. Having applied these principles to the arrangement set out above, a Farmer in the real Dairy Project No. 1 is accepted to be carrying on a business of producing milk and Progeny for sale.

The Simplified Tax System

Division 328

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

100. Changes to the STS rules apply from 1 July 2005. The question of whether a Farmer is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (but refer to Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11). Therefore, any Farmer 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 Application Fees, Ongoing Dairy Cow Lease Management and Agistment Fees, Dairy Production Costs, Performance Fees, insurance premiums and insurance costs

Section 8-1

101. The Application Fees, Ongoing Dairy Cow Lease Management and Agistment Fees, Dairy Production Costs, Performance Fees, insurance premiums and insurance costs are deductible under section 8-1 (see paragraphs 43 and 44 of TR 2000/8). A 'non-income producing' purpose (see paragraphs 47 and 48 of TR 2000/8) is not identifiable in the arrangement and there is no capital component evident in the fees (see paragraphs 49 to 51 of TR 2000/8).

102. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. Provided that the prepayment provisions do not apply (see paragraphs 103 to 111 of this Ruling) a deduction for these amounts can be claimed in the year in which they are incurred. (Note: The meaning of incurred is explained in Taxation Ruling TR 97/7.)

Prepayment provisions

Sections 82KZL to 82KZMF

103. 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.

104. For this Project, the only prepayment provisions that are relevant are section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME and 82KZMF of the ITAA 1936 (operative provisions).

Application of the prepayment provisions to this Project

105. Under the DCLMAA, a Manager incurs fees on application of \$1,760 per Leased Dairy Cow. The Application Fee is made up of:

- \$1,540 for the Initial Management Services to be provided in the Initial Management Period from the date the Farmer's DCLMAA is executed to 29 June 2007; and

- a prepayment of \$220 for the portion of Initial Management Services to be provided during the period from 1 July 2007 to 30 June 2008.

106. The fee of \$1,540 per Leased Dairy Cow for the Initial Management Services, to be provided during the period from the Commencement Date to 29 June 2007, is for services to be provided within the year in which the fee is incurred or paid, and is therefore deductible in that year.

107. The expenditure incurred by a Farmer in the Project for the portion of Initial Management Services to be carried out during the period from 1 July 2007 to 30 June 2008 meets the requirements of subsections 82KZME(1) and (2) of the ITAA 1936 and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of those deductions for those fees are determined under section 82KZMF of the ITAA 1936.

108. The prepaid management fee for the provision of the portion of Initial Management Services for the period from 1 July 2007 to 30 June 2008 does not fall within any of the five exceptions to section 82KZME of the ITAA 1936, therefore, the deduction for the income year ended 30 June 2007 and 30 June 2008 is determined using the formula in subsection 82KZMF(1) of the ITAA 1936. The eligible service period for the expenditure commences on 1 July 2007 and ends on 30 June 2008. Applying this formula to the prepaid management fee results in no amount being deductible in the year ended 30 June 2007, and a deduction of \$220 per Leased Dairy Cow being allowable in the income year ended 30 June 2008.

109. Other than the portion of the Application Fee that relates to the provision of the portion of Initial Management Services for the period from 1 July 2007 to 30 June 2008 (see above), the fees payable under the scheme to which this Product Ruling applies are incurred annually for services to be wholly provided in the year in which those fees are incurred. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to those fees.

110. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Farmer in this Project prepays all or some of the expenditure payable under the DCLMAA, or prepays interest under a loan agreement. Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

111. As noted in the Ruling section above, Farmers who prepay fees, other than the portion of the Application Fee that relates to the provision of the portion of the Initial Management Services during the period from 1 July 2007 to 30 June 2008, 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 and the Commissioner’s discretion

Sections 35-10 and 35-55

112. Division 35 applies to losses from certain business activities for the 2000-01 income year and subsequent income years. Under the rule in subsection 35-10(2), a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

- the ‘exception’ in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

113. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer’s allowable deductions attributable to the business activity over that taxpayer’s assessable income from the business activity.

114. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the exception applies or the Commissioner’s discretion is exercised.

115. The first arm of the Commissioner’s discretion in paragraph 35-55(1)(a) relates to ‘special circumstances’ applicable to the business activity, and has no relevance for the purposes of this Product Ruling. The second arm of the Commissioner’s discretion in paragraph 35-55(1)(b) may be exercised where:

- (i) the business activity has started to be carried on;
- (ii) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

116. If a business activity does not meet all three requirements above then the Commissioner is not able to exercise the second arm of the discretion in paragraph 35-55(1)(b). The meaning of the phrase ‘because of its nature’ is discussed in Taxation Ruling TR 2001/14. Paragraph 35-55(1)(b) is intended to cover a business activity that because of its nature has a lead time, usually a number of years, between the commencement of the activity and the production of any assessable income.

117. Where a business activity is by its nature capable of producing income relatively soon after commencing it is generally not possible to conclude that the second requirement is satisfied, and hence, that the business activity is eligible for an exercise of the second arm of the discretion.

118. An initial inability to satisfy one of the tests must be due to an innate or inherent feature of the industry overall, or well recognised segments in it, rather than just isolated business activities within that industry. The dairy farming activity covered by this Ruling is capable of producing assessable income from the time the business commences, and therefore does not satisfy subparagraph 35-55(1)(b)(i). Therefore, should a Farmer have losses arising from their participation in the project, the Commissioner is not satisfied that it is because of the nature of the business activity that it will not satisfy one of those tests. **The Commissioner will not exercise the second arm of the discretion in subsection 35-55(1) in relation to the business activity. Accordingly should a Farmer have losses arising from their participation in the Project and the activity does not pass one of the tests or the Farmer does not come within one of the exceptions, a deduction for a loss made by an individual from this Project will not be taken into account in the 2006-07 and later income years and is required to be deferred until the activity passes one of the tests set out in Division 35.**

Section 82KL – recouped expenditure

119. 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 of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

120. 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).

121. The real Dairy Project No. 1 will be a ‘scheme’. A Farmer will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 32 of this Ruling 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.

122. Farmers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the production and sale of milk and Progeny. There are no facts that would suggest that Farmers 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

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