


PR 2007/94 - Income tax: 2008 Grain Co-Production Project

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Product Ruling

Income tax: 2008 Grain Co-Production Project

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|-------------------------------------|------|
| Contents | Para |
| LEGALLY BINDING SECTION: | |
| What this Ruling is about | 1 |
| Date of effect | 10 |
| Ruling | 19 |
| Scheme | 28 |
| NOT LEGALLY BINDING SECTION: | |
| Appendix 1: | |
| Explanation | 110 |
| Appendix 2: | |
| Detailed contents list | 134 |

! 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 2008 Grain Co-Production Project or simply as 'the Project'.

Class of entities

2. This part of the Product Ruling specifies which entities:

- are subject to the taxation obligations; and
- can rely on the taxation benefits,

set out in the Ruling section of this Product Ruling.

3. The members of the class of entities who are subject to those taxation obligations and who can rely on those taxation benefits are referred to as Growers.

4. Growers will be those entities that are accepted to participate in the scheme specified below as initial participants¹ on or after the date this Product Ruling is made. They will have executed the relevant Project Agreements set out in paragraph 28 of this Ruling on or before 31 May 2008.

5. 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;
- contract for a CPU where the due diligence requirements listed at paragraph 39 of this Ruling have not been met;
- are accepted into this Project before the date of this Ruling or after 31 May 2008;
- participate in the scheme through offers made other than through the Product Disclosure Statement;
- finance their participation in the Project through loans with entities associated with Macro Funds Ltd other than those described at paragraphs 101 to 109 of this Ruling; or
- are Macro Funds Ltd or its associates.

¹ For the purposes of this Product Ruling an 'initial participant' means a participant who has obtained their interest in the scheme from the Responsible Entity or the Manager of the scheme.

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 28 to 109 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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Barton ACT 2600

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Superannuation Industry (Supervision) Act 1993

9. 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.

Date of effect

10. This Product Ruling applies prospectively from 21 November 2007, the date this Product Ruling is made. It therefore applies only to the specified class of entities that enter into the scheme from 21 November 2007 until 31 May 2008, 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. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

11. 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.

12. 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)).

13. 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.

14. 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

15. 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.

16. 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

17. 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

18. 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 Grower/Investor) 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**

19. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 28 to 109 of this Ruling.

20. The Grower's participation in the Project must constitute the carrying on of business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of execution of their Grower Sub-Lease Agreement and Grower Management Agreement.

21. 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.

Concessions for 'small business entities'²

22. From the 2007-08 income year, a range of concessions previously available under the simplified tax system (STS), will be available to an entity if it carries on a business and satisfies the \$2 million aggregated turnover test (a 'small business entity').

23. A 'small business entity' can choose the concessions that best suit its needs. Eligibility for some small business concessions is also dependent on satisfying some additional conditions. Because of these choices and the eligibility conditions the application of the small business concessions to Growers who qualify as a 'small business entity' is not able to be dealt with in this Ruling.

Assessable income***Sections 6-5 and 17-5***

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

² The meaning of 'small business entity' is explained in section 328-110.

Grower's deductions***Section 8-1 and Division 27 of the ITAA 1997 and sections 82KZME and 82KZMF of the Income Tax Assessment Act 1936***

25. A Grower may claim tax deductions for the following fees and expenses on a per Co-Production Unit basis, as set out in the table below:

| Fee Type | Year ended 30 June 2008 | Year ended 30 June 2009 | Year ended 30 June 2010 |
|--|--|--|---|
| Initial Period Fee | \$4,345 See Notes (i) and (ii) | \$3,850 (plus CPI) See Notes (i), (ii) and (iv) | \$3,850 (plus CPI) See Notes (i), (ii) and (iv) |
| Subsequent Period Fee | | \$445.50 See Notes (i), (ii) and (iv) | \$445.50 (plus CPI) See Notes (i), (ii) and (iv) |
| Rent | \$55 See Notes (i) and (ii) | \$440.00 See Notes (i), (ii) and (iv) | \$247.50 (plus CPI) See Notes (i), (ii) and (iv) |
| Harvest Period Costs | | As incurred See Notes (i) and (ii) | As incurred See Notes (i) and (ii) |
| Harvest Bonus | | As incurred See Notes (i) and (ii) | As incurred See Notes (i) and (ii) |
| Harvest Bonus Adjustment | | As incurred See Notes (i) and (ii) | As incurred See Notes (i) and (ii) |
| Managed Grain Pools & Harvest Loan Costs | | As incurred See Notes (i), (ii) and (iii) | As incurred See Notes (i), (ii) and (iii) |
| Warehouse Costs | | As incurred See Notes (i) and (ii) | As incurred See Notes (i) and (ii) |
| Crop & Multi Peril Insurance | | As incurred See Notes (i) and (ii) | As incurred See Notes (i) and (ii) |
| Interest on loans with the Preferred Financier | As incurred See Notes (ii), (iv) and (v) | As incurred See Notes (ii), (iv) and (v) | As incurred See Notes (ii), (iv) and (v) |
| Borrowing Expenses for loans with the Preferred Financier | Must be calculated See Note (vi) | Must be calculated See Note (vi) | Must be calculated See Note(vi) |

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, Harvest Bonus, Warehouse Costs, Managed Grain Pools and Harvest Loan Costs, Harvest Bonus Adjustment, Crop and Multi Peril Insurance, Rent, and interest on loans with Momentum, the Preferred Financier, are deductible under section 8-1 in the income year in which they are incurred.
- (iii) The Responsible Entity will inform the Grower each Season of the amount of any Managed Grain Pools and Harvest Loan Costs and in which financial year the amount is paid and therefore incurred.
- (iv) This Ruling does not apply to Growers who choose to prepay fees or who choose, or are required to prepay interest under a loan agreement (see paragraphs 119 to 123 of this Ruling). 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 *Income Tax Assessment Act 1936* (ITAA 1936). Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (v) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Momentum (the Preferred Financier), is outside the scope of this Ruling. Growers who enter into agreements with other financiers may request a private ruling on the deductibility of the interest incurred.
- (vi) The loan Application Fee payable to Momentum is a borrowing cost and is deductible under section 25-25. 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 Financier 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

26. A Grower who is an individual accepted into the Project by 31 May 2008 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 below, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for Growers for the income year ended **30 June 2008**. 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.

Prepayment provisions and anti-avoidance provisions

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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME and 82KZMF (but see paragraphs 119 to 123 of this Ruling);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Scheme

28. The scheme that is the subject of this Ruling is identified and described in the following documents:

- Application for a Product Ruling as constituted by documents and correspondence received on 31 August 2007, 4 September 2007, 11, 19, 24, 25 and 30 October 2007;
- Draft Product Disclosure Statement for the 2008 Grain received 31 August 2007;
- **Grower Management Agreement** between Macro Funds Ltd (as Responsible Entity) and the Grower, received 31 August 2007;

- **Grower Sub-Lease Agreements** between Macro Funds Ltd (as Responsible Entity) and the Grower, received 31 August 2007;
- **Grower Sub-Lease Agreements (Subsequent Years)** between Macro Funds Ltd (as Responsible Entity) and the Grower, received 31 August 2007;
- **Constitution** for the 2008 Grain Co-Production Project, received 31 August 2007;
- Compliance Plan for the 2008 Grain Co-Production Project, received 31 August 2007;
- Farmer Management Agreement between Australian Agricultural Contracts Ltd (AACL) and the Farmer, received 4 September 2007;
- Farm Lease Agreement between the Farm Lessor and AACL, received 4 September 2007;
- Service Agreement between Macro Funds Ltd and AACL, received 4 September 2007;
- Farm Lease Agreement between the Farm Lessor and AACL, received 4 September 2007;
- Finance Application (including Loan Terms) between Alco Managed Investments Limited (AMIL) as trustee for the Gateway Momentum Funding Trust No. 1 (Preferred Financier) and the borrowing Grower, received 19 October 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.

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

30. 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

31. Following is a summary of the scheme:

| | |
|---|--|
| Location | The Australian grain-belt |
| Type of business to be carried on by each participant | Wheat and barley farming |
| Number of hectares offered for cultivation | Approximately 125,000 hectares |
| Size of each Co-Production Unit | Between 10 and 40 hectares (depending on productivity) |
| Minimum interest | 6 Co-Production Units |
| Term of the Project | Approximately 52 months |
| Initial cost per Co-Production Unit (2008 Season) | \$4,400 |
| Initial cost per interest (6 Co-Production Units – 2008 Season) | \$26,400 |
| Ongoing costs | <ul style="list-style-type: none"> • Initial Period Fees; • Rent; • Subsequent Period Fee; • Harvest Period Costs; • Warehouse Costs; • Harvest Loan Costs; • Project Finalisation Fee; • Management Production Bonus; • Rent Bonus; • Harvest Bonus Adjustment • Crop insurance; and • Multi peril insurance (subject to availability and market conditions). |

32. The Project is registered as a managed investment scheme under the *Corporations Act 2001*. Macro Funds Ltd (Macro) has been issued with Australian Financial Service Licence No 254421 and will be the Responsible Entity for the Project.

33. The Project will involve the planting, growing and harvesting of wheat and barely for sale. A wheat or barley crop will be planted in the 2008, 2009 and 2010 Seasons.

34. An offer to participate in the Project will be made on the Application Form included in the Product Disclosure Statement (PDS). The offer under the PDS is for approximately 125,000 hectares of land to be planted with wheat or barley. There is no minimum amount to be raised under the PDS.

35. A Grower who participates in the Project will do so by acquiring an interest in the Project which will consist of a minimum of six Co-Production Units. Thereafter, a Grower may apply for interests in increments of one Co-Production Unit (CPU). Each CPU is a parcel of land which is expected to yield 40 tonnes of wheat or 45 tonnes of barley per Season. The size of a CPU will range from 10 to 40 hectares based on productivity of between one and four tonnes of grain per hectare. The actual size of a CPU will depend on the expected productivity of the land.

36. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints Macro to enter into, on behalf of the Grower, a Grower Sub-Lease Agreement and a Grower Management Agreement and any other documents required to hold an interest in the Project.

37. The land on which the Project will be conducted is situated on various grain properties throughout the Australian Grain-belt. Australian Agricultural Contracts Ltd (AACL) will enter into Farm Lease Agreements with various Farm Lessors for the provision of land for the Project. 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.

38. Each Grower will use their CPUs for the purpose of carrying on a business of cultivating and harvesting wheat or barley and the sale of the harvested produce.

Due diligence

39. Land will not be included in the Project unless it meets the following requirements:

- all land selected must be established wheat or barley land and is recognised to be situated in the Australian Grain-belt as defined by ABARE;
- each farmer entering the Project must have completed a Farmer Expression of Interest form;
- each Farmer entering the Project must have a suitable credit rating and credit history;
- each Farmer entering the Project must have appropriate farm management qualifications or experience;
- each farm to be included in the Project must have an average production history of one tonne per hectare or greater over the last 10 years;

- a qualified agricultural consultant must have inspected the land prior to contracting and certified that the land is suitable;
- the qualified agricultural consultant must have inspected the land and confirm that each paddock to be included in the Project has a yield range of one ton per hectare or greater.
- historical production history must be confirmed by at least one independent source;
- each farm to be included in the Project must have the requisite capital equipment required to efficiently undertake grain production; and
- a qualified agricultural consultant must inspect the land post seeding to confirm that contractual obligations are being met.

Constitution

40. The Constitution establishes the Project and operates as a deed binding on all of the Project's Growers and Macro. 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.

41. In order to acquire an interest in the Project, the Grower must make an application for CPUs in accordance with clause 10. Among other things, the application must be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant, lodged at the registered office of the Responsible Entity and accompanied by payment of the Application money in a form acceptable by the Responsible Entity.

42. Under clause 11 of the Constitution, the Responsible Entity holds the Application funds as bare trustee. The Responsible Entity will deposit all Application money in the Project Fund (clause 3.5).

43. Once the Responsible Entity has accepted the Application and the Grower Sub-Lease Agreement and Grower Management Agreement have been executed and sealed, the Application funds may be released and applied against the fees due to the Responsible Entity (clause 11.6).

44. Amongst other things, the Constitution sets out provisions relating to:

- how the Responsible Entity is to hold property for the Growers (clause 4);
- complaint handling (clause 5);

- the obligations and powers of the Responsible Entity (clause 9);
- Growers' income and distributions (clause 12);
- general powers and duties of the Responsible Entity (clause 15);
- register of Growers (clause 16); and
- winding up of the Project (clause 24).

Compliance Plan

45. 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.

Lease

46. Subject to the execution of a Service Agreement, Macro will enter into a Lease Agreement with AACL each Season to lease CPUs for the Project. The Property for each Subsequent Years Lease Agreement (for the 2008 and 2009 Seasons) may change at the discretion of the Project Manager.

47. The Responsible Entity must use the CPUs for the purpose of growing wheat or barley for sale.

48. The Responsible Entity may sub-lease the CPUs for a term equivalent to the Term of the Lease. The Term of the Lease Agreement is from the Commencement Date (on or before 31 May for the relevant Season) to the day after the grain has been harvested but no later than 10 months from the Commencement Date.

Growers Sub-Lease Agreement

49. Each year the Grower will execute a Grower Sub-Lease Agreement with the Responsible Entity as the Lessor. The Sub-Lease sets out the right and obligations of the parties to the Agreement.

50. The Responsible Entity will grant to the Grower the right to use the CPUs for the purposes of managing the Scheme and developing the Growers' CPUs. The Grower Sub-Lease Agreement is conditional on the Grower executing a Grower Management Agreement with the Responsible Entity.

51. A Grower's allocated CPUs for each Subsequent Years Sub-Lease Agreement may change at the Responsible Entity's discretion (clause 2.3).

52. The Term of each Grower Sub-Lease Agreement reflects the wheat and barley 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 2008) to the day after the wheat or barley 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.

53. If the Grower is unable to plant a Crop on a CPU in any Season due to weather conditions or the inability of the Responsible Entity to source suitable land by 15 June each year, then the Responsible Entity must repay any Rent already paid by the Grower by no later than 20 June in the financial year in which it was paid (clause 10).

Growers Management Agreement

54. Under the Grower Management Agreement, the Grower appoints the Responsible Entity to manage the CPUs and to carry out management services subject to the terms and conditions of the Agreement. The Grower Management Agreement is conditional on the Grower entering into a Grower Sub-Lease Agreement with the Responsible Entity (clause 2).

55. The Agreement will commence on the date the Responsible Entity accepts the Grower's application under the PDS and shall continue until its termination under clause 14.

56. Each Season of the Project will have an Initial Period and a Subsequent Period. The Initial Period is the period from Season Commencement until the following 30 June (2008, 2009 and 2010) during which planting of the Crop occurs. Season Commencement is the date the new Crop planting is commenced, being no later than 15 June for each Season. The Responsible Entity will commence the provision of services in the Initial Period and will complete the services by 30 June in the relevant Season.

57. Clause 3.1 of the Grower Management Agreement specifies the services to be provided by the Responsible Entity in the Initial Period. These include:

- supply, propagate and husband the Seed for the CPU;
- carry out planting and sowing of the Seed;
- supply and maintain a pest and weed control programme including spraying;
- supply and spread fertiliser on the CPU;
- maintain firebreaks; and
- conduct regular checks on the progress of the Crop on each of the CPUs.

58. In each Season of the Project, the Responsible Entity will commence services in the Subsequent Period from 1 July to the date on which the Crop is harvested.

59. Clause 3.2 of the Grower Management Agreement specifies the services to be provided by the Responsible Entity in the Subsequent Period. These include:

- maintain firebreaks;
- maintain a pest and weed control programme including spraying as required;
- supply and spread fertiliser on the CPU as required;
- arrange compulsory crop insurance and multi-peril insurance (if available) for the Grower;
- 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; and
- undertake by marketing or other means the sale of the Crop as soon as practically possible after its harvest.

60. If the Grower is unable to plant a Crop on a CPU in any Season due to weather conditions or the inability of the Responsible Entity to source suitable land by 15 June each year, then the Responsible Entity must repay any Initial Period Fees already paid by the Grower by no later than 20 June in the financial year in which they were paid (clause 10).

Service Agreement and Management Agreement

61. The Responsible Entity will enter into a Service Agreement with AACL engaging them as Project Manager for the purpose of managing and producing wheat or barley subject to the terms and conditions of the Agreement. AACL will in turn enter into a Farm Management Agreement with various Farmers engaging them to carry out management duties on their behalf.

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

Crop insurance and multi-peril insurance

63. 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.

64. 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.

Pooling and distribution of net proceeds

65. Clause 12 of the Constitution and clauses 7 and 8 of the Grower Management Agreement set out the provisions relating to the Grower's entitlement to harvest proceeds. Each Grower's Farm Produce will be pooled with the Farm Produce of other Growers in the Project to form the Gross Pool Produce.

66. After the Harvest Bonus is deducted from the Gross Pool Produce, the Responsible Entity will market and sell the balance of the Crop in the Project Pool, called the Net Pool Produce.

67. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Growers who have contributed Farm Produce or insurance proceeds are entitled to benefit from distributions of harvest proceeds from the pool; and
- any pooled Farm Produce must consist only of wheat or barley contributed by Growers of the same Project class.

68. The proceeds from the Net Pool Produce will be deposited into the Project Fund. The Grower will be entitled to a distribution of the sale proceeds in proportion to the number of CPUs held by the Grower in the Project Pool.

69. The Responsible Entity is entitled to deduct from the Grower's share of the sale proceeds any Project Pool Outgoings. The balance will then be distributed to the Growers on a proportionate basis.

Fees and outgoings

70. Under the terms of the Grower Management Agreement and the Grower Sub-Lease, a Grower will make payments as described below on a CPU basis.

Fees and outgoings payable under the Grower Management Agreement

71. The following fees and outgoings are payable by the Grower under the Grower Management Agreement:

- Initial Period Fee for each Season (clause 9.1);
- Subsequent Period Fee for each Season (clause 9.3);
- Management Production Bonus (clause 9.4);
- Harvest Bonus Adjustment (clause 9.9);
- Project Finalisation Fee (clause 9.13);
- Crop insurance (clause 4.2.5); and
- Multi peril insurance (if available) (clause 4.2.6).

72. In addition, under clause 8.2 of the Grower Management Agreement, the Responsible Entity will pay all Project Pool Outgoings for each Season from the Project Fund. Project Pool Outgoings include Harvest Period Costs, Warehouse Costs and Harvest Loan Costs.

73. If the funds available in the Project Fund are insufficient to pay the Harvest Period Costs and the Warehouse Costs then the Grower must pay the shortfall prior to 30 June immediately following Harvest.

Initial Period Fee

74. For the 2008 Season, the Initial Period Fee is \$4,345 per CPU. The Initial Period Fee is paid for services from the Commencement Date to 30 June 2008.

75. For each of the 2009 and 2010 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 May 2009 and 31 May 2010, respectively (clause 9.11).

Subsequent Period Fee

76. 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 from 1 July to the date on which the Crop has been harvested from the CPU.

77. 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 (clause 9.3).

Harvest Bonus

78. The Harvest Bonus is made up of:

- the Management Production Bonus; plus
- the Rent Bonus.

Management Production Bonus

79. 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 at Harvest each Season.

80. The Management Production Bonus forms part of the Harvest Bonus and is paid where the Grower's CPU achieves a Harvest Surplus (clause 9.5). A Harvest Surplus will arise where the value of the Crop harvested from the Grower's CPU is greater than the Target Value – Tier 1 of \$5,230.50.

81. The Responsible Entity will retain 20% of the Harvest Surplus in the Project Fund pending the calculation of the Harvest Bonus Adjustment. This is called the Harvest Bonus Retention.

82. The Management Production Bonus is 50% of the Distributable Harvest Surplus (Harvest Surplus less the Harvest Bonus Retention).

83. The Management Production Bonus is deducted from the Gross Pool Produce and paid in the form of grain. The calculation of the Management Production Bonus is set out in Item 14 of the Schedule to the Grower Management Agreement.

84. In calculating the Management Production Bonus the Responsible Entity must determine the Delivered Price. If the Responsible Entity determines that the method for calculating the Delivered Price as set out in Item 11 of the Schedule to the Grower Management Agreement does not provide an appropriate benchmark for the price of wheat or barley the Responsible Entity must select another method which it considers is an appropriate benchmark (clause 9.5).

Harvest Bonus Adjustment

85. The Harvest Bonus Adjustment is made up of the Harvest Bonus Adjustment – Tier 1 and the Harvest Bonus Adjustment – Tier 2.

86. The Harvest Bonus Adjustment – Tier 1 is essentially a recalculation of the Harvest Bonus (Management Production Bonus and Rent Bonus) at the Determination Date and is based on the Final Value of the wheat or barley rather than the Delivered Value.

87. The Determination Date means the earliest of:
- (i) the date that all proceeds from the sale of the Net Pool Produce have been received as determined by the Responsible Entity; or
 - (ii) in respect of each season the following dates:
 - Season 2008 – 30 April 2009;
 - Season 2009 – 30 April 2010; or
 - Season 2010 – 30 April 2011.
88. The Harvest Bonus Adjustment Tier 2 is calculated as 90% of the Performance Surplus. A Performance Surplus will arise where the Farm Surplus is greater than the Target Value – Tier 2 of \$5,500. The Farm Surplus is the Net Proceeds before the Harvest Bonus Adjustment less the Harvest Bonus Adjustment – Tier 1.
89. The calculation of the Harvest Bonus Adjustment is set out in Item 18 of the Schedule to the Grower Management Agreement.
90. The Harvest Bonus Adjustment is payable in each Season of the Project and is paid from the proceeds in the Project Fund on the Determination Date. If the funds available in the Project Fund are insufficient then the Grower must pay the shortfall prior to 30 June immediately following Harvest (clause 9.9).

Project Finalisation Fee

91. The Responsible Entity is entitled to be paid the Project Finalisation Fee of \$132 per CPU at the earlier of the receipt of all Project Pool Proceeds from each Season's Project Pool or the Determination Date for Season 2009 (clause 9.13).
92. The Project 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 prior to 30 June 2011.

Fees payable under the Grower Sub-Lease Agreements

93. Under the Grower Sub-Lease Agreements, the following fees are payable by the Grower:
- Initial Period Rent;
 - Subsequent Period Rent; and
 - Rent Bonus (clause 5).

Rent

94. The Grower will pay the Responsible Entity Rent of \$247.50 for the 2008 Season of the Project consisting of:

- \$55 payable on Application, for the Initial Period from the Commencement Date to 30 June 2008; and
- \$192.50 for the Subsequent Period, from 1 July 2008 until the completion of Harvest. The Subsequent Period Rent is payable prior to 30 June 2008 from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall.

95. For the 2009 and 2010 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

96. In consideration of the performance by the Responsible Entity in the selection of the land for the Project the Responsible Entity is entitled to a Rent Bonus.

97. The Rent Bonus forms part of the Harvest Bonus and is paid where the Grower's CPU achieves the Target Value – Tier 1 of \$5,230.50 (clause 5.6).

98. The Rent Bonus is calculated as 40% of the Distributable Harvest Surplus and is deducted from the Gross Pool Produce of the Project Pool and paid in the form of grain at Harvest.

99. The calculation of the Management Production Bonus is set out in Item 12 of the Schedule to the Grower Sub-Lease Agreement.

100. In calculating the Rent Bonus the Responsible Entity must determine the Delivered Price. If the Responsible Entity determines that the method for calculating the Delivered Price as set out in Item 9 of the Schedule to the Grower Management Agreement does not provide an appropriate benchmark for the price of wheat or barley the Responsible Entity must select another method which it considers is an appropriate benchmark (clause 5.5).

Finance

101. A Grower who does not pay the Initial Period Fees in full upon application may borrow from the Preferred Financier or from an independent lender external to the Project.

102. Only the finance arrangements set out below are covered by this Product Ruling. This Ruling only applies to finance arrangements for the 2008 Initial Period. A Grower cannot rely on this Product Ruling if the Grower enters into a finance arrangement with the **Preferred Financier** if:

- the arrangement materially differs from that set out in the documentation provided to the Tax Office with the application for the Product Ruling; or
- any of the Subsequent Period Fees or further Initial Period Fees (2009 or 2010) are financed through Further Loan Amounts available through the finance arrangement as described in the documentation provided to the Tax Office with the application for the Product Ruling.

103. A Grower who enters into a finance arrangement with an **independent lender** external to the Project other than the Preferred Financier may request a private ruling on the deductibility or otherwise of interest under finance arrangements not covered by this Product Ruling.

104. Growers cannot rely on any part of this Ruling if the Application Amount is not paid in full on or before 30 June 2008 by the Grower or, on the Grower's behalf, by a lending institution. Where an application is accepted subject to finance approval by any lending institution other than the Preferred Financier, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by the lending institution by 30 June 2008.

Finance offered by Momentum

105. Subject to the terms and conditions of the Loan Agreement a Grower can finance their Initial Period Fees, payable on Application, by borrowing that amount from Momentum.

106. Subject to Momentum accepting the Grower's application, the Grower will be bound by the terms and conditions of the Loan Agreement.

107. The Loan Agreement has the following features:

- 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 11.25% per annum during the interest only period and 11.00% during the remainder of the term. This is based on current interest rates (this is an indicative rate 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; and
- a break cost fee will be charged on early repayments of loans.

108. The loans from the Preferred Financier are made on a full recourse commercial basis and normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers. The loans will be secured by a fixed charge over the Grower's interest(s) in the Project.

109. 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 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, other than Preferred Financier, are involved or become involved in the provision of finance to Growers for the Project.

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 Grower carrying on a business?

110. For the amounts set out in the table at paragraph 25 of this Ruling to constitute allowable deductions the Grower's grain growing activities as a participant in the 2008 Grain Co-Production Project must amount to the carrying on of a business of primary production.

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

112. 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?

113. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly, paragraph 89, is more specific to arrangements such as the 2008 Grain Co-Production Project. 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.

114. Having applied these principles to the arrangement set out above, a Grower in the 2008 Grain Co-Production Project is accepted to be carrying on a business of growing and harvesting grain for sale.

Deductibility of Project Pool Outgoings and interest on loans with the Preferred Financier

Section 8-1

115. The Management fees, Rent and Insurance fees 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 Management fees, Rental fees and Insurance fees (see paragraphs 49 to 51 of TR 2000/8).

116. 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 119 to 123 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.)

117. Some Growers may finance their participation in the Project through a Loan Agreement with the Preferred Financier. Applying the same principles as that used for the Management fee and the Rental fee, interest incurred under such a loan has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

118. Other than where the prepayment provisions apply (see paragraphs 119 to 123 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

Prepayment provisions

Sections 82KZL to 82KZMF

119. 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.

120. 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

121. Under the scheme to which this Product Ruling applies Management fees, Rental fees and other fees are incurred annually and the interest payable to the Preferred Financier is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this scheme.

122. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project prepays all or some of the expenditure payable under the Allotment Management Agreement and Allotment Licence Agreement, or prepays interest under a loan agreement (including loan agreements with lenders other than the Preferred Financier). Where such a prepayment is made these prepayment provisions will also apply to 'small business entities' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

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

Borrowing costs**Section 25-25**

124. A deduction is allowable for expenditure incurred by a Grower in borrowing money to the extent that the borrowed money is used for the purpose of producing assessable income (subsection 25-25(1)).

125. In this Project, the Application fee of \$250 plus 0.5% of the loan amount payable to Momentum, the Preferred Financier, is incurred to borrow money that is used or is to be used solely for income producing purposes during each income year over the term of the loan.

126. The deduction for the borrowing expense is spread over the period of the loan or 5 years, whichever is the shorter (subsection 25-25(4)).

Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner’s discretion

127. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income year ended 30 June 2008, the Commissioner has applied the principles set out in Taxation Ruling TR 2007/6 Income tax: non-commercial business losses: Commissioner’s discretion. Based on the evidence supplied, the Commissioner has determined that for those income years:

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

128. 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.

129. 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

130. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefits'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL 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

131. 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).

132. The 2008 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 paragraphs 25 to 26 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.

133. 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 wheat or barley. 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

134. The following is a detailed contents list for this Ruling:

| | Paragraph |
|--|------------------|
| What this Ruling is about | 1 |
| Class of entities | 2 |
| Qualifications | 6 |
| Superannuation Industry (Supervision) Act 1993 | 9 |
| Date of effect | 10 |
| Changes in the law | 15 |
| Note to promoters and advisers | 17 |
| Goods and Services Tax | 18 |
| Ruling | 19 |
| Application of this Ruling | 19 |
| Concessions for 'small business entities' | 22 |
| Assessable income | 24 |
| <i>Sections 6-5 and 17-5</i> | 24 |
| Grower's deductions | 25 |
| <i>Section 8-1 and Division 27 of the ITAA 1997 and sections 82KZME and 82KZMF of the Income Tax Assessment Act 1936</i> | 25 |
| Division 35 – deferral of losses from non-commercial business activities | 26 |
| <i>Section 35-55 – exercise of Commissioner's discretion</i> | 26 |
| Prepayment provisions and anti-avoidance provisions | 27 |
| <i>Sections 82KZME, 82KZMF and 82KL and Part IVA</i> | 27 |
| Scheme | 28 |
| Overview | 31 |
| Due diligence | 39 |
| Constitution | 40 |
| Compliance Plan | 45 |
| Lease | 46 |
| Growers Sub-Lease Agreement | 49 |
| Growers Management Agreement | 54 |
| Service Agreement and Management Agreement | 61 |
| Crop insurance and multi-peril insurance | 63 |

| | |
|---|------------|
| Pooling and distribution of net proceeds | 65 |
| Fees and Outgoings | 70 |
| <i>Fees and outgoings payable under the Grower Management Agreement</i> | 71 |
| <i>Initial Period Fee</i> | 74 |
| <i>Subsequent Period Fee</i> | 76 |
| <i>Harvest Bonus</i> | 78 |
| <i>Management Production Bonus</i> | 79 |
| <i>Harvest Bonus Adjustment</i> | 85 |
| <i>Project Finalisation Fee</i> | 91 |
| <i>Fees payable under the Grower Sub-Lease Agreements</i> | 93 |
| <i>Rent</i> | 94 |
| <i>Rent Bonus</i> | 96 |
| Finance | 101 |
| <i>Finance offered by Momentum</i> | 105 |
| Appendix 1 – Explanation | 110 |
| Is the Grower carrying on a business? | 110 |
| Deductibility of Project Pool Outgoings and interest on loans with the Preferred Financier | 115 |
| <i>Section 8-1</i> | 115 |
| Prepayment provisions | 119 |
| <i>Sections 82KZL to 82KZMF</i> | 119 |
| Application of the prepayment provisions to this Project | 121 |
| Borrowing costs | 124 |
| <i>Section 25-25</i> | 124 |
| Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner’s discretion | 127 |
| Section 82KL – recouped expenditure | 130 |
| Part IVA – general tax avoidance provisions | 131 |
| Appendix 2 – Detailed contents list | 134 |

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 97/11; TR 98/22;
TR 2000/8; TR 2007/6

Subject references:

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

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

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