



PR 2008/17 - Income tax: Moora Citrus Project - 2008 Growers

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 This document has changed over time. This is a consolidated version of the ruling which was published on 4 June 2008



Product Ruling

Income tax: Moora Citrus Project – 2008 Growers

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	9
Ruling	18
Scheme	29
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	83
Appendix 2:	
Detailed contents list	110

ⓘ 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.

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

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 Product Ruling relates. Unless otherwise indicated, all legislative references in this Product Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997). In this Product Ruling the scheme is referred to as the 'Moora Citrus Project' 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 Growers. Growers 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 29 of this Product Ruling on or before 15 June 2008. 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 Product Ruling or after 15 June 2008;
- participate in the scheme through offers made other than through the Product Disclosure Statement;
- elect to market their own produce (see paragraph 64 of this Product Ruling);
- enter into finance arrangements with entities associated with the Project other than the Preferred Financier;
- enter into finance arrangements with the Preferred Financier other than the arrangements specified at paragraphs 75 to 80 of this Product Ruling;
- have their application conditionally accepted by Primary Securities Ltd subject to finance for the payment of the Application Fee, where the finance has not been approved by the lender and/or the funds have not been paid in full to Primary Securities Ltd by 15 June 2008;

- have their application conditionally accepted by Primary Securities Ltd subject to finance for the payment of the Rent and Ongoing Management Fees for the 2008-09 and 2009-10 income years, where the finance has not been approved by the lender and/or the funds have not been paid in full to Primary Securities Ltd by 30 September 2008 and 30 September 2009 respectively; or
- have not paid the Application Fee by 15 June 2008, where they have not entered into a finance arrangement.

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 29 to 81 of this Product 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 27 February 2008, the date this Product Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 27 February 2008 until 15 June 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.

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 ruling relates has not begun; and
- the scheme to which the ruling relates 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 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 Product Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Ruling**Application of this Product Ruling**

18. 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 29 to 81 of this Product Ruling.

19. The Grower's participation in the Project must constitute the carrying on a 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 Management Agreement and Citruslot Sub-Lease on or before 15 June 2008.

20. 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.

Small business concessions¹

21. 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').

22. 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. Accordingly application of the small business concessions to Growers who qualify as a 'small business entity' is not able to be dealt with in this Product Ruling.

¹ The meaning of 'small business entity' is explained in section 328-110.

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

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

24. The Grower recognises ordinary income from carrying on the business of horticulture at the time that income is derived.

Deductions for the Initial Services Fee, Rent, Ongoing Management Fees, Interest and Borrowing Expenses**Sections 8-1, 25-25 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 'Citruslot' basis**, as set out in the Table.

Fee Type	2007-08 Income Year	2008-09 Income Year	2009-10 Income Year
Initial Services Fee	\$3,168 See Notes (i), (ii) and (iv)		
Rent	\$12 See Notes (i), (ii) and (iv)	\$275 See Notes (i), (ii) and (iv)	\$283 See Notes (i), (ii) and (iv)
Ongoing Management Fee		\$1,130 See Notes (i), (ii) and (iv)	\$1,161 See Notes (i), (ii) and (iv)
Interest on loans with the Preferred Financier		See Notes (iii) and (iv)	See Notes (iii) and (iv)
Loan Application Fee	See Note (v)	See Note (v)	See Note (v)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.

- (ii) The Initial Services Fee and Rent payable on application and the ongoing Rent and Ongoing Management Fees are deductible in the income year they are incurred.
- (iii) Interest on loans with the Preferred Financier is deductible in the income year in which it is incurred (section 8-1). The deductibility or otherwise of interest arising from agreements entered into with financiers other than the Preferred Financier is outside the scope of this Product Ruling.
- (iv) This Product 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 91 to 95 of this Product 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). Growers who prepay such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (v) The loan application fee payable to the Preferred Financier is a borrowing expense and is deductible under section 25-25. Borrowing expenses of \$100 or less are deductible in the income year in which they are incurred. If the borrowing expenses are greater than \$100, 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 Product Ruling.

Deductions for capital expenditure

Subdivision 40-F and Subdivision 328-D

26. A Grower will be entitled to tax deductions relating to the irrigation system (water facility) and the establishment of the Citrus Fruit trees. Deductions shown in the following Table are determined under Subdivision 40-F. Small business entities may choose to calculate the deduction for the irrigation system under Subdivision 328-D (see note (vi)).

PR 2008/17

Fee type	ITAA 1997 section	2007-08 income year	2008-09 income year	2009-10 income year
Water facility	40-515	\$440 See Notes (i) & (vi)	\$440 See Notes (i) & (vi)	\$440 See Notes (i) & (vi)
Establishment of horticultural plants (Citrus Fruit trees)	40-515	Nil see note (vii)	Nil see note (vii)	Must be calculated see note (vii)

Notes:

- (vi) The irrigation system meets the definition of 'depreciating asset' in section 40-30 and is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a) for the capital expenditure incurred by each Grower on the installation of the irrigation system (the underlying asset). Each Grower's interest in the underlying asset is a 'depreciating asset'. This deduction is equal to one third of the capital expenditure in the income year in which it is incurred and one third in each of the next two years of income (section 40-540).

Small business entities may choose to calculate their deduction under Subdivision 40-F (as discussed above) or under Division 328. For Division 328 to apply, the Grower must be a small business entity for the income year in which it holds the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the cost apportionable to the asset is less than \$1,000, the asset is treated as a 'low cost asset' and the amount is deductible in full (section 328-180). If the asset is not treated as a low cost asset, the tax deduction allowable in the 2007-08 income year is determined by multiplying its cost by half the relevant small business pool rate. At the end of the income year, it is allocated to the relevant small business pool and in subsequent income years the full pool rate will apply (section 328-190).

- (vii) Each Grower will also be entitled to tax deductions relating to the citrus trees planted on the Grower's Citruslot. A 'horticultural plant' is a 'depreciating asset' as defined in section 40-30 and citrus trees are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a sub-lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the citrus trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred that is attributable to their establishment. The deduction is determined using the formula in section 40-545. TR 2007/3 lists at Table A the effective lives of the varieties of citrus trees. Orange trees have an effective life of 30 years and Mandarin trees have an effective life of 25 years. Therefore the write-off rate used in the formula at section 40-545 would be 7% and 13% respectively. The deduction is allowable when the citrus trees enter their first commercial season (section 40-530, item 2). The Responsible Entity will notify Growers when their citrus trees enter their first commercial season and the amount incurred by the Land Company in establishing the citrus trees.

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

Section 35-55 – exercise of Commissioner's discretion

27. A Grower who is an individual accepted into the Project by 15 June 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 these Growers for the **2007-08 to 2011-12 income years**. 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.

Section 82KL and Part IVA

28. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Citruslot Sublease 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 Product Ruling.

Scheme

29. The scheme that is the subject of this Product Ruling is specified below. The scheme incorporates the following:

- Application for a Product Ruling as constituted by the following documents and additional correspondence including e-mails received on 23 February 2006, 17 March 2006, 19 April 2006, 28 April 2006, 1 May 2006, 8 May 2006, 9 May 2006, 20 November 2007, 21 November 2007, 28 November 2007, 4 February 2008, 6 February 2008, 18 February 2008 and 19 February 2008;
- Additional correspondence and documents, received 1 April 2008, 23 April 2008, 28 April 2008 and 8 May 2008;
- Draft Product Disclosure Statement for the Moora Citrus Project, received 19 February 2008;
- Draft **Constitution** of the Moora Citrus Project, received 4 February 2008;
- Draft **Management Agreement** for the Moora Citrus Project between Primary Securities Ltd (as Responsible Entity) and the Grower, received 4 February 2008;
- Draft Lease between Midwest Holdings Group Pty Ltd (as Lessor) and Primary Securities Ltd (as Lessee), received 18 February 2008;
- Draft **Citruslot Sub-Lease** for the Moora Citrus Project between Primary Securities Ltd (as Responsible Entity) and the Grower, received 4 February 2008;
- Responsible Entity Services Agreement for the Moora Citrus Project 2006 between Agcorp Australia Pty Ltd (as Project Manager), Midwest Holdings Group Pty Ltd (as Land Owner), Moora Citrus Holdings Pty Ltd (as Holding Company) and Primary Securities Ltd, dated 6 June 2006;
- Custodian Agreement for the Moora Citrus Project between Primary Securities Ltd (as Responsible Entity) and the Custodian, dated 3 May 2006;
- Rules for the Moora Citrus Project, dated 15 June 2006;
- Draft Orchard Management Agreement for the Moora Citrus Project between Primary Securities Ltd (as Responsible Entity) and Agcorp Australia Pty Ltd (as Project Manager), received 4 February 2008;

- Compliance Plan for the Moora Citrus Project, received 3 August 2006;
- Independent Horticulturist's Report dated 13 November 2007; and
- Draft **Loan Agreement** and loan documents including Application Forms, received 23 February 2006, 20 November 2007 and 6 February 2008.

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

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

31. The documents highlighted (in bold) are those that a Grower may enter into. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the scheme. The effect of these agreements is summarised below:

Overview

32. The main features of the Moora Citrus Project are as follows:

Location	Moora, 200 kms North East of Perth
Type of business each participant is carrying on	Commercial growing and cultivation of Citrus Fruit Trees (Navel and Valencia oranges and mandarins) for the purpose of harvesting and selling the produce.
Term of the Project	Approximately 19 years.
Number of hectares offered for cultivation	Approximately 184
Size of each Citruslot	0.075 hectares.
Minimum allocation per Grower	2 Citruslots
Minimum subscription	Nil
Initial cost	\$9,000 for 2 Citruslots
Ongoing Costs	<ul style="list-style-type: none"> • Rent • Ongoing Management Fees
Other costs	<ul style="list-style-type: none"> • Processing costs • Performance Incentive

33. The Project has been registered as a Managed Investment Scheme under the *Corporations Act 2001*. Primary Securities Ltd has been issued with Financial Services Licence Number 224107 and will be the Responsible Entity for the Project.

34. The Project involves the cultivation of citrus trees and the harvest and sale of the Citrus Fruit.

35. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer made under the PDS is for 184 hectares which corresponds to 2,452 Citruslots in the Project. There is no minimum subscription for the Project.

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

37. Primary Securities Ltd has secured 210 hectares of land at Moora, Western Australia for the Project at the following location:

- the whole of lot 803 on Deposited Plan 53636 and being the whole of the land comprised in Certificate of Title Volume 2660 Folio 815, located on Prices Road, off Dandaragon Road, Shire of Dandaragan.

38. The land is owned by Midwest Holdings Group Pty Ltd (the Land Company). The Land Company will lease the property to the Responsible Entity for the duration of the Project.

39. Water for the irrigation of the Citruslots will be acquired from the Leederville Parmelia Aquifer via a production bore. A licence from the Waters and Rivers Commission allows an annual entitlement of 1,890 megalitres of water.

40. A Grower that participates in the Project will do so by acquiring an interest in the Project which will consist of a minimum of two Citruslots of 0.075 hectares in size. Each Citruslot will consist of a combination of different lots to total approximately 2 Tree rows. By the end of May 2008, the Land Company will plant 40% of each Citruslot with existing trees. The Land Company will plant the balance 60% of each Citruslot with new trees between October 2008 and April 2009. The Citruslots will be planted at the rate of approximately 800 trees per hectare.

41. This Product Ruling only applies to Growers who are accepted to participate in the Project from the date of this Product Ruling until 15 June 2008 (2008 Growers).

Constitution

42. The Constitution establishes the Project and operates as a deed binding on all of the Growers and Primary Securities Ltd as the Responsible Entity. The Constitution sets out the terms and conditions under which Primary Securities Ltd agrees to act as the Responsible Entity for the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

43. In order to acquire an interest in the Project, the Grower must make an application for Citruslots in accordance with the PDS. Among other things, the application must be completed in a form approved by the Responsible Entity, signed on behalf of the applicant, lodged at the registered office of the Responsible Entity and accompanied by payment of the Application Fee in the form acceptable to the Responsible Entity.

44. Under the terms of the Constitution, all moneys received from Growers on application (the Application Fees) shall be paid to the Responsible Entity. The Responsible Entity will enter into a Custodian Agreement under which the Custodian will hold the Application Fees (as agent for the Responsible Entity) in a trust account set up for this purpose.

45. The Responsible Entity will also:

- enter into the Management Agreement and Citruslot Sub-Lease on behalf of the Grower;
- enter into any agreement for the sale of the Citrus Fruit on behalf of the Grower; and
- deposit the Receipts from the sale of Citrus Fruit into the trust account held by the Custodian and pay the Grower's Proportion of the Receipts to the Grower following deduction of costs and outstanding fees in accordance with clause 11.

Compliance Plan

46. As required by the Corporations Act, a Compliance Plan has been prepared for the Project. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

47. Pursuant to clause 12 of the Compliance Plan, the Responsible Entity will arrange for the Custodian to open a trust account to receive the Application Fees paid by the Growers. After the Grower has entered into the Citruslot Sub-lease and the Management Agreement, the Responsible Entity must pay the bulk of the Application Fee to the Project Manager.

Head Lease

48. Under the Head Lease (between Primary Securities Ltd as Responsible Entity and the Land Company), the Land Company will lease the land to Primary Securities Ltd for the duration of the Project. The Land Company is responsible for establishing the Orchard at its own cost. This includes preparing the land and installing all infrastructure such as the Dam, Irrigation System and windbreaks. The Land Company will also purchase Tree stocks and plant the Trees on the Citruslots (40% by the end of May 2008 and 60% between October 2008 and April 2009) so there is an average of no less than 60 trees per Citruslot (clause 6.2).

49. The Responsible Entity must use the land only for Citrus Farming and the Harvesting of Citrus Fruit.

Citruslot Sub-Lease

50. Growers participating in the Project will enter into a Citruslot Sub-Lease with Primary Securities Ltd in its capacity as Responsible Entity and Lessor of the Moora Citrus Project. Growers are granted an interest in land in the form of a Sub-Lease to use their Citruslots for carrying on the business of Citrus Farming (clause 2 of the Citruslot Sub-Lease).

51. Under the Citruslot Sub-Lease, Growers have an exclusive right and title to the Citrus Fruit on the Trees on the Citruslots (clause 2 of the Citruslot Sub-Lease).

52. The sub-lease will commence on the date the Citruslots are allotted to Growers and will continue for a period of approximately 19 years or until the Project is terminated. Each Grower must pay Rent annually to the Responsible Entity (Clause 4 and Item 5 of the Schedule to the Citruslot Sub-Lease).

53. Under clause 2.3 of the Citruslot Sub-Lease, the Grower has the right to use the Irrigation System, the Dam, the licence to draw water from the Water Source and any other infrastructure on the land for the purpose of asserting these rights.

54. Under the Citruslot Sub-Lease, among other things, the Grower:

- must not use the Citruslots for any purpose other than Citrus Farming and Harvesting of Citrus Fruit;
- must maintain the Citruslots in good condition and effect repairs when needed;
- must take out a public risk insurance policy and additional insurance as the Grower sees fit; and
- shall comply with all laws relating to the use and occupancy of the Citruslots.

55. If the Trees are destroyed or materially damaged, a mineral or petroleum lease is established over the Citruslots, or the Grower and Responsible Entity agree that it is no longer viable to carry out Citrus Farming then the parties may terminate the Citruslot Sub-Lease pursuant to clause 10.

Management Agreement

56. Growers participating in the scheme will enter into Management Agreement with Primary Securities Ltd in its capacity as Responsible Entity for the Project. The Management Agreement commences on the date of Allotment of the Citruslots to the Grower. Under the Management Agreement, each Grower appoints the Responsible Entity to perform the Initial Services, Citrus Farming, Replanting (if necessary) and Processing in accordance with the duties and obligations detailed in the relevant Management Plans. The Responsible Entity will also cause the Irrigation System to be installed to the extent required for irrigating the Grower's Citruslots.

57. The Initial Services provided for under the Management Agreement must be completed during the period from the date of Allotment of the Citruslots to the Grower to 30 June 2008. These services will only be conducted after the Citruslots are leased to the Grower. The Initial Services include:

- inspection of all existing trees on the Land;
- preparation of a report to the effect that the Citruslots have been established in accordance with the terms of the Citruslot Sub-Lease;
- preparation of a soil report for the Growers;
- monitoring of the leaching of nutrients from the soil;
- preparation of the Initial Orchard Management Plan;
- preparation of a cash flow forecast for the following year;
- inspection, supervision and management activities in respect of the Initial Services that are carried out by sub-contractors; and
- all other activities required for Citrus Farming.

58. Services that will be provided during the Term of the Project are Citrus Farming, Replanting and Processing. These include, among other things:

- Planting suitable replacement trees in lieu of those Grower's Trees that failed within the first 2 years after 30 June 2008;
- cultivating, tending, culling, watering, pruning, thinning, fertilising, spraying and otherwise caring for existing trees;

- maintaining a pest management programme;
- monitoring and maintaining soil quality;
- obtaining all necessary approvals and consents in relation to the provision of the services listed in the Management Agreement;
- arranging insurance of the Citrus Fruit pursuant to clause 7; and
- harvesting, grading, checking, packaging, storing and delivering the Citrus Fruit.

59. The Responsible Entity will carry out the above services in accordance with good horticultural and agricultural practices generally recognised as good practice for the growth of premium quality Citrus Fruit.

60. The Responsible Entity will provide a report to the Grower by the first 31 December following Allotment and on 31 December of each succeeding year setting out information on matters relevant to the Grower's business including the general state of the Orchard. In addition the Responsible Entity will provide a report within 60 days after the completion of Harvesting each season setting out details of the sale of Citrus Fruit, the Gross Sale Proceeds, Processing Costs and Net Proceeds to Growers.

61. The Responsible Entity will be responsible for insuring the Orchard against public risk. The Responsible Entity is also required to insure the Citruslots against damage or theft, damage to picked Citrus Fruit resulting from cool store breakdown or other plant breakdown, loss due to fortuitous circumstances, product liability and other such risks in respect of the Citruslots and Citrus Fruit in a manner consistent with prevailing industry practice.

Orchard Management Agreement

62. Under the Orchard Management Agreement between Primary Securities Ltd (as Responsible Entity) and Agcorp (as Project Manager), the Responsible Entity engages the Project Manager, as an independent contractor to carry out, direct, supervise and monitor the management of the Orchard (including Initial Services, Citrus Farming, Replanting and Processing) for and on behalf of the Responsible Entity. The Project Manager must carry out these services in accordance with good horticultural and agricultural practices having regard to the various Management Plans required to be prepared under clause 6 of Orchard Management Agreement.

63. Under clause 16 of the Orchard Management Agreement, the Project Manager agrees to buy all the Citrus Fruit delivered to the Project Manager and the Project Manager will use its best endeavours to on-sell the Citrus Fruit for the highest price practicable having regard to the circumstances at the relevant time.

Pooling of Citrus Fruit and Grower's Entitlement to Net Proceeds

64. The first Harvest of Citrus Fruit is expected two income years after Allotment with full production in the fifth income year after Allotment.

65. Growers may elect, by notice in writing to the Responsible Entity by the second 30 June following Allotment of the Citruslots, to sell the Citrus Fruit harvested from their Trees (clause 9 of the Management Agreement). **This Product Ruling does not apply to Growers who make such an election.**

66. If no such election is made, the Grower irrevocably authorises the Responsible Entity to sell (and to appoint the Project Manager to sell) the Citrus Fruit harvested from the Grower's Trees (clause 8 of the Management Agreement).

67. The Responsible Entity will pool and sell all Citrus Fruit from the Orchard for which an election under clause 9 of the Management Agreement has not been made. The Management Agreement sets out the circumstances relating to the pooling of Growers' Citrus Fruit and the distribution of the proceeds of sale. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- Growers who have contributed Citrus Fruit from a Harvest to the pool making up the proceeds are entitled to benefit from distributions from those proceeds in proportion to their contributions; and
- Citrus Fruit can only be pooled with the Citrus Fruit of Growers accepted to participate in the Moora Citrus Project.

68. The Net Proceeds to Growers (Gross Sale Proceeds less Processing Costs) will be paid by the Project Manager to the Responsible Entity for deposit to the trust account in the name of the Custodian. The Grower's Proportion of the Net Proceeds to Growers will be dealt with in the following order of priority (clause 11 of the Constitution), to pay:

- the Grower's Proportion of the Processing Costs (to the extent not already paid);
- any outstanding Rent or Management Fees or other costs owing by the Grower to the Responsible Entity;
- the balance to the Grower.

69. The term 'Grower's Proportion' is defined in clause 1.1 of the Management Agreement.

70. In the event of total or partial damage to the Trees on the Citruslots, the Grower's Proportion will be correspondingly reduced (clause 13 of the Management Agreement).

Fees

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

- **Application Fee** of \$4,500 payable on application. This is comprised of the Initial Services Fee (\$3,168), the Irrigation System Fee (\$1,320) and Rent (\$12) for the period from the Lease Commencement Date to 30 June 2008;
- **Ongoing Management Fees** of \$1,130 for the 2008-09 income year, \$1,161 for the 2009-10 income year and \$1,193 for the 2010-11 income year. For the 2011-12 and subsequent income years the Ongoing Management Fee is equal to the greater of \$770 indexed for each income year from the 2011-12 income year and the Grower's proportion of the anticipated Operating and Scheme Costs plus a Margin of 15%. Ongoing Management Fees are invoiced on or about 1 July each income year and are payable on or before 30 September of that income year;
- Annual **Rent** of \$275 for the 2008-09 income year, \$283 for the 2009-10 income year and \$290 for the 2010-11 income year. The Rent for the 2011-12 income year and each subsequent income is the Rent for the previous income year Indexed. Rent is invoiced on or about 1 July each income year and is payable on or before 30 September of that income year;
- **Processing Costs** for harvesting, grading, freight and selling to be deducted from Gross Sale Proceeds;
- **Performance Incentive** of 15% of Net Proceeds to Growers payable from the income year in which the Orchard commences harvest for commercial purposes.

Finance

72. A Grower who does not pay the Application Fee in full upon application can borrow from the Preferred Financier, or from an independent lender external to the Project.

73. Only the finance arrangements set out below are covered by this Product Ruling. A Grower cannot rely on this Product Ruling if they enter into a finance arrangement with the Preferred Financier that materially differs from that set out in the documentation provided to the Tax Office with the application for this Product Ruling. 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 incurred under finance arrangements not covered by this Product Ruling.

74. Growers cannot rely on this Product Ruling if the Application Fee is not paid in full on or before 15 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, Growers cannot rely on this Product Ruling if written evidence of that approval has not been given to the Responsible Entity by the lending institution by 15 June 2008.

Finance offered by the Preferred Financier

75. Subject to the terms and conditions of the respective Loan Agreements, a Grower can enter into either or both of the following two loans:

- a loan of:
 - up to 100% of the cost of the Application Fee (including GST); and
 - at the option of the Grower, up to 100% of the Rent and Ongoing Management Fees (including GST) payable by 30 September 2008 and 30 September 2009;
- a loan of up to 100% of the Rent and Ongoing Management Fees (including GST) payable by 30 September 2010 and 30 September 2011.

76. This corresponds to a maximum total facility of \$19,800 (including GST) for each minimum allocation of two Citruslots (excluding any loan establishment fee and stamp duty that may be included in the loan).

77. Under each loan agreement, the Preferred Financier will lend on a full-recourse commercial basis under the following arrangements:

- monthly payments of interest only for 3 years plus monthly instalments of principal and interest for 7 years;
- monthly payments of interest only for 2 years plus monthly instalments of principal and interest for 5 years;
- monthly payments of interest only for 2 years plus monthly instalments of principal and interest for 3 years; and
- monthly instalments of principal and interest over 3 years.

78. Payments commence one month following the date on which the Principal is advanced with all outstanding amounts to be paid by the end of the Term of the loan. The indicative interest rate is 11.45%. The actual interest rate will be set on the loan drawdown date. Interest will accrue on the unpaid balance of the loan and is charged monthly in arrears.

79. An establishment fee of \$295 plus 1.0% of the total amount borrowed is payable on application in relation to each loan agreement. These fees (and any applicable stamp duty) may be added to the relevant loan.

80. Although there may be multiple drawdowns (on application, 30 September 2008, 30 September 2009 for the first loan, and 30 September 2010 and 30 September 2011 for the second loan) each loan will be treated as a single loan. This means that the interest only period (if applicable) will end 2 or 3 years after the first drawdown. The total loan will be repaid by the end of 3, 5, 7 or 10 years (as the case may be) from the first drawdown.

81. The loans are secured by a registered charge over the Grower's interest in the Project. Normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers.

82. This Product Ruling also does not apply if a Grower enters into an agreement that 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' 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 terms are of a non-arm's length nature;
- repayments of the principal and 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) back to the lender or any associate;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than the Preferred Financier are involved or become involved, in the provision of finance 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?

83. For the amounts set out in paragraphs 25 to 26 of this Ruling to constitute allowable deductions, the Grower's horticultural activities as a participant in the Moora Citrus Project must amount to the carrying on of a business of primary production.

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

85. 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?

86. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the Moora Citrus 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.

87. Having applied these principles to the arrangement set out above, a Grower in the Moora Citrus Project is accepted to be carrying on a business of growing and harvesting citrus fruit for sale.

Deductibility of the Initial Services Fee, Ongoing Management Fees, Rent and interest on loans with the Preferred Financier

Section 8-1

88. The Initial Services Fee, Ongoing Management Fees and Rent are deductible under section 8-1 (see paragraphs 43 and 44 of Taxation Ruling TR 2000/8). A 'non-income producing' purpose (see paragraphs 47 and 48 of Taxation Ruling TR 2000/8) is not identifiable in the arrangement and there is no capital component evident in the Initial Services Fee, Ongoing Management Fees or Rent.

89. 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 91 and 92 of this Product Ruling) a deduction for these amounts may be claimed in the income year in which they are incurred. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7.)

90. 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 Initial Services Fee, Ongoing Management Fees and Rent, interest incurred under such a loan has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

91. Other than where the prepayment provisions apply (see paragraphs 91 to 95 of this Product Ruling), a Grower can claim a deduction for such interest in the income year in which it is incurred.

Prepayment provisions

Sections 82KZL to 82KZMF

92. 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 income year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year of income, then it is not expenditure to which the prepayment rules apply.

93. 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

94. Under the Scheme to which this Ruling applies the Initial Services Fee is incurred on application and the Ongoing Management Fees and Rent are incurred annually for services to be wholly provided in the income year in which those fees are incurred 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.

95. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a 'Grower' in this Project chooses to prepay all or some of the expenditure payable under the Management Agreement and/or the Citruslot Sub-Lease or chooses or is required to prepay interest under a loan agreement (including loan agreements with lenders other than the Preferred Financier).

96. As noted in Note (iv) of paragraph 25 of this Ruling, prepayments of fees or interest are not covered by this Product Ruling and Growers who make such prepayments may instead request a private ruling on the tax consequences of the prepaid fees and/or interest.

Expenditure of a capital nature***Division 40 and Division 328***

97. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to the irrigation system and the establishment of the citrus trees is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328.

98. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is a 'small business entity'.

99. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 26 of this Product Ruling in the Table and the accompanying notes.

Borrowing costs***Section 25-25***

100. 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)).

101. In this Project, the loan application fee payable to 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.

102. Borrowing expenses of \$100 or less are deductible in the income year in which they are incurred (subsection 25-25(6)). Where the amount exceeds \$100, 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

103. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the **2007-08 to 2011-12** income years, 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 citrus growing industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

104. 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

105. 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 Product Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Product 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

106. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefits(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

107. 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).

108. The Moora Citrus 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 and 26 of this Product 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.

109. Growers to whom this Product Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the Citrus Fruit. 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 Product 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

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

	Paragraph
What this Ruling is about	1
Class of entities	2
Superannuation Industry (Supervision) Act 1993	5
Qualifications	6
Date of effect	9
Changes in the law	14
Note to promoters and advisers	16
Goods and Services Tax	17
Ruling	18
Application of this Product Ruling	18
Small business concessions	21
Assessable income	23
<i>Section 6-5 and 17-5</i>	23
Deductions for the Initial Services Fee, Rent, Ongoing Management Fees and Borrowing Expenses	25
<i>Section 8-1, section 25-25 and Division 27 of the ITAA 1997 and sections 82KZME and 82KZMF of the Income Tax Assessment Act 1936</i>	25
Deductions for capital expenditure	26
<i>Subdivision 40-F and Subdivision 328-D</i>	26
Division 35 – deferral of losses from non-commercial business activities	27
<i>Section 35-55 – exercise of Commissioner’s discretion</i>	27
Section 82KL and Part IVA	28
Scheme	29
Overview	32
Constitution	42
Compliance Plan	46
Head Lease	48
Citruslot Sub-Lease	50
Management Agreement	56
Orchard Management Agreement	62

Pooling of Citrus Fruit and Growers' Entitlement to Net Proceeds	64
Fees	71
Finance	72
<i>Finance offered by the Preferred Financier</i>	74
Appendix 1 – Explanation	83
Is the Grower carrying on a business?	83
Deductibility of the Initial Services Fee, Ongoing Management Fees, Rent and Interest on loans with the Preferred Financier	88
<i>Section 8-1</i>	88
Prepayment provisions	92
<i>Sections 82KL to 82KZMF</i>	92
<i>Application of the prepayment provisions to this Project</i>	94
Expenditure of a capital nature	97
<i>Division 40 and Division 328</i>	97
Borrowing costs	100
<i>Section 25-25</i>	100
Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner's discretion	103
Section 82KL – recouped expenditure	106
Part IVA – general tax avoidance provisions	107
Appendix 2 – Detailed contents list	110

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 2007/3

Subject references:

- borrowing expenses
- 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
- tax avoidance
- taxation administration

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
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- ITAA 1997 25-25
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