TR 2007/8 - Income tax: registered agricultural managed investment schemes

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As noted in the Commissioner of Taxation's Media Release 2008/61 this Ruling will be withdrawn as a result of the Full Federal Court's decision in Hance v. FC of T; Hannebery v. FC of T [2008] FCAFC 196; 2008 ATC 20-085.

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Taxation Ruling

Income tax: registered agricultural managed investment schemes

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What this Ruling is about

1. This Ruling deals with the application of section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997)[1] to contributions by investors to registered agricultural managed investment schemes.[2]

2. This Ruling also deals with the question of whether interim and final returns to investors are, either wholly or in part, an amount of ordinary income for the purposes of section 6-5, or an amount of 'statutory income' for the purposes of section 6-10.

[1] All references in this Ruling are to the ITAA 1997 unless otherwise stated.
[2] On 21 December 2006 the Government announced that, with effect from 1 July 2007, investors in forestry MIS would be entitled to immediate upfront deductibility for their expenditure provided that at least 70 per cent of the MIS expenditure was directly related to developing forestry. New Division 394 has been enacted to provide this.

Class of entities/scheme

3. This Ruling applies to entities[3] participating as investors[4] in, and responsible entities of, registered agricultural managed investment schemes. These schemes exhibit the first three of the following features, and many of the remaining eleven:

- the scheme is a managed investment scheme (MIS) within the meaning in section 9 of the *Corporations Act 2001* (Corporations Act) involving the conduct of some type of agricultural activity, for example, the growing of agricultural produce for sale, such as standing timber, various sorts of horticultural produce, etc., or the breeding or maintenance of animals, including marine animals, for sale, or for their produce;
- under section 9 of the Corporations Act, a scheme is a MIS where:
  - participants contribute money or money's worth to acquire rights to benefits produced by the scheme (such rights being referred to as 'interests');
  - the contributions are pooled or used in a common enterprise to produce financial benefits or benefits arising from interests in property for the contributors (referred to as 'members' of the MIS); and
  - members do not have day to day control[5] over the operation of the scheme (whether or not they have the right to be consulted or give directions);
- under Chapter 5C of the Corporations Act the scheme is required to be registered,[6] and there is a Responsible Entity, which under subsection 601FB(1) of Chapter 5C, is '… to operate the scheme and perform the functions conferred on it by the scheme's constitution',[7] and which under section 601FC of Chapter 5C, takes on certain trustee duties and responsibilities, including holding 'scheme property' on trust for the scheme members;

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[3] In this Ruling the term *entity* has the meaning set out in section 960-100.
[4] Various names are used interchangeably in this Ruling to describe the entities participating as investors, for example, participants, members, investors and investor participants
[5] As to the meaning of the phrase 'day to day control', see *Burton & ors v. Arcus & Anor* [2006] WASCA 71.
[6] Section 601ED of the Corporations Act sets out when a managed investment scheme must be registered.
[7] Section 601GB of the Corporations Act says that the constitution of a registered scheme must be a document that is 'legally enforceable as between the members and the responsible entity'. Section 601GA of the Corporations Act says that the constitution must 'make adequate provision for' the consideration to be paid to acquire an interest in the scheme (paragraph (1)(a)); and the powers of the responsible entity in relation to dealing with scheme property (paragraph (1)(b)).

- under the scheme:
  - the investor participants typically enter into contractual arrangements which, on their face, provide for them to have some form of right of access to land or other medium on which the relevant agricultural activity is conducted, which may include rights to the use of certain other assets, and for the provision of various types of services connected with the operation of that activity;
  - amounts charged for things to be done for investors in their first year in the scheme often appear disproportionately high, when compared to amounts charged for the same or similar things to be done in subsequent years;
  - the produce of investors in the scheme is pooled under the control of a manager, for the purposes of sale; and
  - almost invariably, the scheme will be for a fixed duration;
- the scheme is designed in terms of the scheme documentation conferring certain rights on the investors, (as described above), to give the appearance of those investors carrying on a business.[8] However, the size of the area of, for example, land allotted to an investor, may be quite small, especially in relation to the overall size of the scheme operations;
- other aspects of the overall design of the scheme look to ensure that the scheme is operated as a whole, rather than as a number of smaller operations, as it makes little commercial or agricultural sense to operate the scheme other than as one operation;
- consistently with the immediately preceding feature, investors are provided with incentives not to operate their interests personally, for example, changes to the operation of the scheme may require agreement from a high percentage of investors, which can constitute a significant practical impediment;

[8] A similar observation was made in *Puzey v. FC of T* [2003] FCAFC 197 by Hill and Carr JJ (French J agreeing), in relation to a sandalwood scheme, similar to the type to which this Ruling applies. Their Honours said at [54]: 'In our view the present case is on the borderline. It would be possible as the learned Primary Judge said, to see Mr Puzey as no more than a passive investor, despite agreements he entered into which sought to give him the appearance of a person carrying on a business.'

- wide ranging powers of attorney are commonly sought (and are often irrevocable), so that the investors' personal involvement with the operation of the scheme may be limited simply to the signing of an application form and power of attorney, and the payment of their initial contribution. As a result, investors become bound, for example, by the Constitution of the scheme, and other agreements relevant to the operation of the scheme. Typically, this may mean that in reality, the investors place themselves under the control of an 'agent' for the duration of the scheme;
- there may be restrictions imposed on investors so that, for example, they cannot go on the land to which they ostensibly have access, or take any part in the agricultural operations, without the permission of the manager, in contrast to the position of a business owner or manager in any ordinary sense;
- during the term of the scheme the identity of investors may change without reference to the other investors, and there may be associated agreements under which investors acquire shares or units connected with the conduct of the scheme;
- calculation of returns payable to investors is not confined solely to, for example, the agricultural activities conducted on their allotment, but done with reference to the results of the operation of the scheme as a whole;[9]
- sometimes the scheme will involve investors being introduced into a 'going concern', for example, where the Responsible Entity has acquired control over an already established business, such as an established orchard or vineyard;
- the most important and ultimate obligation owed to investors does not concern the provision of certain services or access to land, but the investors' entitlement to receive a share of the net proceeds of the sale of the agricultural produce from the scheme as a whole in proportion to the number of interests they hold in the scheme;
- often the key attraction to investors is the expectation that they will be able to deduct all, or a substantial part of, the 'amount of their investment', including any portion represented by borrowed funds.[10]

[9] See for example, albeit in the context of a non agricultural scheme, *Australand Corporation (Qld) Pty Ltd v. Johnson & ors* [2007] QSC 13, and the observations of McMurdo J at [40], to the effect that the scheme there involved 'the one business'.

[10] In Australian Securities & Investments Commission, in the matter of *GDK Financial Solutions Pty Ltd v. GDK Financial Solutions Pty Ltd* [2006] FCA 1415, Finkelstein

Withdrawal of Taxation Ruling TR 2000/8

4. Taxation Ruling TR 2000/8 Income tax: investment schemes will be withdrawn on and from the date of effect of this Ruling.

Ruling

Investors' contributions are capital, or of a capital nature, and not deductible under section 8-1 (refer to paragraphs 26 to 126 of this Ruling)

5. In Taxation Ruling TR 2000/8 the deductibility of investor contributions under section 8-1 was linked primarily to whether or not an investor could be held to be carrying on business. This was based on reasoning that included accepting that the correct approach to be applied was that the character of those contributions should be strictly according to their legal form.

6. The position in TR 2000/8 has been reviewed in light of recent case law, including that concerning the Corporations Act as it relates to managed investment schemes. As a result, the better view is considered to be that investor contributions should more properly be characterised according to the substance of the schemes in question.

7. This approach produces the result that these contributions are considered to be of a capital nature, because they are the capital cost of the investor's interest in the scheme, and hence not deductible amounts under section 8-1 (per paragraph 8-1(2)(a)). It is important to note that this conclusion applies regardless of whether investors are characterised as beneficiaries of a trust (refer paragraphs 8 to 10 of this Ruling), or as some other form of passive investor (refer paragraphs 11 to 12 of this Ruling). In either case the better view is considered to be that the investors' contributions obtain for them an income producing asset, in the shape of their interest in the scheme, the cost of which is on capital account (see paragraphs 116 to 126 of this Ruling).

J said in relation to investors investing in the managed investment scheme in that case (a retirement village scheme), at [4]: 'The key attraction to investors was the expectation that they would be entitled to deduct from their assessable income not only the amount of their investment but also their proportionate share of the loan taken to pay the balance of the purchase price.'

Investors are beneficiaries of a trust (refer to paragraphs 56 to 66 of this Ruling)

8. The investors are beneficiaries of a trust, of which the responsible entity is trustee. This is because the scheme is a registered managed investment scheme, where there is certain property employed in the operation of the scheme, which is 'scheme property', held by the responsible entity on trust for scheme members (see subsection 601FC(2) of the Corporations Act, as explained in paragraphs 33 and 45 to 55 of this Ruling). Where the scheme as a whole otherwise has the hallmarks of a business, the nature of this property, the way it is used in conducting this business, and the relationship between the responsible entity as trustee and the members as beneficiaries, mean that it is the responsible entity as trustee which carries on the business, rather than the investor members.

9. The types of property considered to be scheme property in this regard include rights impliedly granted to the responsible entity, which are necessary for the conduct of the scheme as a whole, such as access to land and the capacity to deal with third parties in relation to pooled produce. The nature of this property and the way it is used in the business mean that the gross income from the conduct of the scheme is derived by the responsible entity in its capacity as trustee.

10. The finding that the investors are beneficiaries of a trust, operated by the responsible entity as trustee, is consistent with the conclusion that investor contributions are more properly characterised as being for the acquisition of their interest in this trust, as constituted by their interest in the scheme. The conclusion that these contributions are on capital account is consistent, in turn, with the situation for any passive investor acquiring an interest in an investment trust, for example, a unit in a unit trust of this type.

Investors are passive investors who do not carry on business (refer to paragraphs 67 to 100 of this Ruling)

11. Investors in schemes to which this Ruling applies are not considered to carry on business as a result of their membership of the scheme. Rather, they are more correctly described as 'passive investors', who acquire interests in an investment scheme with a view to obtaining returns based on their proportionate interest in the net proceeds derived from operating the scheme as a whole.

12. This conclusion is reached on the basis that the weight to be given to an outward appearance of regular acts conducted on behalf of individual investors in the course of small businesses they are said to carry on, is much less than that to be given to the competing factors of:

- it rarely, if ever, making commercial or agricultural sense to operate the scheme as a large number of separately managed smaller businesses, as distinct from one larger enterprise;

- investors not having day to day control over the running of the scheme, and often being actively encouraged not to interfere in this respect, but instead giving wide-ranging and irrevocable powers of attorney to the same controlling entity;
- a regulatory scheme operating in respect of them, whose design is premised on scheme members being passive investors;
- calculation of investor returns occurring with respect to the operation of a scheme as a whole, rather than being confined to the operations of what is said to be an investor's individual business; and
- the substance of the arrangement being one where the better characterisation of what the investors' contributions are for, is that they obtain for them their interest in the scheme.

Alternatively, investors carry out a profit making undertaking or scheme (refer to paragraphs 127 to 138 of this Ruling)

13. Alternatively, some investors may neither carry on business as a result of their involvement in the scheme, nor will they be passive investors. Rather, their involvement will have a profit making purpose which marks them out as a participant in a profit making undertaking or plan, carried out on their behalf. The profit or loss (computed at the completion of the scheme), will be, respectively, ordinary income under section 6-5, or an allowable deduction under section 8-1.

14. This will not be the case where regular returns to the investor are assessable as ordinary income in the year of income in which they are derived, for in such cases it is the gross return itself, rather than any net profit, which is the amount of ordinary income assessable under section 6-5 (see *Federal Commissioner of Taxation v. Citibank Ltd & ors* 93 ATC 4691; (1993) 26 ATR 423). In practice therefore, this view has application only to those schemes like afforestation schemes, where no regular annual returns are contemplated and there is only one significant return, at the completion of the scheme, although there may be some incidental returns prior to this (for example, those connected with the thinning of the trees).

Alternatively, investor expenditure may be affected by certain prepayments rules

15. Alternatively, if an investor's contributions are deductible under section 8-1 of the ITAA 1997, that expenditure may not be wholly deductible in the year in which it has been incurred (the 'expenditure year'), because a prepayment rule applies to apportion the deduction over that year and a later year(s): see sections 82KZME, 82KZMF and 82KZMG of the ITAA 1936.

16. This will occur where the expenditure is incurred under a managed arrangement (within subsection 82KZME(3) or 82KZMG(3) of the ITAA 1936), and is not in return for doing something under the arrangement which is to be wholly done, either:

(a) within the expenditure year (paragraph 82KZME(2)(a) of the ITAA 1936, for non-forestry expenditure); or

(b) within 12 months, or the end of the year of income after the expenditure year (subsection 82KZMG(2) of the ITAA 1936, for forestry expenditure)[11].

17. Whether or not this is the case is determined from the facts of the arrangement as a whole. Relevant factors will include whether the things promised to be done by certain times can realistically be done within those timeframes, and whether there is evidence of inflation of initial amounts, when compared to equivalent expenditure in subsequent years (see paragraphs 160 to 166 of Taxation Ruling TR 2000/8).

Treatment of returns to investors

Returns represent either a share of net income of a trust estate, and are assessable under Division 6 of Part III of the ITAA 1936 (refer to paragraphs 139 to 145 of this Ruling), or unit trust dividends, assessable under Division 6C of Part III of the ITAA 1936 (refer to paragraphs 146 to 156 of this Ruling)

18. The interim and final returns distributed to investors in relation to their right to share proportionately in the net proceeds from the scheme represent amounts to be included in their assessable income under section 97 of Division 6 of Part III of the ITAA 1936, being their share of the net income of a trust estate for a year of income. This is based on the conclusion that their right to share proportionately in the net proceeds amounts to them being presently entitled to an equivalent share of the income of the trust estate in question, assuming the other requirements for section 97 to apply are met.[12]

19. Accordingly, provided that Division 6C of Part III of the ITAA 1936 does not apply, interim and final returns are 'statutory income' for the purposes of section 6-10 of the ITAA 1997.

20. In some situations, returns to investors will be 'unit trust dividends' within the meaning of this term in section 102M of the ITAA 1936 because they will be distributions by a trustee of a public trading trust to an investor as a unitholder in that trust.

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[11] Note that section 82KZMG cannot apply however, to expenditure covered by this Ruling, as under paragraph 82KZMG(2)(a), the section can only apply to expenditure incurred on or before 30 June 2008. It can also be noted that new section 82KZMGA of the ITAA 1936 also cannot apply to expenditure covered by this Ruling, as that section can only apply to expenditure 'in relation to which the requirements in section 82KZMG are met' (subsection 82KZMGA(1))

[12] These other requirements concern such things as the beneficiary not being under any legal disability, and whether or not they are a resident.

21. This will be where:

- the responsible entity is trustee of a trust estate, which is a unit trust, within the ordinary meaning of that term;
- the operation of the scheme as a trust estate amounts to the carrying on of a 'trading business' (within section 102M), or the trustee controls, or is able to control, directly or indirectly, the affairs or operations of another person in respect of the carrying on by that other person of a trading business (refer section 102N of the ITAA 1936);
- the unit trust is a 'public unit trust' within section 102P of the ITAA 1936; and
- either the unit trust is a resident unit trust in relation to the relevant year of income (section 102Q, ITAA 1936), or a 'public trading trust' in relation to an earlier year of income.

22. In these cases the unit trust dividend is deemed to be a dividend, the unitholder is deemed to be a shareholder and the trust estate is deemed to be a company, for the purposes of subsection 44(1) of the ITAA 1936 (see subsections 102T(12), (14) and (11) of the ITAA 1936, respectively).

23. The unit trust dividend is assessable income of the investor under subsection 44(1) of the ITAA 1936, and will be statutory income for the purposes of section 6-10 of the ITAA 1997.

Alternatively, returns represent ordinary income from property, under section 6-5 (refer to paragraphs 157 to 167 of this Ruling)

24. In the alternative, returns to investors are ordinary income from property, and form part of the investor's assessable income under section 6-5.

Date of effect

25. This Ruling applies to losses or outgoings incurred, and amounts included in assessable income, in relation to schemes begun to be carried out on and after 1 July 2008.[13] However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of effect of the Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

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[13] However, if a test case is finalised prior to 30 June 2008 and confirms the Tax Office view, product rulings will not issue past the date of the decision.

Appendix 1 – Explanation

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

Investor contributions are capital, or of a capital nature, and not deductible under section 8-1

26. Section 8-1 allows a deduction broadly speaking, for certain losses and outgoings incurred in gaining or producing assessable income, or necessarily incurred in carrying on a business with the purpose of producing assessable income. One of the categories of exclusions to section 8-1 is where the loss or outgoing is capital or capital in nature (refer paragraph 8-1(2)(a)).

27. An investor's contributions to an agricultural managed investment scheme will therefore not be deductible under section 8-1 if they are capital or capital in nature (see, for example, *Vincent v. Commissioner of Taxation* [2002] FCAFC 291 at [60] (*Vincent*)).

28. In order to determine whether an investor's contributions are capital it is appropriate to begin with an examination of the nature of the interest they acquire when they become a member of a registered managed investment scheme.

Nature of an investor's interest in a registered managed investment scheme

29. Chapter 5C of the Corporations Act deals with the registration, regulation and winding-up of managed investment schemes. The responsible entity of a registered scheme must be a public company that holds an Australian financial services license authorising it to operate a managed investment scheme (section 601FA of the Corporations Act). A responsible entity has power to appoint an agent, or otherwise engage a person to do anything that it is authorised to do in connection with the scheme (subsection 601FB(2) of the Corporations Act).

30. Section 9 of the Corporations Act defines 'managed investment scheme', as, *inter alia*:

> a scheme that has the following features:
>
> (i) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);
>
> (ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the *members*) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);

(iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions);

31. Section 9 of the Corporations Act also provides that:

'interest in a managed investment scheme' means a right to benefits produced by the scheme (whether the right is actual, prospective or contingent and whether it is enforceable or not).

32. Under subsection 601FB(1) of the Corporations Act the responsible entity is required to operate the scheme and perform the functions conferred on it by the scheme's constitution, and the Corporations Act.

33. The responsible entity holds scheme property on trust for scheme members (subsection 601FC(2) of the Corporations Act). The term 'scheme property' is defined by section 9 of the Corporations Act only in relation to a 'registered scheme'. That definition is as follows:

scheme property of a registered scheme means:

(a) contributions of money or money's worth to the scheme; and

(b) money that forms part of the scheme property under the provisions of this Act or the ASIC Act; and

(c) money borrowed or raised by the responsible entity for the purposes of the scheme; and

(d) property acquired directly or indirectly, with, or with the proceeds of, contributions or money referred to in paragraph (a), (b) or (c); and

(e) income and property derived, directly or indirectly, from contributions, money or property referred to in paragraph (a), (b), (c) or (d).

Note 1: Paragraph (a) – if what a member contributes to a scheme is rights over property, the rights in the property that the member retains do not form part of the scheme property.

Note 2: [not presently relevant].

Corporations Law cases

34. In *Enviro Systems Renewable Resources Pty Ltd v. Australian Securities and Investments Commission* [2001] SASC 11 (*Enviro Systems*), the plaintiff company was seeking a declaration that a scheme inviting investors to participate in the growing, harvesting and sale of timber was a franchise for the purposes of the managed investment scheme regime in Chapter 5C of the Corporations Law, now the Corporations Act. The Australian Securities and Investments Commission (ASIC) opposed this on the basis that the company had been operating an unregistered managed investment scheme. The ASIC submission was that on a proper view of the scheme's operation it did not involve a franchise because the participants were passive investors who obtained interests in a collective investment scheme, being their interests in the timber plantation.

35. Martin J said at [24]:

> Throughout the recent development of the regulatory regimes governing managed investment schemes and franchises, a distinction has been drawn between passive investments and those arrangements in which the prospects of the business succeeding are, to a significant extent, dependent upon the activities of investors.

36. His Honour referred to a number of sources in support of this distinction. He then went to a consideration of the scheme in its 'entirety', in order to determine whether it amounted to a franchise. In this respect he held that the total scheme revealed a number of significant features found in the types of schemes to which this Ruling applies. These features included:

- the scheme being designed to ensure that in practice the agricultural activity (the timber plantation in this case), was managed as a whole, rather than as separate, much smaller lots; and
- participants were offered strong incentives not to manage their lots personally, but rather were strongly encouraged towards the use of a manager put forward by the company.

37. His Honour concluded at [36]:

> In my opinion, when the scheme documentation is analysed in its entirety, the intent of the scheme is that Enviro will control the day-to-day operations of the scheme from beginning to end. Enviro offers a total package which is presented in such a way that potential participants are encouraged to take up the entire package. Notwithstanding the assertion that participants will be running their own businesses, Enviro does not intend that participants should take an active role in the day-to-day operations of any aspect of the scheme. The success or otherwise of the scheme is entirely dependent upon Enviro. In reality, although it is possible that some participants may choose to take an active role, the scheme is designed to attract passive investors.

38. The decision in *Enviro Systems* sets out the history of the MIS provisions in Chapter 5C of the Corporations Act. That history involves removal of the separation of responsibilities of manager and trustee which occurred under the former prescribed interest schemes, and the creation now of a new entity, referred to as the 'Responsible Entity'.

39. A number of cases have now considered, in different settings, the meaning of each of the 3 characteristics the definition of 'managed investment scheme' requires such schemes to have. Windeyer J in *ASIC v. Hutchings* (2001) ACSR 387 dealt with the issue of whether a particular investment scheme was being operated as an unregistered managed investment scheme. At 393 his Honour said:

> I have little doubt that what was being done amounted to a scheme. It was an arrangement under which funds would be borrowed from numerous investors, put together and then re-invested in, or perhaps gambled on, securities. There is no doubt that the features referred to in sub-paragraphs (ii) and (iii) of the s9(1) definition were present. The investors were told that their contributions were to be pooled and used in a common purpose, which would produce financial benefits for them not otherwise available. It is clear that they thought that these benefits would be available through the ability of the borrowers to use the pooled funds to obtain high returns. It is clear that the lenders had no control whatsoever over the operation of the scheme. All they had was the right to receive the interest and the principal. None of them suggested otherwise, except that some were told that in some way the capital was insured, which it was not. The question then is whether the 'lenders' contributed money as consideration to acquire rights to benefits produced by the scheme. It seems to me that this is determined by the decisions in *Waldron v. Auer* [1977] VR 236 and *ASIC v. Enterprise Solutions 2000 Pty Limited* (2000) QCA 452. **In the latter case it was held that the term 'interest' included 'a right to have a scheme operate in accordance with the agreements they have made and to be paid moneys due'**. … (emphasis added)

40. The meaning of the term 'pooled' and the expression 'to be pooled' and 'common enterprise', along with the meaning of 'scheme', in the context of the definition of managed investment scheme, were discussed in *ASIC v. Takaran* [2002] NSWSC 834. In this case Barrett J agreed with the propositions from *Australian Securities and Investment Commission v. Enterprise Solutions 2000 Pty Limited (2000) QCA 452* (*Enterprise Solutions*), that pooling will occur where moneys are paid into or collected in an account, and that attempts to read down the broad words of the definition of managed investment scheme should be discouraged (at [13]). His Honour also emphasised that schemes coming within this definition will not necessarily possess the three characteristics alone. At [16] he said:

> It must also be emphasised that a scheme having the characteristics bringing it within the s.9 definition of 'managed investment scheme' will not necessarily possess those characteristics alone. In *Royal Bank of Canada v. Inland Revenue Commissioners* [1972] Ch 665, Megarry J observed, in relation to the concept of 'ordinary banking business', that 'a statement of the essentials of a business does not seem to me, without more, to be exhaustive of all that is ordinary in that business'. A managed investment scheme, like a banking business, may involve elements beyond the core attributes that give it its essential character. Elements which lie beyond those attributes but contribute to the coherence and completeness which make a 'programme' or 'plan of action' must form part of that 'scheme'. Every programme or plan of action must be taken to include the logical incidents of and consequences of and sequels to its acknowledged components.

41. His Honour's approach is consistent with that of Martin J in *Enviro Systems*, in examining the scheme 'as a whole', in determining whether or not it qualifies as a managed investment scheme. However, his remarks further suggest that the operation of the scheme should be looked at holistically, so as to bring within this scope of operation 'logical incidents of and consequences of and sequels to' the acknowledged components of the scheme. In this way, even if separate agreements that depended for their logical consequences on there being a managed investment scheme within the section 9 of the Corporations Act definition, were expressly alleged to not be part of this scheme, it would still be proper to consider their effect as part of a consideration of the managed investment scheme viewed as a whole.

42. In *Crocombe v. Pine Forests of Australia Pty Ltd* [2005] NSWSC 151 (*Crocombe*) Young CJ in EQ addressed the issue of whether land held by investors in a particular scheme, in undivided shares, could be said to have been contributed to the scheme, as 'money's worth'. At [49] to [50] his Honour said:

> I agree with Mr Foster that, generally speaking whilst it is clear that in interpreting the definition of managed investment scheme the Court is encouraged to take a broad view.
>
> Doing this, it would seem to me that the mere fact that parties contribute their interest in land rather than cash means they still contribute in money's worth.

43. His Honour further noted, at [54], that the Courts had also taken a wide view of the meaning of 'contribution', in this area of the law, referring to *ASIC v. Young* (2003) 173 FLR 441 at 448. His Honour agreed with a submission that the initial members of the scheme had become bound in contract to contribute their interests in certain land and trees on that land, to the scheme in question (at [53]).

44. In *ASIC v. Pegasus Leveraged Options Group Pty Ltd* (2002) 41 ACSR 561 the court dealt with the question of whether a sole director of a company which promoted and operated a particular managed investment scheme, should also be considered to be someone operating that scheme. Davies AJ said at [55] to [57]:

> The word 'operate' is an ordinary word of the English language and, in the context, should be given its meaning in ordinary parlance. The term is not used to refer to ownership or proprietorship but rather to the acts which constitute the management of or the carrying out of the activities which constitute the managed investment scheme. …

Scheme property

45. In *Investa Properties Ltd & anor* [2001] NSWSC 1089 (*Investa Properties*) Barrett J considered the operation of subsection 601FC(2) of the Corporations Act in circumstances where one responsible entity of a registered MIS had been replaced by another. His Honour said at [13]:

> Implicit in what I have just said is the proposition that s.601FC(2) does not just specify the manner or capacity in which the responsible entity holds property independently vested in it but is, rather, a provision which establishes and maintains the connection between all property within the definition of 'scheme property' and the responsible entity.
>
> …
>
> Section 601FC(2) produces a legal result when two circumstances coincide. One is that a particular entity is the 'responsible entity' of a particular registered managed investment scheme. The other is that particular property is 'scheme property' of that scheme. The legal result of the coincidence of circumstances is that the entity holds the property and does so as trustee.

46. As noted already, the courts have taken a broad approach to the meaning of 'managed investment scheme': see, for example, *Enterprise Solutions*, where it was said that attempts to read down the broad words of the definition should be discouraged.

47. Thus, in *ASIC v. Knightsbridge Managed Funds Ltd & anor* [2001] WASC 339 Pullin J said in relation to the first element of the definition of 'managed investment scheme', concerning whether the investors had contributed money or money's worth in exchange for obtaining rights to benefits produced by the scheme, at [51]:

> There is no doubt that the investors contributed money. This money was paid as consideration to acquire rights, namely the right to earn interest from a borrower under a loan arrangement which would be secured by mortgage in favour of the investors. In addition, the money was paid knowing that fees would be deducted from it by Knightsbridge Finance. On that basis, the money was also paid as consideration to acquire rights, namely the right to secure the services of Knightsbridge Managed Funds as responsible entity, and Knightsbridge Finance as the entity responsible for managing the scheme.

48. In *Southern Wine Corporation Pty Ltd (in liq) v. Frankland River Olive Co Ltd & anor* [2005] WASC 236 (*Southern Wine Corporation*) the Western Australian Court of Appeal dealt with the question of whether the responsible entity of the scheme in that case was entitled to unpaid management fees, and in particular, whether it had an equitable charge over certain of the proceeds of the scheme.

49. McLure JA (Wheeler JA agreeing), in describing certain aspects of the management agreement between the responsible entity and investors in the scheme, said at [14]:

> I infer from cl 9.1 that the management fee is intended to cover, inter alia, the responsible entity's costs and expenses of managing the Grower's Project. Clause 11 deals with the harvesting of grapes and the distribution of net profits to Growers. The Grower has the full right, title and interest to any grapes produced from the vines from the Grower's Area together with the right to sell such produce (cl 11.1). **It may be inferred that all other property is Scheme property**. (emphasis added)

50. Her Honour then considered the legislative changes affecting Corporations Law in this area, and the effect of these on the areas of law the court would need to consider. At [22] to [23] she said:

> The legislative history and framework for managed investment schemes is relevant. Under the Law prior to the introduction of Ch 5C there was a division of responsibility between the trustee (who held the scheme assets) and the management company (who operated the scheme) of what were then known as prescribed interest schemes. One of the main purposes of Ch 5C was to eliminate the former dual responsibility by having a single responsible entity combining both functions of holding the scheme property as trustee and operating the scheme (s 601FB(1)). **As the Law requires the scheme property to be held in trust, the general law rights, duties and powers of trustees apply.** The extent of their application may be affected by the structure of individual schemes. Consistent with the general law of trusts, the responsible entity is obliged to hold scheme property separately (s 601HA). Further, the Court has jurisdiction to give judicial advice to the responsible entity under the *Trustees Act 1962* (WA): *Re Westfield Holdings Ltd* (2004) 49 ACSR 734.
>
> Within the statutory parameters of Ch 5 of the Law, the legal structure of Scheme is sourced in the Constitution and the Management Agreement, both of which are contracts. **The general law of contract, agency as well as trusts apply**. (emphasis added)

51. In relation to the claim of an equitable charge on those 'Gross Income' amounts ostensibly due to what were referred to as 'Participating Growers' (being those who had not chosen to collect and market the grapes produced from their allotments), her Honour framed this issue as also embracing whether the responsible entity had an arguable claim on 'scheme property generally' (at [31]). Then her Honour went on to say at [32] to [33]:

> A relevant preliminary issue is whether the Gross Income is Scheme (and therefore trust) property. I would answer that question in the affirmative. Firstly, it falls within par (e) of the definition of Scheme property. The Growers are obliged to make a number of payments in advance under the Management Agreement. They include in years 1 to 3 licence fees and management fees and in years 1 and 2 moneys for the installation of irrigation, the purchase and planting of vines and for buildings to be used for the Scheme.

> Thus, in the initial years Growers payments fund the establishment of the Scheme businesses and in years 4 to 20 the intention is that the obligation to pay licence and management fees be funded out of the Gross Income generated by the business.
>
> Secondly, the opening paragraph of cl 12.1 provides that the responsible entity is entitled to management fees from 'SWC MIS Property as follows', thereafter referring to payment of management fees from the Gross Income. This is consistent with the definition of management fees. Thirdly, notwithstanding that the grapes are the property of the Growers and the responsible entity is appointed agent for sale, it is clear the income is paid to the responsible entity who is required to deduct, inter alia, the management fees and then pay the net income to the Grower. **The Gross Income in the hands of the responsible entity is clearly held by it as trustee**. This conclusion would follow even if the Gross Income was not Scheme property: *Re Global Finance Group Pty Ltd (in liq)* (2002) 26 WAR 385. (emphasis added)

52. The decided cases on the meaning of 'scheme property' need to be read in the context of the issues in contention, the arguments advanced in relation to those issues, and the facts found by the courts. None of these cases have involved arguments framed with particular tax law issues in mind. Importantly, no court has yet considered the argument that investors in the schemes in question expressly or impliedly grant certain rights to the responsible entity necessary for the conduct of the scheme as one, larger, enterprise. Under this argument those rights are 'contributions of money's worth', which are not retained by the investors. Accordingly, they come within paragraph (a) of the definition of 'scheme property'.

53. Thus, for example, it is arguable that the grant to the responsible entity of a licence by the investor of their rights to access certain land and of their rights to have certain services performed, are all 'money's worth', which are contributed in a legal sense (*Crocombe*), in return for a right to share proportionately in the net proceeds to be derived from the conduct of the overall scheme. Alternatively, those rights are property acquired directly or indirectly with contributions of money by the investors, so as to come within paragraph (d) of the definition of 'scheme property'.

54. In similar fashion, in the schemes in question, the rights to future produce from areas of land investors have rights over, are contributed by the investors, and not retained by them. This contribution is reflected in the fact that they give up their right to proceeds from the sale of produce from those areas in exchange for taking up a right to share proportionately in the net sale proceeds of the sale of the produce from the whole scheme. This also constitutes a contribution of money's worth within paragraph (a) of the definition of 'scheme property'. Alternatively, investors' contributions, as contributions of money, come within paragraph (a) of this definition. Where these contributions result in the responsible entity impliedly holding rights to future produce, because of pooling arrangements, these rights will be property acquired directly or indirectly with contributions of money by the investors, so as to come within paragraph (d) of the definition.

55. Where the interest in the produce of the scheme is 'scheme property' it will be held by the responsible entity on trust for the investors as scheme members (*Investa Properties*), and subsequent transactions involving the sale of that produce will produce income which will be derived by the responsible entity in its capacity as trustee.

Investors are beneficiaries of a trust

56. It is considered that the better view is that the rights referred to previously, which are ostensibly personal rights of investors, are contributed in a way that they become 'scheme property', and so are held on trust by the responsible entity for the investors. Moreover, they are then employed by the responsible entity as trustee in the conduct of the scheme as the one enterprise. These rights typically cover such things as access to land, the provision of certain services and an interest in future produce. In exchange for making these contributions expressly or impliedly under the totality of the scheme agreements, most importantly the scheme constitution, an investor receives in return a right to share proportionately in the net proceeds. The holding of these rights by the responsible entity as trustee constitutes a 'trust estate' for income tax purposes, where the investors are beneficiaries of the trust. The investor's interest in this trust equates to their interest in the scheme (refer paragraph 31 of this Ruling). Their interest can be measured by the extent to which they are entitled to share in the net proceeds from the scheme.

57. This conclusion is supported by the decision at first instance in *Puzey v. Federal Commissioner of Taxation* [2002] FCA 1171 (*Puzey*). In that case the then named Australian Securities Commission (ASC) had a role in administering schemes similar to those in question, and had initially granted an exemption for the scheme from compliance with relevant provisions of what was at the time referred to as the Corporations Law.

58. Subsequently this exemption was revoked, and the ASC concluded that the scheme was a 'prescribed interest', and required the promoter to offer investors the choice of withdrawing from the scheme and receiving a refund of all monies invested, or participating in a restructured scheme operated by a trustee. The taxpayer elected to continue and became a beneficiary of a trust under a trust deed, the trust fund of which was said to include such things as all monies payable to the promoter under the scheme agreements concerning purchase of seedlings, access to land, and provision of management services.

59. At [30] Lee J said:

> The applicant, and others who elected not to withdraw from the project, signified by their conduct acquiescence in the alteration of their position to conform with the purpose and terms of the trust deed. Pursuant to the trust deed the applicant became a participant in a pooled investment conducted by the trustee, in which the beneficial interest of the applicant consisted of a right to participate pro rata in any distribution made by the trustee of proceeds obtained from the sale of timber produced by the trustee from the conduct of the project. **In other words, the seedlings acquired by the applicant, and the land leased by the applicant, were made available to the trustee by the applicant for the purpose of conducting the enterprise provided for by, and under, the trust deed**. The interest of the applicant was not in the net proceeds of sale of products produced on the land leased by him but a shared interest in the net proceeds of sale obtained by the trustee in the conduct of the project by the trustee. (emphasis added)

60. His Honour clearly saw this change of events as relevant to the issue of whether Mr Puzey thereafter could still be said to carry on business. At [50] he said:

> Certainly, it may be concluded that from May 1998, when the applicant accepted reformation of the project according to the directions of the ASC, the applicant was not carrying on a business. Henceforth the applicant's interests as lessee, purchaser of the seedlings, and beneficiary of services supplied by Lincfel, were applied to, or invested in, the purposes of the trust and the applicant became an investor in a project carried on by the trustee who was authorised to use the investments of the participants to grow, harvest and sell timber. **The applicant had no longer a defined interest in the trees on his lot as a product to be produced, harvested and sold by the applicant. The applicant had an interest in the outcome of the conduct of a business carried on by the trustee and in the distribution of the proceeds of the conduct of the trustee's business**. The trustee was not conducting the applicant's business as agent for the applicant. (See: *Clowes & Anor v. Federal Commissioner of Taxation* (1954) 10 ATD 316; (1954) 91 CLR 209; *Milne v. Federal Commissioner of Taxation* 76 ATC 4001; (1976) 133 CLR 526.) (emphasis added).

61. On appeal, this conclusion was reviewed by the Full Federal Court.[14] Hill and Carr JJ (French J agreeing) said at [55] to [57]:

> The next question is whether the restructuring of the arrangements at the request of the ASC had the consequence that Mr Puzey thereupon ceased to carry on the business which he had commenced in June 1997 as his Honour held. It is important to note that the contracts of lease and management entered into by Mr Puzey continued in operation and continued to be enforceable by him. **On one view, what changed was that rather than being entitled to the proceeds of timber from the harvesting of his own lot Mr Puzey became entitled pro rata to a share of the proceeds of timber harvested from the totality of lots in the scheme with the trustee of the unit trust being obliged to receive the proceeds and hold them for the unit holders including Mr Puzey.**

[14] *Puzey v. FC of T* [2003] FCAFC 197.

> **The learned Primary judge interpreted the agreements entered into as meaning that each lot owner made his lot available to the Trustee or Manager of the Trust and that thereafter the planting, tendering and harvesting activities were activities of the Trustee or Manager and not of the lot holders. The key to his Honour's conclusion was that after the restructuring the Trustee or Manager under the trust deed carried on the business of planting, tendering and thereafter harvesting all of the trees on the whole leased area. It was the Trustee's business and not the business of each individual lessee. On this basis clearly Mr Puzey did not thereafter carry on a business.**
>
> **There is some ambiguity in the documentation, but on balance we agree with the interpretation of his Honour with the consequence that Mr Puzey thereafter ceased to be carrying on business and became a passive investor in a managed investment scheme, just as was the case from the outset of the investor in *Enviro Systems Renewable Resources Pty Ltd v. Australian Securities and Investments Commission* (2001) 80 SASR 1.** (emphasis added)

62. During public consultation on the draft version of this Ruling it was argued that the facts in *Puzey* are distinguishable from the schemes in question. Reasons put forward for this included that the trust in *Puzey* involved an express trust in the form of a unit trust, and that the rights of the investors in the schemes in question, in relation to access to land, and the provision of services, remain personal rights of those investors.

63. It is important to focus however, on the findings made in *Puzey*, from which the conclusion there was reached that after a certain time it was a trustee who carried on the relevant business, and not the investors. These findings, in the form summarised by the Full Federal Court, as set out in paragraph 61 of this Ruling, point to the presence of two key elements. The first is that ostensibly personal rights of the investors were part and parcel of those investors making their lots 'available to' the trustee (or manager) of the scheme. The second is that what changed was the investor relinquishing any entitlement to the proceeds from sale of timber from their own lot, and becoming entitled to a share of the net proceeds from sale of timber from the scheme as a whole.

64. The Court acknowledged that the conclusion was arguable, and turned on a construction of the overall scheme documentation. The same degree of difficulty applies to schemes covered by this Ruling. Nevertheless, on balance, it is considered that there remain strong parallels with the two key elements identified above from *Puzey*. As a matter of principle it should not matter whether these elements exist from the time of commencement of the scheme, or are subsequently imposed at a later stage.

65. The relevant parallels are as follows. Firstly, personal rights conferred on investors are made available to a trustee, albeit one arising under a statutory regime concerning the provision of investor protection. This regime is tailored to investors who have agreed not to have day to day control over, but to instead share collectively in a broader enterprise operated by someone else. Secondly, the broader enterprise is not operated in a way to provide individual investors with returns based solely on produce from an area of land in which they ostensibly have a related interest. Rather, the scheme is operated as the one enterprise, with investors sharing proportionately in the net proceeds from the scheme as a whole.

66. All this is reinforced by the operation of Chapter 5C of the Corporations Act, and the case law which show that the definition of 'managed investment scheme' is to be interpreted broadly. Further, the decision in *Crocombe* illustrates that in the definition of 'scheme property' what is a 'contribution of money's worth is also not to be read down. It is arguable then that notwithstanding statements in scheme documentation to the contrary, personal rights to be held by investors become either contributions of money's worth, or property obtained from investors contributing money. These rights which might otherwise support a conclusion that investors carry on their own separate businesses become scheme property, thereby held on trust by the responsible entity. In this fashion those rights are then employed by the responsible entity in its operation of the scheme, as one, overall, enterprise. Where this enterprise amounts to the carrying on of a business, it is the responsible entity as trustee therefore who carries it on, and not the investors.

Investors are passive investors who do not carry on business

67. Whether or not investors are beneficiaries of a trust as discussed above, it is our view that investors are passive investors who do not carry on business.

68. Notwithstanding the need to look at the particular circumstances of individual situations, a number of cases support the conclusion that participants in agricultural managed investment schemes carry on their own separate, albeit usually quite small, businesses (see for example, the authorities referred to in *Commissioner of Taxation v. Cooke* [2004] FCAFC 75 (*Cooke*) and *Commissioner of Taxation v. Sleight* [2004] FCAFC 94) (*Sleight*). It is noted though that these cases did not concern schemes covered by Chapter 5C of the Corporations Act.

69. However, in *Sleight,* Hill J noted at [55] that in *Enviro Systems* Martin J of the South Australian Supreme Court held, although not in the context of income tax, that there was a managed investment scheme in which the investors were passive and did not carry on a business.

70. The decision was relevant because, just as in *Sleight*, the underlying investment activity was agricultural (the growing of trees). And, as noted already, in *Puzey v. Federal Commissioner of Taxation* [2003] FCAFC 197, the Full Federal Court upheld the finding at first instance, in relation to the 1998 year of income, that once the agricultural scheme in that case had been restructured and a trustee introduced into the scheme, the investor no longer carried on business. Rather, the investor held rights to the net proceeds of a business carried on by the trustee.

Clowes' case

71. The term 'passive investor' has considerable lineage in relation to Australian income tax law. In *Clowes v. Federal Commissioner of Taxation* (1954) 91 CLR 209; HCA 10, (*Clowes*) Dixon CJ said of the taxpayer in that case, who was involved with a pine tree growing company, that:

> The taxpayer himself is described as a draper and it is obvious that he paid the sum of 75 pounds to Pine Plantations Pty. Ltd. by way of investment. He passively awaited whatever return he might receive from that company.[15]

72. The contractual agreements governing the taxpayer's involvement with the pine tree growing company described him as a lot-holder; contained a recital describing him as being desirous of becoming possessed of a beneficial interest in the timber produced by the company; indicated that the company was under an obligation to plant and maintain pine trees; and provided that the company was under a duty to sell the resulting timber and distribute among lot holders their share of the total net sale proceeds.[16]

73. The Chief Justice said that:

> From the taxpayer's point of view he laid out a sum of money entitling him at the end of a protracted period of time to an uncertain return in a lump sum which he hoped might prove larger than his outlay though it might well prove smaller. In the event, when a period of fifteen to eighteen years had elapsed, he received back a sum equal to his outlay and an additional forty per cent. But the taxpayer did nothing but lay out his money on the faith of the contract and await the result. The company was in no sense his agent. The money which he paid in pursuance of the contracts became part of the general funds of the company. Its obligations to him were simply contractual. It made the contract for its own advantage and in performing it acted independently of the direction or control of any lot-holders, whose relationship to the company was simply that of persons providing it with money on special terms. …

[15] 91 CLR 209 at 215.
[16] 91 CLR 209 at 216.

74. At first instance in *Clowes*, the Board of Review No. 2 had found that the taxpayer's involvement with the company was little different from that which was before the High Court in relation to the flax growing scheme considered in *New Zealand Flax Investments Ltd v. Federal Commissioner of Taxation* (1939) 61 CLR 179 (*New Zealand Flax*): see Case C13 [1952] 3 TBRD 104. The Board said that they considered that it made no difference that in *New Zealand Flax* it was the liability of the company in that case that was at issue.

75. The Board noted that in both the case before them and in *New Zealand Flax* the taxpayer's payment of the monies in questions secured the receipt by them of bonds in return, but that in the latter case Dixon J, as he then was, had said at p.200, that the relevant terms under which the bonds were issued gave the holders 'a contractual right to the performance of the obligations undertaken by the company'.

76. In *Clowes*, Kitto J agreed with the Chief Justice, holding that the case considered from Mr Clowes' point of view, was simply one of 'a purchase of a right to receive a fixed proportion of a future fund as to which everything was uncertain'.[17] Kitto J acknowledged that the pine growing company was obligated to plant the land in question with pine trees and to make appropriate arrangements for the sale of the produce. However, according to Kitto J the entitlement of each lot-holder to an aliquot share in the net sale proceeds was the sense in which the recital concerning lot holders having a beneficial interest in the produce must be understood.[18]

77. Kitto J said at 223:

> The essence of the matter simply was that the company bound itself to follow, over an indefinite period of years, a course of action which it expected would yield substantial net proceeds, and, in consideration of an immediate payment by the appellant, it promised to pay him a proportion of those net proceeds if and when they should come in. In the event, that for which he had paid 75 pounds turned out to be an amount of 105 pounds. The 75 pounds was capital, and there is no reason for denying the same character to the larger sum which ultimately replaced it.

78. The other two members of the Court disagreed with this conclusion. Webb J held that Mr Clowes' involvement amounted to him deriving income from a profit-making undertaking or scheme in the form of cultivation of the lots.[19] Taylor J also agreed that there had been income derived from a profit-making scheme, but described it as one of an investment of a sum of money for the purpose of securing an aliquot share of the net profits of a business undertaking.[20]

[17] 91 CLR 209 at 222.
[18] 91 CLR 209 at 222.
[19] 91 CLR 209 at 219.
[20] 91 CLR 209 at 232.

79. In *Milne v. Federal Commissioner of Taxation* (1975-76) 133 CLR 526 (*Milne*), in a unanimous decision however, the High Court agreed with the statutory majority of the Chief Justice and Kitto J in *Clowes*.

Distinguishing Clowes' case

80. In *Federal Commissioner of Taxation v. Lau* (1984) 6 FCR 202 (*Lau*), which also concerned a pine tree growing scheme, Beaumont J distinguished *Clowes* and *Milne*. His Honour held that the key points of distinction concerned the facts that in *Lau* the taxpayer was given access to the relevant land by way of a lease, and had an identifiable interest in the trees to be grown on that land, and had contracted with a manager to provide services in relation to the tending of those trees. In *Lau* it was also found that the taxpayer had the right to terminate the manager's services. It is also noted in this respect, that at first instance, the primary judge had found that the documentation in this case revealed 'a substantial degree of control over the designated manager'.[21]

81. In *Cooke* the Full Federal Court acknowledged that one element of the flower growing scheme before them, namely, the circumstances of the pooling of the produce, 'presented as an element of the matters considered in *Clowes* and *Milne*'.[22] Notwithstanding, the Court thought that the circumstances of their case were 'closer to the pine tree plantation circumstances in *Lau*'.[23] The Court referred to the decision of the Full Federal Court in *Vincent*, and indicated that they thought that in that case Hill, Tamberlin and Hely JJ had accepted the existence of the distinguishing features between the circumstances in *Clowes* and *Milne*, and those in *Lau*.

82. During public consultation on the draft version of this Ruling it was argued that the facts in *Clowes* and *Milne* are distinguishable from the schemes in question, on the very same basis noted above. It was said that nothing has been put forward as to why courts would not continue to find the same distinguishing features they have in the past.

83. However, it is important in this respect to look closely at the manner in which these features were identified. In *Lau* this was done by accepting the legal form of the scheme agreements, and concluding that the taxpayer in that case did have a lease of land, an interest in the trees to be grown on that land, and a contract with a manager to provide services relating to the growing of those trees.

[21] *Lau v. FC of T* (1984) 54 ALR 167 at 174.
[22] *Commissioner of Taxation v. Cooke* [2004] FCAFC 75 at [69].
[23] *Commissioner of Taxation v. Cooke* [2004] FCAFC 75 at [68].

84. Nevertheless, in *Clowes* the scheme documentation also indicated an intent to grant a similar interest in trees, and there were contractual obligations relating to the growing of those trees and the harvesting of timber for sale. In respect of these obligations the Chief Justice said, however, at p.218:

> But the operation giving rise to the profits so described was the planting of the pine trees, the cultivation of the plantation and the logging and disposal of timber. These appear to me to have been both in fact and in law the operations of the company conducted on its own behalf and not on behalf of the lot-holders. **True it is that the company had contracted with the lot-holders to plant the trees, market the timber and pay over the stipulated portion of the proceeds. But these were the contractual terms on which the money was raised by the company.** From the taxpayer's point of view the only profit in contemplation was an increase in the amount he invested with the company when the amount became repayable as a result of the operations of the company, operations which as part of the terms of the investment the company became bound to carry out. (emphasis added)

85. In our opinion the line is finely balanced between those situations where the form of the scheme documentation is given full recognition, and those where the contractual obligations in question are seen as part of the terms on which passive investment monies have been raised. Accordingly, we are of the view that schemes covered by this Ruling are not relevantly distinguishable from *Clowes* and *Milne*. This is because we consider that the proper characterisation of the contractual obligations under the schemes in question is that they are the terms on which investors passively invest their money, and no more.

86. Moreover, it is to be noted that in *Vincent* at first instance,[24] the primary judge was persuaded by elements that mirror those in *Clowes* and *Milne*, to find that the investor in that agricultural scheme, was not carrying on any business as a result of her investment in a cattle leasing operation. Thus, French J said at [100]:

> The Commissioner submitted that the outgoings were of a capital nature which secured for Ms Vincent an interest in a business operated by ACM. She was a passive investor in someone else's business. The focus of this argument seemed to be on the two year term of the Management Agreement and the Lease Agreement and Ms Vincent's inactivity in relation to the actual operation of the project. Her failure to extend these agreements was said to indicate that what she did in investing in the project was no more than make a one off arrangement for the delivery of progeny. Reference was made to evidence of her passivity as an investor.

[24] *Vincent v. Commissioner of Taxation* [2002] FCA 656.

87. His Honour's judgment at first instance was founded on an operation of the first limb of subsection 51(1) of the ITAA 1936. However, at [108] he said:

> Ms Vincent's position can be no better under the second limb of s51(1) than under the first and it is therefore unnecessary for me to express a concluded view about it. Nevertheless, having regard to her non-involvement in the operation of the project and the way in which ACM managed the herd as an undifferentiated group of cattle without regard to the rights of particular investors, I could not accept that her outgoings were necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. …

88. It is important to note in this respect, as dealt with more fully below, that on appeal the Full Federal Court dealt with the issue of deductibility of the expenses in question from the factual standpoint that Ms Vincent was not carrying on business. Further, they held that her expenditure under the Management Agreement was really for the delivery of certain cows, resulting, in the circumstances, in that expenditure being characterised as capital in nature.

The substance of the investor's involvement in the scheme

89. In *Sleight* Hill J said (Hely J agreeing), albeit in the context of Part IVA of the ITAA 1936, at [81]:

> There is a difference between the form and the substance of the present scheme. In form there is an option whether to farm alone or to employ the management company. There is a management agreement and financing and interest payments. The form, involving pre-payment of management fee and interest is, it may be readily concluded, designed to increase the taxation deductions available to an investor. The substance is, however, quite different. As Senior Counsel for the Commissioner put it, in substance the investor is a mere passive investor in what, once the tax features are removed, is a managed fund where no deduction would be available, or perhaps an alternative characterisation of the substance of the scheme is an investment in shares in the Land Company which at expiration of 15 years is to own the tea tree plantation.

90. His Honour's reference in the above passage to 'once the tax features are removed' qualifies the extent to which this view of the substance of such agricultural schemes (in *Sleight*, the growing of tea trees) affects any conclusion about whether investors in them carry on any business. This perhaps aids in explaining why Hill J held that notwithstanding other comments about the 'use of a somewhat artificial structure' of the scheme in *Sleight*, Mr Sleight was carrying on a business of growing tea trees.

91. As noted already, the decisions of the Full Federal Court in *Vincent*, *Cooke* and *Sleight* all contain reference to previous authorities concerning the question of when investors in various agricultural schemes will be considered to carry on business. The latter two decisions undoubtedly support the view that investors involved in schemes of the type to which this Ruling applies, can conduct their own separate businesses, as a result of this involvement.

92. In Taxation Ruling TR 2000/8, paragraph 35 set out certain factors under which it was acknowledged that such involvement, could amount to the carrying on of a business, other factors to the contrary not outweighing this conclusion.

93. And, as the Full Federal Court noted in *Cooke*, at [50]:

> … It is of course a well established principle that a person may conduct, or share in the conduct of, a business through an agent or agents or contractors, so that passivity alone is not necessarily a decisive test. Otherwise a 'silent partner' might be said not to be a person carrying on business in partnership. …

94. However the above passage does not deny that 'passivity' is a relevant factor to take account of when reaching a conclusion about whether investors involved in schemes to which this Ruling applies do carry on their own separate businesses, or merely are passive investors holding interests in a collective investment scheme.

95. The references above to the Corporations Law perspective show clearly that from that standpoint, the better view is that where a MIS structure is used, investors are passive and do not carry on business. This is consistent with the fact that, by definition, investors in such schemes do not have day to day control over the operation of the scheme. It is also consistent with a finding reasonably inferred from the features set out in paragraph 3 of this Ruling, that the managers of the schemes in question are not 'managers' in the ordinary sense of persons over whom their principals exercise any considerable degree of control. Rather, these managers play a dominant role in the operation of these schemes, to which the wishes of investors are generally subservient.

96. The authorities confirm that determination of whether an entity carries on a business occurs as a matter of 'the large or general impression gained': see *Martin v. Federal Commissioner of Taxation* (1953) 90 CLR 470. No one factor is necessarily determinative: *Evans v. Federal Commissioner of Taxation* 89 ATC 4540; (1989) 20 ATR 922. However, none of those propositions deny the possibility that in certain situations the weight attached to control, or its negatively phrased relation, passivity, may be such as to tip the balance towards the conclusion that no business is being carried on.

97. These schemes are, as a matter of the large or general impression of their key features, ones where too much weight should not be placed on any outward appearance of investors carrying on their own small business separately from each other investor in the scheme. This outward appearance is an artificial one, when, viewed as a practical matter, investors participate in one, much larger, commercial undertaking, over which they do not have day to day control, and where calculation of their returns occurs by reference to the results of that undertaking, and not individual efforts in relation to the small businesses they are said to carry on.

98. Moreover, this separation of the activities said to be undertaken on behalf of the investors from the means by which they reap their returns from their investment mirrors the situation in *Clowes* and *Milne*, and may mean that a court would also conclude that investors do not participate with each other or with each other and the manager in any profit making undertaking or scheme. In this respect the decisions in *Clowes* and *Milne* may not be relevantly distinguishable.

99. A conclusion that it is the trustee of the scheme that is carrying on the relevant business however, will not necessarily decide the question of whether investors in these schemes can deduct their scheme contributions under section 8-1.

100. This is because it is still open to argument that the contributions styled as, for example, rent and management fees are really for those things, and as such, the outgoings in question are incurred in gaining or producing assessable income for the investors in the form of distributions from a trust: see for example, *Puzey*, in relation to the 'management fees'.

The approach in Vincent's case

101. In *Vincent* the Full Federal Court said at [61] to [62]:

> The question whether a loss or outgoing is of capital or of a capital nature involves the characterisation of the loss or outgoing. Relevant will be the tests enunciated by Dixon J, as his Honour then was, in the seminal discussion of the subject in *Sun Newspapers Ltd and Associated Newspapers Ltd v. Federal Commissioner of Taxation* (1938) 61 CLR 337 at 359-361. They are so well known that it is unnecessary to repeat them here.

> It may be accepted that moneys outlaid for management services to be rendered on a recurrent basis will ordinarily be on revenue account, particularly, although not necessarily limited to the case, where the services are rendered for a business carried on by a taxpayer. The same may be said of recurrent chattel leasing expenditure. And this result will ordinarily not be affected (absent legislative provision) merely because some part of the consideration may be payable in advance, cf *Federal Commissioner of Taxation v. Lau* (1984) 6 FCR 202 and *Federal Commissioner of Taxation v. Woolcombers (WA) Pty Ltd* (1993) 47 FCR 561. **However, it cannot be extrapolated from cases such as those just cited that every time there is an agreement which nominates a consideration for services to be performed the payment will be on revenue account. Whether it is will depend upon all the circumstances and particularly an analysis of the agreement under which the payments are made**. (emphasis added)

102. The Full Court went on to refer to what they termed a self evident proposition found in *Commissioner of Taxation v. Broken Hill Pty Co Ltd* (2000) 179 ALR 593 (*Broken Hill*), concerning the 'important matter of substance and form in the resolution of issues such as the proper characterisation of an outgoing' (*Vincent* at [63]). The court cited with approval the following passage of Hill J in *Broken Hill* (Heerey and Merkel JJ agreeing), at 606, where his Honour said:

> While, no doubt, questions such as whether a covenanted payment is an annuity will, having regard to historical matters, depend on some, perhaps a considerable extent on the form which the parties have adopted … it is not to be assumed that form must always prevail over substance. The law has moved somewhat from the rather rigid adherence to form to be found in cases such as *Inland Revenue Commissioners v. Duke of Westminster* [1936] AC 1. This is not to say that legal rights are not important or even, in a case such as the present, determinative. **It is merely to emphasise that the courts will always consider the substance of a transaction in characterising … the advantage which is sought to be obtained in determining whether an outgoing is on revenue account or whether, as here, on capital account and thus excluded from deductibility**. (emphasis added)

103. The Full Court said that the first question which must be asked in this process of characterisation, was 'what the outgoing is really for' (*Vincent* at [65]). Reference was made to the High Court decisions in *Colonial Mutual Life Assurance Society Ltd v. Federal Commissioner of Taxation* (1953) 89 CLR 428 at 454 and *Hallstroms Pty Ltd v. Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648, in this respect.

104. Before applying this approach to the facts of the case before them, the Full Court noted that in some cases the question might arise as to 'whether the answer to the question what the outgoing is really for depends solely upon the contractual rights and obligations which the taxpayer acquires for the outlay under consideration or whether it is necessary to go outside the contractual rights and obligations acquired to find the true character of the outgoing: *Federal Commissioner of Taxation v. South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645 at 659 per Gibbs ACJ' (*Vincent* at [67]). They held that this was not an issue in the present case, but noted that it was an example of cases 'where one may be distracted from the process of characterisation by the labels which the parties employ' (*Vincent* at [68]).

105. The Full Court then said at [69]:

> In form the Management Agreement sets out a number of services which the Manager is required to perform and details the fees which are to be paid for these services. Those are not unimportant matters. However, when one considers the agreement carefully it is clear that the **ultimate obligation** of the Manager is the supply of six calves to the owner within the time stipulated in the agreement. … (emphasis added)

106. After making some observations about that result, the Court then went on to state at [71] to [73]:

> Had the agreement been framed as an agreement to give title to six cows to be born, so far as possible from ovum transplants on premises of the Manager and to be cared for by the Manager it would be obvious that the consideration payable was for the six cows, rather than the acts necessary to produce them. This is not to say that the Manager would not be in breach of such an agreement if it did not provide agistment, veterinary services etc.
>
> It is difficult to see why the result should be different merely because the agreement entered into was expressed as being an agreement whereby the Manager was to perform nominated services but the agreement guaranteed that six full-blooded calves would be handed over at the stipulated times. **In both cases the substance of the agreement would be the same. In both cases the payments which the Owner contracted to make would be the same. In both cases the payments which the Owner contracted to make would ultimately really be for the calves which are to be produced.**
>
> In any event, the character of the payments made for the services which the Manager contracted to perform, in the context of the underlying agreement to ensure ownership in Ms Vincent of six pure-bred calves, is clearly determined by reference to this underlying agreement. (emphasis added)

107. The Court held that the expenditure incurred under the Management Agreement was the cost of producing certain calves, and in the circumstances, 'an outgoing of capital and simply not deductible'.[25] In support of this conclusion they said at [75]:

> …it is clear that where a person not carrying on a business acquires an asset for the purpose of sale other than in the course of a business, that asset could not be trading stock, although the sale of the asset might give rise to a profit being assessable income. Further, the acquisition of that asset would be an acquisition on capital account.

108. A number of aspects of the Court's approach to the issue of characterisation of the outgoing bear emphasising. The first is that the agreement under examination plainly involved, amongst other things, the provision of certain services. However, the Court held that the mere fact that an agreement might nominate a consideration for those services was not conclusive of the payment being on revenue account. This would depend on all the circumstances, and particularly an analysis of the agreement under which the payments were made (refer paragraph 101 of this Ruling).

109. The second aspect is that the Court was clearly of the view that in judging what the outgoing in question (the 'management fees'), was 'really for', or what was 'the advantage which the taxpayer sought to obtain from the outlay', it was not appropriate to be distracted by 'the labels which the parties employ' (see paragraph 104 of this Ruling).

110. Lastly, it is evident that the approach of the Court in identifying the relevant advantage sought from the payment of the management fee in question was to determine what the Court referred to as the 'ultimate obligation' owed to the taxpayer. In this respect it is clear that the Court considered that it was proper to consider the substance of the agreement under which this obligation arose. In this way the Court looked past the form of the agreement, and identified the ultimate obligation of the manager as the supply of certain calves. However, notably, the Court had earlier, at [68], expressly stated that there was no suggestion that the management agreement was a sham.

Other investment schemes involving capital expenditure

111. In *Anderson v. Commissioner of Taxation* 89 ATC 4982; (1989) 20 ATR 1210 (*Anderson*), the Federal Court dealt with certain deductions claimed to arise out of losses said to have been made a partnership in connection with a film investment scheme. The scheme was not carried through to its end and Wilcox J held that the partnership did not at any stage carry on any business.

[25] *Vincent v. Commissioner of Taxation* [2002] FCAFC 291 at [80].

112. The Commissioner argued that a critical outgoing of the partnership, if incurred, was to give the partners the copyright in certain films. Wilcox J considered that no acquisition of this copyright occurred.[26] His Honour said though:

> However, I do not think that this affects the substance of the argument. Whether or not they obtained the copyright of the films, the partners certainly acquired the right to exploit the films for their own benefit, less 5% for Andromeda. The purchase of this right was a purchase of a source of income. The $1,000,000 payment was an affair of capital.[27]

113. In *Taylor v. Federal Commissioner of Taxation* [2006] AATA 1120 (*Taylor*) the Administrative Appeals Tribunal (AAT), dealt with the issue of the deductibility of certain outgoings under subsection 51(1) of the ITAA 1936, arising from the taxpayer's involvement in a 'franchise scheme'. The outgoings were labelled as 'Franchise Fees, service fees, marketing fees and training fees''. One of the arguments advanced by the Commissioner was that these fees were of a capital nature.

114. The AAT said at [19]:

> In resolving the issue whether outgoings are on revenue or capital account it is incumbent on the Tribunal to analyse all the rights and obligations of the applicant in asking what the outgoings are really for, rather than rely on the way the outgoings were styled: *Vincent v. FCT* (2002) 124 FCR 350 at [65] and [67]. A casual investment of capital to yield an enlargement at the end of a period of time but without forming any business system or practice by the taxpayer, is passive investment and the outgoings are on capital account: cf *Clowes v. FCT* (1954) 91 CLR 209 at 218; *Milne v. FCT* (1976) 133 CLR 526 at 535; and *Enviro Systems Renewable Resources Pty Ltd v. ASIC* (2001) 80 SASR 1 at [36], [43], [44].

115. The conclusion of the AAT on this point was, at [37]:

> Further, in the Tribunal's opinion the evidence including that of the applicants' witnesses shows that the outgoings, although styled as franchise fees, service fees, marketing fees and training fees were in fact for nothing more than the purchase of a passive investment and hence were in the Tribunal's view capital in nature and not deductible under section 51(1).

Conclusion on whether investor contributions are capital

116. Schemes to which this Ruling applies have the features set out in paragraph 3 of this Ruling. As part of these features investor contributions to a scheme are typically styled as fees charged to them in connection with the operation of a business conducted on their behalf by a manager.

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[26] 89 ATC at 4993.

[27] 89 ATC at 4993. His Honour considered that the right to exploit the films was a capital asset notwithstanding that 'like most other capital assets, it was capable of sale' (ibid).

117. As the Court said in *Vincent*, in Australia the appropriate tests of whether a loss or outgoing is to be characterised as capital, or of a capital nature, are those outlined by Dixon J in *Sun Newspapers Ltd and Associated Newspapers Ltd v. Federal Commissioner of Taxation (1938) CLR 337* (*Sun Newspapers*). His Honour said there at p.363:

> There are, I think, three matters to be considered, (a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.

118. While all three heads were stated separately, mention was made of some overlap. Further, in *Broken Hill* the Full Federal Court indicated at [27] that the first test was the 'critical' one, in determining whether an outgoing was deductible under subsection 51(1) of the ITAA 1936 (and, hence, now under section 8-1 of the ITAA 1997). The Court continued at [27]:

> …the significance of that question, which is directed to ascertaining the advantage sought to be obtained, is essential to the determination of the true characterisation of an outgoing.

119. It is generally accepted that an outgoing which allows a taxpayer to obtain an advantage in the shape of an asset that is part of the 'structure or organisation' by which profit or income is to be gained, will be on capital account (*Sun Newspapers*). Thus, the cost of an income producing asset, such as an interest in the scheme, or a related trust estate, will be part of the 'structure or organisation' by which investors in the schemes in question gain their income. The cost of this interest will be wholly on capital account, even though it may take the form of consideration which is payable in instalments, over a period of time (refer to the discussion in *Broken Hill* at [44] to [49]).

120. The conclusion to be drawn from analysis of the nature of investments in managed investment schemes is that the substance of these schemes does not match their form, as depicted in the scheme documentation, concerning the making of investor contributions. In substance the investors are passive investors who do not carry on any business, and this needs to be recognised when considering the nature of the advantage sought to be obtained from incurring the contributions in question (*Vincent*).

121. Accordingly, in answering the question, what are the investors' contributions 'ultimately really … for' (*Vincent*), it is necessary in the circumstances, to give less weight to their form, as being for the provision of certain services, etc., and identify, as in *Vincent*, what is the 'ultimate obligation' the investor is owed.

122. It is considered that this obligation is to pay the investor their proportionate share of the net proceeds from the sale of goods produced from the scheme (whether that be in the form of animals, or their produce, or some other agricultural produce). These net proceeds may arise annually or only at intermittent intervals over the course of the scheme.

123. The following considerations support this conclusion:

- the operation of the scheme should be looked at in its entirety, just as is the case for Corporations law purposes. In this way it is not fatal to the argument that investor contributions are capital, that no one agreement specifies that an investor provides consideration to acquire their interest in the scheme;
- central to the operation of a registered managed investment scheme is the fact that investors do become members of it, and acquire 'interests', as a result, which by definition, encompass their rights to benefits **provided by the scheme**;
- investors do not carry on their own, small, separate businesses, but rather are passive beneficiaries of a trust constituted by the holding of scheme property by the responsible entity, which is used in its operation of the scheme as a whole; and
- investors acquiesce to their produce being pooled, and to their rights, for example, to access land, or to obtain services, being contributed to the operation of the scheme as a whole, in exchange for an interest in the net proceeds from the scheme.

124. The legal form of the agreements under which rights conferred on investors to access land etc., and to obtain the services of a manager are promised, should not deter a proper examination of the substance of the scheme as a whole. As Hill J said in *McLennan v. Federal Commissioner of Taxation* 90 ATC 4047 at 4052:

> The law is not so blinkered by form as to ignore entirely the substance of the transaction.

Once it is appreciated that the scheme is not operated as a large number of small and separate businesses, but as one larger enterprise, and that investors as members of a registered managed investment scheme acquiesce in relation to rights held by them as a matter of legal form, and the employment of those rights in the larger enterprise, one key consequence arises. This is that it is necessary to look at the substance of the larger enterprise in order to answer the question of what the investors' contributions to the scheme really obtain for them.

125. The substance of the schemes in question in this respect is that the right to share in these net proceeds is the most important part of the investor's parcel of rights, constituted as their 'interest' in the investment scheme. The investor's contributions can be said on this basis to procure for them this right. The contributions might also be labelled as the cost of a 'source of income' (*Anderson*), or the cost of their 'passive investment' (*Taylor*).

126. Whatever description is used, and whether or not the contributions are made just once, or by instalments over the life of the scheme, they represent the cost of a capital asset in the shape of a parcel of rights intended to be exploited to give rise to a return, or a series of returns, on the investor's investment. The advantage obtained is an income producing asset that is a crucial part of the structure or organisation of their income producing activity arising from their involvement in the scheme. The cost of this asset is on capital account and not deductible under section 8-1 (*Anderson*, *Vincent*, *Taylor*). This conclusion applies, it should be noted, irrespective of whether or not the investors are found to be beneficiaries of a trust for income tax purposes, the trustee of which is the responsible entity.

Alternatively, investors carry out a profit making undertaking or scheme

127. However, despite, as in *Cooke*, there being some element of those factors present in *Clowes* and *Milne*, courts have been reluctant subsequently to reach the same conclusion that investors in the schemes in question are passive investors only, and typically have held that the cases before them were distinguishable (see for example, *Cooke*, *Puzey*, *Sleight*).

128. This tendency does not preclude however, the argument which found favour with the minority in *Clowes*, that these investors participate either with each other or with each other and the manager, in a profit making undertaking or scheme.

129. Under this argument there is an important difference between the carrying on of a business which produces assessable income and a scheme which produces a net profit (or loss), measurable at the conclusion of that scheme.

130. The concept of taxing a profit from a profit making undertaking or scheme found statutory recognition with the enactment of former paragraph 26(a) of the ITAA 1936,[28] the second limb of which was considered in *Clowes*. Webb and Taylor JJ formed the minority in that case. Webb J said at p 219:

> If several farmers agreed upon a joint harvesting and marketing of crops and shared the proceeds on an acreage basis, the share of each would, I think, have its source in his land and not in the agreement; although the agreement might render that share greater or less than the proceeds of individual operations. Here the source of the income in question is in the cultivation of the lots, i.e., in the profit-making undertaking or scheme, and not in the shareholding in the company.
>
> So regarded the taxpayer was as much a party to his profit-making undertaking or scheme as was the company which operated his lots. As a lot-holder in the land he received his share of the profit. He was not a shareholder in receipt of assets of the company. As to nine-tenths, the profits from his lots were made for him and not for the company. The company received the remaining one-tenth as its share of the proceeds of the joint venture.

131. Schemes to which this Ruling applies do not, as a general rule, cater for the manager to also share in the net profits. However, this difference is not considered significant in the context of what alternative conclusions need to be examined once the investors in these schemes are not considered to carry on business.

132. There is little case law on the precise demarcation between the circumstances which are properly described as the carrying on of a business, and those answering the description of a profit making undertaking or scheme.

133. In *Crow v. Federal Commissioner of Taxation* 88 ATC 4620; (1988) 19 ATR 1565, Lockhart J said at ATC 4627; ATR 1574:

> In my view, the second limb of sec. 26(a) may be applicable where there is evidence of system, organisation and of profit-making purpose sufficient to establish a 'profit-making undertaking or scheme', although such evidence is not sufficient to establish the carrying on of a business…

134. Other relevant authorities discuss principles that have been applied to situations where taxpayers who carry on a business, obtain a profit from a separate activity separate and distinct from the trading activities of this business: see *Federal Commissioner of Taxation v. Whitfords Beach Pty Ltd* (1982) 150 CLR 355; 82 ATC 4031; (1982) 12 ATR 692, *Moana Sand Pty Ltd v. Federal Commissioner of Taxation* 88 ATC 4897; (1988) 19 ATR 1853 and *RAC Insurance Pty Ltd v. Federal Commissioner of Taxation* 90 ATC 4737; (1990) 21 ATR 709.

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[28] The relevant provision is section 15-15, subsection (1) of which says: 'Your assessable income includes profit arising from the carrying on or carrying out of a profit-making undertaking or plan.'

135. A relevant difference can be said to be some feature or features that set the taxpayer's circumstances apart from those where the overall impression is that they amount to the carrying on of a business. Notwithstanding these features however, the circumstances still exhibit certain business-like or commercial features: see generally the discussion in Taxation Ruling TR 92/3. These features are best categorised in relation to the schemes in question, as ones to do with the separation referred to earlier, between the outward appearance of large numbers of separate undertakings, and the true nature of the schemes, as one larger enterprise, with a preordained start and finish point, and hence having more the character of investment transactions 'entire in themselves': see *Australasian Catholic Assurance Co Ltd v. Federal Commissioner of Taxation* (1959) 100 CLR 502 at 509 and *Investment & Merchant Finance Corporation Ltd v. Federal Commissioner of Taxation* (1971) 125 CLR 249 at 255-264.

136. If the proper conclusion is that the investors do not carry on business, as a result of their involvement in the schemes in question, but nevertheless, participate in a profit-making undertaking or scheme carried out on their behalf, the question arises of how to treat their contributions to the scheme. The usual promotional material regarding these schemes will forecast a reasonable likelihood of investors receiving returns in excess of their contributions, as a result of the manager utilising the investors' funds in an organised and systematic way. This will usually be sufficient to establish a profit making purpose to the investors' involvement in the scheme.

137. Under this approach the proper characterisation of the investors' activities in relation to the schemes therefore, is the creation of an interest in a scheme not to produce assessable income in the form of sales, for example, of agricultural produce from large numbers of small commercial undertakings, but to produce a future profit calculated by deducting from any interim and final proceeds from the scheme, the costs incurred in operating the scheme, and so producing the final profit (or loss). The conclusion therefore under this view is that the investors do participate in a profit making undertaking or plan, for the purposes of section 6-5, so that their assessable income under this section will include any profit made from the scheme, and conversely, any loss realised at the completion of the scheme will be deductible under section 8-1.

138. This will not be the case where regular returns to the investor are assessable as ordinary income in the year of income in which they are derived, for in such cases it is the gross return itself, rather than any net profit, which is the amount of ordinary income assessable under section 6-5 (see *Federal Commissioner of Taxation v. Citibank Ltd & ors* 93 ATC 4691; (1993) 26 ATR 423). In practice therefore, this view has application only to those schemes like afforestation schemes, where no regular annual returns are contemplated, and in the usual case, there is only one significant return, at the completion of the scheme, although there may be some incidental returns prior to this (for example, those connected with the thinning of the trees).

Treatment of returns to investors

Returns to investors represent a share of net income of a trust estate, assessable under Division 6

139. Division 6 of Part III of the ITAA 1936 provides one set of provisions intended to deal with the liability of trustees (and others) to pay income tax on the income of a trust estate. Subsection 6(1) of the ITAA 1936 provides that for this purpose, the meaning of 'trustee' is:

> 'trustee' in addition to every person appointed or constituted trustee by act of parties, by order, or declaration of a court, or by operation of law, includes:
>
> (a) an executor or administrator, guardian, committee, receiver or liquidator; and
>
> (b) every person having or taking upon himself the administration or control of income affected by any express or implied trust, or acting in any fiduciary capacity or having the possession, control or management of the income of a person under any legal or other disability.

140. Rather than requiring any calculation of any taxable income of the trust estate, the provisions in Division 6 of Part III of the ITAA 1936 operate by reference to the concept of 'net income', which is defined in subsection 95(1) of Division 6. However, there is no definition of 'trust estate' for these purposes.

141. In *The Registrar of the Accident Compensation Tribunal (Vic) v. Federal Commissioner of Taxation* (1993) 178 CLR 145; 93 ATC 4836; (1993) 26 ATR 353 the minority of the High Court said (the majority basing their judgment on a finding that the taxpayer held the property in question as a trustee in the ordinary sense, and not on a consideration of this point), at CLR 187, ATC 4853, ATR 378-9, in the context of the definition of 'trustee', that:

> A 'trust estate' for the purposes of Div. 6 of Pt III of the *Income Tax Assessment Act* must bear a corresponding meaning, that is, property of any kind held or controlled by a trustee in one or other of the capacities prescribed by the definition. In *Manning v. Federal Commissioner of Taxation* (1928) 40 C.L.R. 506 at p.509 Knox C.J. said in reference to the definition of 'trustee' in the Income Tax Assessment Act 1922-1925 (Cth):
>
> > Wide as this definition is, it requires at least as an essential ingredient in the position of 'trustee' under the Act, the existence of a fiduciary obligation towards some other person. The existence of a fiduciary obligation to another person must, I think, always involve a liability to account at the instance of that other person, and if I am right in thinking that the gift of income to the appellant involves no such liability it seems to me to follow that she is not a trustee of the income within the meaning of the Act.

142. It is considered that the statutory scheme under which responsible entities of registered managed investment schemes of the type in question operate mean that they do owe such obligations to the members of these schemes. In fact, they are trustees in the ordinary sense, in the manner described in *Investa Properties* and *Southern Wine Corporation* (see paragraphs 45 and 50 to 51 of this Ruling), notwithstanding the fact that this comes about under a particular statute. Accordingly, it is considered that they are trustees for the purposes of Division 6 of Part III of the ITAA 1936 and that the scheme property held by them on trust for members comprises the trust estate for these purposes.

143. Section 96 of Division 6 of Part III of the ITAA 1936 says that 'except as provided in this Act, a trustee shall not be liable as trustee to pay income tax upon the income of the trust estate'. In the typical case of an investor who is a resident of Australia, and not under any legal disability, and the scheme is conducted wholly in Australia, section 97 of Division 6 of Part III of the ITAA 1936 will apply, to mean the trustee is not liable to pay income tax on the income of the scheme.

144. Section 97 of the ITAA 1936 relevantly provides in broad terms concerning such a case, that the investor as a beneficiary of the trust estate in question, presently entitled to a share of the income from this trust estate, includes in their assessable income the relevant share of the net income of that trust estate.

145. Investors as beneficiaries, holding rights to share proportionately in the net proceeds from the scheme will hold a corresponding right of present entitlement, being that same proportion, to the income of the scheme as a trust estate. Their interest in the income from the trust will be both present and vested in the relevant sense: see the authorities referred to in, for example, *Harmer & Ors v. Federal Commissioner of Taxation* (1991) 173 CLR 264; 91 ATC 5000; (1991) 22 ATR 726.

Returns represent unit trust dividends under Division 6C of Part III

146. In some situations the specific provisions of Division 6C of Part III of the ITAA 1936 may take precedence over the more general ones in Division 6 of Part III of the ITAA 1936. Division 6C contains provisions intended broadly to provide for a system of taxing certain public unit trusts which carry on business, in a way similar to that in which companies are taxed. That is, the net income of such trusts is taxed to the trustee and distributions to unit holders are treated in the same way as dividends paid by a company.

147. Under section 102R of Division 6C of Part III of the ITAA 1936, a trust cannot be a 'public trading trust', to which the Division applies, unless it first meets the requirements of being a 'public unit trust', noting that under section 102R, the trust must also come within the description of being a 'unit trust', which is not a defined term for the purposes of Division 6C.

148. Section 102P of the ITAA 1936 contains the requirements for a unit trust to be a 'public unit trust'. The first requirement concerns whether any of the units in the unit trust were listed on a stock exchange (paragraph 102P(1)(a)), were offered to the public (paragraph 102P(1)(b)), or were held by not fewer than 50 persons (paragraph 102P(1)(c)).

149. The term 'unit' is defined in section 102M of the ITAA 1936, 'in relation to a prescribed trust estate', as including 'a beneficial interest, however described, in any of the income or property of the trust estate'. Because this extended definition applies only in relation to a prescribed trust estate it does not broaden the meaning of 'public unit trust' beyond those trusts which are unit trusts. The definition ensures that where there is a prescribed trust estate, all beneficial interests in any of the income or property of the trust estate are treated as 'units'.

150. The terms 'prescribed trust estate' and 'unitholder' are also defined in section 102M of the ITAA 1936 respectively as:

> ***prescribed trust estate*** means a trust estate that is, or has been, a public trading trust in relation to any year of income.
>
> ***unitholder***, in relation to a prescribed trust estate, means the holder of a unit or units in the prescribed trust estate.

151. A 'public trading trust' is one which meets the definition of this term in section 102R of the ITAA 1936. While some elements of such a trust will vary, depending on the circumstances applying in the relevant year of income, to qualify the trust must be both a 'trading trust' and a 'public unit trust', in relation to the relevant year.

152. On this basis, a trust estate comprising scheme property, which under subsection 601FC(2) of the Corporations Act is held on trust by the responsible entity, for members of the registered managed investment scheme, can be a unit trust for the purposes of section 102P of the ITAA 1936. This will be where the trust is a unit trust within the ordinary meaning of that term.

153. In the usual case, the scale and regularity of the responsible entity's operations in relation to its operation of the scheme will mean that it will carry the scheme on as a 'trading business', within the meaning of this term in section 102M of the ITAA 1936.[29] Accordingly, they will operate 'trading trusts', within the meaning in section 102N of the ITAA 1936. Such trusts will be public trading trusts for the purposes of section 102R of the ITAA 1936, being both public unit trusts and trading trusts, and 'resident unit trusts' under section 102Q of the ITAA 1936, where the business is carried on in Australia.

[29] Section 102M of the ITAA 1936 defines 'trading business' to mean: '… a business that does not consist wholly of eligible investment business'. Schemes to which this Ruling applies are very unlikely to carry on a business consisting wholly of eligible investment business activities of the type defined in section 102M.

154. As a consequence of this:

- the trustee of the public trading trust is liable to pay tax on the net income of the trust at the rate declared by Parliament for the purposes of section 102S of the ITAA 1936; and
- subsection 44(1) of the ITAA 1936, concerning taxing dividends paid by companies, applies as if references there to:
  - 'company' include the prescribed trust estate or its trustee (subsection 102T(11) of the ITAA 1936;
  - 'dividend' include a unit trust dividend (as defined in section 102M of the ITAA 1936 (subsection 102T(12) of the ITAA 1936); and
  - 'shareholder' include a unitholder in a prescribed trust estate (subsection 102T(14) of the ITAA 1936).

155. The term 'unit trust dividend' is defined in section 102M of the ITAA 1936 as:

> ***unit trust dividend*** means:
>
> (a) any distribution made by the trustee of a prescribed trust estate, whether in money or in other property, to a unitholder; and
>
> (b) any amount credited by the trustee of a prescribed trust estate to a unitholder as a unitholder,
>
> but does not include:
>
> (c) money paid or credited, or property distributed, by the trustee of a prescribed trust estate to the extent to which the money or property is attributable to profits arising during a year of income in relation to which the prescribed trust estate was not a public trading trust; or
>
> (d) money paid or credited, or property distributed, by the trustee of a prescribed trust estate in respect of the cancellation, extinguishment or redemption of a unit to the extent to which:
>
> (i) the money paid or credited or the property distributed represents money paid to, or property transferred to, the trustee for the purpose of the creation or issue of that unit; and
>
> (ii) the amount of the money paid or credited or the value of the property distributed as the case may be, does not exceed the amount of the money paid to the trustee, or the value, at the time of transfer, of the property transferred to the trustee, for the purpose of the creation or issue of that unit.

156. For practical purposes, normal returns to investors from the scheme will qualify as unit trust dividends, where the responsible entity operates the scheme in a way that means it qualifies as a public trading trust for the purposes of Division 6C of Part III of the ITAA 1936. In these cases the returns will be dividends under subsection 44(1) of the ITAA 1936, and included in the assessable income of the investor as statutory income, within section 6-10 of the ITAA 1997.

Alternatively, returns represent ordinary income from property under section 6-5

157. If neither Division 6 nor Division 6C of Part III of the ITAA 1936 apply, the question then arises whether or not interim and final returns to investors from their passive investments are either wholly or in part, assessable income, as 'ordinary income' under section 6-5 of the ITAA 1997. In *Clowes* neither the actual return nor any profit or gain made in relation to it, was held to be assessable income. Conversely, in *Vincent*, the Full Federal Court acknowledged the possibility that a gain made from the disposal of the taxpayer's capital asset in that case might be assessable income.

158. Although the facts in *Federal Commissioner of Taxation v. Montgomery* [1999] HCA 34 (*Montgomery*) differ widely from those in the schemes in question, much of what the majority of the High Court said in that case about the attributes of ordinary income is relevant here.

159. Gaudron, Gummow, Kirby and Hayne JJ examined a number of general propositions concerning the nature of ordinary income. At [68] they said:

> Each of the general propositions we have mentioned is qualified: income is often (but not always) a product of exploitation of capital; income is often (but not always) recurrent or periodical; receipts from carrying on business are mostly (but not always) income. …

160. The amounts in dispute in *Montgomery* related to the conduct of the business of a partnership. The taxpayer in that case submitted that these amounts were received for the partnership to take a long term lease of premises from which its professional practice would be conducted, and that lease was a capital asset, the payments were also capital in nature.

161. The majority of the High Court accepted that the lease was part of the 'profit yielding structure of the firm's business',[30] but said that this did not necessarily mean that an aspect of the obtaining of that lease was on capital account. At [92] they said:

> It is important to keep well in mind that the receipts now in question were receipts associated with, or on the occasion of, the acquisition of part of the profit-yielding structure of the firm. That is, the receipts came in on an occasion different from many, if not most, that have fallen for consideration in other cases. In those cases the receipt is the one that came in on the *disposition* of part of the profit-yielding structure. Similarly, it must be remembered that the sums now in question were receipts connected with the acquisition of part of the taxpayer's capital structure. In this respect, too, this occasion differs from those in other cases, where there was a *payment to acquire* part of that structure.

162. The majority also rejected submissions of the taxpayer that the amounts in question were analogous to a premium or for the modification of the firm's capital structure. They turned their attention to the 'singular' nature of the transaction giving rise to these amounts, and noted that this feature might suggest, in contrast to the conclusion that the amounts were ordinary income, that they represented the proceeds from a 'mere realisation of a capital asset or change of investment, rather than a transaction on revenue account'.[31]

163. At [117] to [118] the majority expressed their conclusion that the amounts in dispute were ordinary income, in the following manner:

> The inducement amounts received by the firm did not augment the profit-yielding structure of the firm. The lease was acquired as part of that structure; the inducement amounts were not. There was, in the words of Pitney J in *Eisner v. Macomber* '*not* a gain *accruing to* capital, *not* a *growth or increment* of value in the investment, but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and coming in, being 'derived', that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal'.
>
> To put the matter another way, the firm used or exploited its capital (whether its capital is treated for this purpose as being the agreement to take premises or its goodwill) to obtain the inducement amounts. As the papers presented to the firm in August 1989 said, the firm was then 'of a size which makes it a particularly attractive tenancy target'. And it was because it was a particularly attractive tenancy target that it was suggested in those papers that the firm should receive a good inducement offer to take the premises. The firm used or exploited its capital in the course of carrying on its business, albeit a transaction properly regarded as singular or extraordinary. And the sums it received from the transaction were not as some growth or increment of value in its profit-yielding structure – the receipts came in or were derived for the separate use, benefit and disposal of the firm and its members as they saw fit …

[30] [1999] HCA 34 at [91].
[31] [1999] HCA 34 at [113].

164. In the schemes in question it is possible to envisage that an investor might reap some return from their investment in the shape purely and simply of disposal proceeds from the realisation of their interest in the scheme. Whether those proceeds were from the 'mere realisation of a capital asset' would depend on the facts of the case.

165. More typically, investors in these schemes are promised returns in the shape of a share of the net proceeds derived from the underlying agricultural activity. These returns do not represent a gain accruing to the capital value of their interest in the scheme, for the reason that that they are severed from that interest and intended to be made available for the separate use and benefit of the investor. They are more properly characterised as returns from exploiting the investor's capital asset, being their interest in the scheme, in the sense referred to in *Montgomery*, notwithstanding the fact that this exploitation occurs in a non business setting.

166. Accordingly, these returns are considered to be ordinary income, which are included in the investor's assessable income under section 6-5.

167. As such, section 118-20 (reducing capital gains if amount otherwise assessable) may apply, to reduce the amount of any capital gain made from a CGT event, where the shape of the return means it has been derived in connection with that CGT event. Normally the return will be fully assessable under section 6-5, and thus the capital gains tax (CGT) provisions of Part 3-1 will have no practical impact.

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.

Whether investors carry on business

168. As acknowledged above, a number of cases can be referred to in support of a conclusion that investors in the schemes in question do carry on their own separate businesses as a result of their involvement in the scheme: see, for example, the discussions of the relevant authorities in *Puzey, Cooke and Sleight*.

169. Further, in none of the cases referred to previously, with the exception of *Vincent*, has it been held that features connected to passivity and lack of control over the day to day operations of the scheme, lead to the conclusion that a business is not being carried on. Rather, relatively extensive conferral of powers on managers, coupled with a consequential reduction in the degree of control actually able to be exercised by investors, have been held not to 'necessitate the conclusion that a business is not being carried on' (*Sleight* at [61]).

170. In like fashion, the pooling of produce from the scheme as a whole, so that investors' returns derive from a proportionate share in the whole of the net sale proceeds from the scheme, has also been held not to be inconsistent with a finding that investors carry on their own separate businesses (see for example, *Cooke* and *Sleight*).

171. However, as the Full Federal Court said in *Sleight* at [51]:

> In *Puzey* it was also pointed out that reliance can seldom be placed on a particular decided case to conclude that a business is, or is not, carried on, unless there is a complete identity of fact between that case and the circumstances under consideration. However in this case, some guidance can nevertheless be obtained from the decisions to which counsel for both parties referred.

172. And there is the fact that in the second year considered in *Puzey*, the restructuring of the scheme resulted in the primary judge finding that because this introduced a trustee into the scheme who held the investors' rights under the scheme, it was that trustee rather than the investors who thereafter carried on the relevant business.

173. Once factors like passivity and lack of control, and the structuring of scheme returns in the shape of proportionate sharing of the net sale proceeds from the scheme as a whole, are taken into consideration, we do not believe we can continue to accept that investors in the schemes in question do carry on their own separate businesses, in the relatively straightforward and unequivocal manner in which this is stated in paragraph 35 of Taxation Ruling TR 2000/8.

174. We consider that there is not a 'complete identity of fact' (to adopt the language from *Sleight*), between the decided cases said to stand for a contrary conclusion, and those to which this Ruling applies. For this reason, we do not accept this alternative view.

Whether investors are beneficiaries of a trust

175. An alternative view to that where the investors in the schemes in question are beneficiaries of a trust, is that primacy ought still be given to the rights held by investors against the responsible entity as manager of the scheme. In doing so, it is possible to still conclude that it is the investors on whose behalf the manager is conducting businesses for them. This is particularly so, where it is concluded that the rights investors hold in relation to agreements to allow them access to land, etc., and in relation to the provision of management services, are not 'scheme property'[32].

176. In any event, the proposition that the responsible entity holds scheme property on trust can only apply by definition to a registered managed investment scheme.

177. Further, it is possible to argue either:

(a) that the responsible entity only ever holds the scheme property as bare trustee; or

(b) that even if the responsible entity holds, for example, gross income from the scheme on an active trust, it does so in a way where the investors' rights to the things sold which gave rise to that income ought to be recognised first. Under this view the responsible entity would not be recognised as deriving that income for income tax purposes, because it will have been derived by the investors.[33]

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[32] During public consultation on the draft version of this Ruling, reference was made to the decision in *Syncap Management (Rural) Australia Ltd v. Lyford* [2004] FCA 1352. This case involved a registered agricultural managed investment scheme. The point was made that none of the rights held by investors in this scheme were considered to be 'scheme property'. In response, we refer to paragraph 52 of this Ruling, where the observation was made that none of the decided cases on the meaning of scheme property have concerned cases with arguments framed with the type of tax law issues dealt with in this Ruling in mind. The same point also applies to certain obiter comments in *Mier & Jonsson v. FN Management* [2005] QCA 408, also referred to during the public consultation

[33] On this basis, the finding in *Southern Wine Corporation* that the 'scheme property' included the Gross Income would not mean that the responsible entity had derived that amount as income. Rather, it means no more than that it held the amount as capital of the trust. The case is not authority that the Growers did not derive income in relation to sales of produce made on their behalf.

178. Moreover, in *Puzey*, on appeal the Full Federal Court (Hill and Carr JJ), held that this change, involving the taxpayer becoming a passive investor in a scheme operated by a trustee, did not affect the deductibility of amounts laid out by him as rent and management fees. They said at [58]:

> The question which then arises is whether the change affects the deductibility of the amounts outlaid by Mr Puzey. There can be no doubt that a contractual payment to a manager to manage such a scheme would be deductible. So too would rent paid by Mr Puzey. Outgoings such as rent and fees for services, if for the purpose of gaining or producing assessable income, are deductible and not on capital account.

179. Given the view taken about the role of the responsible entity in conducting as trustee the scheme as a business, we do not accept that the correct description of them is merely a 'bare trustee'. The role the responsible entity carries out as trustee of the scheme property we consider goes well beyond that usually held to apply to a bare trustee, as described for example, in *Herdegen v. Federal Commissioner of Taxation* (1988) 84 ALR 271; 88 ATC 4995; (1988) 20 ATR 24.

180. The Commissioner's view is, therefore, that for the reasons stated previously:

(a) it is the responsible entity which carries on any business concerning the operations of the scheme, in its capacity as trustee;

(b) the position of the responsible entity as trustee is analogous to the position of the trustee in *Puzey*; and

(c) the outgoings of investors labelled for example, as management fees, are really for the investor acquiring their interest in the scheme, and are capital, or capital in nature.

For these reasons the alternative views in paragraphs 175 to 177 of this Ruling are not agreed with. The comments from *Puzey*, as quoted in paragraph 178 of this Ruling, are not considered to apply, as the investor's outgoings are not viewed as rent or fees for services.

Whether investor contributions are capital

181. The question of whether investor contributions are capital is also arguable. In *Cooke*, for example, the court refused to accept an argument that any part of the investors' contributions were for the acquisition of any rights of an enduring nature, so as to be capital expenditure. Alternatively, the conclusion in *Puzey v. Federal Commissioner of Taxation* [2004] FCAFC 23, that part of the investor's contributions styled as the 'plantation establishment fee' was on capital account, can be argued to be restricted to the facts of that case.

182. Furthermore, in *Sleight* Hill J (Hely J agreeing) said at [31], in relation to the decision at first instance:

> His Honour held also that the amounts claimed were, in consequence of the finding that a business was carried on, and not denied deductibility as being outgoings of capital. In this part of his Honour's judgment his Honour considered and rejected a submission on behalf of the Commissioner that the initial cash outlay was not in substance for management fees and interest 'but for the right to a proportionate share of the overall proceeds of the sale of oil produced by the Project'. In so doing his Honour noted that there was no contention that the payments were a sham. Such a submission was bound to fail, unless they were a sham.

183. Nevertheless, we consider that the approach of the Full Federal Court in *Vincent* should be applied to the whole of the scheme documentation in question. On this basis, as outlined earlier in this Ruling, we consider that the better view is that contributions by investors are really ultimately for their interest in the scheme, primarily in the form of their rights to share proportionately in the net sale proceeds from the scheme. When the scheme documentation is viewed as a whole it is considered that this interest is in truth, what the ultimate obligation owed to the investor is about. Such a characterisation of the overall documentation does not rely on it being a sham. This characterisation leads to the conclusion that investor contributions are capital or capital in nature, and not deductible under section 8-1, for the reasons outlined in paragraphs 116 to 126 of this Ruling.

184. Some submissions received during public consultation on the draft version of this Ruling argued that even if an investor's initial contribution to the scheme was on capital account, this was not the case for fees payable in subsequent years. These subsequent year fees were said to be for rent and for the services of a manager to manage the investor's investment in the scheme, deductible under section 8-1 and not on capital account.

185. For this view to be accepted there needs to be a basis on which to differentiate the factors relevant to the proper characterisation of the initial contribution from those relevant in this respect, to the subsequent year fees. No such basis is considered to exist. Rather, we believe the proper characterisation of both the initial contribution and the subsequent year fees is that of the costs of the investor's interest in the scheme. As discussed in paragraph 119 of this Ruling, the cost of this interest is wholly on capital account, even where payable over a period of time.

Whether investors participate in a profit making undertaking or scheme

186. The Commissioner's argument that investors in a sandalwood growing scheme participated in a profit making undertaking or scheme was considered and rejected by Lee J in *Puzey* at first instance.[34] In that case the Commissioner submitted that there was only one critical object of the scheme, and that was to see certain seedlings planted and a crop from them harvested in 15 years time. This was said to represent a scheme to obtain a future or emerging profit calculated by deducting from any eventual harvest proceeds the costs of constructing and bringing the scheme to fruition.

187. Lee J said at [63]:

> However, in the instant case the applicant was engaged in a project to obtain a return from the pooling of his interest in timber seedlings with like interests, and from the management of those interests in common to produce a commodity able to be harvested and sold at a profit. The interests included an area of land held under lease by the applicant on which sandalwood seedlings purchased by the applicant were to be planted. At the time the outgoings in issue were incurred the applicant was to pay regular outgoings by way of rent and management fees in connection with the growing and maturation of his seedlings. Therefore, the return sought was not a capital accretion on a sum invested but a return from the growth, harvest and sale of a product purchased for resale, that return to be promoted by regular outgoings incurred for the purpose of producing the product for sale. Accordingly, the distribution to the applicant of monies obtained as proceeds from the sale of the timber harvested from the plantation would represent the gaining of assessable income according to ordinary concepts.

188. It can be seen that the above conclusion depends on the same findings of fact as those related to successfully concluding that each investor carries on their own separate business, that is, that the legal form of the scheme is paramount; that investor contributions are only for what the form of the relevant agreements say they are for, and that the separation between the outward appearance of regular outgoings being incurred on a regular basis for the conduct of this business, and the way returns to investors are calculated, is not relevant.

[34] *Puzey v. FC of T* [2002] FCA 1171.

189. However, once those factual findings are not accepted, it is considered that the question of whether or not investors nevertheless participate in a profit making undertaking or scheme carried out on their behalf, remains an issue.[35]

[35] In calculating the 'profit' from such an undertaking or scheme it has been argued during public consultation on the draft version of this Ruling, that it does not automatically follow that expenditure incurred in carrying out the scheme will be included. It is noted however, that the courts have adopted a broad view to what is included in this respect: see for example, *Elsey v. FC of T* (1969) 121 CLR 99; 69 ATC 4115; (1969) 1 ATR 389. In this case items such as land levelling costs, subdivision and agents' charges and interest on moneys borrowed to 'enable the scheme to be carried out' were all considered to form part of the calculation of the 'profit' from the profit making undertaking or scheme.

Appendix 4 – Detailed contents list

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Previous draft:

TR 2007/D2

Related Rulings/Determinations:

TR 92/3; TR 2006/10

Previous Rulings/Determinations:

TR 2000/8

Subject references:

- assessable income
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- public rulings
- tax shelters
- taxation administration

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