



PR 1999/11 - Income tax: The Larenta Olive Project

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Product Ruling

Income tax: The Larenta Olive Project

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Preamble

The number, subject heading, and the What this Product Ruling is about (including Tax law(s), Class of persons and Qualifications sections), Date of effect, Withdrawal, Arrangement and Ruling parts of this document are a 'public ruling' in terms of Part IVAAA of the Taxation Administration Act 1953. Product Ruling PR 98/1 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Larenta Olive Project, or simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:

- section 6-5 (of the *Income Tax Assessment Act 1997* ('ITAA 1997'));
- section 8-1 (ITAA 1997);
- Subdivision 387-B (ITAA 1997);
- Subdivision 387-C (ITAA 1997);
- Part IVA (of the *Income Tax Assessment Act 1936* ('ITAA 1936'));
- section 82KJ (ITAA 1936);
- section 82KK (ITAA 1936);
- section 82KL (ITAA 1936); and
- section 82KZM (ITAA 1936).

Class of persons

3. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Growers'.

4. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

5. The Ruling provides this specified class of persons with a binding ruling as to the tax consequences of this product. The Commissioner accepts no responsibility in relation to the commercial viability of this product, and gives no assurance the prices charged for the product are reasonable, appropriate, or represent industry norms. A financial (or other) adviser should be consulted for such information.

6. The Commissioner rules on the precise arrangement identified in the Ruling.

7. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 12 to 25) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

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Date of effect

9. This Ruling applies prospectively from 5 May 1999, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

10. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, the Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

12. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- draft Lease and Management Agreement between Premium Olive Managers Limited ('the Manager'), Gingin Land Company Ltd and the Grower dated 8 February 1999;
- draft Constitution of Larenta Olives dated 9 February 1999;

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- draft Olive Oil Processing Agreement between the Manager as the Grower's representative and Premium Olive Processing Pty Ltd dated 8 February 1999;
- draft Olive Oil Supply Agreement between the Manager as the Grower's representative and Premium Olive Marketing Pty Ltd dated 8 February 1999;
- draft Prospectus for Larenta Olives dated 3 March 1999;
- a Product Ruling application dated 9 February 1999; and
- correspondence from the applicant dated 16 April 1999.

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

13. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be a party to.

14. This arrangement is called 'The Larenta Olive Project'. The Project is to carry out a large scale planting of olives, principally for the production of olive oil. Growers entering into the Project will lease land from Gingin Land Company Ltd for a period of 16 years. The minimum individual holding is one leased area, being an allotment of 0.4 hectares of land planted with an average of 200 olive trees. Overall, it is proposed to plant 500 hectares with 250,000 olive trees. The 1,250 leased areas that this represents are separately identified and a map is attached to the Lease and Management Agreement. Growers may also subscribe for shares in Gingin Land Company Pty Ltd.

15. Growers will enter into a contract with Premium Olive Managers Ltd for the purchase and establishment of olive rootlings, the establishment of an irrigation system, and the management of their olive grove. Growers will have an option to take possession of their olives after harvest and be responsible for processing and marketing the olives themselves. Where a Grower does not make this election, the Manager, on behalf of the Growers, will enter into a contract with Premium Olive Processing Pty Ltd to process the olives, and with Premium Olive Marketing Pty Ltd who will buy the oil from the Growers at market price.

Lease and Management Agreement

16. The Growers will make payments to the Project under the Lease and Management Agreement. The Agreement is to be executed by 30 June 1999, assuming receipt of the minimum subscriptions. The payments will be for rent, management fees, establishment of the olive rootlings and irrigation expenses.

17. The Grower leases from Gingin Land Company Pty Ltd a defined area (as set out in Item 1 of the Schedule to the Lease and Management Agreement). Some of the conditions of the lease are that the Grower:

- will not use or permit any other person to use the leased area for any purpose other than the cultivating of olive trees for the purpose of olive oil production;
- will at all times during the lease operate the leased area for the long term commercial success of the Project with due care and skill in accordance with good horticultural practice, and
- will not use, or permit any other person to use the leased area for residential, recreational or tourist purposes.

18. In return, the Grower has the right to pass over the leased area at any time and the Grower will at all times have full right, title and interest in the Grower's olives produced from the leased area. At the expiration of the term the Grower will peaceably surrender and yield up to the Lessor the leased area and fixtures free and clear of rubbish and in good repair and condition.

19. The Grower appoints the Manager to establish, maintain, supervise and manage on a day-to-day basis on behalf of the Grower all activities to be carried on by the Grower on their leased area. The Manager is required to perform these services in accordance with sound commercial practice and good horticultural practice. The Manager will harvest the olives or arrange for some other person to harvest the olives.

20. Unless the Growers have elected otherwise, the Manager is authorised to enter into a contract as agent of the Growers for the processing of the olives into olive oil and for the sale of the olive oil.

Fees

21. The Growers will make the following payments per leased area for the first year of the Project:

- a management fee of \$5,810 to Premium Olive Managers Ltd for the management of the grove for the

period from the execution of the agreement until 30 June 2000;

- an irrigation fee of \$2,000 to the Manager;
- a lease fee of \$50 to the Manager for the Growers' use of the land for the period to 30 June 2000; and
- a fee of \$400 to the Manager for the purchase and establishment of olive rootlings.

22. The Growers will make the following payments per leased area in subsequent years until completion of the 16 year Project:

- a management fee of \$1,732 for year 2 of the Project and \$2,754 in year 3, and further specific amounts for subsequent years as set out in the Lease and Management Agreement; and
- a lease fee of \$52 increasing by approximately \$2 in each subsequent year of the Project.

23. A crushing fee is payable once olives are harvested. The fee is to be determined in accordance with the Olive Oil Processing Agreement. The fee is set at a minimum fee per tonne or 10% of the net proceeds of the sale of the oil.

24. A Grower may choose to insure their olive grove against damage. A premium will be payable to an independent insurance company for this coverage.

Finance

25. There are no funding arrangements as part of the Project. If any Grower borrows funds to take part in the Project, the borrowing will be a private arrangement between the Grower and the party providing the funds. There is no connection as part of the Project between any financier and the Project.

Ruling

26. For a Grower who invests in the Project the following deductions will be available:

- management fees paid for the services outlined in the Lease and Management Agreement will be allowable deductions to the Grower in the year incurred (section 8-1 of the ITAA 1997);

- rent paid by the Grower in relation to the leased area will be an allowable deduction in the year incurred (section 8-1);
- expenses incurred on irrigation will be an allowable deduction to the Grower in the year incurred and the next 2 years at the rate of 33.3% per annum (section 387-125);
- a deduction for the establishment of the olive rootlings will be allowable to the Grower at the rate of 7% per annum, commencing from the first day of what is to be the olive trees' first commercial season (section 387-185); and
- a deduction for insurance premiums for the olive grove covering fire, public risk or loss of profits (section 8-1).

Sections 82KZM, 82KJ, 82KK, 82KL and Part IVA

27. For a Grower who invests in the Project the following provisions of the ITAA 1936 have application as indicated:

- the expenditure by the Grower does not fall within the scope of section 82KZM;
- section 82KJ does not apply to deny deductions otherwise allowable to the Grower;
- section 82KL does not apply to deny the deductions otherwise allowable to the Grower; and
- the provisions in Part IVA will not be applied to the arrangement described in this Ruling.

28. Provided a Grower does not fall within the definition of an 'associate' of Premium Olive Managers Ltd or Gingin Land Company Pty Ltd, section 82KK will not apply to deny the deductions otherwise available to the Grower.

Assessability of income from the Project

29. Growers who invest in the Project will be assessable on their share of the gross proceeds arising from the Project in accordance with section 6-5 (ITAA 1997).

Explanations

30. Consideration of whether the lease and management fees are deductible begins by examining paragraph 8-1(1)(a) of the ITAA 1997. This view proceeds on the following basis:

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

31. An horticultural scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the Project will constitute gross assessable income in their own right. The generation of business income from such a business provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the olive trees and processing of the olives.

32. Generally, a Grower will be carrying on a business of an olive grower where:

- the Grower has an identifiable interest in specific growing trees coupled with a right to harvest and sell the olives produced;
- the olive grove activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business, as used by the Courts, point to the carrying on of a business.

An identifiable interest

33. The Lease and Management Agreement gives Growers an identifiable interest in specific trees and a legal interest in the leased land. Growers have the right personally to process and market the olives attributed to their leased area or they may use the Manager to arrange the processing and marketing of the olives for them. Growers have a continuing interest in the trees from the time they are acquired until the end of the Project. There is a means to identify in which trees the Growers have an interest.

Horticultural activities carried out by the Grower or on the Grower's behalf

34. Under the Lease and Management Agreement Growers appoint Premium Olive Managers Ltd to manage the Project. The Manager is to provide services including the establishment and maintenance of a trickle irrigation system and the cultivation, tending, training, pruning, fertilising, replanting, spraying and otherwise caring for the olive trees. The Manager is also responsible for harvesting the olives.

35. Growers have an obligation to use the land in question for the cultivation of olives for the purpose of olive oil production. The activities described in the Lease and Management Agreement are carried out on the Growers' behalf. The Grower's degree of control over the Manager, as evidenced by the Agreement and supplemented by the Corporations Law, is sufficient. Under the Corporations Law, Premium Olive Managers Ltd are required to prepare annual reports and send them to Growers within 3 months after the end of the financial year. Growers are able to terminate their agreement with the Manager in specified circumstances, such as a substantial breach by the Manager of a material obligation under the Agreement.

General indicators of business

36. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections in the prospectus that suggest the Project should return a 'before-tax' profit to the Growers, that is, a 'profit' in cash terms that does not depend on its calculation, on the fees in question being allowed as a deduction.

37. The outgoings in question have the requisite connection with the operations that more directly gain or produce this income. That is,

the fees directly relate to the planting, tending, maintaining and harvesting of the olive trees.

38. Growers have a continuing interest in the trees from the time they are acquired until the end of the 16 year Project. There is a means to identify in which trees the Growers have an interest. The horticultural activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' activities will constitute the carrying on of a business.

39. The lease and management associated with the grove activities relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income is to be gained from this business. They will be deductible under paragraph 8-1(1)(a). The tests of deductibility under that paragraph are met. The exclusions in subsection 8-1(2) do not apply.

Expenditure of a capital nature

40. Any part of the expenditure of a Grower entering into a horticultural business attributable to acquiring an asset or advantage of an enduring kind, is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, the cost of the olive rootlings and their establishment expenditure, and the costs of irrigation are considered to be capital in nature. The fees for these expenses are not deductible under section 8-1. However, this expenditure falls for consideration under the specific capital write-off provisions of the ITAA 1997.

Subdivision 387-B: irrigation expenditure

41. Subdivision 387-B allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed would be covered by this Subdivision.

42. A deduction is available to a taxpayer who is a lessee of the land. A deduction would be available to the Growers in the Project at a rate of 33.3% per annum for the cost of the irrigation system (subsection 387-125(2)).

Subdivision 387-C: horticultural expenditure

43. Subdivision 387-C allows capital expenditure on establishing horticultural plants for use in an horticulture business to be written off for tax purposes. For the purpose of this Subdivision, a lessee or licensee of land carrying on a business of horticulture is treated as owning the plants growing on that land rather than the actual owner of the land. The write-off under Subdivision 387-C commences on the first day of what is to be the olive trees' first commercial season. The Manager will advise the Growers of this event.

44. Establishment expenditure is limited to capital expenditure. The costs of establishing an horticultural plantation may include the costs of acquiring the plants or seeds, the cost of planting the plants or seeds and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or the initial clearing of the land.

45. Under this Subdivision, where the effective life of the plant is more than 3 years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period.

46. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the olive trees have an effective life in excess of 30 years. The write-off rate for horticultural plants with an effective life of more than 30 years is 7% (section 387-185).

47. The Manager has identified that the relevant expenditure attributable to the establishment of the olive rootlings is \$400. This amount will be subject to the horticultural provisions and allowable as a deduction under Subdivision 387-C.

Insurance

48. Under the terms of the Lease and Management Agreement a Grower may elect to take out additional insurance in respect of their portion of the olive grove. Insurance premiums for fire, public risk or loss of profits are deductible. Therefore, where a Grower takes out insurance to cover these events, the premium will be deductible under section 8-1.

Assessability of income from the Project

49. For a Grower who invests in the Project any income received by them from the sale of their olives, or from the sale of products from their olives, will be assessable income to them under section 6-5.

Section 82KZM

50. Section 82KZM of the ITAA 1936 operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1 of the ITAA 1997. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

51. Under the Lease and Management Agreement the management fee of \$5,810 per holding will be incurred on execution of the Agreement. This fee is charged for providing services to a Grower only for the period of 13 months from the execution of the Agreement. For this Ruling's purposes no explicit conclusion can be drawn from the arrangement's description, that the fee had been inflated to result in reduced fees being payable for subsequent years. The fee is expressly stated to be for a number of specified services. There is no evidence to suggest that the services covered by the fee could not be provided within 13 months of the fee being incurred. Therefore, it cannot be suggested that the 'thing' to be done cannot be wholly done within 13 months of the fee being incurred.

52. The basic precondition of the operation of section 82KZM is not satisfied and the section will not apply to disallow a deduction for the lease and management fee.

Section 82KJ

53. Section 82KJ denies a deduction in respect of certain prepaid outgoings that are incurred as part of a tax avoidance agreement. Section 82KJ's operation depends, among other things, on the taxpayer acquiring, or being reasonably expected to acquire, property and the consideration for that property is less than that which might reasonably be expected to have been payable.

54. 'Property' is defined broadly and includes a chose in action and any estate, interest, right or power, whether at law or in equity, in or over property. The Grower's interest in the Project falls within this definition.

55. The consideration paid by the Growers in respect of the 'property' is not less than that which might reasonably be expected to have been payable. Section 82KJ will not apply to deny the deduction otherwise allowable under section 8-1.

Section 82KK

56. Section 82KK applies where a taxpayer incurs an allowable outgoing to an associate in an income year and the associate does not include that amount as assessable income until a subsequent year. Where the section applies the outgoing is allowable to the taxpayer only in the year in which it is included in the assessable income of the associate.

57. Subsection 82KH(1) defines 'associate' broadly. The definition includes a company where the company or its directors are accustomed to or are under an obligation to act in accordance with the directions of the taxpayer, or where the taxpayer and associates might have the capacity to control the casting of more than 50% of the maximum number of votes that could be cast at a general meeting of such a company.

58. Provided Growers do not fall within the definition of associates of either Premium Olive Managers Ltd or Gingin Land Company Pty Ltd, section 82KK will not apply to deny the deduction otherwise allowable under section 8-1.

Section 82KL

59. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1) a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' and the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

60. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Insufficient 'additional benefits' will arise to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

61. For Part IVA to apply there must be a 'scheme' (section 177A of the ITAA 1936); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

62. The Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the tax deductions per leased area that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme

will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

63. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of the fruit from the trees. Further, there are no features of the Project, for example, such as the management fees being 'excessive', not commercial and predominantly financed by a non-recourse loan, that might suggest that the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that it would attract the operation of Part IVA.

Detailed contents list

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Commissioner of Taxation

5 May 1999

Previous draft:

No draft issued

- tax shelters
- tax shelters project

Related Rulings/Determinations:

PR 98/1; TR 92/1; TR 97/11;
TR 97/16; TD 93/34

Legislative references:

- ITAA1936 82KH(1)
- ITAA1936 82KJ
- ITAA1936 82KK
- ITAA1936 82KL
- ITAA1936 82KL(1)
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1997 6-1
- ITAA1997 8-1
- ITAA1997 387-B
- ITAA1997 387-125
- ITAA1997 387-C
- ITAA1997 387-185

Subject references:

- carrying on a business
- fee expenses
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- product rulings
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- primary production
- primary production expenses
- producing assessable income
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes

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