



PR 1999/99 - Income tax: Hanging Rock Secondo

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 This document has changed over time. This is a consolidated version of the ruling which was published on *27 August 2001*



Product Ruling

Income tax: Hanging Rock Secondo

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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**, **Previous Rulings**, **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 1999/95 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.*

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

Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities in future years to confirm the arrangement has been implemented as described below and to ensure that participants in the arrangement include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This ruling set 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 Hanging Rock Secondo Project offered by Bamboo Plantation Management Pty Ltd, or just simply as 'the Project', or the 'product'.

Tax law(s)

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

- section 8-1 of the Income Tax Assessment Act 1997 ('ITAA 1997');
- section 387-55 of the ITAA 1997;
- section 387-125 of the ITAA 1997;
- section 387-165 of the ITAA 1997;
- Part IVA of the Income Tax Assessment Act 1936 ('ITAA 1936');
- section 82KL of the ITAA 1936;
- section 82KZM of the ITAA 1936.

3. This Ruling does not deal with the consequences or effects of the Goods and Services Tax or any associated 'A New Tax System' legislative reforms, including the proposed changes announced as part of The New Business Tax System or their effect on the various Income Tax Acts (including the provisions set out above).

4. On 21 September 1999, the Government announced a number of changes to the tax system as part of the New Business Tax System. A number of those changes could affect the tax laws dealt with in this Ruling. On 11 November 1999 the government announced further changes, some of which could also affect the tax laws dealt with in this ruling, especially those to do with 'tax shelters'. Some of those changes apply from the dates of announcement and others are proposed to apply from nominated dates in the future.

5. This Ruling does not deal with the announced changes. We cannot give a legally binding ruling on those changes until the relevant legislation is enacted.

Class of persons

6. 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'.

7. 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

8. If the arrangement described in this 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

10. This Ruling applies prospectively from 17 November 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).

11. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely upon 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

12. This Product Ruling is withdrawn and ceases to have effect on 30 June 2003. 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 material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

13. The arrangement that is the subject of this Ruling is described below.. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Information Memorandum received in the ATO under covering letter dated 27 October 1999;
- Product Ruling request dated 12 May 1999;
- Constitution of Hanging Rock Secondo Pty Ltd('HRS') dated 13 January 1999;
- Management Agreement, received in the ATO under covering letter dated 27 October 1999 between Bamboo Plantation Management Pty Ltd ('The Manager') and the Grower;
- Consultancy Agreement between the Manager and Coolamon Plantations Pty Limited;
- Letters from the applicant or his representative dated 12 May 1999, 11 June 1999, 14 July 1999, 6 September 1999, 21 September 1999, 8 October 1999 and 18 October 1999;

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

14. The documents highlighted are those Growers enter into. There are no other agreements, whether formal or informal, and

whether or not legally enforceable, which a Grower, or any associate¹ of the Grower will be party to. The effect of these agreements is summarised as follows.

15. This arrangement is called Hanging Rock Secondo and concerns a bamboo plantation in which some planting has already commenced. It is planned to be completed by 31 December 2000 and to be operational by that date. Growers in this project will subscribe for shares in HRS. The shares give a Grower use of a defined area of land on a property located near Murwillumbah, Northern New South Wales. The Growers contract with 'the Manager' for the purchase of bamboo plants, the nurturing of the plants, the planting, management and harvesting of the bamboo shoots and timber.

16. The minimum holding is one lot of not less than one arable hectare to be planted with 200 bamboo plants. Overall, it is proposed that 60 hectares will be planted with approximately 12,000 bamboo plants. The lots will be identified in a plan of subdivision which will be annexed to and form a part of the Constitution of HRS.

17. The bamboo to be planted in the Project are *Dendrocalamus Asper* and *Dendrocalamus Latifloris*, both clumping non-invasive bamboos, suited for the plantation production of edible shoots and timber.

18. The bamboo plants will be initially trickle irrigated and when the bamboo clumps are about 3 years old this irrigation system will be removed. It is projected that expenditure on an overhead spray irrigation system will occur in year 4.

Growers' Use of Land

19. The company HRS has been specifically incorporated to hold the title to the land. Growers will be issued shares in HRS, and as a result, will be entitled to use specified lots, as set out in the HRS Constitution. Growers will also be entitled to use certain 'common property', such as access ways, dams, and service facilities. A Grower's interest in a specified lot cannot be changed without their consent.

20. Clause 124 of the Constitution divides the initial capital of HRS into 432,003 shares of One Dollar (\$1.00) each. There are 60 lots consisting of 7,200 shares each, and 1 lot of 3 foundation shares. The 60 lots are A to Z (26 lots); A1 to Z1 (26 lots); and A2 to H2 (8 lots). The three directors of HRS hold one foundation share each.

¹ In this Ruling 'associate' has the meaning as defined in section 318 of the ITAA 1936

21. Apart from initial borrowings to purchase the land, HRS is prohibited from borrowing any moneys or using the land to secure any borrowings or advances.
22. 'Growers' rights under the HRS Constitution include;
- the right to occupy the lot(s).
 - the right to own and operate on that lot(s) the business of cultivation of bamboo for the production of edible bamboo shoots and timber, and to harvest and sell such produce.
 - the right to use the common property for the purposes of access to the lot(s) and to use irrigation and other common facilities subject to such charges and regulations as the directors of HRS determine to be appropriate.
 - the right to appoint the Manager to manage their respective lot(s).
 - the right to lease, assign, sell or otherwise sell or transfer their interest in the land subject to the approval of HRS, which approval cannot be unreasonably withheld. (Clauses 126, 127 and 128).
23. The Growers will be liable for proportionate rates, taxes, maintenance levies for common areas, and other costs, as specified in clause 131 of the HRS Constitution.

Directors' Interests

24. Each of the directors of BPM, Victor Cusack, Alexander Hopkins and Peter Topperwien, or interests associated with them, will receive a share allocation (21,000) equivalent to 3 arable hectares each in HRS for work done in relation to the proposed venture. The Directors will not need to contribute to the management and maintenance costs in the first 2 years. Costs per hectare for the remaining 51 lots have been increased by 15% to cover the costs of developing the 9 lots.
25. The Directors' entitlements will be allocated regardless of the total number of lots acquired by Growers. The Directors are underwriting the development themselves and intend to fully develop the property as a bamboo plantation whether or not fully subscribed by other Growers.

Management Agreement

26. The Growers will make payments under the Management Agreement for purchase of bamboo plants, administration, management fees, including care and maintenance of plants, planting out, and costs of landcare work, dams, and irrigation systems.

27. The initial term of the Management Agreement expires on 14 June 2009 (Clause 3.2). The Manager has options for further terms expiring on 14 June 2019 and 14 June 2029 respectively (Clause 4).

28. The Grower appoints the Manager to carry out in accord with sound agricultural practices, the preparation of land and planting out of a bamboo plantation together with all duties necessary to care and nurture those plants to initial harvest.

29. Duties during the first 13 months of the Project include:

- land ripping, clearing and preparation;
- carrying out irrigation works;
- carrying out drainage works and work to prevent soil erosion;
- supply of 200 D Asper and/or D Latiflorus bamboo per hectare;
- tend and nurture the bamboo, including periodic slashing and weeding, fertilising, drip feeding adjustment, mulching, and culm thinning all in accordance with good practice;
- carry out pest treatment where and when necessary; &
- attend to repairs and maintenance as required (Clause 5.1).

30. In subsequent years the Manager agrees to carry out in accord with sound agricultural practices, all duties necessary to care and nurture those plants and to adopt best practices to maximise harvest of the intended crops. These duties include:

- tend and nurture the bamboo, including periodic slashing and weeding, fertilising, drip feeding, adjustment, and culm thinning in accordance with good practice and general husbandry including training the bamboo towards the necessary plant management system for shoot production;
- carry out pest treatment where and when necessary;
- attend to repairs and maintenance as required;

- (subject to the Grower's right to harvest shoots and timber) harvest shoots and timber so as to achieve the maximum sustainable yield for the Grower;
- subject to the Grower's right to market the produce from his land, to market and sell the shoots and timber at the best prices achievable; &
- to account to the grower for the proceeds of such sales (Clause 5.2).

31. Clause 10.1 enables the Manager, for the better performance of its obligations under the Management Agreement, to employ agents, contractors, professional advisers and consultants. Most services under the Management Agreement are subcontracted to Coolamon Plantation Pty Ltd, a company controlled by Victor Cusack and his associates (Clause 9.4 of the Information Memorandum).

32. The land does not need to be cleared or levelled as it is already cleared farming land that has undergone many improvements during the years prior to its proposed use in the Project.

Termination of Manager

33. The Grower may terminate the Management Agreement by notice in writing to the manager in the event of any one of the following occurring:

- the Manager goes into liquidation;
- the Manager has an administrator appointed;
- the Manager is in default of an obligation under this Agreement and receives a written notice from the Grower specifying the default and the Manager fails to rectify the default within 30 days after receipt of such notice; or
- the Manager ceases to carry on business (Clause 12.1).

34. The Manager may terminate this agreement by notice in writing to the Grower in the event of any one of the following occurring:

- The Grower fails to make any payment due to the Manager under this Agreement; or
- The Grower hinders or obstructs the good and sound management of the venture (Clause 12.2).

Fees

35. The Growers will make the following per hectare payments for the first 13 months of operation:

Plant establishment expenses	\$2892
Drainage expenses	\$125
Irrigation expenses	\$1990
Dam expenses	\$625
Management expenses	\$25,768
	\$31,400
	(Clause 7.1)

36. In the second year of operation the Growers will pay \$9,000 per hectare for the management and administrative duties.

37. In the third and subsequent years the Growers will pay the Manager:

- Costs and disbursements incurred plus a margin of 10%; and
- A performance bonus calculated as set out below:

Net Income/ hectare As calculated by the Manager	Bonus % of Net Income
\$10,000 - \$20,000	10%
\$20,000 - \$40,000	15%
> \$40,000	20%

38. The Manager has carried out considerable horticultural and marketing research and engaged experts to review and confirm its prognosis for the successful growing and profitable commercial exploitation of the bamboo.

39. The financial projections are based on a prediction that the first crop of shoots will be harvested in the 4th year of the Project and the first crop of timber will be harvested in the 6th year of the Project. Total gross income per hectare for the life of the Project is predicted to exceed a Grower's total expenses of participating in the Project.

Finance

40. Growers investing in the Project will either fund their contributions personally or borrow from an unassociated lending body. No entity involved in the Project is involved in the provision of financing from the Project. Nor are there any 'preferred lenders' being promoted by the Manager or any other entity associated with the Project. There is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institutions for the provision of any loan or finance for the Growers for any purposes under the Project. Loan transactions to which this Ruling applies will exhibit the following features:

- all loan terms will be of an arm's length nature;
- borrowers will remain fully liable for the balance of the loan outstanding at any time, and the lender will take full legal action against defaulting borrowers;
- none of the funds lent will be transferred back to the lender, or any associate, as part of any 'round robin', or equivalent transaction;
- the loan will not be a 'split loan', of the type described in Taxation Ruling TR 98/22;
- there will be no indemnity, or equivalent agreement, to reduce the borrower's liability;
- repayment of principal and payment of interest will not be linked to deriving income from the Project, and will be made regularly, commencing from or about the time of the making of the loan; and
- insufficient 'additional benefits' will be granted to borrowers for the purpose of section 82KL and the funding arrangements will not be used to transform the Project into a 'scheme' to which Part IVA applies.

Ruling

41. For a Grower who invests in the Hanging Rock Secondo Project by 30 June 2000, and who utilises the services of the Manager and incurs the fees set out in paragraphs 35 and 36 above, the following deductions will be available for the years ended 30 June 2000 to 30 June 2002:

Fee type	Deductions available each year		
	Year 1	Year 2	Year 3

	30/6/2000	30/6/2001	30/6/2002
Management expenses (see note (a))	\$25,768	\$9,000	(see note (b))
Landcare operation expenses (note (c))	\$125		
Water facility expenses (note (d))	\$872	\$872	\$872
Bamboo plant establishment expenses(note (e))	-----	-----	-----

Notes:

- (a) management fees paid for the revenue services outlined in the Management Agreement will be allowable deductions to the Grower in the year incurred (section 8-1);
- (b) From year 3 onwards the Manager is entitled to be reimbursed for all costs and disbursements incurred in carrying out its duties plus a margin of 10%. These future costs are not covered by this ruling;
- (c) deductibility under Subdivision 387-A is dependent on the Grower carrying on a 'primary production business' at the time the expenditure in question is incurred. A Grower who applies and is accepted into the Project on, say, the 30 June 2000, but for whom no services are provided in that year of income, will not be considered to be carrying on such a business;
- (d) expenses incurred on irrigation and dams will constitute allowable deductions to the Grower in the year incurred and in the next two years at the rate of 33.3% per annum (section 387-125); and
- (e) a deduction for bamboo establishment expenditure will be allowable, at a rate of 7% per annum, commencing from the time that the bamboo enters its first commercial season, which is expected to be in the income year ending 30 June 2004-(section 387-165).

Division 35 – Deferral of losses from non-commercial business activities**Section 35-55 – Commissioner's discretion**

41.1 For a Grower who is an individual and who entered the Project on or after 17 November 1999 and on or before 30 June 2000, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2000 to 30 June 2002 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be, carried on in a manner that is not materially different to the arrangement described in this Ruling.

41.2 This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies.

41.3 Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

41.4 Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from such a perspective has not been made.

Sections 82KZM and 82KL; Part IVA

42. For a Grower who invests in the Project the following provisions of ITAA 1936 do not apply:

- the expenditure by Growers does not fall within the scope of section 82KZM;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- The relevant provisions of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 8-1

43. Consideration of whether Management fees and outgoings in respect to the land are deductible under section 8-1 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 paragraph 8-1(1)(b) if it is incurred when the business has not commenced; and
- where a taxpayer 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 paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoing in question would have a sufficient connection with activities to produce assessable income.

44. A bamboo plantation can constitute the carrying of a business. Where there is a business, or a future business, the gross sale proceeds from shoots and timber from the Project will constitute assessable income in their own right. The generation of 'business income' from such a business, or future 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 nurturing, planting, tending, maintaining and harvesting of the shoots and timber.

45. Generally, a Grower will be carrying on a business of a bamboo plantation where:

- the Grower has an identifiable interest in specific growing bamboo coupled with a right to harvest and sell the shoots and timber produced;
- the bamboo plantation 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.

46. In this Project Growers will have under the HRS Constitution and the Management Agreement, rights to use an identifiable area of land and to harvest and sell bamboo grown on that land, consistent with the intention of carrying on a business of commercially growing bamboo. Under the Management Agreement Growers appoint Bamboo Plantation Management Pty Ltd, as Manager, to provide services such as nurturing, planting, tending, fertilising, replanting, spraying, maintaining and otherwise caring for the bamboo. The Manager is also responsible for the harvesting of the shoots and

timber from the bamboo. The specific cost of these services provided in the first thirteen months totals \$31,400 per hectare.

47. The Management Agreement and Constitution combine to give Growers an identifiable interest in specific trees and a legal interest in the land. Growers have the right personally to market the shoots and timber attributed to their lot or they can elect to use the Manager to market the produce for them.

48. Growers have the right to use the land in question for the purpose of owning and operating the business of cultivation of bamboo for the production of edible shoots and timber and to have the Manager come onto the land to carry out its obligations under the Management Agreement. The Growers degree of control over the Manager as evidenced by the Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive a twice yearly account for the proceeds of the sale of shoots and timber and report as to plantation activities from the Manager. Growers are able to terminate arrangements with the Manager in certain instances, such as in cases of default or neglect. The activities described in the Management Agreement are carried out on the Growers' behalf.

49. 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. The research carried out by the Manager and experts on its behalf considers that the Project is realistic and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Offer Document that suggests the Project should return a 'before -tax' profit to the Growers, ie, a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

50. Most Growers are expected to engage the professional services of the Manager with appropriate credentials. These services are based on accepted horticultural practices and are of the type ordinarily found in similar type of businesses such as orchards that would commonly be said to be businesses.

51. Growers have an interest in the bamboo plants from the time they are acquired until either the end of their productive life or the Growers collectively decide to put the land to other uses. The bamboo in which the Growers have an interest can be identified by reference to the survey forming part of the Constitution of HRS. The bamboo plantation activities, and hence the fees associated with such are consistent with an intention to commence regular activities that have an "air of permanence" about them. The Growers' bamboo plantation activities will constitute the carrying on of a business.

52. The fees associated with the bamboo plantation activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the sale of the bamboo shoots and timber), is to be gained from this business. No 'non-income producing' purpose in incurring the fees is identifiable from the arrangement. That portion of those fees that is not capital, or of a capital nature, will be deductible under section 8-1.

Expenditure of a capital nature

53. Any part of the expenditure of Growers entering into a horticultural business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project the costs of establishing the bamboo plants and the costs of irrigation, and constructing the dams and earthworks to prevent slippage, are capital in nature. The fees for these expenses are not deductible under section 8-1. However, expenditure of this nature can fall for consideration under specific capital write-off provisions of the ITAA 1997.

Subdivision 387-A

54. Capital expenditure incurred by a person carrying on a primary production business in respect of various measures primarily and principally for the prevention of land degradation qualifies for a 100% deduction in the year in which the expenditure is incurred, under Subdivision 387-A. The expenditure that qualifies includes, among other things, the construction of a levee or constructing surface or subsurface drainage works for the purpose of assisting in drainage (see section 387-60).

55. In order for the expenditure to qualify as a deduction under section 387-55, a business must be being carried on at the time the expenditure was incurred. A taxpayer incurring such expenditure need not be the owner of the land so long as it is used at that time for carrying on a primary production business. In this case, there will generally be no delay between the signing of the agreements and the commencement of 'business operations'. Accordingly, a Grower's business of primary production will generally have commenced at the time that the expenditure was incurred. The necessary requirements under Subdivision 387-A will thus have been met in this respect.

56. However, where all that occurs in an income year is that a person has been accepted into the Project as a Grower, but no business operations have been commenced on their behalf, they will not be accepted as having commenced a primary production business and no

deduction under Subdivision 387-A will be allowable for that, or any other year of income.

57. The amount of \$125 in the initial fees incurred by a Grower is capital expenditure for the purposes of section 8-1, being attributable to the earthworks to prevent slippages and levees, and culverts to reduce wash outs. A deduction under section 387-55 for this amount will be allowed in the year in which a Grower enters into contractual arrangements with BPM and commences to carry on a primary production business.

Subdivision 387-B

58. 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. The dams and irrigation system of the kind proposed would be covered by this Subdivision.

59. The irrigation system that it is proposed to install is a trickle system to nurture the young plants and the Manager estimates it has no utility after 2 years plant growth. After 2 years plant growth the trickle system cannot put enough water onto the plant nor can it put the water on the bamboo clumps root system that spreads out from the clump. Although the irrigation system has an effective life of less than 3 years, the depreciation provisions at Subdivision 42-D of the ITAA 1997 will not apply. Section 42-45 of the ITAA 1997 will exclude a Growers from obtaining a deduction for the irrigation system under the depreciation provisions as they are entitled to a deduction under Subdivision 387-B.

60. The taxpayer who can claim the deduction does not have to actually own the land but can have an interest equivalent thereto, a deduction would be available to the Growers in the Project at a rate of 33.3% per annum for the cost of the dams and soil conservation.

61. It is projected that expenditure on an overhead spray irrigation system will occur in year 4 of the project and present estimates are at a cost of \$4,500 per hectare for equipment and installation. Costs associated with an overhead spray irrigation system are not covered by this ruling.

Subdivision 387-C

62. Subdivision 387-C allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. The

exclusive occupant of land carrying on a business of horticulture is taken to own the plants growing on the land rather than the actual owner of the land.

63. Under this Subdivision, if the effective life of the plant is less than three years the expenditure can be written off in full, if the effective life of the plant is more than three years an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant is first used to produce assessable income and the Manager will advise the Grower of this date.

64. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. The applicant, in the application for this Product Ruling, states that plants have an estimated commercial life of 100 years. The write-off rate for horticultural plant is detailed in section 387-185. For a plant with an effective life of 30 or more years the rate would be 7% prime cost

Section 82KZM

65. 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 a doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

66. Under the Management Agreement the fee of \$31,400 per minimum holding (1 hectare) 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 has 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 evidence this fee is for services to be provided wholly within 13 months of incurring the expenditure in question.

67. Thus, for the purposes of this Ruling, it is accepted that no part of the fee of \$31,400 is for the Manager to do 'things' that are not to be wholly done within 13 months of the fee being incurred. On this basis, the basic precondition of the operation of section 82KZM is not satisfied and it will not apply to the expenditure by Growers of \$31,400 per hectare.

Section 82KL

68. 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' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

69. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

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

Part IVA

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

72. The Hanging Rock Secondo 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 lot that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

73. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of bamboo shoots and timber from the plantation. 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 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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Related Rulings/Determinations:

PR 98/1; TR 92/1; TR 92/20;
TR 97/11; TR 97/16; TR 98/22;
TD 93/34

Subject references:

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

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- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1997 8-1
- ITAA1997 8-1(1)(a)
- ITAA1997 8-1(1)(b)
- ITAA1997 Div 35
- ITAA1997 35-10
- ITAA1997 35-10(4)
- ITAA1997 35-30
- ITAA1997 35-35
- ITAA1997 35-40
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- ITAA1997 35-55(1)
- ITAA1997 35-55(1)(b)
- ITAA1997 Subdiv 42-D
- ITAA1997 42-45
- ITAA1997 Subdiv 387-A
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- ITAA1997 387-60
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Legislative references:

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