PR 2000/100 - Income Tax: 2001 Timbercorp Olive Project

Product Ruling
Income tax: 2001 Timbercorp 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 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.]*

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 to confirm the arrangement has been implemented as described below and to ensure that the 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 sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons, who take part in the arrangements to which this Ruling relates. In this Ruling these arrangements are sometimes referred to as the 2001 Timbercorp Olive Project, or just 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);
- section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZM and sections 82KZMB – 82KZMD (ITAA 1936);
- sections 82KZME - 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered, for GST and hold a valid tax invoice.

Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable.

Where tax laws change, those changes will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. 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'.

8. 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 the Project.

Qualifications

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

10. 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.

Date of effect

12. This Ruling applies prospectively from 13 September 2000, 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).

13. 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, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 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, who entered into the specified arrangement 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

15. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- application for product ruling for the 2001 Timbercorp Olive Project dated 23 May 2000;

- draft **Constitution** of the 2001 Timbercorp Olive Project Managed Investment Scheme dated 17 May 2000;
- draft **Prospectus** for the 2001Timbercorp Olive Project dated 23 May 2000;
- draft **Grovelot Management Agreement** (the 'Management Agreement') between Timbercorp Securities Limited (the 'Responsible Entity') and each Grower, dated 19 May 2000 and 7 August 2000;
- draft Management Agreement between Timbercorp Securities Limited and Olivecorp Management Limited dated 17 May 2000;
- draft **Licence and Joint Venture Agreement** (the 'Licence and Joint Venture Agreement') dated 18 May 2000;
- copy of put option agreement between Olivecorp Management Limited and Costa d'Oro srl regarding the sale of olive oil dated 23 March 2000;
- draft Option Agreement dated 17 May 2000 between Olivecorp Land Pty Ltd and Land And Water Holdings Limited, an unlisted public company;
- draft Custody Agreement between Permanent Trustee Company Limited and Timbercorp Securities Limited dated 13 April 2000;
- draft Compliance Plan for the Project;
- copy of a **finance package** available through Timbercorp Finance Pty Ltd or its subsidiary Timbercorp Finance (Vic) Pty Ltd ('Timbercorp Finance');
- correspondence from Applicant dated 1 June 2000, 6 June 2000, 16 June 2000, 14 July 2000, 17 July 2000, 19 July 2000, 10 August 2000, 14 August 2000, 31 August 2000 and 21 May 2001.

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

16. The documents highlighted are those Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or

any associate[1] of a Grower, will be a party to, which are part of the arrangements to which this Ruling applies. The effect of these agreements is summarised as follows.

Overview

17. The arrangement is the 2001 Timbercorp Olive Project.

Location	Boort (northwest of Bendigo), Victoria
Type of business each participant is carrying on	Cultivating olive trees on their designated 0.25 hectare olive groves and harvesting the olives for production and sale of olive oil.
Number of hectares under cultivation	Up to 500 with an option to accept oversubscriptions.
Number of olive trees per hectare	An average of 330 trees
Size of the olive groves	0.25 hectares
Number of olive trees per olive grove	83 on average
Minimum number of olive groves per Grower	3
Expected production	First harvest expected in the year ending June 2004 (year 3). Expected fruit yield is between 3 tonnes/hectare in year 3 and 16 tonnes/hectare from year 8.
The term of investment in years	Approximately 23 years commencing on acceptance of a Grower's application and ending on 30 June 2024
Subscription amount per olive grove (0.25 hectares)	$6,600 in year ended 30 June 2001
Management fees	$1,870 in each of years ended 30 June 2002 and 30 June 2003.
Licence Fees	$440 each year indexed to CPI from 30 June 2001.

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

18. The Project is to carry out a large scale business of cultivating and managing olive groves for the production of olive oil.

19. Growers entering into the Project by 31 May 2001 will enter into a Licence and Joint Venture Agreement with Olivecorp Land Pty Ltd ('Olivecorp Land'). Olivecorp Land will agree to establish an olive grove and all associated infrastructure on its land. Under this agreement each Grower will be given a right to use and occupy a minimum of 3 parcels of land for a period of some 23 years for the purpose of cultivating the grove for the production of olives for processing into olive oil for sale. The Responsible Entity may, however, accept an application for less than 3 parcels of land. Each parcel of land is an allotment of 0.25 hectares of land ('grovelot'). Under the agreement, each Grower will also enter into a joint venture arrangement with Olivecorp Land (on a 90%:10% basis) in respect of the cultivation and management of their grovelots. As a result, each Grower will be responsible for 90% of all management costs associated with the cultivation and management of their grovelots and will be entitled to 90% of all produce.

20. Growers (comprising applicants in joint venture with Olivecorp Land) will enter into a Grovelot Management Agreement with the Responsible Entity, to perform services in relation to the cultivation and management of their olive grovelots. Under this agreement, the Responsible Entity will also harvest the olives, procure the processing of olives into olive oil and sell the oil on behalf of the joint venture growers (at market prices) who will be entitled to the proceeds in their respective proportions. Olivecorp Management Limited ('Olivecorp Management'), to whom the Responsible Entity will delegate its managerial responsibilities, has entered into a put option agreement with Costa d'Oro srl, a major Italian olive oil distributor, under which it is entitled to require Costa d'Oro to purchase up to 4,500 metric tonnes of olive oil per annum during the first 19 years of the Project.

21. The cost of participation for a Grower, per grovelot, are set out below (these costs do not include the costs payable by Olivecorp Land as 10% joint venture party):

- The initial subscription costs outlined in the Licence and Joint Venture Agreement and the Grovelot Management Agreement, totalling $6,600 (including $600 GST) per grovelot payable on application;
- Licence fees of $440 (including $40 GST) per grovelot payable on 30 November 2001 (but not before 1 July 2001) and on 30 November 2002 (but not before 1 July 2002) and thereafter on 30 September (but not before 1 July) of each subsequent year, indexed to CPI

from 30 June 2001 (using $400 as the base amount), and increased on account of GST payable;

- Management fees of $1,870 per grovelot payable on 30 November 2001 (but not before 1 July 2001) and on 30 November 2002 (but not before 1 July 2002) for the years ending 30 June 2002 and 30 June 2003 respectively.
- Ongoing costs outlined in the Licence and Joint Venture Agreement and the Grovelot Management Agreement payable in years 4 through to year 23; and
- Any applicable financing costs.

22. Growers will also be given an opportunity to participate in ownership of the land on which the grove will be established by Olivecorp Land together with all capital works, infrastructure and water rights in July-August of 2005.

Licence and Joint Venture Agreement

23. Under the Licence and Joint Venture Agreement, Olivecorp Land agrees to establish olive groves at its own cost (clause 2.1) including construction of necessary infrastructure and carrying out capital works. This will be done on grovelots which are separate identifiable areas of land comprising allotments of 0.25 hectares of land. A portion of grove will be established by 30 November 2000 and the remaining portion will be established by 30 April 2001.

24. Each applicant Grower obtains a non-exclusive licence to use and occupy grovelots (in joint venture with Olivecorp Land). Under the terms of the agreement a Grower may only use the land for the purpose of cultivating and harvesting olives and producing olive oil.

25. At the expiration of the term, each Grower must return the grovelots to Olivecorp Land in good condition but is not required to remove the olive trees or restore the grovelots to their original condition.

26. The agreement provides that Olivecorp Land and each Grower will enter into the Grovelot Management Agreement as joint venturers. It provides that the Grower will be entitled to 90% of the joint venture assets and will be entitled to 90% of the olives and of the proceeds of sale. The Grower will also be responsible for 90% of the management fees.

Management Agreement and Grovelot Management Agreement

27. Under the Grovelot Management Agreement, each Grower (in joint venture with Olivecorp Land) engages the Responsible Entity to manage and cultivate the grove on behalf of the Grower in accordance with the management plan, harvest the olives, procure the processing of the olives into olive oil and market the oil for sale for the duration of the term.

28. The Responsible Entity is required to perform these services in a proper and efficient manner in accordance with good horticultural and environmental practices.

29. The olives from the grove will be pooled with olives from other Grower's grovelots and Growers will be entitled to their pro rata proportion of the olives and the olive oil produced.

30. Although the services described above will be carried out once the grove is established by Olivecorp Land, there will also be services provided before this time. The Responsible Entity is required to oversee the establishment of the grove by Olivecorp Land to ensure that the work is carried out in accordance with good horticultural and environmental practices.

31. The Responsible Entity will endeavour to arrange insurance on the Growers' behalf. Where this is available, Growers are required to insure their grovelots against damage or destruction by fire and other insurable risks. The Responsible Entity will arrange payment of insurance premiums to the appropriate insurers.

32. Under the Management Agreement between the Responsible Entity and Olivecorp Management Limited, the Responsible Entity will delegate its obligations under the Grovelot Management Agreement to Olivecorp Management Limited.

Fees

33. Under the terms of the Licence and Joint Venture Agreement and the Grovelot Management Agreement, a Grower will make the following payments per grovelot:

- the initial subscription costs outlined in the Licence and Joint Venture Agreement and the Grovelot Management Agreement, totalling $6,600 (including $600 GST) per grovelot payable on application;
- licence fees of $440 per grovelot (including $40 GST) indexed to CPI from 30 June 2001 (using $400 as the base amount) and increased on account of GST payable on 30 November 2001 and 2002 and thereafter on 30 September of each subsequent year;

- management fees of $1,870 per grovelot payable on 30 November 2001 and 30 November 2002 for the years ending 30 June 2002 and 30 June 2003 respectively.
- ongoing costs outlined in the Licence and Joint Venture Agreement and the grovelot Management Agreement payable in years 4 through to year 23; and
- any applicable financing costs.

34. The Manager will only provide services following the execution of the Licence and Joint Venture Agreement and the Grovelot Management Agreement.

35. The subscription moneys payable on application (in advance) are payable in respect of services to be wholly provided by 30 June 2001. The fees payable on 30 November 2001 and 30 November 2002 (partly in arrears and partly in advance) are payable in respect of services to be wholly provided by 30 June 2002 and 30 June 2003 respectively.

36. After the third year, i.e., from the financial year ending 30 June 2003, Growers will be required to pay annual licence fees of $440 per annum indexed from 30 June 2001 and management fees that will be estimated, in the first instance, by the Responsible Entity and adjusted once the actual costs of managing the Grower's grovelots are determined. The management fees will be increased on account of GST. Each Grower will also pay to the Responsible Entity its proportion of the following additional annual fees:

(a) a management fee equal to 7.5% of annual gross proceeds from the sale of bulk olive oil less the costs and expenses of processing the olives into olive oil; and

(b) a bonus, being 25% of so much of the annual proceeds (after deducting the fee referred to in paragraph (a) above) payable to a Grower in a financial year as exceeds the proceeds estimated in the prospectus, less any allowance for inflation arriving at such estimate, but indexed from the date of the Management Agreement. This fee will be calculated on a 2 year rolling basis to allow for variations in yields from year to year.

37. The Grower is also responsible for any applicable goods and services tax on any fees payable under the Licence and Joint Venture Agreement and the Grovelot Management Agreement.

Option to acquire an interest in the land

38. Under an Option Agreement between the Land Owner and Land And Water Holdings Limited ('Land And Water'), the latter company is granted an option to acquire a legal interest in the land on which the olive grove will be established that will not exceed 24.9%. That option is exercisable between 1 August 2005 and 31 August 2005.

39. Upon application for grovelots, each Grower (or its associate, as defined), will be issued with options to take up shares in the capital of Land And Water equal to the number of grovelots in the Project that the Grower subscribes for. The options to subscribe for shares are exercisable between 1 July 2005 and 31 July 2005. A Grower or its associate may exercise the option by serving an exercise notice of the option on Land And Water and paying the subscription price of $800 per share. The exercise of options will only be effective if at least 30% of all options issued are exercised.

40. Land And Water will exercise its option over the land under the Option Agreement, so long as it is in the best interest of Growers to do so, at a price which is the lesser of:

(a) the amount calculated by multiplying $1,560,000 by the proportionate interest to be acquired in the land; and

(b) an independent valuation of the land multiplied by the proportionate interest to be acquired in the land.

41. Through its holding of shares, a Grower (or its associate) will receive dividends paid from income derived by Land And Water from licence fees payable by Growers during the life of the Project for the use and occupation of the grovelots. Growers or their associates may also benefit from any net increase in the value of land (which will be wholly reflected in the value of the shares in Land And Water) on disposal of the share.

Finance

42. Growers can either fund their investment in the Project themselves, borrow from an independent lender, or may elect to use proposed financing packages through Timbercorp Finance Pty Ltd or its subsidiary Timbercorp Finance (Vic) Pty Ltd. All interest payments will be made in arrears.

43. The provision of finance involves full recourse loans and the finance provider will pursue legal action against defaulting borrowers.

44. This Ruling does not apply if a Grower enters into a finance agreement that includes any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project are involved in the provision of finance for the Project;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- additional benefits will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism) back to the lender or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Assessable Income

45. A Grower's share of the gross sale proceeds from the Project less any GST payable on these proceeds, will be assessable income of the Growers under section 6-5 of the ITAA 1997. Section 17-5 ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

Section 8-1 – Allowable Deductions

Deductions where a Grower is not registered nor required to be registered for GST

46. A Grower may claim the deductions in the following Table, where the Grower:

- participates in the Project by 31 May 2001 to carry on the business of growing olives and producing olive oil;
- incurs the fees shown in paragraph 33; and

- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 Year ended 30/6/2001	Year 2 Year ended 30/6/2002	Year 3 Year ended 30/6/2003
Application Fee	8-1	$6,600 See note (i) below		
Licence Fee	8-1	$440	$440 (indexed)	$440 (indexed)
Management Fees	8-1		$1,870 See note (i) below	$1,870 See note (i) below
Interest	8-1	See note (ii) below	See note (ii) below	See note (ii) below

Notes:

(i) Where a Grower incurs the application, management and licence fees as required by the Grovelot Management Agreement and the Licence and Joint Venture Agreement those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 66 to 70 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than $1,000, is an 'exception' to any prepayment rules that apply and is deductible in full in the year in which it is incurred.

(ii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Timbercorp Finance Pty Ltd is outside the scope of this Ruling. However, Growers should read carefully the discussion of the prepayment rules in paragraphs 75 to 77 below, as those rules may be applicable if interest is prepaid.

Deductions where a Grower is registered or is required to be registered

47. Where a Grower who is registered or required to be registered for GST:

- participates in the Project by 31 May 2001 or a later date determined by Timbercorp Securities in respect of particular grovelots where it is satisfied that it will be able to complete the management services in respect of those grovelots by 30 June 2001 to carry on the business of growing olives and producing olive oil;
- incurs the fees shown in paragraph 33; and
- is entitled to an input tax credit for the fees,

then the deductions shown in the Table above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 96.

Section 35-55 – losses from non-commercial business activities

48. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001 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 will decide for the income years ending 30 June 2001 to 30 June 2004 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

49. 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 (see paragraph 84 in the Explanations part of this Ruling, below).

50. 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.

Sections 82KL, 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF and Part IVA

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

(i) section 82KL does not apply to deny the deductions otherwise allowable;

(ii) expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 63 to 70);

(iii) expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 63 to 70);

(iv) expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 63 to 70); and

(v) the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 6-5

52. For a Grower who invests in the Project, all income received or receivable by them from the sale of their olive oil will be assessable income to them under section 6-5 of the ITAA 1997.

Section 8-1

53. Consideration of whether lease and management fees are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is 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 the second limb applies. However, that

does not preclude the application of the first limb and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

54. Olive growing activities can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the sale of olive oil from the scheme will constitute gross assessable income. 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 planting, tending, maintaining and harvesting of the olive trees, processing of the olives into oil and marketing the olive oil.

55. Generally, a Grower will be carrying on a business of growing olives where:

- the Grower has an identifiable interest in specific growing trees coupled with a right to harvest and sell the olives produced;
- the olive growing 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.

56. Under the Licence and Joint Venture Agreement, Growers have rights in the form of a licence to use and occupy an identifiable area of land ('grovelot') consistent with the intention to carry on a business of a commercial olive grower. Growers have a continuing interest in the grovelots from the commencement of the Project until the end of the Project.

57. Under the Grovelot Management Agreement, Growers appoint the Responsible Entity, as manager, to provide services such as cultivating and harvesting the olives, procuring the processing of olives into oil and marketing the olive oil. The Growers will have full right, title and interest in the olives and olive oil produced.

58. Under the Licence and Joint Venture Agreement, 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 Grovelot Management Agreement are carried out on the Growers' behalf. The Grower's degree of control over the Manager, as evidenced by the Grovelot Management Agreement and

supplemented by the Corporations Law, is sufficient. Under the Corporations Law, the Responsible Entity is 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 which is not remedied within 3 months after the Grower serves a notice requiring it to be remedied.

59. 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 discussed in that Ruling. The independent expert's report is that the Project has the potential to meet its financial objectives. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

60. Growers will engage the professional services of a manager with appropriate credentials. These services are based on accepted horticultural practices and are of the type ordinarily found in horticultural ventures that would commonly be said to be businesses.

61. Growers have a continuing interest in their grovelots from the commencement of the arrangements and may assign or deal with that interest. All olives grown on the grove will be the property of the Growers until sold. There is a means to identify the grovelots in which Growers have an interest. The Growers' activities will constitute the carrying on of a business.

62. The fees associated with the horticultural 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 olive oil) is to be gained from the business. They will thus be deductible under the first limb of section 8-1.

Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD, and 82KZME – 82KZMF

63. The prepayments provisions of the ITAA operate 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. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

64. In this Project, the Application Fee of $6,600 per Grovelot will be incurred on execution of the Grovelot Management Agreement and the Licence and Joint Venture Agreement. The fees are charged for providing services to a Grower by 30 June of the year of execution of the Agreements. In particular, the Application Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Application Fee has been inflated to result in reduced fees being payable for subsequent years.

65. There is also no evidence that might suggest the services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the agreements as set out in paragraph 33, then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

Growers who choose to pay fees for a period in excess of that required by the Project's agreements

66. Although not required under either the Grovelot Management Agreement or the Licence and Joint Venture Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 65 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

67. The amount and timing of tax deductions for any prepaid fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means generally, the period over which the services are to be provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and whether the Grower is a 'small business taxpayer'.

68. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the *expenditure was incurred*, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

69. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that *expenditure has been incurred*, then section 82KZM will apply if the Grower is a 'small business taxpayer' or section 82KZMD if the Grower is not a 'small business taxpayer'. For a 'small business taxpayer' (see paragraphs 78 to 80) the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same or effectively the same as that shown in paragraph 68 above, concerning section 82KZMF.

70. A prepaid fee of less than $1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(7) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than $1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of a prepaid fee is $1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Interest Deductibility

(i) Growers who use Timbercorp Finance Pty Ltd as the finance provider

71. Growers may finance their participation in the Project through a loan facility with Timbercorp Finance Pty Ltd.

72. The interest incurred for the year ended 30 June 2001 and in subsequent years of income will be in respect of a loan to finance the Project business operations of cultivating and managing olive groves for the production of olive oil and is therefore, directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1. As the loan facility offered by Timbercorp Finance Pty Ltd does not require a Grower to prepay interest, section 82KZME or 82KZMF will not apply. The interest will be deductible in full in the year in which it is incurred.

73. However, a Grower who, contrary to the requirements of the loan contracts offered by Timbercorp Finance Pty Ltd, chooses to prepay interest will be required to determine any tax deduction under the prepayment provisions of the ITAA.

74. Therefore, unless the prepaid interest is 'excluded expenditure', where a Grower chooses to prepay interest and the requirements of section 82KZME are met, relevant Growers will be required to determine any tax deduction using the formula in subsection 82KZMF(1). Where a prepayment is for more than 13 months, any tax deduction must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same or effectively the same as that shown above in paragraph 68 above.

(ii) Growers who DO NOT use Timbercorp Finance Pty Ltd as the finance provider

75. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than Timbercorp Finance Pty Ltd is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by, the Tax Office.

76. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid or a Grower may choose to prepay interest. Under the prepayment rules contained in section 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and will encompass activities, such as a loan to finance participation in the Project, not described in the Arrangement or otherwise dealt with in the Product Ruling.

77. As in paragraph 74 above, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid or a Grower chooses to prepay interest and the requirements of section 82KZME are met, relevant Growers will be required to determine any tax deduction using the formula in subsection 82KZMF(1). Where a prepayment is for a more than 13 months, any tax deduction must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same or effectively the same as that shown above in paragraph 68 above.

Small business taxpayers

78. Whether a Grower is a 'small business taxpayer' depends upon the individual circumstances of each Grower and is beyond the scope of this Product Ruling. It is the individual responsibility of each

Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

79. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less that $1,000,000 or their turnover recalculated under section 960-350 is less than $1,000,000.

80. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

Division 35 - Losses from non-commercial business activities

81. Under the rule in subsection 35-10(2), a deduction for a loss incurred by an individual (including an individual in a general law partnership) from certain business activities will not be allowable in an income year unless:

- the 'Exception' in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

82. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

83. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

84. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity of less than $40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

85. In broad terms, the objective tests require:

(a) at least $20,000 of assessable income in that year from the business activity (section 35-30);

(b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);

(c) at least $500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or

(d) at least $100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

86. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests or produce a taxation profit until the income year ended 30 June 2005. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

87. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

88. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the term of this Product Ruling.

89. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

(i) the business activity has started to be carried on; and

(ii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

90. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 48), in the manner described in the Arrangement (see paragraphs 15 to 44), the Commissioner's

discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

91. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent olive grove expert provided with the application by the Responsible Entity.
- the Put Option Agreement with Costa d'Oro srl for the sale of the olive oil setting out prices that realistically reflect the existing market at the time of sale; and
- independent, objective, and generally available information relating to the olive industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Section 82KL

92. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits'. In the project, insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA

93. 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).

94. The Project will be a 'scheme' commencing generally on the date when the Prospectus was issued. The Growers will obtain a 'tax benefit' from entering into the scheme in the form of the deduction for the initial fee, allowable under section 8-1, 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.

95. 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 olive fruit from the olive trees. Further, there are no features of the Project, such as the payment of excessive management fees and non-recourse loan financing by any entity associated with the Project, 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. No ruling is given on the application of Part IVA to financing arrangements entered into between investors and other financiers in respect of lending arrangements to invest in the Project.

Examples

Example 1 – entitlement to input tax credit

96. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of $5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees however, is reduced by the amount of any input tax credit to which she is entitled. The Project Manager provides Margaret with a tax invoice which includes its ABN and shows the price of the taxable supply for management services ($5,500). Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

1/11 x $5,500 = $500.

Detailed contents list

97. Below is a detailed contents list for this Product Ruling:

Commissioner of Taxation
13 September 2000

Previous draft
Not previously issued in draft form

Related Rulings/Determinations
TR 92/1; TR 92/20; TD 93/34;
TR 97/11; TR 97/16; TR 98/22;
PR 1999/95

Subject references
- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance

Legislative references
- ITAA 1936 82KL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZMA
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
- TAA 1953 Pt IVAAA
- Copyright Act 1968

ATO references:
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