



PR 2000/102 - Income tax: Kaarimba Fresh Fruit Project

 This cover sheet is provided for information only. It does not form part of *PR 2000/102 - Income tax: Kaarimba Fresh Fruit Project*

 This document has changed over time. This is a consolidated version of the ruling which was published on *8 November 2000*



Product Ruling

Income tax: Kaarimba Fresh Fruit 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**, **Previous Ruling**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVA 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

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.

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 person, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Kaarimba Fresh Fruit 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);
 - Section 27-5 (ITAA 1997);
 - Section 35-10 (ITAA 1997);
 - Section 35-55 (ITAA1997);
 - Section 42-15 (ITAA 1997);
 - Section 387-125 (ITAA 1997);
 - Section 387-165 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Section 82KZM (ITAA 1936);
 - Section 82KZMD (ITAA 1936);
 - Section 82KZME (ITAA 1936);
 - Section 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 either of the arrangements described below on or after the date this Ruling is made. They will have a purpose of staying in the relevant 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'. 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. The Commissioner rules on the precise arrangement identified in the Ruling.

9. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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- 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

11. This Ruling applies prospectively from 20 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).

12. 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 Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. 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.

Previous Rulings

14. This Ruling replaces Product Ruling PR 2000/90, which was withdrawn on 23 August 2000. Product Ruling 2000/90 will continue to apply to investors who entered into the Project on or before 23 August 2000.

Arrangement

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

- Application for Product Ruling Kaarimba Fresh Fruit Project ('the Project') received by the Australian Taxation Office ('ATO') 20 April 2000;
- Project's Information Memorandum received by the ATO 20 April 2000, undated;
- Marketing Agreement between Eastfield Orchards Pty Ltd ('Marketer') and Prentice Orchards ('Orchard Manager'), received by the ATO 20 April 2000, undated;
- **Zee Sweet Grower Agreement** between Zee Sweet Pty Ltd and the Grower received by the ATO 2 June 2000, undated;
- Additional correspondence from applicant's legal adviser received by the ATO 6 June 2000;
- Guarantee and Indemnity Agreement between the Lessor and the Guarantor received by the ATO 2 June 2000, undated;
- Amended **Lease and Management Agreement** between Andrew James Prentice and Linda Gaye Prentice ('Lessor') and Prentice Orchards Pty Ltd ('Orchard Manager') and the Grower, received by the ATO 30 June 2000, undated;
- Letter of Offer for business finance between the Lessor and the lending Bank dated 18 May 2000;
- Facsimiles from the applicant's legal adviser received by the ATO 16, 21 and 22 June 2000;
- E-mailed Taxation Opinion and Addendum to the Information Memorandum from the applicant's legal adviser received by the ATO 4 July 2000;

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- E-mailed information from the applicant received by the ATO 31 August 2000.

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.

16. The documents highlighted above are those that the Growers enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be party to, other than those to which paragraphs 44 to 47 applies. The effect of these agreements are summarised as follows.

Overview

17. The arrangement is called the 'Kaarimba Fresh Fruit Project' which, in this document, is referred to as 'the Project'.

Location	The Project Growers will lease land from Andrew James Prentice and Linda Gaye Prentice at Kaarimba approximately 20 kilometres north of Shepparton, Victoria.
Type of business each Participant is carrying on	Commercial growing of fruit trees.
Number of hectares under Cultivation	80 hectares
Name used to describe the Project	Kaarimba Fresh Fruit Project
Size of the Leased Area	2.5 hectares (minimum of two per subscription)
Number of trees per hectare	1,960 approximately
Expected production	For year eight of the Project: Apples 62 tonnes/ha Pears 39 tonnes/ha Peaches & Nectarines 60 tonnes/ha Plums & Pluots 52.4 tonnes/ha Cherries 22 tonnes/ha Apricots 36 tonnes/ha
The term of the investment	12 years ending 30 June 2012

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Cost per leased area	<table border="1"> <thead> <tr> <th></th> <th><u>1 Leased Area</u></th> <th><u>2 Leased Areas</u></th> </tr> </thead> <tbody> <tr> <td>30 June 2001</td> <td>86,636</td> <td>173,272</td> </tr> <tr> <td>30 June 2002</td> <td>89,897</td> <td>179,794</td> </tr> <tr> <td>30 June 2003</td> <td>54,238</td> <td>108,476</td> </tr> <tr> <td colspan="3">For years ending 30 June 2001 to 2003 Growers subscriptions are paid quarterly.</td> </tr> </tbody> </table>		<u>1 Leased Area</u>	<u>2 Leased Areas</u>	30 June 2001	86,636	173,272	30 June 2002	89,897	179,794	30 June 2003	54,238	108,476	For years ending 30 June 2001 to 2003 Growers subscriptions are paid quarterly.		
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Minimum Subscription	The Project does not require a minimum Grower participation before proceeding. However this is not a Project to which the prospectus requirements of the Corporations Law apply. The offer in the Unregistered Prospectus is made to, and applications will only be accepted from, persons that satisfy the exceptions of section 708 of the Corporations Law.															
Ongoing costs per Leased Area	Growers pay all ongoing costs within the cost per leased area.															
Other costs	Growers are charged for ongoing management and operating costs, machinery rental, irrigation, trees, trellising, and rent. All of these charges are included in the costs shown as cost per leased area and cost on a per hectare basis. Growers may be required to make further contributions in a year or years after year 4 of the Project in the event that sales revenue does not exceed orchard costs.															

18. The Orchard is situated at Kaarimba, approximately 20 kilometres north of Shepparton Victoria, a premium fruit growing region. The Project will establish and operate a stone and pome fruit orchard of approximately 157,000 trees on a planted area of 80 hectares over a period of 12 years. The Orchard will be divided into 32 Leased Areas, each of 2.5 hectares.

19. Growers entering into the Project will enter into a Lease and Management Agreement and will lease a minimum of 2 Leased Areas

(5 hectares) from the Lessor until the period ending 30 June 2012 at a cost of \$2200 per year for the 2 Leased Areas, in arrears. Pursuant to the Lease and Management Agreement the Grower's name is matched with a readily identifiable parcel of land, identified in schedule 1 attached to the Lease and Management Agreement.

20. Under the Lease and Management Agreement the Grower will also contract with the Orchard Manager for the establishment, management and harvesting of the fruit for the duration of the Project. The management fee for the period ending 30 June 2001 is \$21,808 per 2 Leased Areas. The management fee thereafter is \$9,625 per 2 Leased Areas payable in arrears for management services to be done in that year.

21. Growers may also contract with the Orchard Manager to market the fruit or they may elect to market the fruit themselves. The Orchard Manager will enter into an agreement with associated entity, Eastfield Orchards Pty Ltd, for the marketing of the fruit of the Project for non-electing growers.

22. Fruit tree varieties to be planted in the Project comprise a mix of new and proven varieties of:

- apples
- peaches
- nectarines
- cherries
- pears
- plums
- pluots
- apricots

23. All trees will be grown on an open V Tatura Trellis system to maximise fruit yield.

24. The orchard has a reliable source of good quality water and will include a computerised micro-irrigation system to ensure efficient use of water to grow high yielding trees.

25. Projected returns for Growers are outlined in the Information Memorandum. The projected returns depend on a range of assumptions and do not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Project. Growers will execute a power of attorney enabling the Orchard Manager to act on their behalf as required when they make an application for Leased Areas.

26. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or

express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

27. The Manager does not propose to accept applications to the Project after 30 September 2000. Applications will only be accepted where the exception requirements of section 708 of the Corporations Law will be complied with. Section 708 specifies certain requirements that a Grower must satisfy and/or certain requirements relating to the level of Grower participation in the Project.

Lease and Management Agreement

28. Under the Lease and Management Agreement, Growers enter into a lease from the Commencement Date and ending at 30 June 2012.

29. The Growers will make payments towards the Project under the Lease and Management Agreement. These payments are for lease and management fees, irrigation, orchard operational costs, machinery rental, trellising and trees. Such payments will be for services provided in the year of payment with no prepayment for services to be provided after the year end.

30. The Lessor grants each Grower a lease of a minimum of two leased areas (set out in a Clause 3 of the Lease and Management Agreement) and each Grower:

- will not use or permit any other person to use the leased area for any purpose other than that of commercial horticulture and the Project;
- will not erect any building or construction (whether temporary or permanent) on the leased area, except with the approval of the Lessor and for the purpose of commercial horticulture and the Project; and,
- will not use, or permit any other person to use the leased area for residential, recreational or tourist purposes.

31. In return, each Grower may peaceably possess and enjoy the leased areas during the term of the lease without any interruption or disturbance from the Lessor or any other person lawfully claiming through the Lessor, cls 8. The Grower is also entitled to use Common Areas for the purposes incidental to the use of the Leased Areas for the purposes of the Project.

32. Each Leased Area will be identified by a reference number on a plan of the Orchard together with all other Leased Areas of all Growers (schedule 1 and 2 of the agreement).

33. At the completion, or sooner determination of the term of the lease, each Grower will peaceably surrender and yield up to the Lessor the leased area and fixtures, free and clear of rubbish, and in good and substantial repair, order and condition.

34. At the completion of the Project, the Lessor shall acquire the Trees, Trellis and Irrigation Systems installed on the Leased Areas for an amount fixed at \$55,000 per two Leased Areas. The Lessor shall pay the purchase price to the Grower on or before 31 December 2012, (cls25 & 26).

35. Each Grower appoints the Orchard Manager to establish and maintain the orchard and the Project on the leased area(s), and to arrange the harvest of the fruit grown on the leased area(s). The Grower is required to pay Orchard Operational costs for each Financial Year in arrears, which relate to expenses and costs incurred for goods and services provided in that Financial Year (cls 25). The Orchard Operational Costs include but are not limited to the following services:

- (a) in the 2000/2001 Financial Year, tree training, chemical and fertiliser consumption, operational staff expenses, soil management costs, rates, communication costs, consumables, horticultural supplies, insurance and motor vehicle expenses.
- (b) in the Financial Years 2001/2002 to 2011/2012 inclusive, tree training, chemical and fertiliser consumption, operational staff expenses, soil management costs, rates, communication costs, general horticultural expenses, insurance, motor vehicle expenses, spraying, pruning, maintenance and other horticultural costs and supplies.

36. The Orchard Manager is required to perform these Services according to good horticultural practices and may provide these services directly or through consultants or other specialists engaged at the Orchard Manager's expense (cls19). The Orchard Manager will have commenced the Services outlined in item 3, Schedule 1 on the Commencement Date and the Annual Management fee shall accrue monthly or part thereof in arrear, as outlined in clause 27 for services performed in that Financial Year. The Orchard Manager will obtain insurance against public risk in respect of the orchard. Growers may take out such additional insurance, as they require at their own expense.

37. Unless Growers have elected to market their produce themselves, the Lease and Management Agreement authorises the Orchard Manager to market the produce of their leased areas as agent of the Growers. The Orchard Manager will enter into an agreement with associated entity, Eastfield Orchards Pty Ltd, to carry out the

marketing of the fruit for Growers who do not elect to market their own fruit.

Fees

38. The Growers will make the following payments per two leased areas over the first 4 years of operation:

	<i>Year 1</i> 30 June 2001	<i>Year 2</i> 30 June 2002	<i>Year 3</i> 30 June 2003	<i>Year 4</i> 30 June 2004
Rent	\$2,200	\$2,200	\$2,200	\$ 2,266
Management Fees	\$21,808	\$9,625	\$9,625	\$9,158
Orchard Operational Costs	\$ 96,146	\$119,178	\$59,696	\$44,292
Machinery Rental	\$566	\$4,086	\$6,380	\$6,571
Trees	\$22,644	\$19,778	\$19,778	\$19,778
Irrigation System	\$28,259	\$14,130	0	0
Trellis System	\$1,650	\$10,797	\$10,797	\$10,797
Total Grower Payments	\$173,273	\$179,794	\$ 108,476	\$92,862

39. The Growers will make the following payments per two leased areas in subsequent years for the remainder of the twelve year project period:

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	Year 5 30 June 2005	Year 6 30 June 2006	Year 7 30 June 2007	Year 8 30 June 2008	Year 9 30 June 2009	Year 10 30 June 2010	Year 11 30 June 2011	Year 12 30 June 2012
Rent	\$2,334	\$2,404	\$2,476	\$2,551	\$2,627	\$2,706	\$2,787	\$2,871
Management Fees	\$9,433	\$9,715	\$10,007	\$10,307	\$10,616	\$10,934	\$11,263	\$11,601
Orchard Operational Costs	\$37,634	\$67,571*	\$69,599*	\$71,686*	\$73,836*	\$76,052*	\$78,333*	\$80,684*
Machinery Rental	\$6,768	\$6,972	\$7,181	\$7,396	\$7,619	\$7,846	\$8,082	\$8,325
Trees	\$19,778	0	0	0	0	0	0	0
Trellis System	\$10,797	0	0	0	0	0	0	0
Total Grower Payments	\$86,744	\$86,662	\$89,263	\$91,940	\$94,698	\$97,538	\$100,465	\$103,481

Note: that the Orchard Costs for Year 6 to 12 are projected costs only and the actual Orchard Operational Costs for those Financial Years shall be determined by Grower approved budgeted amounts submitted by the Orchard Manager.

39. Trees are received and planted in 2 stages. First stage at the end of the year ending 30 June 2001 and second stage at the end of the year ending 30 June 2002. The Orchard Manager has negotiated that the cost of trees be paid by instalments per the above schedules.

40. The cost of the irrigation system will be incurred during the year ending 30 June 2001. The Orchard Manager will allow the Grower to pay for the system over 2 years.

41. The trellis system will be installed in two stages. Stage one of the trellis system will be purchased and installed by 31 December 2000 and stage two installed by 31 December 2001. The Orchard Manager will allow the Grower to pay for the system over 5 years.

42. The Lease and Management Agreement provides that the Orchard Manager may deduct from Grower sales revenue, orchard costs payable by Growers. Therefore, once fruit sales exceed orchard costs, Growers will not be required to make payments to orchard costs. Grower payment contributions are projected to cease in the year ending 30 June 2003.

Finance

43. Growers can fund the investment themselves or borrow up to 35% of Grower Project costs together with interest from the Lessor, Andrew and Linda Prentice.

44. The Lessor has arranged with a bank to borrow funds on security of a mortgage over the land comprising the Kaarimba Orchard.

45. Interest is payable on loans from the Lessor at the fixed rate of 10% per annum, quarterly in arrears.

46. Growers must repay all loans by the Lessor (including principal and interest) by the following instalments:

- \$40,000 per two leased areas on 30 June 2005
- \$105,000 per two leased areas on 30 June 2006
- \$94,304 per two leased areas on 30 June 2007

47. 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 with the exception of the arrangement as detailed in paragraphs 44 to 47, are involved in the provision of finance for the Projects;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrowers risk;
- additional benefits are or 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-arms 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 of the tender; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

48. Other than the arrangement referred to in paragraph 44 to 47 there is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance to the Growers for any purpose associated with the Project.

Ruling

Section 6-5 – assessability of income from the Project

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

Deductions where a Grower is not registered or not required to be registered for GST

50. A Grower may claim tax deductions using the methods and Tables in paragraphs 51 and 52, where the Grower:

- participates in the Project by 30 September 2000 to carry on the business of growing fruit;

- incurs the fees shown in paragraph 38; and
- is not registered or is not required to be registered for GST.

Section 8-1 - allowable deductions

Fee Type	ITAA 1997	<i>Refer Note</i>	Year 1 30 June 2001	Year 2 30 June 2002	Year 3 30 June 2003
Lease Fee	8-1	See note (i) below	\$2,200	\$2,200	\$2,200
Management Fee	8-1	See note (i) below	\$21,808	\$9,625	\$9,625
Operating Costs	8-1	See note (ii) below	\$96,146	\$119,178	\$59,696
Machinery Rental	8-1	See note (ii) below	\$567	\$4,087	\$6,380
Interest	8-1	See note (iii) below	as incurred	as incurred	as incurred

Notes:

- (i) A Grower incurs the Lease and Management fees for the period ending 30 June 2001 at the time the Lease and Management Agreement commences. These fees for the period ending 30 June 2001 accrue monthly in arrears and are payable in instalments as outlined in schedule 4 of the Lease and Management Agreement. However, if a Grower **chooses** to prepay fees for the doing of things (eg, 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 discussed in paragraphs 101 to 107 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) A Grower incurs the Operating and Machinery Rental costs for the period ending 30 June 2001 at the time the

Lease and Management Agreement commences. These fees for the period ending 30 June 2001 accrue monthly in arrears and are payable in instalments as outlined in schedule 4 of the Lease and Management Agreement. However, if a Grower **chooses** to prepay fees for the doing of things 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, refer to paragraph 104 to 107.

- (iii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than the Lessor is outside the scope of this Ruling. However, Growers should read carefully the discussion of the prepayment rules in paragraphs 108 to 114 below, as those rules may be applicable if interest is prepaid.

Deductions for capital expenditure

51. A Grower who invests in the Project will also be entitled to the following tax deductions:

Deductions for capital expenditure Per 2 Leased Areas					
Fee Type	ITAA 1997	Refer Note	Year 1 30 June 2001	Year 2 30 June 2002	Year 3 30 June 2003
Depreciation on Trellising	42-15	See note (iv) below			
Irrigation	387-125	See note (v) below	\$14,130	\$14,130	\$14,129
Horticulture Expenditure	387-185	See note (vi) below			

- (iv) The tax deduction for depreciation of trellising will depend upon whether or not the Grower is a 'small business taxpayer' (see paragraphs 75 to 77 below).

For a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the tax deduction for depreciation of **trellising** is determined using the rates in section 42-125 and the formula in either subsection 42-160(1) ('diminishing value method') or subsection 42-165(1) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which

the Grower owned an interest in the trellising and the extent to which the trellising is installed ready for use during the year. The Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Depending upon the method the Grower elects to use, the rate for calculating the tax deduction will be 13% prime cost method or 20% diminishing value method.

Note: The depreciation deductions for 'small business taxpayers' discussed above apply until the introduction of the Simplified Tax System on 1 July 2001 (see paragraphs 72 to 74).

For a Grower who is NOT a 'small business taxpayer' or who is a 'small business taxpayer' who does not satisfy the conditions in section 42-345, the tax deductions for depreciation of **trellising** is determined using the formula in either subsection 42-160(3) ('diminishing value method') or subsection 42-165(2A) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising and the extent to which each is installed ready for use during the year. The formulae use 'effective life' rather than rate to determine the deduction for depreciation. The Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Note: This is only applicable to plant acquired after 21 September 1999 (see paragraphs 80 to 85).

- (v) Fees paid under the Lease and Management Agreement in relation to irrigation will constitute an allowable deduction to the Grower under section 387-125. A deduction for capital expenditure for the irrigation system is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next two years. The irrigation system is to be installed in Year 1. The deductions available in Years 1 to 3 have been calculated on the basis of one third of the capital expenditure incurred of \$42,389 in Year 1.
- (vi) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and

establishment of the fruit trees for use in a horticultural business. The deduction is allowable when the fruit trees, as horticultural plants, enter their first commercial season. If the fruit trees have an 'effective life' for the purposes of section 387-185 of greater than '13 but fewer than 30 years', this results in a write-off rate of rate of 13% prime cost. The Project's manager will inform Growers of when the fruit trees enter their first commercial season. According to the Project Manager, stage 1 is expected to enter their first commercial season in the year ending 30 June 2003. Stage 2 is expected to enter their first commercial season in the following year.

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

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

- participates in the Project by 30 September 2000 to carry on the business of growing fruit;
- incurs the fees shown in paragraph 38; and
- is entitled to an input tax credit for the fees

then the tax deductions calculated using the methods and Tables in paragraphs 51 and 52 (above) will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 121.

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

53. 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 2003 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.

54. 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 93 in the Explanations part of this Ruling, below).

55. 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, ie, 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.

Section 82KL, 82KZM and Part IVA

56. The following provisions of the ITAA 1936 have application for a Grower as indicated:

- (iv) section 82KL does not apply to deny any deductions otherwise allowable;
- (v) the expenditure by Growers who are small business taxpayers for things to be done wholly within 13 months of the expenditure being incurred is not within the scope of section 82KZM;
- (vi) 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 – management, lease, operational and rental costs

57. Consideration of whether Management fees, Lease and Orchard Operational Costs are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business

58. An orchard scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from fruit from the scheme will constitute gross assessable income under section 6-5. 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 include the planting, tending, maintaining and harvesting of the fruit trees as well as the distribution and marketing of the fruit.

59. Generally, a Grower will be carrying on a business of an orchard where:

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

60. For this Project, Growers have, under the Lease and Management Agreement, rights in the form of a Lease over an identifiable area of land consistent with the intention to carry on a business of a commercial orchard. Under these agreements, Growers appoint Prentice Orchards Pty Ltd, as Orchard Manager, to provide services such as planting, tending, pruning, training, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. The Orchard Manager is also responsible for the harvesting of the produce from the trees. Growers can also use the Orchard Manager to market and sell the produce from the trees.

61. The Lease and Management Agreement gives Growers an identifiable interest in specific trees and Growers have a legal interest in the land by virtue of this Agreement.

62. Growers have the right to use the land in question for horticultural purposes and to have Prentice Orchards Pty Ltd come onto the land to carry out its obligations under the Lease and

Management Agreement. The Growers' degree of control over Prentice Orchards Pty Ltd, as evidenced by the agreements, is sufficient. Under the Project, Growers are entitled to receive on or before 30 June each Financial Year a certificate for the proceeds of the sale of fruit from the Orchard Manager as well as regular reports of the orchard's activities from the auditors. Growers are able to terminate arrangements with Prentice Orchards Pty Ltd in certain instances, such as cases of default or neglect. The activities described in the Lease and Management Agreement are carried out on the Growers' behalf.

63. 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 independent horticultural report in the Information Memorandum considers 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 in the Information Memorandum 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.

64. Growers will engage the professional services of the Orchard Manager with appropriate credentials. These services are based on accepted horticultural practices and are of the type ordinarily found in orchards that would commonly be said to be businesses.

65. The Lease and Management Agreement must specify the separate and distinct allotment or allotments as allocated by the Orchard Manager. Growers have a continuing interest in the trees from the time they are acquired or leased until they reach the end of the most productive period of their life. The orchard's activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' orchard activities will constitute the carrying on of a business.

Expenditure of a capital nature

66. Any part of the expenditure of a Grower 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 irrigation, and the establishment of horticultural plants are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

Section 42-15 - depreciation of trellising

67. Growers accepted into the Project incur expenditure on trellising upon which the fruit trees are attached and are to be used on their behalf in the operation of the Orchard business. This is attached to the land as a fixture. This expenditure is of a capital nature.

68. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose of producing assessable income where they are the owner or quasi-owner of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, absolutely owned by the owner of the land.

69. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where the lessee is considered to be the owner of those improvements. Income Tax Ruling IT 175 sets out the Australian Taxation Office's (ATO's) views on this issue. Where a lessee is considered to own the improvements under a state law, as detailed in the Ruling, or where he/she have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the lessee is entitled to claim depreciation for the fixture.

70. Under section 42-15 Growers are entitled to depreciation deductions in relation to the acquisition and installation of trellises on the land. The deduction available, however, will depend upon the date the investment is made, when the plant is installed ready for use and whether or not a Grower is a 'small business taxpayer'.

71. For plant acquired or constructed after 11:45 a.m. by legal time in the Australian Capital Territory on 21 September 1999, accelerated rates of depreciation are no longer available except to some 'small business taxpayers'. The Government has announced that 'small business taxpayers' who meet the conditions in section 42-345 will have access to accelerated rates of depreciation until the introduction of the proposed Simplified Tax System on 1 July 2001.

72. The immediate deduction for items of plant costing \$300 or less has been removed from 1 July 2000, except for 'small business taxpayers'. The Government has announced that 'small business taxpayers' will be able to claim the immediate deduction until the introduction of the proposed Simplified Tax System.

73. The depreciation of trellising as explained in this Product Ruling is based on existing legislation and may be subject to change.

Small business taxpayers

74. 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 than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

75. '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).

76. Whether a Grower is a 'small business taxpayer' depends upon the circumstances of each Grower and is beyond the scope of this Product Ruling. It is the responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

Depreciation deductions for Growers who are 'small business taxpayers'

77. The depreciation deduction for **trellising** available to a Grower who is a 'small business taxpayer' and who complies with the conditions contained in section 42-345 is calculated using the formula in either subsection 42-160(1) or subsection 42-165(1). The depreciation deduction depends on the cost of the trellising and the number of days the trellising was owned by the Grower during the income year. It also depends on the extent to which the trellising is installed ready for use during the year.

78. The deduction is calculated using a rate of 13% prime cost or 20% diminishing value. These accelerated rates of depreciation are shown in section 42-125 and apply to plant with an effective life of between 13 and 30 years. The Project Manager will advise Growers of the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

Depreciation deductions for Growers who are not small business taxpayers

79. A Grower who is NOT a 'small business taxpayer' or is a 'small business taxpayer' who does not satisfy the conditions in section 42-345 will not be able to claim accelerated depreciation on plant used in the Project because of section 42-118. The depreciation deduction for trellising for such a Grower is calculated using the formula in either subsection 42-160(3) or subsection 42-165(2A).

80. The deduction depends on the cost of the plant, the number of days the plant was owned by the Grower during the income year and the 'effective life' of the plant (see paragraph 86). It also depends upon the extent to which the plant is installed ready for use during the year. The Project Manager will advise Growers of the date that the

trellising are installed and begin to be used for the purpose of producing assessable income.

81. From 1 July 2000, however, the immediate 100% depreciation deduction for plant costing \$300 or less has been replaced by a 'low value pool' arrangement for all taxpayers except 'small business taxpayers'

82. Under subsection 42-455(1), a Grower who is not a 'small business taxpayer' can choose to allocate 'low cost plant' to a 'low value pool' in the year of acquisition. 'Low cost plant' is plant costing less than \$1,000. Once the choice is made to allocate 'low cost plant' to the pool, all 'low cost plant' acquired in that income year and subsequent income years must be included in the pool (subsection 42-460(1)).

83. A 'low value pool' is depreciated using a diminishing value rate of 37.5%. However, low cost plant is depreciated at 18.75% in the year it is allocated to the pool, irrespective of the date it is allocated. The value of plant, included in or disposed, of from such a pool will be added to or subtracted from the value of the pool.

84. Under the Management Agreement, for each interest acquired in the Project a Grower incurs expenditure of \$20,380 for trellising and will first be entitled to claim a deduction for depreciation in the year ended 30 June 2001. As the cost of trellising exceeds \$1,000 for a Grower who acquires a single interest in the Project it will not qualify as 'low cost plant'. However, provided the Grower uses the diminishing value method to depreciate the trellising, the plant can be allocated to a 'low value pool' after it has been depreciated below \$1,000 (paragraph 42-455(3)(b)).

Determination of effective life

85. Subdivision 42-C provides the choice of methods for determining the 'effective life' of plant. Growers can either self-assess the effective life of plant or use the effective life specified by the Commissioner. In the schedule, the Commissioner has determined that the effective life of trellising is 20 years.

Subdivision 387-B - expenditure on conserving or conveying water

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

production business. Irrigation systems of the kind proposed would be covered by this Subdivision.

87. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or licensee who is conducting a primary production business on land in Australia, a deduction would be available to the Growers in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

Subdivision 387-C - horticultural provisions

88. 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. A lessee or licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land.

89. 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 enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant with an effective life of 13 to 30 years, as in this Project, that rate is 13%.

Division 35 - losses from non-commercial business activities

90. 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; or
- 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.

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.

91. 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.

92. 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.

93. 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).

94. 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 until the income year ended 30 June 2003. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

95. 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.

96. 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.

97. 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.

98. 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 54), in the manner described in the Arrangement (see paragraphs 15 to 49), 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.

99. 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 horticulturalist and additional independent soil tests provided with the application by the Orchard Manager;
- the binding marketing contract(s) with the (named independent) Marketer for the sale of the fruit setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the fruit trees are grown;
- independent, objective, and generally available information relating to the horticultural industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Applicant;
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project.

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

100. 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 or the leasing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

101. In this Project, the Management fees of \$21,808 and a Lease fee of \$2,200 per 2 Leased Areas will be incurred on execution of the Lease and Management Agreement. The Management Fee and the Lease Fee are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. In particular, the Management 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 Management Fee has been inflated to result in reduced fees being payable for subsequent years.

102. There is also no evidence that might suggest the management 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 38, 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

103. Although not required under the Lease and Management 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 103 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.

104. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Lease 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'.

105. 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.

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

106. 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 75 to 77), 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 those shown in paragraph 106 above, concerning section 82KZMF.

Interest deductibility

(i) Growers who use the Lessor as the finance provider

107. Growers may finance their participation in the Project through a loan facility with the Lessor. Growers can borrow up to 35% of Grower Project costs through a loan arranged through the Lessor.

108. 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 horticulture 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 the Lessor 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.

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

110. Therefore, unless the prepaid interest is 'excluded expenditure', where the 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 106 above.

(ii) Growers who DO NOT use the Lessor as the finance provider

111. 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 the Lessor 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 ATO.

112. 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. 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.

113. As in paragraph 111 above, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid 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 those shown above in paragraph 106 above.

Section 82KL - recouped expenditure

114. 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'.

115. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b) is, broadly speaking, a benefit 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.

116. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Here, there may be a loan provided to the Grower. The loan will be

provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA - general tax avoidance provisions

117. 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).

118. The Kaarimba Fresh Fruit Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 51 to 52 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.

119. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the fruit. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Example 1 – entitlement to 'input tax credit'

120. 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:

$$1/11 \times \$5,500 = \$500$$

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 less \$500).

Detailed contents list

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

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- commencement of business
- fee expenses
- interest expenses
- management fees expenses

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- primary production
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- producing assessable income
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