# *PR 2000/11 - Income tax: Goulburn Valley Orchards 2000 Project*

# Product Ruling
Income tax: Goulburn Valley Orchards 2000 Project

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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.

***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 in future years to confirm the arrangement has been implemented as described below and to ensure that participants in the arrangement include in their income tax returns income derived in those future years.

## Terms of use of this Product Ruling

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

## What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Goulburn Valley Orchards 2000 project offered by G V Management Ltd, or just simply as 'the Project', or the 'product'.

### Tax law(s)

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

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 8-1 of the ITAA 1997
- section 42-15 of the ITAA 1997;
- section 387-125 of the ITAA 1997;
- section 387-185 of the ITAA 1997;
- Part IVA of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KL of the ITAA 1936; and
- section 82KZM of the ITAA 1936.

3. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of the changes, especially those to do with 'tax shelters', could affect the tax laws dealt with in this Ruling. Some of the changes apply from the date of announcement and others are proposed to apply from nominated dates in the future.

4. Although this Ruling mentions certain of these announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally binding advice in respect of those changes cannot be given until the relevant laws(s) are enacted.

5. However, if the changes become law, the operation of that law will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded.

### Class of persons

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

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

### Qualifications

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

9. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 14 to 29) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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

**Note:** A material difference may arise in relation to a variation in the facts of the arrangement described in the Ruling. It may also arise in circumstances where the person otherwise included in the class of persons enters into the arrangement as described, but also enters into transactions or arrangements (including financing arrangements) that, when viewed as a whole with the arrangement described in the Ruling, will produce a different taxation consequence for the arrangement. This might include, for example, where the Grower borrows to enter into the arrangement by way of a limited or non-recourse loan and the overall consequence might be that the arrangement is one that would have attracted the application of a tax avoidance provision.

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## Date of effect

11. This Ruling applies prospectively from 8 March 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, the 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 on 30 June 2003. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

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

- Draft Goulburn Valley Orchards 2000 Constitution;
- Product Ruling request dated 10 December 1999;
- Lease and Management Agreement between G V Management Ltd ('Responsible Entity'), GV Properties Ltd ('Lessor'), G V Operations Pty Ltd ('Operations Manager') and the Grower;
- Goulburn Valley Orchards 2000 draft Prospectus dated 16 December 1999;
- Letter dated 15 February 2000 supplied by G V Management Ltd.

**Overview**

15. The arrangement is called the Goulburn Valley Orchards 2000 Project with Series 2000 Growers and Series 2001 Growers.

| | |
|---|---|
| Location | The Project will lease land from G V Properties Ltd in the vicinity of Shepparton, Victoria. |
| type of business each participant is carrying on | Commercial growing of fruit trees. |
| number of hectares under cultivation | This prospectus provides for 108 hectares to be planted. |
| name used to describe the product | Goulburn Valley Orchards 2000 Project |
| size of the leased area | 0.125 hectares (minimum of two per subscription) |
| number of trees per hectare | 2100 |
| expected production | For the fifth year after planting:<br>Apricots: 52.5 tonnes per hectare<br>Apples: 80 tonnes per hectare<br>Sophie's Pride Pears: 85 tonnes per hectare<br>Corella Pears: 60 tonnes per hectare<br>Peaches & Nectarines and Plums & Pluots: 55 tonnes per hectare |

| | |
|---|---|
| the term of the investment | 15 years |
| initial cost per leased area | $7528 for applications lodged on or before 30 April 2000 (Series 2000), and $8650 for applications lodged between 1 May 2000 and 31 December 2000 (Series 2001) |
| initial cost on a per hectare basis | $60224 or $69200 |
| ongoing costs per leased area | Series 2000 Growers pay a further $7508 for the period 1 July 2001 until 30 June 2001. Series 2001 Growers pay a further $8650 for the period 1 January 2001 until 30 June 2002. |
| other costs | Growers will be charged for ongoing management and administration fees, irrigation, tree and trellising instalments and rent. |

16. Growers applying under this prospectus join one of two series, depending on their date of application. The date of application also determines the date of execution of the Lease and Management Agreement and the period of provision of establishment services to which the initial fee relates. The two relevant series are summarised as follows:

| ***Application lodged*** | ***Project*** | ***Date of Execution*** | **Fee per leased area** | **Period of provision of establishment services** |
|---|---|---|---|---|
| On or before 30/4/2000 | Series 2000 | On or before 30/4/2000 | $7528 | From date of execution of Lease and Management Agreement to 30/6/2000 |
| Post 30/4/2000 | Series 2001 | At any time between 1/7/2000 and 31/12/2000 (inclusive) | $8650 | From date of execution of Lease and Management Agreement to 30/6/2001 |

17. Growers may either subscribe for "series 2000" leased areas by 30 April 2000 or "series 2001" leased areas after 30 April 2000. The orchard development has commenced. It is planned to be substantially completed by 30 June 2000 for series 2000 leased areas and to be operational by that date. For series 2001 leased areas, completion of the orchard development will be no later than a year after series 2000 leased areas. Growers entering into the Project will sublease land from G V Properties Ltd in the vicinity of Shepparton, Victoria, for a period ending 30 June 2015. The Growers purchase the fruit trees, irrigation and trellising system that is on their leased area. Growers then contract with G V Operations Pty Ltd for the management and harvesting of the fruit.

18. The minimum individual holding is two leased areas totalling 0.25 hectares of land planted with 525 fruit trees (each individual leased area is 0.125 hectares). Overall, it is proposed that 108 hectares will be planted with approximately 226,800 fruit trees. The proposed 864 leased areas are identified on the plan of the orchard attached to the Lease and Management Agreement.

19. The tree varieties to be planted in the Project are 'Pink Lady', 'Lady William', 'Granny Smith' and 'Sundowner' type apples, pears and 'Pluots' as well as 'sub-acid' varieties of peach, nectarine, apricots and plums. Plants will be grown on an 'open V' Tatura Trellis system which will allow for a more dense planting of the Project than is usual for a 'traditional' style orchard.

20. The Project is also to use the latest available computer controlled 'trickle' irrigation system to apply water to the plants according to current Regulated Deficit Irrigation principals, potentially using substantially less water than is provided for in the water licence.

### Lease and Management Agreement

21. The Growers will make payments towards the Project under the Lease and Management Agreement these payments are for lease rental, administration and management fees, and for irrigation, 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.

22. The Lessor grants each Grower a lease of a leased area (set out in item 1 of the Schedule attached to 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.

23. In return, each Grower may peaceably possess and enjoy the leased area during the term of the lease without any interruption or disturbance from the Lessor. The Growers and their invitees may also use the common areas of the Project.

24. At the expiration, 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.

25. Each Grower appoints the Operations 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 Operations 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 Operations Manager's expense. The Operations Manager will have commenced these business operations on behalf of each Grower by the later of 30 April 2000, or the date the Lease and Management Agreement is executed. The Responsible Entity will obtain insurance against public risk in respect of the orchard and use its best efforts to arrange insurance of the leased area against damage by fire on behalf of the Grower.

26. Unless Growers have elected to market their produce themselves, the Lease and Management Agreement authorises the Responsible Entity to market the produce of their leased area(s) as agent of the Growers.

**Fees**

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

(i) Series 2000 Growers

- a management fee of $5,993 to G V Operations Pty Ltd for management of the orchard for the period 1 May 2000 to 30 June 2000;

- an administration fee of $375 to G V Management Ltd for administration of the Project for the period to 30 June 2000;
- lease rental of $20 to G V Properties Ltd for lease of the Grower's leased area of the orchard for the period to 30 June 2000;
- instalment on cost of the irrigation system of $400 to G V Properties Ltd; and
- instalment on purchase price of fruit trees and trellising of $602 and $138 respectively to G V Properties Ltd.

(ii) Series 2001 Growers

- a management fee of $6832, payable after 30 June 2000, to G V Operations Pty Ltd for management of the orchard for the period to 30 June 2001;
- an administration fee of $428 to G V Management Ltd for administration of the Project for the period to 30 June 2001;
- lease rental of $91 to G V Properties Ltd for lease of the Grower's leased area of the orchard for the period to 30 June 2001;
- instalment on cost of the irrigation system of $456 to G V Properties Ltd; and
- instalment on purchase price of fruit trees and trellising of $686 and $158 respectively to G V Properties Ltd.

28. The Growers will make the following payments per leased area in subsequent years for the remainder of the fifteen year project period:

(i) Series 2000 Growers

- a management fee to the Operations Manager set at $5993 for the year ended 30 June 2001, $1856.50 for the year ended 30 June 2002 and $1912.50 for the year ended 30 June 2003. This fee will be increased yearly by the greater of three percent or the percentage increase in the inflation adjustment factor ("the CPI") from the immediately preceding year;

- an administration fee to the Responsible Entity set at $375 for the year ending 30 June 2001 and thereafter increased by the greater of three percent or the percentage increase in the CPI from the immediately preceding year;
- lease rental to the Landowner set at $80 for the year ended 30 June 2001 and thereafter increased by the greater of three percent or the percentage increase in the CPI from the immediately preceding year;
- instalment on cost of irrigation system of $400 to GV Operations Pty Ltd for the year ended 30 June 2001 and 30 June 2002, total being $1,200; and
- instalment on purchase price of fruit trees and trellis until fully paid. Total paid for fruit trees being $2,750 and trellising $630.

(ii) Series 2001 Growers

- a management fee to the Operations Manager set at $6832 for the year ended 30 June 2002 and $4,307.50 for the year ended 30 June 2003. This fee will be increased yearly by the greater of three percent or the percentage increase in the CPI from the immediately preceding year;
- an administration fee to the Responsible Entity set at $428 for the year ending 30 June 2002 and $453.50 thereafter increased by the greater of three percent or the percentage increase in the CPI from the immediately preceding year;
- lease rental to the Landowner set at $91 for the year ended 30 June 2002 and $97 for the year ended 30 June 2003.Thereafter it will be increased by the greater of three percent or the percentage increase in the CPI from the immediately preceding year;
- instalment on cost of irrigation system of $456 for the year ended 30 June 2002 and 30 June 2003 to GV Operations Pty Ltd, total being $1,368; and

- instalment on purchase price of fruit trees and trellis until fully paid, total purchase price paid for fruit trees and trellis being $3,135 and $718.50 respectively.

29. The Goods and Services Tax will be applicable to services provided by the Manager after 1 July 2000. The Management Agreement states that the Goods and Services Tax is to be added to the amount of fees detailed above.

### Finance

30. Growers can fund the investment themselves or borrow from an unassociated lending body. No entity involved in the Project is providing any financial support or guarantee to financiers. Independent finance providers may be introduced to Growers by Goulburn Valley Orchards 2000 Project, or its related entities on an arm’s length commercial basis.

31. Growers who enter into any financing arrangement are advised only to do so under the following conditions:

- all loan terms are arm’s length in nature;
- borrowers remain fully liable for the balance of the loan outstanding at any time and lenders will take legal action against defaulting borrowers;
- there is no right to assign;
- there are no ‘round robin’ characteristics;
- there are no split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are no indemnity arrangements or any other collateral agreements in relation to the loan; and
- repayments of principal and payments of interest are not linked to derivation of income from the Project and are made regularly, starting shortly after the making of the loan.

## Ruling

### Goods and Services Tax

32. For a Grower who invests in the Project, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any

deduction allowable by any GST input tax credit to which the Grower is entitled or, in the case of section 27-5, a decreasing adjustment that a Grower has.

**Division 35 – deferral of losses from non-commercial business activities**

**Section 35-55 – Commissioner's discretion**

32.1. For a Grower who is an individual and who entered the Project on or after 8 March 2000 and prior to any withdrawal of this Product Ruling, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2002 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be, carried on in a manner that is not materially different to the arrangement described in this Ruling.

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

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

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

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

33. For a Series 2000 Grower who applies for and is accepted into the Goulburn Valley Orchards 2000 Project before 30 June 2000, the following deductions will be available for the years ended 30 June 2000 to 30 June 2002:

| Expense type | ITAA 1997 Section | Deductions available each year | | |
|---|---|---|---|---|
| | | Year of Application Year ended 30/6/2000 | Year 1 Year ended 30/6/2001 | Year 2 Year ended 30/6/2002 |
| Fees under the Lease and Management Agreement | | | | |
| - management fees | 8-1 | 5,993 | 5,993 | 1856.50 |
| - administration fees (see paragraph 35) | 8-1 | 375 | 375 | 375 (see note 1) |
| - lease rental (see paragraph 36) | 8-1 | 20 | 80 | 80 (see note 1) |
| Irrigation instalment (see paragraph 37) | 387-125 | 400 | 400 | 400 |
| Depreciation on trellising (see paragraph 39) | 44-15 | See Note 2 below | 82 | 82 |
| Horticultural write-off ( see paragraph 38) | 387-185 | | | 357 |

34. For a Series 2001 Grower who applies for and is accepted into the Goulburn Valley Orchards 2000 Project before 30 June 2001 , the following deductions will be available for the years ended 30 June 2001 to 30 June 2002:

| Expense type | ITAA 1997 Section | Deductions available each year | | |
|---|---|---|---|---|
| | | Year of Application Year ended 30/6/2000 | Year 1 Year ended 30/6/2001 | Year 2 Year ended 30/6/2002 |
| Fees under the Lease and Management Agreement | | | | |
| - management fees | 8-1 | | 6832 | 6832 |
| - administration fees | 8-1 | | 428 | 428 |
| (see paragraph 35) | | | | |
| - Lease rental | 8-1 | | 91 | 91 |
| (see paragraph 36) | | | | |
| Irrigation instalment (see paragraph 37) | 387-125 | | 456 | 456 |
| Depreciation on trellising (see paragraph 39) | 42-15 | See Note 2 below | 93 | 93 |
| Horticultural write-off (see paragraph 38) | 387-185 | | | 407 |

**Notes:**

1. As increased by the greater of the CPI or 3% as set out in paragraph 28.

2. The deduction in the first year will be allowable from the date on which the Grower's trellising is installed and ready for use for the purpose of producing assessable income. See paragraph 39 below.

### Management and Administration Fees

35. The Management and Administration Fees paid by a Grower for the services outlined in the Lease and Management Agreement will be an allowable deduction in the year incurred (section 8-1).

### Lease Rental

36. The lease rental fee paid by a Grower in relation to the Grower's leased area will be an allowable deduction in the year incurred (section 8-1).

### Irrigation

37. A Grower's capital expenditure on irrigation will be an allowable deduction, on the basis of one-third of the total expenditure in the year the expenditure is incurred, and one-third in each of the following two years of income (section 387-125).

### Tree establishment

38. A deduction under section 387-165 for the cost of establishing the trees will be allowable to the Grower from the income year that the trees are first held ready for use for the purpose of producing assessable income in a horticultural business. The deduction is calculated on the effective life of the trees from that time. It is predicted in the Prospectus that the trees will enter their first commercial season in the year ending 30 June 2002. The deduction specified is on the basis that the trees do enter their first commercial season in the year ending 30 June 2002. For further explanation see paragraphs 68-70.

### Trellising

39. The deduction for depreciation of trellising under section 42-15 will depend on whether the Grower chooses to depreciate at 13% per annum under the 'prime cost method' or at 20% per annum under the 'diminishing value method'. The deduction will be allowable from the date on which the Grower's trellising is installed and ready for use for the purpose of producing assessable income. GV Properties Ltd will advise Growers of this date for purposes of

calculating the deduction allowable for the year ended 30 June 2000. Deductions for the two succeeding years have been calculated, for illustrative purposes, on the basis that the trellising has been installed by 1 July 2000 and that the Grower has chosen to depreciate at 13% under the prime cost method. The deduction available, however, will depend on whether or not a Grower is a ‘small business taxpayer’ as defined in section 960-335 and, if so, whether the Grower complies with the conditions contained in section 42-345.

### Sections 82KZM and 82KL; Part IVA

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

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

(ii) Part IVA does not apply to expenditure in respect of the arrangement as outlined in paragraphs 14 to 29 in this ruling.

### Assessable income

41. Growers will be assessable on their share of the gross sale proceeds from the project in accordance with section 6-5.

## Explanations

### Sections 27-5 and 27-30 - Goods and Services Tax

42. Section 27-30 of the ITAA 1997 operates to deny a deduction that would be otherwise available under section 8-1 for the year ended 30 June 2000 to the extent that the loss or outgoing (incurred after 30 November 1999 and before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled after 1 July 2000.

43. Section 27-5 of the ITAA 1997 operates to deny a deduction, that would be otherwise available under section 8-1, to the extent that the loss or outgoing incurred (after 1 July 2000) includes an amount relating to an input tax credit to which a Grower is entitled or a decreasing adjustment that a Growers has.

### Subdivision 960-Q - Small business taxpayers

44. In this product ruling the term 'small business taxpayer' is relevant for the purposes of discussion relating to the depreciation of trellising.

45. 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'.

46. 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 that year is less than $1,000,000 or their turnover recalculated under section 960-350 is less than $1,000,000.

47. '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).

### Section 8-1

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

49. 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 in their own right. The generation of 'business

income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the fruit trees.

50. 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.

51. 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 the Lease and Management Agreement, Growers appoint G V Operations Pty Ltd, as Operations Manager, to provide services such as planting, tending, pruning, training, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. The Operations Manager is also responsible for the harvesting of the produce from the trees.

52. 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 a Lease. Growers have the right personally to market the produce attributed to their leased area or they can elect to use the Responsible Entity, G V Management Ltd, to market the produce for them.

53. Growers have the right to use the land in question for horticultural purposes and to have G V Operations Pty Ltd come onto the land to carry out its obligations under the Lease and Management Agreement. The Growers' degree of control over G V Operations Pty Ltd as evidenced by the Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive a yearly account for the proceeds of the sale of fruit from the Custodian as well as regular reports of the orchard activities from the Auditors. Growers are able to terminate arrangements with G V Operations 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.

54. 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 considers that the Project is realistic and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the 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.

55. Growers will engage the professional services of an Operations 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.

56. Growers have a continuing interest in the trees from the time they are acquired until they reach the end of the most productive period of their life. There is a means to identify which trees Growers have an interest in. The orchard 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.

57. The fees associated with the orchard 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 trees' produce), is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. No capital component is identifiable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

**Division 42**

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

59. Generally speaking, if a taxpayer incurs expenditure of a capital nature on plant or equipment, used during the year of income for the purposes of producing assessable income, and it is expenditure to which section 42-15 of the ITAA 1997 applies, a deduction will be allowed for depreciation on the item under that section. 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.

60. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of the improvements. Taxation 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 they 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.

61. A Grower accepted into the Project enters into a licence for a right to occupy certain land upon which they are entitled to grow trees to conduct a business of an orchard. Subject to the terms and conditions of the Lease and Management Agreement they have a right to remove the trellising at the end of the Project.

62. The Responsible Entity will advise Growers the date when the trellising is installed and begins to be used for the purpose of producing assessable income. Therefore, the cost that relates to the acquisition and installation of trellises on the land, will be eligible for a depreciation deduction by the Growers under section 42-125, at a rate of 13% prime cost or 20% diminishing value from this date.

63. The deduction available, however, will depend on whether or not a Grower is a 'small business taxpayer' as defined in section 960-335 and, if so, whether the Grower complies with the conditions contained in section 42-345.

64. The depreciation deduction 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 cost of the trellising and 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.

65. Growers who are not 'small business taxpayers' will have entered the Project after 21 September 1999, and will not be able to claim accelerated depreciation on plant used in the Project because of section 42-118. The deduction for such Growers is calculated using the cost of the trellising and its effective life only. Subdivision 42-C provides the choice of methods available for determining the effective life of plant.

### Subdivision 387-B

66. 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.

67. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant or lessee, a deduction would be available to the Growers in the Project at a rate of 33.3% per annum for the cost of the irrigation system.

### Subdivision 387-C

68. 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.

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

70. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. The Responsible Entity, in the application for this Product Ruling, states the plants have an estimated commercial life of 15 years. The write-off rate for horticultural plant is detailed in section 387-185. For a plant with an effective life of 13 to 30 years the rate would be 13%.

### Section 82KL

71. 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'.

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

essentially the tax saved if a deduction is allowed for the relevant expenditure.

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

**Part IVA**

74. 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).

75. The Goulburn Valley Orchards 2000 Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the tax deductions per leased area that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

# Detailed contents list

77. Below is a detailed contents list for this Ruling:

**Commissioner of Taxation**
8 March 2000

*Previous draft:*
Not previously issued in draft form

*Related Rulings/Determinations:*
TR 92/1; TR 92/20; TR 97/11; TR 97/16; TD 93/34; TR 98/22; PR 1999/95: IT 175

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

*Legislative references:*
- ITAA 1936 82KH(1)
- ITAA 1936 82KH(1F)(b)
- ITAA 1936 82KL
- ITAA 1936 82KL(1)
- ITAA 1936 82KZM
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 27-5
- ITAA 1997 27-30
- ITAA 1997 Div 35
- ITAA 1997 35-10
- 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)(b)
- ITAA 1997 42-C
- ITAA 1997 42-15
- ITAA 1997 42-118
- ITAA 1997 42-125
- ITAA 1997 42-345
- ITAA 1997 44-15
- ITAA 1997 387-B
- ITAA 1997 387-125
- ITAA 1997 387-C
- ITAA 1997 387-185
- ITAA 1997 960-Q
- 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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