PR 2000/115 - Income tax: Goulburn Valley Orchards 2000 Project

Product Ruling
Income tax: Goulburn Valley Orchards 2000 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 Rulings**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax 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) dealt with in this Ruling are:

- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Section 45-15 (ITAA 1997);
- Section 387-55 (ITAA 1997);
- Section 387-125 (ITAA 1997);
- Section 387-165 (ITAA 1997);
- Section 388-55 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KZL (ITAA 1936);
- Section 82KZM (ITAA 1936);
- Sections 82KZMB - 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

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

Business Tax Reform

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

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

Note to promoters and advisers

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

Class of persons

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

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

Qualifications

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

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 32) is carried out in accordance with the 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

12. This Ruling applies prospectively from 6 December 2000, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect 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

15. 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 PR 2000/11 "Goulburn Valley Orchards 2000" issued 8 March 2000;
- Product Ruling request dated 3 October 2000;
- 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 Prospectus dated 3 March 2000;
- Copy of Term Loan Package from Goulburn Valley Finance Pty Ltd; and
- Letter from Applicant dated 2 November 2000.

Overview

16. The arrangement is called the Goulburn Valley Orchards 2000 Project. This Ruling discusses the arrangement in relation to Series 2001 Growers obtaining finance, for subscription monies and ongoing fees, from Goulburn Valley Finance Pty Ltd.

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
Number of trees per hectare	2100
Expected production	For the fifth year after planting: Apricots: 52.5 tonnes per hectare Apples: 80 tonnes per hectare Sophie's Pride Pears: 85 tonnes per hectare Corella Pears: 60 tonnes per hectare Peaches & Nectarines and Plums & Pluots: 55 tonnes per hectare
The term of the investment	15 years
Initial cost per leased area	$8650 for applications lodged after 5 June 2000 (Series 2001)
Initial cost on a per hectare basis	$69200
Ongoing costs per leased area	Series 2001 Growers pay a further $8650 for the period 1 July 2001 until 30 June 2002
Other costs	Growers will be charged for ongoing management and administration fees, irrigation, tree and trellising instalments and rent

17. From the date of this ruling, Growers applying under this prospectus, or an extension of this prospectus, will join the second of two series ('series 2001'). Series 2001 leased areas became available after 5 June 2000. Applications lodged after the date of this ruling will be accepted, and the Lease and Management Agreement will be executed, on or before the expiry date of the prospectus up to 5 June 2001 (if the prospectus is reissued or extended to 5 June 2001). The provision of establishment services will occur from the date of execution of the Lease and Management Agreement to 30 June 2001.

18. The orchard development has commenced and was substantially completed by 30 June 2000 for series 2000 leased areas and 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 of the orchard and harvesting of the fruit.

19. The minimum individual holding is one leased area totalling 0.125 hectares of land planted with 262 fruit trees. 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.

20. 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.

21. 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 principles, potentially using substantially less water than is provided for in the water licence.

Lease and Management Agreement

22. The Growers will make payments towards the Project under the Lease and Management Agreement 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.

23. 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.

24. 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.

25. 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.

26. 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 from 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.

27. 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

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

- a management fee of $6832, payable on or before 30 June 2001, 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 GV Properties Ltd.

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

- 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.

Finance

30. Growers can fund their investment in the Project themselves, borrow from an independent lender or borrow through finance arrangements offered by Goulburn Valley Finance Pty Ltd, an associated company of GV Management Ltd.

31. Goulburn Valley Finance Pty Ltd will offer Growers a loan to finance up to 100% of the subscription monies and ongoing fees as applicable. The finance will be provided at a fixed interest rate and all principal and interest will be payable within 5 years of the first drawdown. The loan will be drawn down progressively as payments are required. The loans are made on a full recourse basis, and

Goulburn Valley Finance Pty Ltd will pursue legal recovery action against defaulting borrowers.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's 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-arm's length;
- repayments of the principal and payments of 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, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than Goulburn Valley Finance Pty Ltd, are involved or become involved, in the provision of finance to Growers for the Project.

Ruling

Assessable Income

33. 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. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

Deductions where a Series 2001 Grower is <u>not</u> registered nor required to be registered for GST

34. A Grower may claim tax deductions in the Tables below where the Grower:

- participates in the Project by 30 June 2001 to carry on the business of growing fruit;
- incurs the fees shown in paragraphs 28 and 29; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 deductions	Year 2 deductions	Year 3 deductions
Management Fee	8-1	$6832 – See Note (i) (below)	$6832 – See Note (i) (below)	$4307 - See Note (i) (below)
Administration Fee	8-1	$428 – See Note (i) (below)	$428 – See Note (i) (below)	$453 - See Note (i) (below)
Lease Rental	8-1	$91 – See Note (i) (below)	$91 – See Note (i) (below)	$97 - See Note (i) (below)
Interest	8-1	As incurred - See Note (ii) (below)	As incurred - See Note (ii) (below)	As incurred - See Note (ii) (below)

Notes:

(i) Where a Grower incurs the management fees and the lease fees as required by the Lease and Management Agreement those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 91 to 95 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than $1,000, is an 'exception' to any prepayment rules that apply and is deductible in full in the year in which it is incurred.

(ii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Goulburn Valley Finance Pty Ltd is outside the scope of this Ruling.

Tax deductions for capital expenses

35. A Series 2001 Grower who participates in the Project will also be entitled to the following tax deductions:

Fee type	ITAA 1997 section	Year 1 deductions	Year 2 deductions	Year 3 deductions
Trellising	42-15	Must be calculated - See note (iii) below	Must be calculated - See note (iii) below	Must be calculated - See note (iii) below
Irrigation costs	387-125	$456- see notes (iv) and (v) below	$456- see notes (iv) and (v) below	$456- see notes (iv) and (v) below
Establishment of horticultural plants	387-165	Nil - see note (vi) below	See note (vi) below	See note (vi) below

Notes:

(iii) The tax deduction for depreciation of trellising will depend upon whether or not the Grower is a 'small business taxpayer' (see paragraphs 59 to 61 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 56 to 58).

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 64 to 66).

A Grower who is NOT a 'small business taxpayer' has the option of allocating the **trellising** to a 'low value pool' and calculating the depreciation deduction under section 42-470 using the diminishing value method (see paragraphs 67 to 71 below). Note: This choice is only available from 1 July 2000.

(iv) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction 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 2 years of income.

(v) A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on landcare operations and/or facilities to conserve or convey water. This is an alternative to claiming deductions under sections 387-55 and 387-125.

(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.

Deductions where a Series 2001 Grower is registered or is required to be registered for GST

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

- participates in the Project by 30 June 2001 to carry on the business of growing fruit trees;
- incurs the fees shown in paragraphs 28 and 29; and
- is entitled to an input tax credit for the fees

then the tax deductions shown in the Tables above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 101.

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

37. 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.

38. 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 80 in the Explanations part of this ruling, below).

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

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

40. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Lease Agreement, the following provisions of the ITAA 1936 have application as indicated:

- expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 88 to 90);
- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 88 to 90);
- expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 88 to 90);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 8-1

41. Consideration of whether the management fees and the lease 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 outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that 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?

42. An Orchard scheme can constitute the carrying on of a business. Where there is a business, or a future business, the Gross Harvest Proceeds each year from fruit from the trees comprising the Project 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 each year from the trees. Generally, a Grower will be carrying on a business of an orchard where:

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

43. For this Project Growers have rights under the Lease and Management Agreement in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing fruit trees. Under the Lease and Management Agreement Growers engage the Project Manager to acquire fruit tree rootlings and plant out the rootlings on the leased land and to provide ongoing services to care and maintain the trees. Growers are considered to have control of their operations.

44. The Lease and Management Agreement provides Growers with more than a chattel interest in the trees. The Project documentation contemplates Growers will have an ongoing interest in the trees.

45. Growers have the right to use the land in question for horticulture purposes and to have the Project Manager come onto the land to carry out its obligations under the Lease and Management Agreement. The Growers' degree of control over the Project Manager as evidenced by the Lease and Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Project Manager's activities. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect. The orchard activities described in the Lease and Management Agreement are carried out on the Growers' behalf.

46. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections 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.

47. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify which trees Growers have an interest in. These services are based on accepted horticulture practices and are of the type ordinarily found in orchard ventures that would commonly be said to be businesses.

48. Growers have a continuing interest in the trees from the time they are acquired until the cessation of the Project. 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.

49. The lease fees and management 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 income (from the regular sale of fruit) is to be gained from the 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. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Interest deductibility

50. Growers may finance their participation in the Project through a loan facility with Goulburn Valley Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of lease and management fees.

51. 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 growing fruit 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.

Expenditure of a capital nature

52. Any part of the expenditure of a Grower entering into an orchard 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 trellising, 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, all of this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

Section 42-15: depreciation of trellising

53. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose or purposes 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.

54. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. Taxation Ruling IT 175 sets out the views of the Tax Office 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.

55. Under section 42-15 Growers in the Project are entitled to depreciation deductions for capital expenditure 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' (see paragraphs 59 to 61).

56. For plant acquired or constructed after 11:45am 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.

57. 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.

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

Small business taxpayers

59. 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.

60. '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).

61. 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'

62. 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.

63. 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'

64. 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).

65. 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. 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 is installed and begins to be used for the purpose of producing assessable income.

Determination of effective life

66. 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.

Low value pool option

67. From 1 July 2000 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'.

68. 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)).

69. 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.

70. Under the Lease and Management Agreement, for each interest acquired in the Project a Grower incurs expenditure of $718 for trellising and will first be entitled to claim a deduction for depreciation in the year ended 30 June 2001. Therefore, a Grower who is not a 'small business taxpayer' will have the option of including trellising in a 'low value pool'.

71. Where a Grower acquires more than one interest in the Project the cost of the trellising will exceed $1,000 and, therefore, the trellising 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)).

Subdivision 387-B – Irrigation expenditure

72. Section 387-125 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.

73. 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 a Grower in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

74. However, a deduction under section 387-125 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Grower can only choose a water facility tax offset where:

- had the Grower chosen a deduction instead of the tax offset, the Grower's taxable income for the income year would have been $20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Subdivision 387-C - Vines and horticultural provisions

75. Section 387-165 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 (section 387-210).

76. 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 plants, such as the fruit trees in this Project, with an effective life of 13 to 30 years, that rate is 13%.

Division 35 - Losses from non-commercial business activities

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

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

78. 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.

79. 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.

80. 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.

81. 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).

82. 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 2004. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

83. 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.

84. 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.

85. 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.

86. 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 37), in the manner described in the Arrangement (see paragraphs 15 to 32), 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.

87. 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 provided with the application by the Responsible Entity; and
- the report of the independent marketing expert stating that there is a stable demand and that the prices realistically reflect the existing market and/or the

projected market in the geographical regions where the fruit are grown and marketed.

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

88. 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.

89. In this Project, the Management Fee of $6832, Administration Fee of $428 and a Lease Fee of $91 per leased area will be incurred on execution of the Lease and Management Agreement. The Management Fee, Administration 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.

90. 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 paragraphs 28 and 29, 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

91. Although not required under either the Management Agreement or the Lease 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 90 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.

92. 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, where the 'eligible service period' exceeds 13 months, whether the Grower is a 'small business taxpayer'.

93. 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.

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

In the formula, the 'eligible service period' means, generally, the period to which the services are to be provided.

94. 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 59 to 61) the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same, or effectively the same as that shown in paragraph 93 above, concerning section 82KZMF.

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

Interest deductibility

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

Section 82KL - recouped expenditure

97. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits(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.

Part IVA - general tax avoidance provisions

98. 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).

99. The Goulburn Valley Orchards 2000 Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 34 and 35 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.

100. 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'

101. 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' showing its ABN and the price of the taxable supply for management services as $5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

1/11 x $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

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

Detailed contents list **102**

Commissioner of Taxation
6 December 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; PR 2000/11

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 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZMA
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 27-5
- ITAA 1997 27-30
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Subdiv 42-C
- ITAA 1997 42-15
- ITAA 1997 42-118
- ITAA 1997 42-125
- ITAA 1997 42-160(1)
- ITAA 1997 42-160(3)
- ITAA 1997 42-165(1)
- ITAA 1997 42-165(2A)
- ITAA 1997 42-345
- ITAA 1997 42-455(1)
- ITAA 1997 42-455(3)(b)
- ITAA 1997 42-460(1)
- ITAA 1997 42-470
- ITAA 1997 45-15
- ITAA 1997 Subdiv 387-B
- ITAA 1997 Subdiv 387-C
- ITAA 1997 387-55
- ITAA 1997 387-125
- ITAA 1997 387-165
- ITAA 1997 387-185
- ITAA 1997 387-210
- ITAA 1997 388-55
- ITAA 1997 Subdiv 960-Q
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345

- ITAA 1997 960-350

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