



PR 2000/23 - Income Tax: Emerald Hills Cattle Project

 This cover sheet is provided for information only. It does not form part of *PR 2000/23 - Income Tax: Emerald Hills Cattle Project*

 This document has changed over time. This is a consolidated version of the ruling which was published on *19 April 2000*



Product Ruling

Income tax: Emerald Hills Cattle Project

Contents	Para
What this Ruling is about	1
Date of effect	10
Withdrawal	12
Arrangement	13
Ruling	30
Explanations	37
Detailed contents list	58

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications sections**), **Date of effect**, **Withdrawal**, **Previous Rulings**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

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

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.

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.

What this Product Ruling is about

1. This ruling set out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this ruling relates. In this Ruling this arrangement is sometimes referred to as the Emerald Hills Cattle Project, or just simply as 'the Project'.

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 27-5 of the ITAA 1997;
- section 27-30 of the ITAA 1997;
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82 KZM of the ITAA 1936;
- section 82 KZMB to 82KZMD of the ITAA 1936;
- section 92 of the ITAA 1936; and
- Part IVA of the ITAA 1936.

3. On 21 September 1999, the Government announced a number of changes to the tax system as part of the New Business Tax System. A number of those changes could affect the tax laws dealt with in this Ruling. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of those 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 those 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 law(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. If requested, when the relevant law(s) are enacted, the Commissioner will formalise the non-binding

information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

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 'Lessees' or 'Breeders'.

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

Qualifications

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

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

9. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, Ausinfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

10. This Ruling applies prospectively from 22 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).

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

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

Withdrawal

12. This Product Ruling is withdrawn and ceases to have effect on 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling lodged by Emerald Hills Cattle Pty Ltd, dated 15 December, 1999;
- **Power of Attorney** between the Breeders and Emerald Hills Cattle Pty Ltd;
- **Deed of Partnership Agreement** between the Breeders and Emerald Hills Cattle Pty Ltd;
- **Livestock Lease** between Timothy Mansfield and Emerald Hills Cattle Pty Ltd;
- **Deed of Management Agreement** between Bashan Cattle Management Pty Ltd, Emerald Hills Cattle Pty Ltd and Timothy Mansfield;
- Correspondence received from Emerald Hills Cattle Pty Ltd dated 11 January 2000, 7 February 2000, 8 February 2000, and 9 February 2000;
- **Updated Deed Of Partnership Agreement** between the Breeders and Emerald Hills Cattle Pty Ltd received 16 February 2000;

- **Updated Livestock Lease** between Timothy Mansfield and Emerald Hills Cattle Pty Ltd received 16 February 2000;
- **Updated Deed of Management Agreement** between Bashan Cattle Management Pty Ltd, Emerald Hills Cattle Pty Ltd and Timothy Mansfield received 16 February 2000;
- **Updated Deed of Management Agreement** between Bashan Cattle Management Pty Ltd, Emerald Hills Cattle Pty Ltd and Timothy Mansfield received 24 February 2000; and
- Correspondence received 29 February 2000 from Emerald Hills Cattle Pty Ltd.

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

14. The highlighted Documents are the documents the Breeder enters into through their Attorney (Emerald Hills Cattle Pty Ltd). There is no minimum subscription per Breeder. However, the Project will not commence unless a minimum subscription of 50 units has been met. The Project is to commence on or before 30 April 2000 for the Studmaster to undertake the activities as set out in the Cattle Breeding Management Agreement by 30 June 2000. The effect of these agreements are summarised as follows.

Overview

15. The arrangement is called the Emerald Hills Cattle Project.

Location	"Mandaring" at Holbrook, NSW.
Type of business the partnership is carrying on	The development of a herd of pedigreed stud breeding cattle.
Number of cows involved in breeding program	50 minimum and 300 maximum
Expected production	50 to 300 calves in the first generation
The term of the investment	Minimum period of 15 years
Initial cost per unit	\$3,535
Ongoing costs per unit	\$600 in year 2 and \$221 in year 3

16. The Breeders sign a Limited Power of Attorney document between themselves (called "the Partner/s" in this document) and Emerald Hills Cattle Pty Ltd. The Limited Power of Attorney document allows Emerald Hills Cattle Pty Ltd as Attorney to execute

the following documents on behalf of the Partner/s summarised below:

- The Partnership Deed between the Partners (Breeders) and the Attorney (Emerald Hills Cattle Pty Ltd) as Owners Representative;
- The Cattle Breeding Management Agreement between the Attorney (Emerald Hills Cattle Pty Ltd), for and on behalf of the Partnership (Breeders), Bashan Cattle Management Pty Ltd (The Studmaster) and Timothy Mansfield (the Guarantor);
- The Recipient Cattle Lease Agreement between the Attorney (Emerald Hills Cattle Pty Ltd), on behalf of the Partnership (Breeders), and Timothy Mansfield.

17. The above Agreements are now summarised below;

Deed of Partnership Agreement

18. The Deed of Partnership Agreement between the Partner/s and Emerald Hills Cattle Pty Ltd amongst other things recites;

- (A) The Partners shall become partners one with each other upon the terms and conditions contained in the deed. A share of the Partnership shall be called a Partnership Unit. Each Partner shall be deemed to hold the number of Partnership Units adjacent to the name of the respective Partner in the First Schedule hereto. The partnership business shall be that of breeding and developing a herd of any of the following pure bred Angus & Red Angus, Poll Hereford and Hereford Cattle for commercial sale, the marketing of embryos, ova and semen collected from such cattle and the rental of the herd to commercial Breeders.
- (B) The business of the Partnership shall be carried on at such place or places as the Studmaster may determine from time to time.
- (C) The Partners appoint the Owner's representative company – Emerald Hills Cattle Pty Ltd as their attorney to enter into the Management Agreement with Bashan Cattle Management Pty Ltd and the Lease Agreement with Timothy Mansfield on behalf of the partners;
- (D) The Partners shall own the Herd developed by the Studmaster on behalf of the Partnership as tenants-in-common in the same proportion as the Partner's interest in the Partnership.

- (E) Each Partner shall initially contribute capital to the Partnership of the amount appearing adjacent to their respective names in the First Schedule hereto which amount is \$3535 times the number of Partnership Units held by each respective Partner.
- (F) Each Partner shall contribute in the second year further capital to the Partnership of an amount equal to \$400 times the number of Partnership Units held by each respective Partner contained in the First Schedule contained hereto.
- (G) Each Partner shall contribute in the third further capital to the Partnership of an amount equal to \$221 times the number of Partnership Units held by each respective Partner contained in the First Schedule contained hereto.
- (H) Other than by a majority of 75% of the Partners at a duly convened meeting no Partner shall be called upon to contribute further capital.
- (I) There shall be maintained at all times an up-to-date Register of Units containing particulars of the Holders thereof ("the Register"). The Register shall at all reasonable times be open for inspection by the Partners at the registered office of the Partner's Representative. Units shall be transferable only in accordance with the provisions of this Deed.

Deed of Management Agreement

19. The parties to the Deed of Management Agreement are: - Bashan Cattle Management Pty Ltd as the Studmaster; Emerald Hills Cattle Pty Ltd as the Owners Representative Company for the Breeders; and Timothy Mansfield as the Guarantor.

20. Management Fees are divided into three parts. The Initial payment of \$3215 is paid upon execution of this deed. \$3005 will be expended on services provided by the Studmaster before 30 June 2000. The balance, \$210 will be expended on services provided by the Studmaster after 30 June 2000. The Second Payment of \$400 will be paid in the next year for ongoing costs of the Project in the second year. The Third Payment \$221 will be paid in the third year to meet ongoing costs in the third year.

21. The Partnership will pay as a fee 35% of the Gross Income of the Partnership for the life of the Project.

22. The Studmaster undertakes for the term of the Deed of Partnership to market produce from the recipients and the herd. The

Studmaster's expense and profit are to be met from the above payments only.

23. All Gross Income derived by the Studmaster is paid to the Owner's Representative. Then 35% of this income is paid to the Studmaster.

24. In return for the fees received from the Partnership, the Studmaster will:

- (a) provide skilful management of the herd and register the herd with the proper breed society;
- (b) organise advertising, auctions, private sales, and showing of the herd at appropriate times;
- (c) keep the books, records, accounts, documents and registration papers of the herd;
- (d) regularly monitor the mix and quality of genetics used in the herd;
- (e) advise the Owner's Representative when sales of cattle will take place;
- (f) once a year provide reports to the Owners Representative reviewing the Cattle Breeding Enterprise;
- (g) make available to the Owner's Representative and any auditor appointed by the Partnership any oral or written information that it may require;
- (h) act in a fiduciary relationship of utmost good faith to the Partnership and use some arms length arrangements to enhance the cattle breeding enterprise;
- (i) ensure that all recipient cattle and progeny are numbered in accordance with the terms of the Lease so that at all times the Recipients are clearly identifiable;
- (j) warrant that it will obtain suitable ova and semen to create embryos of Poll Hereford, Hereford, Angus and Red Angus stud quality and will implant recipients with these embryos to form the herd. These embryos will be the sole ownership of the partnership. The Studmaster gives up any title it may have in these embryos when they are implanted in leased recipients.

25. The parties to the Partnership Deed agree that the services of the Studmaster in respect of which the Initial Payment is made shall include these services; maintenance of recipients, provision of semen and ova, and embryo acquisition and creation, implantation, labour, veterinary treatment, transport, administration and management, agistment and feed provisions, and registration of cattle.

26. Any party to the deed or authorised representative may with reasonable notice visit the place where the herd is run to inspect the partnership cattle and inspect the accounts, books and records maintained by the Studmaster under this deed.

The Livestock Lease

27. The Livestock Lease is between Timothy Mansfield and Emerald Hills Cattle Pty Ltd, as Owner's Representative for the Partners. This Livestock Lease among other things, provides that:

- (a) the Lessor has title to the Livestock to allow them to enter into the Lease;
- (b) the Lessor gives exclusive possession of the Livestock to the Lessee pursuant to this Lease;
- (c) the Lessor acknowledges that the Livestock will be used for the purposes of breeding cattle;
- (d) the Lessor agrees that the title and interest in progeny of the Livestock vests in the Lessee;
- (e) the Lessee agrees that the Lease is for a 12 month period from the signing of the Lease;
- (f) the Lessee shall pay to the Lessor \$300 per annum for the rent of each head of livestock;
- (g) the Lessee has the option to renew the Lease for a further 12 months and will take proper care of the livestock and provide necessary grazing, feeding, veterinary services and safe guard the cattle to the best of their ability from sickness, disease, and other loss.
- (h) the Lessee will allow the Lessor or any other authorised person to enter the property that the Livestock are held to inspect them;
- (i) the Lessee will keep the cattle at all times in his possession;
- (j) indemnify the Lessors against loss or injury to the Livestock;
- (k) the Lessee will obtain all necessary licences, permits and permissions for the pasturing of the Livestock and do not do anything to the Livestock which is contrary to the law;
- (l) the Lessee will not assign, let, pledge, mortgage, charge, encumber or otherwise deal with the Livestock or create any lien on the Livestock whether for veterinary services or otherwise;

- (m) the Lessee will pay to the Lessor interest on overdue rent instalments at the rate equal to the Westpac Indicator rate plus 1.5% per annum;
- (n) where any of the Livestock is lost, stolen, destroyed or injured by or as a result of negligence or wrongful act of a third party the Lessee shall:
 - (i) immediately notify the Lessors thereof;
 - (ii) not compromise any claim without the consent of the Lessors;
 - (iii) allow the Lessors to take over the conduct of any negotiations;
 - (iv) at his own expense take such proceedings as the Lessors shall direct holding all sums recoverable together with any monies received by the Lessee under the policy of insurance procured by the Lessee pursuant to the provisions of this agreement.
- (o) the Lessor agrees to consider any proposal by the Lessee to reduce the rental herein upon the occurrence of one of the following:
 - A major fire on the Property;
 - A declared drought in the districts of the property; Although the parties acknowledge that the Lessor is under no legal obligation to reduce the rental or grant any other relief.
- (p) The Lessor and the Lessee covenant and agree that if:
 - the rent or any other monies payable pursuant to this lease are unpaid;
 - the Lessee shall fail to observe and perform any of the terms, covenants and conditions contained in this Lease; then it shall be lawful for the owner to determine the lease and repossess the livestock.
 - the Lessors hereby direct the Lessee to pay the rent for the Livestock to Bashan Cattle Management Pty Ltd.

Finance

28. Breeders may fund the investment themselves or borrow from an unassociated lending institution. No entity or related entity

involved in the Project is involved in the provision of financing for the Project.

29. This Ruling only applies where any finance agreements entered into exhibit the following features:

- All loan terms are of an arm's length 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

30. 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 Partnership is entitled or, in the case of section 27-5, a decreasing adjustment that the Partnership has.

Section 8-1

31. The Partnership will commence the Project once minimum subscription has been met. **This ruling does not apply if minimum subscription is not met and the Project does not commence on or before 30 April 2000.**

32. For the period of 3 years from the date of this Ruling, section 8-1, and Section 25-25 will apply to the Partnership as follows:

Fee Type (tax law applicable)	ITAA 1997	Year 1	Year 2	Year 3
Management Fee	Section 8-1	\$3215	400	221
Lease Fee	Section 8-1	\$300	200	

PR 2000/23

Administration	Section 8-1	\$20		
Borrowing Costs	Section 25-25	See note (ii)		
Interest on Loan	Section 8-1	See note (iii)		

Notes:

- (i) \$3215 Management Fees being the cost of managing the production of embryo calves for the Breeder/s from the Commencement Date until the end of the First Financial Year and; \$400 being the annual management fee for the Second Financial Year; \$200 being the annual management fee for the third Financial Year;
- (ii) Deductibility of Borrowing Costs under section 25-25 is calculated on the basis of the loan used by the Breeder to finance investment in the Project. Where the borrowing costs exceed \$100, they are deductible over the period of the loan specified in the loan contract, or the actual loan period, or five years, whichever is the shorter period, beginning with the year in which they are incurred. Where the borrowing costs are \$100 or less, they are deductible when incurred; and
- (iii) Deductibility of interest costs under section 8-1 is calculated on the basis of the loan used by the Breeder to finance investment in the Project.

Partnership

33. The Project is a partnership for the purposes of Division 5 of Part III of the ITAA 1936 (see definition of 'partnership' in section 995-1, ITAA 1997).

34. Each Breeder will be a partner in a partnership and in accordance with section 92 of the ITAA 1936, where the Breeder is a resident, will be required to include his or her individual interest in the net income of the partnership in his or her assessable income. Where the Breeder is a non-resident, he or she is required to include in his or her assessable income, his or her individual interest in the net income of the partnership as is derived from a source in Australia.

35. Each Breeder will be entitled to a deduction under section 92 of so much of his or her individual interest in any loss of the partnership as is attributable to a period when he or she was a resident. Where the Breeder is a non-resident, he or she will be entitled to a deduction for so much of his or her individual interest in the

partnership loss as is attributable to a period when he or she was a resident.

Sections 82KL, 82KZM and Part IVA

36. The following provisions of the ITAA 1936 have application as indicated:

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

Explanations

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

37. 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 the Partnership will be entitled after 1 July 2000.

38. 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 the Partnership is entitled or a decreasing adjustment that the Partnership has.

Section 8-1

39. Consideration of whether the initial fee(s) payable is deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and

- where all that happens in a year of income is a taxpayer contractually commits himself to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

40. An outgoing or loss incurred in carrying on a business for the purpose of gaining or producing assessable income is deductible under the general deduction provision, section 8-1, provided it is not expenditure or a loss of capital or of a capital, domestic or private nature. A business includes a 'primary production business'. A cattle-breeding scheme can constitute the carrying on of a business of primary production. Where there is a business, or a future business, the gross proceeds from the sale of animals, semen or embryos will constitute gross assessable income in their own right. The generation of business income from such a business, or future business, provides the necessary basis from which to access a genuine purpose for incurring the outgoings in question and have the requisite connection with the operations or activities that more directly gain or produce this income.

Is the Breeder in Business?

41. Generally, a Breeder will be carrying on a business of cattle breeding where the available evidence indicates that:

- the Breeder has an identifiable interest in the specific animals and embryos;
- the activities are carried out on the Breeder's behalf; and
- the venture has a businesslike flavour and is conducted systematically with the intention of deriving assessable income.

42. For this Project, Breeders have lease rights in identified Host Cows and, subsequently, ownership of identified progeny by means of ear tag and registration certificates. Bashan is responsible for arranging the specialist services provided by Embryo Transfer practitioners and locating suitable premises to manage the Host Cows and progeny on behalf of the Breeders. Breeders are considered to have control over their investment. Emerald Hills Cattle Pty Ltd considers that, within three years, the Breeder will be in a position to derive assessable income. Progeny are considered livestock when

they are born and will be brought to account as natural increase in the year of birth.

43. The Breeders' degree of control over their embryos and calves, as evidenced by the Agreement, is sufficient. The cattle breeding activities described in the Agreement are, therefore, carried out on the Breeders' behalf.

44. The general indicators of a business, as developed by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators discussed in that Ruling. Breeders to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in material provided by Emerald Hill Cattle Pty Ltd that suggest the Project should return a 'before-tax' profit to the Breeders, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

45. Emerald Hills Cattle Pty Ltd will engage the professional services of Bashan. There is a means to identify which calves Breeders have an interest in. These services are based on accepted practices and are of the type ordinarily found in farming ventures that would commonly be said to be businesses.

46. Breeders have a continuing interest in the eggs, embryos or calves from the time of implantation in the Host Cows on their behalf. The 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 Breeders' cattle breeding activities will constitute the carrying on of a business.

Deductibility of Expenses

47. The outgoings associated with the cattle breeding activities will relate to the gaining of income from this business and, hence, have a sufficient connection to the operations by which this income is to be gained from this business. They will, thus, be deductible under section 8-1, except to the extent they are capital, or of a capital nature. No capital components of the outgoings have been identified. No 'non-income producing purpose' in incurring the outgoings is identifiable from the arrangement. The tests of deductibility under section 8-1 are met. The exclusions in subsection 8-1(2) do not apply.

Interest Deductibility

48. Some Breeders may finance the investment through a loan facility. Whether the resulting interest fees are deductible under section 8-1 depends on the same reasoning as that applied to whether the management fees are deductible. The interest fees incurred will be

in respect of a loan to finance the establishment of the herd, and it's development in the first years – which will continue to be directly connected with the gaining of 'business income' from the Project. These fees will, thus, have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them.

Partnership

49. As the Project is a partnership for the purposes of the ITAA 1936 and the ITAA 1997, the Breeders are considered to be partners in a partnership and accordingly the provisions of Division 5 of Part III of ITAA 1936 apply to include as income, each Breeder's individual interest in the net income of the Project of each year of income.

50. Further, where a partnership loss is incurred by a partnership in a year of income, there shall be an allowable deduction to a partner in the partnership based on their individual interest in the partnership.

51. Accordingly, a partnership return will be required to be furnished for each year of income, as per section 91, ITAA 1936. The Breeders will be required to disclose their share of the partnership net income or loss in their returns of income as per section 92, ITAA 1936.

Borrowing costs deductibility

52. The expenses incurred by a Breeder for borrowing money to finance their investment are deductible under section 25-25.

Section 82KL

53. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Here, no 'additional benefit' has been identified to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Section 82KZM

54. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. The section applies to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement that is not wholly done within the same year of income as the execution of the relevant agreement.

55. Management and Lease fees are incurred on execution of the Management and Livestock Lease Agreements. The fees are charged for providing services to the Partnership by 30 June of the year of execution of the Agreements. The fees are expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years.

56. There is no evidence that might suggest the services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, no part of the initial fee is for the Studmaster doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditures identified above in each of the financial years ended 30 June 2000 to 30 June 2002. New sections 82KZMB, 82KZMC and 82KZMD will not apply to the Project since the services to be provided in respect of the initial fee are to be completed in the same year of income as the expenditure is incurred (see paragraph 82KZMA(3)(c)).

Part IVA

57. 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). The Project will be a 'scheme', commencing when the Agreement is executed. The Breeder will obtain a 'tax benefit' from entering into the scheme, in the form of a deduction of the initial fee, allowable under section 8-1, that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out for the dominant purpose of obtaining this tax benefit.

Detailed contents list

58. Below is a detailed table of contents list for this Product Ruling:

	Paragraph
What this Product Ruling is about	1
Tax law(s)	2
Class of persons	6
Qualifications	8

PR 2000/23

Date of effect	10
Withdrawal	12
Arrangement	13
Overview	15
Deed of Partnership	18
Deed of Management	19
The Livestock Lease	27
Finance	28
Ruling	30
Goods and Services Tax	30
Section 8-1	31
Partnership	33
Sections 82KL, 82KZM and Part IVA	36
Explanations	37
Sections 27-5 and 27-30 - Goods and Services Tax	37
Section 8-1	39
Is the Breeder in Business?	41
Deductibility of Expenses	47
Interest deductibility	48
Partnership	49
Borrowing costs deductibility	52
Section 82KL	53
Section 82KZM	54
Part IVA	57
Detailed contents list	58

Commissioner of Taxation

22 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; TR 98/22; TD 93/34*Subject references:*

- carrying on a business
- commencement of business
- fee expenses
- interest expenses

- management fees expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 82KZM

ATO references:

NO 99/17192-8

BO

FOI number: I 102280

ISSN: 1441-1172

- 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 995-1(1)
- TAA 1953 Pt IVAAA
- Copyright Act 1968