



PR 2000/32 - Income tax: Olea Australis

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 This document has changed over time. This is a consolidated version of the ruling which was published on *20 August 2001*



Product Ruling

Income tax: Olea Australis

Contents	Para
What this Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	35
Explanations	56
Detailed contents list	112

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

Terms of use of this Product Ruling

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

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 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 Olea Australis Project, or 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 of the ITAA 1997;
- section 27-5 of the ITAA 1997;
- section 27-30 of the ITAA 1997;
- subdivision 387-B of the ITAA 1997;
- subdivision 387-C of the ITAA 1997;
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936'); and
- section 82KZM of the ITAA 1936;
- section 82KZMA of the ITAA 1936;
- section 82KZMB of the ITAA 1936;
- section 82KZMC of the ITAA 1936;
- section 82KZMD of the ITAA 1936; and
- Part IVA of the ITAA 1936.

3. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of 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 'Growers'.

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

Qualifications

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

9. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 14 to 34) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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

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Date of effect

11. This Ruling applies prospectively from 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 taxation dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 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 change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

14. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, 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:

- application for a product ruling for the Olea Australis Project, dated 20 January 2000;
- draft Constitution of Olea Australis Managed Investment Scheme, dated 14 February 2000;
- copy of Prospectus for Olea Australis;
- draft Lease and Management Agreement between Dandaragan Olives Management Ltd (the 'Responsible Entity' or 'Manager'), Dandaragan Olives Management

Ltd (the 'Lessor') and the Grower, printed on 11 February 2000 (the 'Lease and Management Agreement');

- draft Lease Agreement between Dandaragan Olive Holdings Ltd and Dandaragan Olives Management Ltd, printed on 2 March 2000 (the 'Head Lease');
- draft Agreement for Sale of Olives between Dandaragan Olives Management Ltd and Dandaragan Olives Processing Ltd, printed on 14 February 2000;
- copy of Custodian Agreement between Custodian and Funds Management Services, a Division of Gillard Turner & O'Brien Pty Ltd, and Dandaragan Olives Management Ltd, dated 9 February 2000;
- copy of the Olea Australis Compliance Plan, dated 14 February 2000;
- copy of a finance package available through Australian Agribusiness Finance Pty Ltd; and
- Additional information provided by the applicant upon request.

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

15. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be a party to.

Overview

16. This arrangement is called the 'Olea Australis Project'.

Location	Dandaragan, approximately 150 kilometres north of Perth in Western Australia
Type of business each participant is carrying on	Planting and cultivating olive trees on their designated 0.2 hectare olive grove(s) and harvesting the olives for sale.
Number of hectares to be put under cultivation	A minimum of 56 and up to 400 hectares

PR 2000/32

Number of olive trees per hectare	An average of 555 trees
Size of the olive groves	0.2 hectares
Number of olive trees per grove	111 on average
Expected production	First harvest expected in the year ended 30 June 2004. Expected fruit yield is between 22 and 52 kilograms per tree.
The term of investment in years	Approximately 20 years
Subscription amount per olive grove	\$10,247
Initial share subscription per olive grove	5,000 shares at \$0.20 per share in Olea Australis Limited
Cost of each 5000 share parcel	\$1,000

17. The Project is to carry out a large scale planting of olives principally for the production of olive oil.

18. Growers entering into the Project will lease parcels of land from Dandaragan Olives Management Ltd for a period of approximately 20 years. The minimum individual holding is one olive grove, being an allotment of 0.2 hectares of land. For each grove subscription, the Grower or his nominee must also subscribe for 5000 shares in Olea Australis Limited. The prospectus seeks minimum subscriptions of 280 olive groves (56 hectares) and 1,400,000 ordinary shares in Olea Australis Limited. The minimum subscription has been underwritten by Norgard Clohessy Equity Ltd, John (Gus) Simpson, Ian Peter Middlemas and Stephen Wayne Randell. The maximum subscription is 1,500 olive groves and 7,500,000 shares in Olea Australis Limited. Over subscriptions for a further 500 olive groves and 2,500,000 shares may be accepted.

19. Growers will enter into a contract with Dandaragan Olives Management Ltd to perform services in relation to the establishment of the olive trees, the establishment of an irrigation system, and the development and management of their olive groves. Growers will have an option to take possession of their olives after harvest and be responsible for processing and marketing the olives themselves. Where a Grower does not make this election, the Responsible Entity, on behalf of the Growers, will sell the olives to Dandaragan Olives Processing Ltd ('the Processor') at market price. The Responsible Entity has entered into a pre-sales agreement with the Processor. The

Processor will purchase all of the olives produced by the Groves and marketed by the Responsible Entity.

20. The cost of participation for a Grower, per olive grove, will be:

- The share subscription costs (\$1,000 for 5,000 shares);
- The initial costs outlined in the Lease and Management agreement, totalling \$10,247 in the first 3 years;
- Ongoing costs outlined in the Lease and Management Agreement payable in years 4 through to year 20;
- Any applicable insurance costs;
- Any applicable financing costs; and
- Any applicable GST.

21. Dandaragan Olive Holdings Ltd, a wholly owned subsidiary of Olea Australis Limited, owns the relevant land. Pursuant to a head lease it will lease the land to Dandaragan Olives Management Ltd, the Responsible Entity, for the period of the Project. The Responsible Entity will in turn lease specific 0.2 hectare parcels of land to individual Growers for the life of the Project, in accordance with the Lease and Management Agreement.

Lease and Management Agreement

22. Under the Lease and Management Agreement, each Grower leases a defined area (as set out in Item 3 of the Schedule to the Agreement). Under the terms of the Agreement a Grower may only use the land for the purpose of commercial olive horticulture and is not entitled to reside permanently or temporarily on the land or use it for any residential, recreational or tourism purposes.

23. Each Grower has full right, title and interest in the olive trees on its olive grove and the right to have the olives produced from the leased area sold for its benefit. At the expiration of the term, each Grower will peaceably surrender and yield up to the Lessor the leased area and fixtures, free and clear of rubbish and in good repair and condition.

24. Unless a Grower has elected otherwise before the 31 May 2000, or within 1 month of execution of the Lease and Management Agreement, the Responsible Entity is authorised to enter into a contract as agent of the Grower for the sale of the olives to Dandaragan Olives Processing Ltd.

25. Each Grower appoints the Responsible Entity to establish, cultivate, develop, manage and maintain the Grower's olive grove(s) for the duration of the term of the Lease and Management Agreement. The Responsible Entity is required to perform these services in a

PR 2000/32

proper and efficient manner, in accordance with sound commercial practice and good horticultural practice. The Responsible Entity will arrange for the olives to be harvested and delivered up for sale.

26. Each Grower will make payments in relation to the Project under the Lease and Management Agreement. In the first 3 years, the payments will be for rent, management fees, establishment of the olive trees, trellising and irrigation expenses.

27. The Responsible Entity will endeavour to arrange insurance on the Growers' behalf. Where this is available, Growers are required to insure their Olive Groves against damage or destruction by fire. The Responsible Entity will arrange payment of insurance premiums to the appropriate insurers on the Growers' behalf and at the Growers' expense.

Fees

28. Under the terms of the Lease and Management Agreement, a Grower will make the following payments per olive grove for the first years of the Project:

Expenses	Year 1 (yr ended 30 Jun 00)	Year 2 (yr ended 30 Jun 01)	Year 3 (yr ended 30 Jun 02)
Management Fee	2,525	3,595	1,740
Irrigation	375	375	375
Olive trees costs	-	924	-
Trellising	-	134	-
Rent	66	68	70
Totals	2,966	5,096	2,185

(Note: All figures shown are exclusive of GST)

29. The Manager will only provide services following the execution of the Lease and Management Agreement.

30. Growers who invest on or before 31 May 2000 will pay the Year 1 fees in respect of management services which will be wholly undertaken before 30 June 2000. For Growers who invest after 31 May 2000, the Year 1 fees will be paid in respect of services which will be performed after 30 June 2000 and before 30 June 2001.

31. Fees are generally payable by 30 June of the relevant financial year, except in the first year, where a deposit of \$1,000 is payable upon application and the balance is payable by 30 June 2000. The rent payments are payable yearly in advance. The \$66 payment due in

year 1, i.e., by 30 June 2000, is in respect of rent for the period 1 July 2000 to 30 June 2001 and so on.

32. There will be ongoing costs for Growers after the third year, i.e., from the financial year ending 30 June 2003. These will consist of annual management fees, rent, harvesting fees, and any insurance premiums. The Responsible Entity is also entitled to be paid a bonus, being 25% of the value of the land produce (i.e., the olives) received each year in excess of the projected total returns per grove set out in the Prospectus. From the year ended 30 June 2003, the management fees will be calculated by reference to the previous year's management fee increased by the Consumer Price Index ending 31 March of the financial year of review (the 'CPI'), or 3%, whichever is the greater. The rent is similarly calculated by reference to the previous year's rent, increased by the CPI or 3%, whichever is the greater. The Grower is also responsible for any applicable goods and services tax.

Finance

33. Growers can either fund their investment in the Project themselves, borrow from an independent lender, or may elect to use proposed financing packages available on a full recourse basis through Australian Agribusiness Finance Pty Ltd.

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

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

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Goods and Services Tax

35. For a Grower who invests in the Project, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Grower is entitled or, in the case of section 27-5, a decreasing adjustment that a Grower has.

Allowable deductions

36. For a Grower who invests in the Project, the timing of any deduction available for prepayments may depend upon the date that the investment is made and/or whether or not they are a 'small business taxpayer' (refer paragraphs 58 to 61).

37. The following will be allowable deductions:

- rent paid by the Grower in relation to the leased area (section 8-1 of the ITAA 1997);
- management fees paid for the services outlined in the Lease and Management Agreement (section 8-1 of the ITAA 1997);
- expenditure incurred on irrigation - section 387-125 of ITAA 1997. A deduction for capital expenditure on irrigation is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next two years. The full amount of \$1,125 for irrigation expenditure is considered to be incurred on execution of the Lease and Management Agreement, albeit recouped by the Responsible Entity in three instalments.
- depreciation for the cost of trellising (section 42-15 of ITAA 1997). The rate at which the deductions are calculated will depend on whether a Grower is a small business taxpayer or not and whether the Grower elects to use the 'diminishing value method', or 'prime cost method'. The initial (i.e., Year 2) deduction allowed will depend 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

- costs of establishing the olive trees - section 387-165 of ITAA 1997. The deduction is calculated on the basis of the trees, as horticultural plants, entering their first commercial season and a Grower determining, under section 387-175, that they have an 'effective life' for the purposes of section 387-185 of greater than 30 years. This results in a write-off rate of 7% per annum, starting from the year in which they enter their first commercial season.

IMPORTANT: Paragraphs 38 to 40 (relating to 'small business taxpayers') and paragraphs 41 to 45 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Growers are advised to carefully consider the information contained in paragraph 54 relating to proposed changes to the prepayment rules. Growers who invest in the Project after 1pm, AEST, 11 November 1999 may be affected by these changes.

Growers who are small business taxpayers

38. For a Grower who is a 'small business taxpayer,' the rent and management fees will be deductible in the year that the expenses are incurred, as the services will be wholly provided within 13 months of the expenditure being incurred (but see non-binding advice at paragraph 54).

39. For a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the 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 initial (i.e., Year 2) deduction allowed will depend 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. The applicable rates are 60% for diminishing value or 40% for prime cost.

40. The following is an estimate of deductions available to a Grower, who is a 'small business taxpayer', over the first three years of the investment where:

PR 2000/32

(a) the Grower invests prior to 30 June 2000:

Expenses	Legislation ITAA 1997	Refer Note	Year 1	Year 2	Year 3
			30/6/2000	30/6/2001	30/6/2002
Management Fee	8-1	(i)	2,525	3,595	1,740
Irrigation	387-125		375	375	375
Tree costs	387-165	(ii)	-	-	-
Trellising	42-15	(iii)	-	54	54
Rent	8-1	(i)	66	68	70
Total			2,966	3,092	2,239

(Note: All figures shown are exclusive of GST)

(b) the Grower invests after 30 June 2000:

Expenses	Legislation ITAA 1997	Refer Note	Year 1	Year 2	Year 3
			30/6/2000	30/6/2001	30/6/2002
Management Fee	8-1		-	6,120	1,740
Irrigation	387-125		-	375	375
Tree costs	387-165	(ii)	-	-	-
Trellising	42-15	(iii)	-	54	54
Rent	8-1		-	134	70
Total			nil	6,683	2,239

(Note: All figures shown are exclusive of GST)

- (i) Proposed legislative change applying to expenditure incurred after 1.00pm AEST 11 November 1999 means that the full deduction may be allowed to Growers who invest on or after 1 June 2000. See the non binding advice in paragraphs 54 and 55.
- (ii) The Manager will advise the Growers of the years in which a deduction will be allowable.
- (iii) Trellising is to be installed in Year 2. The Manager is to advise Growers of the number of days in which the Growers owned an interest in the trellising.
- (iv) The deductions available in Years 2 and 3 have been calculated on the basis of using the prime cost method at a rate of 40%, assuming that is the method that the Grower has chosen under section 42-25. A Grower who elects to use the diminishing value method may be able to claim up to \$80 in Year 2 and \$32 in Year 3.

Growers who are not 'small business taxpayers'

41. For a Grower who invests in the project and is not a 'small business taxpayer' and is carrying on a business, the provisions of 82KZMB apply to effectively apportion the deductions for the expenses to coincide with the period to which they relate. Hence, the rent and management fees paid by the Grower will be allowable as a deduction in the year those services will be provided.

42. The rent is generally prepaid, hence a deduction for the rent will be allowable in the year following the payment.

43. As to the management fees, under the Lease and Management Agreement all services are to be provided in the financial year in which the payment for those services is due. For investors who invest after 31 May 2000 and before 30 June 2000 the Responsible Entity will defer execution of the agreement until 1 July 2000 and undertake all relevant services in that year, and a deduction for those fees will be allowable in the year ended 30 June 2001.

44. The deduction for depreciation of trellising is determined using the rates in section 42-125 and the formula in either subsection 42-160(3), 'diminishing value method', or subsection 42-165(2A), 'prime cost method'. The initial (ie, Year 2) deduction allowed will depend 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. The deduction is determined on the basis of the effective life of the trellising, which is estimated at 3 years. On this basis, the cost of the trellising will be deductible over 3 years, using a prime cost basis, or at the rate of 50% if using the diminishing value method.

45. The following is an estimate of deductions available to a Grower, who is not a 'small business taxpayer', over the first three years of the investment where:

(a) the Grower invests on or before 31 May 2000:

Expenses	Legislation ITAA 1997	Refer Note	Year 1	Year 2	Year 3
			30/6/2000	30/6/2001	30/6/2002
Management Fee	8-1		2,525	3,595	1,740
Irrigation	387-125		375	375	375
Tree costs	387-165	(iv)	-	-	-
Trellising	42-15	(v)	-	45	45
Rent	8-1		-	66	68
Total			2,900	4,081	2,228

(Note: All figures shown are exclusive of GST)

PR 2000/32

(b) the Grower invests after 31 May 2000:

Expenses	Legislation ITAA 1997	Refer Note	Year 1	Year 2	Year 3
			30/6/2000	30/6/2001	30/6/2002
Management Fee	8-1		-	6,120	1,740
Irrigation	387-125		-	375	375
Tree costs	387-165	(iv)	-	-	-
Trellising	42-15	(v)	-	45	45
Rent	8-1		-	66	68
Total			nil	6,606	2,228

(Note: All figures shown are exclusive of GST)

- (i) The Manager will advise the Growers of the years in which a deduction will be allowable.
- (ii) Trellising is to be installed in Year 2. The Manager is to advise Growers of the number of days in which the Growers owned an interest in the trellising.

The deductions available in Years 2 and 3 have been calculated on the basis of using the prime cost method at a rate of 33.33%, assuming that is the method that the Grower has chosen under section 42-25. A grower who elects to use the diminishing value method may be able to claim up to \$67 in Year 2 and \$33 in Year 3.

Sections 82KZM, 82KZMB, 82KZMC, 82KL and Part IVA

46. For a Grower, who is a small business taxpayer the expenditure for management fees does not fall within the scope of section 82KZM (**but see paragraph 54**).

47. For a Grower, who is not a small business taxpayer and who is carrying on a business, the following provisions have application as indicated:

- Where a Grower invests in the Project before 1 June 2000, the expenditure for management fees does not fall within the scope of section 82KZMB as the services will be provided by 30 June 2000; and
- Where Growers invest in the Project on or after 1 June 2000, the Lease and Management Agreement will not be executed until after 30 June 2000, and therefore if no payment is made until then, expenditure for management fees will not fall within the scope of

section 82KZMB as the services to be provided in respect of the Year 1 fee will be provided entirely in the year ended 30 June 2001 (**but also see paragraph 54**).

48. Section 82KL does not apply to deny the deductions otherwise allowable.

49. The relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained by any Grower under a tax law dealt with in this Ruling.

Cost of shares

50. Under section 8-1 of the ITAA 1997, no deduction is allowable to a Grower for the acquisition of shares in Olea Australis Limited. The cost of the shares is a capital outgoing and is excluded from deductibility by subsection 8-1(2).

51. The cost of the shares will be included in the cost base of these shares for the purpose of calculating a capital gain or capital loss under Part 3-1 of the ITAA 1997 if a CGT event occurs in respect of the shares.

Division 35 – Deferral of losses from non-commercial business activities

Section 35-55 – Commissioner’s discretion

51.1 For a Grower who is an individual and who entered the Project on or after 5 April 2000 and prior to any withdrawal of this Product Ruling the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2003 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be carried on in a manner that is not materially different to the arrangement described in this Ruling.

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

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

51.3 Where, either the Grower’s business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any

excess of deductions attributable to their business activity in excess of any assessable income from that activity, ie, any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

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

Assessable Income

52. For a Grower who invests in the Project, any gross proceeds received from the sale of olives from the Grower's Olive Grove will be assessable income under section 6-5 of ITAA 1997 in the year of income in which the proceeds are derived.

53. Where a Grower elects to take possession of the olives after harvest, any olives on hand at the end of the income year will need to be accounted for in accordance with the trading stock provisions contained in Part 2-25 of ITAA 1997.

54. [Omitted]

55. [Omitted]

Explanations

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

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

57. 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 (on or after 1 July 2000) includes an amount relating to an input tax credit to which a Grower is entitled or a decreasing adjustment that a Grower has.

Section 960-Q: Small business taxpayers

58. In this Product Ruling the term ‘small business taxpayer’ is relevant for the purposes of certain prepaid expenditure and depreciation of trellising.

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

60. 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.

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

Section 8-1 ITAA 1997: Rent and Management Fees

62. It is appropriate, as a starting point, to consider whether rent and management fees are deductible under paragraph 8-1(1)(a). This consideration proceeds on the following basis:

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

63. An horticultural scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the Project will constitute gross assessable income under section 6-5 of the ITAA 1997. The generation of business

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

64. Generally, a Grower will be carrying on a business of an olive grower where:

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

65. Under the Lease and Management Agreement, Growers have rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of a commercial olive grower. Under the Lease and Management Agreement, Growers appoint the Responsible Entity, as Manager, to provide services such as planting. The agreement gives Growers full right, title and interest in the olives produced and the right to collect their olives after harvest or have the olives sold for their benefit.

66. Under the Agreement, Growers appoint the Manager to provide services such as planting of olive trees, the installation of trellising and irrigation, and all operations necessary to develop and maintain a mature fruit bearing tree. The Manager is also responsible for harvesting the olives, and, for non-electing Growers, selling them.

An identifiable interest

67. The Lease and Management Agreement gives Growers an identifiable interest in specific trees and a legal interest in the leased land. Growers have the right personally to process and market the olives attributed to their leased area or they may use the Manager to arrange the sale of the olives for them. Growers have a continuing interest in the trees from the time they are acquired until the end of the Project. There is a means to identify in which trees the Growers have an interest.

Horticultural activities carried out by the Grower or on the Grower's behalf

68. Under the Lease and Management Agreement Growers appoint Dandaragan Olives Management Ltd to manage the Project. The Manager is to provide services including the establishment and maintenance of an irrigation system and the cultivation, tending, training, pruning, fertilising, replanting, spraying and otherwise caring for the olive trees. The Manager is also responsible for harvesting the olives.

69. Growers have an obligation to use the land in question for the cultivation of olives for the purpose of olive oil production. The activities described in the Lease and Management Agreement are carried out on the Growers' behalf. The Grower's degree of control over the Manager, as evidenced by the Agreement and supplemented by the Corporations Law, is sufficient. Under the Corporations Law, Dandaragan Olives Management Ltd are required to prepare annual reports and send them to Growers within 3 months after the end of the financial year. Growers are able to terminate their agreement with the Manager in specified circumstances, such as a substantial breach by the Manager of a material obligation under the Agreement.

General indicators of a business

70. 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 in the prospectus that suggest the Project should return a 'before-tax' profit to the Growers, that is, a 'profit' in cash terms that does not depend on its calculation on the fees in question being allowed as a deduction.

71. The outgoings in question have the requisite connection with the operations that more directly gain or produce this income. That is, the fees directly relate to the planting, tending, maintaining and harvesting of the olive trees.

72. Growers have a continuing interest in the trees from the time they are acquired until the end of the 20 year Project. There is a means to identify in which trees the Growers have an interest. The horticultural 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' activities will constitute the carrying on of a business.

73. The lease and management services associated with the grove activities 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 be deductible under paragraph 8-1(1)(a). The tests for deductibility under that paragraph are met. The exclusions in subsection 8-1(2) do not apply.

Expenditure of a capital nature

74. Any part of the expenditure of a Grower entering into a horticultural business 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 cost of the olive trees and their establishment expenditure and the costs of irrigation and trellising are considered to be capital in nature. The fees for these expenses are not deductible under section 8-1. However, this expenditure falls for consideration under the specific capital write-off provisions of the ITAA 1997.

Section 42-15: trellising expenditure

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

76. 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 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.

77. 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. Income Tax Ruling IT 175 sets out the Australian Taxation Office's (ATO's) views on this issue. Where a lessee is considered to own the improvements under a state law, as detailed in the Ruling, or where 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.

78. Under section 42-15 Growers are entitled to depreciation deductions for expenditure of \$134, relating to the acquisition and installation of trellises on the land. The timing of the deduction, however, will depend on whether or not a Grower is a 'small business taxpayer' as defined in section 960-335 and, if so, whether the Grower complies with the conditions contained in section 42-345.

79. The depreciation deduction available to a Grower who is a 'small business taxpayer' and who complies with the conditions contained in section 42-345 is calculated using the cost of the

trellising and a rate of 40% prime cost or 60% diminishing value. These accelerated rates of depreciation are shown in section 42-125 and apply to plant with an effective life of between 3 and 5 years.

80. Growers who are not 'small business taxpayers' will have entered the Project after 11.45am, AEST, 21 September 1999, and will not be able to claim accelerated depreciation on plant used in the Project because of section 42-118. The deduction for such Growers is calculated using the cost of the trellising and its effective life only. Growers, who are not small business taxpayers, will be eligible for a depreciation deduction under subsections 42-160(3) or 42-165(2A), at a rate of 33.33% prime cost or 50% diminishing value.

81. The Responsible Entity will advise Growers of the date the trellising is installed and ready to be used for the purpose of producing assessable income. Costs of acquisition and installation of trellises on the land will be eligible for depreciation deduction by the Growers from that date.

Subdivision 387-B: irrigation expenditure

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

83. A deduction is available to a taxpayer who is a lessee of the land. A deduction would be available to the Growers for the cost of the irrigation system, whereby one third of the expenditure is allowable in the year that it is incurred and one third in each of the next two years of income (subsection 387-125(2) ITAA 1997). The full amount of \$1,125 for irrigation expenditure is considered to be incurred on execution of the Lease and Management Agreement, albeit recouped by the Responsible Entity in three instalments.

Subdivision 387-C: horticultural expenditure

84. Subdivision 387-C allows capital expenditure on establishing horticultural plants for use in an horticulture business to be written off for tax purposes. For the purpose of this Subdivision, a lessee of land carrying on a business of horticulture is treated as owning the plants growing on that land rather than the actual owner of the land. The write-off under Subdivision 387-C commences on the first day of what is to be the olive trees' first commercial season. The Manager

will advise the Growers of this event which is expected to occur in Year 4.

85. Establishment expenditure is limited to capital expenditure. The costs of establishing an horticultural plantation may include the costs of acquiring the plants or seeds, the cost of planting the plants or seeds and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or the initial clearing of the land.

86. Under this Subdivision, where the effective life of the plant is more than 3 years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period.

87. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the olive trees have an effective life in excess of 30 years. The write-off rate for horticultural plants with an effective life of more than 30 years is 7% (section 387-185).

88. The Manager has identified that the relevant expenditure attributable to the establishment of the olive trees is \$924. This amount will be subject to the horticultural provisions and allowable as a deduction under Subdivision 387-C as outlined.

Insurance

89. Under the terms of the Lease and Management Agreement a Grower may elect to take out insurance in respect of their portion of the olive grove. Insurance premiums for fire, public risk or loss of profits are deductible. Therefore, where a Grower takes out insurance to cover these events, the premium will be deductible under section 8-1.

Assessability of income from the Project

90. For a Grower who invests in the Project any income received by them from the sale of their olives, or from the sale of products from their olives, will be assessable income to them under section 6-5.

Section 82KZM : Prepaid expenditure for small business taxpayers

91. Section 82KZM of the ITAA 1936 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 of the ITAA 1997. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the

agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

92. Under the Lease and Management Agreement the management fee of \$2,525 per holding will be incurred on execution of the Agreement. This fee is charged for providing services to a Grower only for the period up to 30 June 2000 for Growers who subscribe up to 31 May 2000. For Growers who subscribe after 31 May 2000 the services will be provided wholly in the year ended 30 June 2001 as the agreement will not be executed until after 30 June 2000.

93. For the purposes of this Ruling, no explicit conclusion can be drawn from the description of the arrangement, that the fee had been inflated to result in reduced fees being payable for subsequent years. The fee is expressly stated to be for a number of specified services. There is no evidence to suggest that the services covered by the fee could not be provided within the specified period. Therefore, it cannot be suggested that the services to be done cannot be wholly done within 13 months of the fee being incurred.

94. The basic precondition of the operation of section 82KZM is not satisfied and the section will not apply to disallow a deduction for the rent and management fees.

Sections 82KZMA - 82KZMD - Prepaid expenditure for taxpayers other than small business taxpayers

95. For a Grower who is not a 'small business taxpayer' and is carrying on a business, sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the expenditure year). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

96. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Growers investing in the Project, transitional treatment applies to prepayments initially incurred in the 1999-2000 income year. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service period ends more than 13 months after the date the expenditure was incurred, and does not apply to the Project.

97. The deduction available to Growers for the rent will be determined in accordance with the rules contained in section 82KZMB.

Proposed changes to prepayment rules

98. The changes announced by the Government to apply from 11 November 1999 but not yet enacted will affect all taxpayers that participate in a 'tax shelter arrangement' and prepay expenditure for up to 13 months. It is proposed that deductions otherwise allowable under section 8-1 of the ITAA 1997 be spread over the period to which the prepayment relates. Under the proposed changes, there will be no exemption for small business taxpayers and no transitional rules will apply.

99. A tax shelter arrangement is described as existing where:

- under the arrangement, the taxpayer's allowable deductions for the income year exceed the assessable income for that year; and
- all significant aspects of the arrangement during the income year are conducted by people (e.g., a manager) other than the taxpayer; and
- either:
 - more than one taxpayer participates in the arrangement; or
 - the manager, or an associate of the manager, also manages similar arrangements on behalf of others.

100. The arrangement relating to the Project and described at paragraphs 14 to 34 of this Ruling is within the description of a 'tax shelter arrangement'. Therefore, prepayments incurred by Growers who invest in the Project after 11 November 1999 will be deductible over the period the services are provided.

Section 82KJ

101. Section 82KJ denies a deduction in respect of certain prepaid outgoings that are incurred as part of a tax avoidance agreement. Section 82KJ's operation depends, among other things, on the taxpayer acquiring, or being reasonably expected to acquire, property and the consideration for that property is less than that which might reasonably be expected to have been payable.

102. 'Property' is defined broadly and includes a chose in action and any estate, interest, right or power, whether at law or in equity, in or over property. The Grower's interest in the Project falls within this definition.

103. The consideration paid by the Growers in respect of the 'property' is not less than that which might reasonably be expected to have been payable. Section 82KJ will not apply to deny the deduction otherwise allowable under section 8-1.

Section 82KK

104. Section 82KK applies where a taxpayer incurs an allowable outgoing to an associate in an income year and the associate does not include that amount as assessable income until a subsequent year. Where the section applies the outgoing is allowable to the taxpayer only in the year in which it is included in the assessable income of the associate.

105. Subsection 82KH(1) defines 'associate' broadly. The definition includes a company where the company or its directors are accustomed to or are under an obligation to act in accordance with the directions of the taxpayer, or where the taxpayer and associates might have the capacity to control the casting of more than 50% of the maximum number of votes that could be cast at a general meeting of such a company.

106. Provided Growers do not fall within the definition of associates of Dandaragan Olives Management Ltd, section 82KK will not apply to deny the deduction otherwise allowable under section 8-1.

Section 82KL

107. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1) a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' and the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

108. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Insufficient 'additional benefits' will arise to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

109. For Part IVA to apply there must be a 'scheme' (section 177A of the ITAA 1936), a 'tax benefit' (section 177C), and a dominant

purpose of entering into the scheme to obtain a tax benefit (section 177D).

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

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

Detailed contents list

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

	Paragraph
What this Ruling is about	1
Tax law(s)	2
Class of persons	6
Qualifications	8
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	16
Lease and Management Agreement	22
Fees	28
Finance	33
Ruling	35
Goods and Services Tax	35
Allowable deductions	36
Growers who are small business taxpayers	38
Growers who are not ‘small business taxpayers’	41

Section 82KZM, 82KZMB, 82KZMC, 82KL and Part IVA	46
Cost of shares	50
Division 35 – Deferral of losses from non-commercial business activities	51.1
Section 35-55 – Commissioner’s discretion	51.1
Assessable Income	52
Explanations	56
Section 27-5 and 27-30: Goods and Services Tax	56
Section 960-Q: Small business taxpayers	58
Section 8-1 ITAA 1997: Rent and Management Fees	62
An identifiable interest	67
Horticultural activities carried out by the Grower or on the Grower’s behalf	68
General indicators of a business	70
Expenditure of a capital nature	74
Section 42-15: trellising expenditure	75
Subdivision 387-B: irrigation expenditure	82
Subdivision 387-C: horticultural expenditure	84
Insurance	89
Assessability of income from the Project	90
Section 82 KZM: Prepaid expenditure for small business taxpayers	95
Proposed changes to prepayment rules	98
Section 82KK	104
Section 82KL	107
Part IVA	109
Detailed contents list	112

Commissioner of Taxation

5 April 2000

Previous draft:

Not previously issued in draft form

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

Subject references:

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

- ITAA 1997 27-5
- ITAA 1997 27-30
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
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- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 42-15
- ITAA 1997 42-345
- ITAA 1997 42-160
- ITAA 1997 42-165
- ITAA 1997 42-118
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- ITAA 1997 387-165
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- ITAA 1997 960-335
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- ITAA 1997 960-350
- TAA 1953 Pt IVAAA
- Copyright Act 1968

Legislative references:

- ITAA 1936 82KL
 - ITAA 1936 82KZMA
 - ITAA 1936 82KZMB
 - ITAA 1936 82KZMC
 - ITAA 1936 82KZMD
 - ITAA 1936 Pt IVA
 - ITAA 1997 6-5
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-

ATO references:

NO 99/18828-6
BO
FOI number: I 102401
ISSN: 1441-1172