PR 2000/34 - Income tax: Heydon Park Olive Project

Product Ruling
Income tax: Heydon Park Olive Project

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Preamble

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

*[**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.

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 Heydon Park Olive Project, or just simply as 'the Project', or the 'product'.

Tax law(s)

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

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 8-1 of the ITAA 1997;
- section 25-25 of the ITAA 1997;
- section 27-5 of the ITAA 1997;
- section 27-30 of the ITAA 1997;
- subdivision 387-A of the ITAA 1997;
- subdivision 387-B of the ITAA 1997;
- subdivision 387-C of the ITAA 1997;
- subdivision 960-Q of the ITAA 1997.
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- 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 choose to maintain and operate their own olive groves, those 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. Neither does it include persons or entities who are associates, as that term is defined in subsection 82KH(1) of the ITAA 1936, of any entities involved in the arrangement.

Qualifications

8. 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.

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 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 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

12. This Product Ruling is withdrawn and ceases to have effect on 30th 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 is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Application for Product Ruling dated 28 January 2000;
- Draft Heydon Park Olive Project Prospectus
- **Constitution between Heydon Park Ltd (referred to herein as 'HPL' or the 'Manager'), Cardinal Financial Securities Limited (referred to herein as 'Cardinal' or the 'Custodian'), RRAP Investments**

Pty Ltd ('RRAP' or 'the Landowner') and the Growers;

- **Management Agreement between Heydon Park Ltd ('HPL' or the 'Manager') and the Grower**;
- Agreement to Lease between RRAP and Cardinal;

Note: certain information received from Heydon Park Ltd has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Overview

Location	"Rohan Hill" Talmalmo near Albury in Southern NSW
The Land	160 Hectares suitable for growing olives
Term of the Project	24 years
Number of investments available	400
Minimum Subscription	Minimum subscription of 50 farms, totalling $1,170,000.
Minimum initial cost	$23,400 per farm, consisting: Olive seedling purchase $500; Occupation fee $750; Management fee $22,150.
Annual on-going cost from the second year	Prior year Occupation fee increased by the greater of 3% or CPI (per year); plus Management fee of $1,750 (indexed by CPI from and including the third year); plus The growers proportion of all harvesting costs, public and product liability insurance, and other project management costs.

14. 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 a Grower, will be a party to. The documents

highlighted are those the Growers enter into. The effect of these arrangements is summarised as follows.

15. This arrangement is called the Heydon Park Olive Project. The Project involves establishing, planting, cultivation and harvesting olives and the sale of olives or olive oil. The Project is to be conducted on the RRAP property. The minimum number of applications required before the Project could commence is 50. The maximum number of farms on offer is 400. **This Ruling does not apply if the minimum number of applications has not been received by 30 June 2000.**

16. Participants are invited to enter the Project by applying under a Prospectus to be registered with the Australian Securities and Investment Commission. Each Participant shall complete an Application Form and Power of Attorney attached to a current Prospectus. The Power of Attorney appoints HPL to do everything necessary to execute the Management Agreement.

17. The fees payable on acceptance are $23,400 in respect of the purchase of Olive trees, and for the occupation fee and the management fee for the Initial Period. The 'Initial Period' means the period beginning on the date of issue of each Participant's Interest and ending 12 months from the date thereof.

18. The Grower has the option of paying the full amount of $23,400 on application or accepting the instalment plan offered. If Growers accept the instalment plan a deposit of $3,400 is payable on application and 24 consecutive payments of $890 will be payable. The instalment plan includes interest at 6% or $1,360 over the two years.

19. The monies will be held by the Custodian, until minimum subscription is met, and upon acceptance of the application and the granting of an Interest, the Olive Grove fee and the amounts paid will then be paid to the Manager.

20. Clause 14 and 15 of the Constitution provides that Growers who enter into a Management Agreement with HPL, will be covered by the Constitution. Growers become a party to and are bound by the terms of the Constitution. After the Initial Period Growers may elect to manage their own olive grove. Any Grower who so elects will no longer be entitled to rely on this Ruling.

21. Cardinal will act as Custodian for the Grower, receiving initial application money and releasing this only when both the minimum subscription has been reached and the lease on the land has been registered with the registrar generals office. All future income from the project will be paid to the Custodian who will then pay this to the Growers. The Custodian will be paid an annual fee of $10,000 (indexed) over the term of the Project.

22. RRAP will lease land required for the Project to the Custodian. Growers in consideration for an annual occupancy fee acquire the right to occupy a defined area of approximately 0.4 hectares (the olive grove) for the purpose of growing olive trees (clause 30.1 of the Constitution). The right to occupy shall include the entitlement to enter the land. (clause 3.5 of management agreement). Each Olive Grove can be physically identified and differentiated from all Olive Groves and Growers will be advised of the exact location of their grove, (clauses 1.1 of the Management Agreement). The Manager may from time to time in its absolute discretion allocate and reallocate Grower's Olive Grove. Where the Grower is reallocated a different farm the Grower will no longer be entitled to rely on this Ruling.

23. Possible projected returns for Growers are outlined in the Prospectus. These depend upon a range of assumptions made by HPL. There is no assurance or guarantee whatsoever in respect of the future success of or financial returns associated with the Project. Based on the assumptions, the Manager forecasts that a Grower could expect to achieve an average rate of return of 24% or an internal rate of return of 13% with a cash contribution. Income of the Project is to be paid into the Scheme Bank Account. It is be to held for the Growers by the Custodian and to be applied in payment of the Growers' obligations under the Management Agreement . An account shall be established and maintained for each Grower. Any income remaining after the payment of fees is to be distributed to Growers at such intervals as HPL may determine but not later than five months from the end of each Accrual period or 30 June each year as applicable.

24. The Project will conclude on 30 June 2024 unless termination under the constitution occurs earlier.

25. Growers enter into a Management Agreement with the Manager, HPL, to manage their business, plant not less than 100 olive trees seedlings per interest, tend and arrange for the harvest and marketing of the Olives, and sell the fruit on behalf of the Grower.

26. Except as expressly provided by the Constitution, all costs expenses and liabilities incurred or required to be met under the Constitution during the Initial Period for each Participant shall be met by the Manager who shall indemnify the Participants in respect of those costs. Those costs will be met out of the income of the Project during each subsequent Accrual period*.

Note: the 'Accrual Period means, in respect of Interest, each twelve monthly period ending on the last day of the month of June in each year during the term of this Deed provided that the period from the expiration of the Initial Period to and including the next following last day of June shall be an Accrual Period and the period from and including the first day of July immediately prior

to the date of termination of this Deed until the date of termination of this Deed shall be an Accrual Period'.

27. The management services provided are detailed in clause 1.1 of the Management Agreement and include the application of adequate fertiliser; noxious plant, animal and insect control; establishment of the trees; arranging for harvesting of the olives; and marketing of the olives; and the effecting, on behalf of Growers, public and product liability insurance. Growers may elect to manage their own Olive Grove. Any Grower who so elects will be outside the arrangement to which this Ruling applies and will be unable to rely on this Ruling.

28. The agreement terminates on 30 June 2024 unless terminated earlier under the terms of the Constitution. The Grower has the right under the Management Agreement to terminate the arrangement. Under the Constitution the Growers can terminate the services of the Manager and appoint a new manager by calling an extra ordinary general meeting and passing an extraordinary resolution to do so. (In such circumstance this Ruling will cease to have effect.)

29. HPL is authorised to pool the olives harvested from each olive grove. Proceeds of pooled sales after deduction of all amounts as provided under the management agreement such as harvesting costs and taxes will be paid to into the Scheme Bank Account for crediting to each Grower. The amount of each Grower's share is calculated on a proportional basis determined by the number of olive groves held and taking into account that different farms may have been in existence for different parts of the period to which the sold olive products relate.

Fees payable by the Grower

30. Growers will make a payment of $23,400, the application money, per 0.4 hectare Olive Grove, being for:

- a olive seedling fee of $500;
- an initial fee of $22,150 to HPL for business management and cultivation services to be provided within 12 months and on or before 30 June 2001; and
- an occupation fee of $750 in respect of the subsequent 12 month period ending on or before 30 June 2001.

31. The Growers will make the following payments, per 0.4 hectare farm, in subsequent Accrual Periods for the remainder of the Project period:

- an occupation fee of the prior year occupation fee increased by the greater of 3% or CPI (per year) paid in advance, on or before the last day of the Accrual Period or Initial Period immediately preceding the Accrual Period for which it relates. This fee shall be invoiced to the Grower and payable within 28 days;

- an ongoing management fee of $437.50 per quarter ($1,750 per annum) increased annually by the proportional increase of the CPI from the June quarter of 1998. The fee is to be paid in advance and invoiced to the Grower. The Grower will have the option of charging the amount due to his account to be offset against future income with interest accruing thereon at 6% or paying the amount due within 28 days. This amount is to be paid out of the Undistributed Income in the Growers account. If there is insufficient income to meet this fee the amount payable shall accrue and be paid when sufficient income exists to cover the amount due. Should a shortfall exist at the end of the project then the shortfall shall be payable by the Grower.
- the growers proportion of all harvesting costs; and
- for each year after the Initial Period that Grower's share of the cost of public and product liability insurance and such project management costs as are required to be paid by the Grower.

Finance

32. Growers may avail themselves of an instalment plan to pay the amount due under the prospectus. In this case a deposit of $3,400 is payable and 24 payments of $890 are due. Interest at 6% or $1,360 applies and is included in the above figures.

33. Other than in respect of the above no entity associated with the Project is involved in the provision of any other form of finance for the Project. Any finance arrangements undertaken by the entities associated with the Project, including the Manager, and the Landowner, are outside the arrangement to which this Ruling applies.

34. No entity associated with the Project is involved in the provision of finance to the Growers (other than the instalment plan mentioned above). Growers can fund their individual investments themselves, or borrow from an unassociated lending body. Such finance arrangements are outside the arrangement to which this Ruling applies.

35. HPL advises all loans will be offered on normal commercial terms both in form and substance. They will be full recourse and borrowers will be obliged to make repayments as required under the

loan agreements, regardless of any income being derived from the Project. HPL will be put in funds directly as a result of these loans, on the Grower being accepted as a borrower. HPL will not be putting any of these funds on deposit with these financiers or any associated persons, but will substantially use these funds, subject to the Custodian's approval, in carrying out its obligations under the Management Agreement. As the arrangements have not been examined in detail they are outside the arrangement to which this Ruling applies.

36. This Ruling does not apply if the Participant enters into a finance agreement, other than that described in paragraphs 33 and 36 (that agreement not containing any of the following features), that includes any of the following features:

- split loan features of the type described in Taxation Ruling TR 98/22;
- entities associated with the Project become involved in the provision of finance;
- indemnity arrangements, or equivalent collateral arrangements, limiting the borrower's risk;
- non-arm's length terms and conditions;
- 'additional benefits', for the purposes of section 82KL, are granted to borrowers, or the funding arrangement transforms the Project into a 'scheme' to which Part IVA may be applied;
- repayments of principal and payments of interest are linked to derivation of income from the Project;
- funds borrowed, in whole or in part, are not available for the conduct of the Project, but are transferred (by any means, and whether directly or indirectly) back to the lender, or any 'associate'; or
- lenders do not have the capacity under the loan agreement, or do not have a genuine intention, to take legal action against defaulting borrowers.

Ruling

Income

37. For a Grower who invests in the Project, any income derived by them from the sale of olive products from their olive grove will be assessable income to them under section 6-5.

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

Section 35-55 – Commissioner's discretion

37.1. 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.

37.2. 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.

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

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

Goods and services tax

38. 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

39. For a Grower who invests in the Project, the deduction available for the prepaid Management Fee or the prepaid Occupation Fee will depend upon the date that the investment is made and in some cases whether or not they are a **'small business taxpayer'**.

IMPORTANT: Paragraph 40 (relating to 'small business taxpayers') and paragraphs 41 to 44 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Growers are advised to carefully examine the information contained in paragraphs 47 and 48 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.

40. For a Grower who is a **'small business taxpayer'** who invests in the project the deductions shown in the table below will be available in the year in which they are incurred:

Fee type	***ITAA* 1997 section**	**Deductions for small business taxpayers only**		
		Year 1	**Year 2**	**Year 3**
Management	8-1	$18040 – see Note (i) below	$1750 - increased by CPI	$1750 - increased by CPI
Occupation	8-1	$750 – see Note (i) below	$750 - as increased by greater of 3% or CPI	Year 2 fee as increased by greater of 3% or CPI
Landcare	387-55	$880 - see Note (ii) below		
Irrigation	387-125	$597 - see Note (iii) below	$597	$597

Horticultural Plants	387-165	see Note (iv) below		

Notes:

(i) Legislative change for Growers who are not 'small business taxpayers' means the full deduction will not be allowed in 2000. See paragraphs 41 to 44 and Example 1.

Proposed legislative change for all Growers applying to expenditure incurred after 11 November 1999 means the full deduction will not be allowed in 2000. See paragraphs 47 and 48 and Example 2.

(ii) The amount of $880 of the initial management fee of $22,150 incurred by a Grower is identified as capital expenditure for the purposes of section 8-1 as being attributable to the eradication of plant growth detrimental to the land. A deduction under section 387-55 for this amount will be allowed in the year in which a Participant enters into contractual arrangements with the Manager and commences to carry on a primary production business.

(iii) A deduction under section 387-125 for capital expenditure for the irrigation system is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.

(iv) A deduction under section 387-165 for the cost of establishing olive seedlings will be allowable to the Grower during the income year that the trees first are used for the purpose of producing assessable income. The amount of the deduction is calculated on the basis that $500 is dedicated to the cost of seedlings and $1,439 is the 'establishment expenditure' component of the undissected initial management fee. The total amount of $1,939 is to be written off at the rate of 13% per annum, with the first deduction available in the year the trees are first used for the purpose of producing assessable income. The applicant expects the first commercial season in the year ended 30th June 2004.

41. For a Grower who invests in the Project before 30 June 2000 who is **not a 'small business taxpayer'** and is carrying on a business, the deduction available in respect of the Management Fee and Occupation Fee is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in

Columns 3 and 4 of the Table in subsection 82KZMB(5). (Example 1 at paragraph 120 illustrates the application of this method).

42. In calculating the deduction available, the term ‘expenditure’ refers to expenditure otherwise allowable under section 8-1 whose ‘eligible service period’ ends not more than 13 months after it is incurred by the taxpayer. The ‘eligible service period’ (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

Year 1: Expenditure incurred on or before 30 June 2000

Available deduction = A + B

Where :

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

B = (Expenditure *less* A) x 80%

Year 2: Expenditure is incurred after 1 July 2000 and on or before 30 June 2001

Available deduction = A + B + C

Where :

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

B = (Expenditure *less* A) x 60%

C = balance of the Year 1 expenditure not previously deducted

Year 3: Expenditure incurred on or after 1 July 2001 and on or before 30 June 2002

Available deduction = A + B + C

Where :

A = Expenditure X Number of days of eligible service period in the expenditure year
____

Total number of days of the eligible service period

B = (Expenditure *less* A) x 40%

C = balance of the Year 2 expenditure not previously deducted.

43. For a Grower who is **not 'a small business taxpayer'** and is carrying on a business, who invests in the Project after 30 June 2000, the deduction available in respect of the Management Fees and Lease Fees will be as per the table shown at paragraph 40.

44. For a Grower who invests in the Project before 30 June 2000 who is **not a 'small business taxpayer'** and is carrying on a business, the deductions available in respect of capital expenditure are shown in the Table below:

	ITAA	**Deductions for capital expenditure for taxpayers who are not small business taxpayers and are carrying on a business**		
	1997	**Year 1**	**Year 2**	**Year 3**
Fee type	**section**			
Landcare	387-55	$880		
Irrigation	387-125	$597 - see Note (iii) above	$597	$597
Horticultural Plants	387-165	See Note (iv) above		

Deductibility of borrowing costs

45. Expenses incurred in borrowing these funds will be entitled to a deduction under section 25-25. If the total amount is $100 or less, the full amount can be deducted in the income year the expenditure is incurred. If the total amount is more than $100, the expenditure can be deducted over the period of the loan or 5 years, commencing on the first day on which the expenditure is incurred. The amount allowable in the first year of income will be the amount of the fee multiplied by the number of days from the first day on which the funds are borrowed until 30th June, divided by the number of days in the loan period, or five years, whichever is the shorter period.

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

46. For a Grower who invests in the Project the following provisions have application as indicated:

- expenditure by Growers who are small business taxpayers is not within the scope of section 82KZM **(but see paragraphs 47 and 48);**
- section 82KZMB applies to expenditure by Growers who are not small business taxpayers and are carrying on a business **(but also see paragraphs 47 and 48)**;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

47. [Omitted]

48. [Omitted]

49. [Omitted]

Explanations

Assessable income

50. Gross sale proceeds derived from the sale of olive products and by-products will be assessable income of the Growers, under section 6-5, in the year in which a recoverable debt accrues to them. This will depend on the specific sale contracts entered into.

Sections 27-5 and 27-30 - Goods and services tax

51. 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 on or before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled after 1 July 2000.

52. 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.

Subdivision 960-Q - small business taxpayers

53. In this product ruling the term 'small business taxpayer' is relevant for the purposes of certain prepaid expenditure and the depreciation of trellising.

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

55. 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.

56. '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 – Management fees and occupation fees

57. Consideration of whether occupation and management fees are deductible under section 8-1 begins with the first limb of the section.

58. Whether an item of expenditure satisfies the wording of the limb, it is necessary to consider whether expenditure has been incurred for the purposes of the section. It is also material to determine the objective purpose for which the expenditure was incurred. As Latham CJ, Rich, Dixon, McTiernan and Webb JJ said in *Ronpibon Tin NL and Tongkah Compound NL v. Federal Commissioner of Taxation* (1949) 78 CLR 47 at 56-7 (*Ronpibon Tin*):

> 'For expenditure to form an allowable deduction as an outgoing incurred in gaining or producing the assessable income it must be incidental and relevant to that end…
>
> In brief substance, to come within the initial part of the sub-section it is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income.'

59. Deductibility of occupation and management fees under the first limb depends on 'whether', and if so to what 'extent' the expenditure is 'incurred in gaining or producing assessable income' (see *Fletcher & Ors v. FC of T* 91 ATC 4950 at 4957-8; (1991) 22 ATR 613 at 621-623). To satisfy this test, it is said that, at the time

the fees are incurred, the expenditure must have a 'sufficient connection' with the 'operations' which more directly gain or produce the 'assessable income' (see *Ronpibon Tin*; *Charles Moore & Co (WA) Pty Ltd v. FC of T* (1956) 95 CLR 344; and *FC of T v. DP Smith* 81 ATC 4114; (1981) 11 ATR 538). The existence of a sufficient connection is determined by looking at the scope of the income producing operations and the relevance of the expenditure to those operations (see Dixon J in *Amalgamated Zinc (de Bavay's) Ltd v. FC of T* (1935) 54 CLR 295 at 309).

60. Where expenditure is incurred prior to the commencement of the actual income producing operations, it may be incurred 'too soon' for it to be incurred 'in' gaining or producing assessable income. That is, the expenditure may be incurred 'too soon' to be characterised as expenditure that is incidental and relevant to the gaining or producing of assessable income. This position was recently restated by the High Court in *Steele v. DC of T* [1999] HCA 7 where Gleeson CJ, Gaudron and Gummow JJ said at paragraph 44:

> 'There are cases where the necessary connection between the incurring of an outgoing and the gaining or producing of assessable income has been denied upon the ground that the outgoing was entirely preliminary to the gaining or producing of assessable income eg *Softwood Pulp & Paper Ltd v. FCT* (1976) 7 ATR 101 at 113; 76 ATC 4439 at 4450 or was incurred too soon before the commencement of the business or income producing activity *FCT v. Maddalena* (1971) 2 ATR 541; 71 ATC 4161; *Lodge v. FCT* (1972) 128 CLR 171; 3 ATR 254; 72 ATC 4174; *FCT v. Riverside Road Lodge Pty Ltd (in liq)* (1990) 23 FCR 305. The temporal relationship between the incurring of an outgoing and the actual or projected receipt of income may be one of a number of facts relevant to a judgment as to whether the necessary connection might, in a given case, exist, but contemporaneity is not legally essential, and whether it is factually important may depend upon the circumstances of the particular case.'

61. Relevantly, in *FC of T v. Brand* 95 ATC 4633 at 4646; (1995) 31 ATR 326, the Full Federal Court (Lee, Lindgren and Tamberlin JJ) allowed prepaid licence fees to a prawn farmer investor under the first limb of subsection 51(1) of the ITAA 1936. The Court decided that an outgoing did not have to be contemporaneous with the activity directed to the gaining of income for it to be deductible and, in this case, the expenditure was not incurred at a point too soon. It was decided that the outgoing was incidental and relevant to the gaining or producing of assessable income. It was considered that the contractual commitment to the project provided sufficient connection between the expenditure and the operations, which it was expected

would gain or produce assessable income, to make the payment deductible under subsection 51(1).

62. Similarly, in this Project at the time the application is accepted, the Management Agreement executed and monies paid, there is a commitment by the investor to carrying on a business of horticulture in the future, such that the expenditure incurred prior to the actual commencement of the income producing operations would ordinarily be incidental and relevant to the gaining or producing of assessable income.

Is the Grower carrying on a business?

63. An olive project can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the sale of olive products from the Project will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining, and harvesting of the olives and sale of olive products.

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

- the Grower has an identifiable interest in specific growing trees coupled with a right to harvest and sell the olive products;
- the farming, and marketing 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. For this Project Growers have, under the Constitution and Management Agreement, rights over an identifiable area of land consistent with the intention to carry on a business of growing olives and selling the olive products obtained therefrom. Under the Management Agreement Growers appoint HPL, as Manager, to provide the olive seedlings and undertake land preparation, planting, tending, fertilising, maintaining and otherwise caring for the trees. The Manager is also responsible for the harvesting of the fruit from the trees and the subsequent sale of olive products.

66. The Constitution gives Growers the right to occupy an identifiable area of land for the purpose of growing olive trees. Growers have the right to use the land in question for horticultural

purposes and to, through HPL, come onto the land to carry out its obligations under the Management Agreement and Constitution. The Growers' degree of control over HPL, as evidenced by the Constitution, Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Constitution, the Manager shall keep a trading account in respect of each Grower. Growers are entitled to receive reports on the Manager's activities. Growers are able to terminate arrangements with HPL in certain instances, such as cases of default in the performance of its duties. The activities described in the Management Agreement are carried out on the Growers' behalf.

67. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. The Independent Horticultural Report and the Independent Marketing Report consider that the Project is realistic and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

68. The Manager has entered into a 10 year contract with an independent Olive Processor to take all of the olive products from the Manager. This will guarantee an end market for the olive products produced by each Grower and confirms the ability of the Manager to ensure that the Growers will realise income from the project which will be distributed to the Growers.

69. Growers have a continuing interest in the olive trees from the time they are acquired until the termination of the Project. There is a means to identify which trees Growers have an interest in. The farming 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.

70. By weighing up all of the attributes of the Project it is accepted that Growers will be in a business of primary production from the date that 'business operations' are first commenced on their behalf. 'Business operations' in this context, means such things as preparation of the land and other preplanting work, all conducted as part of a co-ordinated and concerted plan to grow olive trees and sell the product thereof. The Growers' activities will constitute the carrying on of a business.

71. The fees associated with the farming activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the sale of

olive products), is to be gained from this business. No 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. They will thus be deductible under the first limb of section 8-1 to the extent they are incurred for the purposes of the provision and are not capital or capital in nature.

Reasonable basis of apportionment of initial fees

72. On application, the Grower is required to make payments for three identifiable expenses:

- $500 is payable to the Manager in respect of the seedling fee;
- $750 is payable to the Manager for the occupation fee; and
- $22,150 is payable to the Manager for management fees in respect of the Initial Period (ending 12 months from the date of issue of the Participant's interest).

73. The seedling fee is a capital cost, wholly not deductible under section 8-1 and will be further discussed below.

74. The occupation fee of $750 paid for occupation rights of the individual farm is wholly of a revenue nature and an allowable deduction under section 8-1.

75. The management fee of $22,150 represents a payment made for a number of advantages that accrue to the Grower. More than one object is to be derived by the Grower in consideration for the payment of the initial management fee. The fees are directed not only to manage the business, but to establish the olive grove in terms of establishing trees on each grove (not less than 100 seedlings per interest), provide the infrastructure for the Project, tend and harvest the fruit, and sell the olive products on behalf of the Grower.

76. Apportionment will be called upon in circumstances where the fee or a portion of the fee is directed to various objects, some of which are of a revenue character and some of which are of a capital character.

77. The apportionment must be fair and reasonable: see *Ronpibon Tin* at 59:

> '…there must be some fair and reasonable assessment of the extent of the relation of the outlay to assessable income.'

78. Notwithstanding the description of $22,150 as a 'management fee', the authorities show that it is the character of the advantage sought by the taxpayer, and not the description given to the outgoing by the parties, which is the relevant issue in determining deductibility

under section 8-1: *Federal Commissioner of Taxation v. South Australian Battery Makers* (1978) 140 CLR 645 and *Colonial Mutual Life Assurance Society Ltd v. Federal Commissioner of Taxation* (1953) 89 CLR 428. Brennan J in *Magna Alloys & Research Pty Ltd v. FC of T* (1980) 49 FLR 183; 11 ATR 276; 80 ATC 4542, when considering the question as to whether expenditure has the character of revenue or capital, said at FLR 191, ATR 283; ATC 4548:

> 'It is necessary to ascertain in each case what expenditure is for, because a "bare payment of money is itself devoid of character", as Stephen J said in *Cliffs International Inc, supra*, at p. 4071. When the question is whether expenditure has the character of capital or of a revenue payment, as in the two cases last cited, the advantage for which the expenditure was incurred must be identified and the manner in which it "is to be relied upon or enjoyed" must be considered (*Sun Newspapers Ltd v. FC of T*; *Associated Newspapers Ltd v. FC of T* (1938) 61 CLR 337 at 363). The role of the advantage in the income-earning undertaking requires examination.'

79. The relevant time to determine the advantage sought by the taxpayer is the time it becomes contractually bound to make payments under the Management Agreement: see, for example, *NMRSB Ltd et al v. FC of T* (1998) 98 ATC 4188 at 4204-4206; (1998) 38 ATR 308 at 325-327.

80. Any part of the expenditure incurred by a Grower entering into the business that is attributable to establishing the profit yielding structure of the business or in acquiring an asset or advantage of an enduring kind will be capital or capital in nature and will not be an allowable deduction under section 8-1. In this case, the Management Agreement provides the Grower services of both a capital and a revenue nature. As the management fee is undissected and thus serves both objects, the fee is not wholly deductible under section 8-1, and apportionment is called for on a 'fair and reasonable basis': *Ronpibon Tin* at 59.

81. The 'fair and reasonable' basis we have adopted in this case, involves estimating the value of the two respective types of services, having regard to the Manager's projected expenditure and anticipated profit from providing both. Some of these projected expenditures can be seen, from their description, to be directly linked to specific capital services, e.g., the expense of establishing and planting the trees, and others can be seen to be directly linked to specific revenue services, e.g., any post planting expenditure, such as ongoing maintenance and weeding, etc. The remaining projected expenditure ('overheads' or 'indirect expenses') have no such direct link, and have been attributed to the two separate values of the capital and revenue services using the formula:

$$\frac{\text{total projected overheads (indirect expenses) plus profit}}{\text{total projected direct expenses}} \times \frac{100}{1}$$

82. The resulting percentage is a 'mark-up' figure applied to both sets of projected direct expenses (i.e., both capital and revenue), to obtain the total values for the two, ensuring that the entire sum of $22,150 is referable to one advantage or another.

83. As a consequence of this apportionment calculation, the following values have been placed on the sum of $22,150 expended by the Growers:

- $18040 of the management fee represents an array of costs incurred by the Manager that accrue revenue advantages to the Grower. This amount will be an allowable deduction under section 8-1;
- $880 of the management fee is of a capital nature, being the amount of the management fee attributed to the capital costs of landcare;
- $1791 of the management fee is of a capital nature, being the amount of the management fee attributed to the capital costs of conserving or conveying water, irrigation and water facilities; and
- $1,439 of the management fee is the 'establishment expenditure' component and represents (together with the $500 for seedlings referred to later) the cost of establishing the olive plants.

84. As mentioned earlier, in addition to the management fee, a Grower entering into the Project incurs and pays an amount of $500 for the olive tree seedlings. Olives are harvested by mechanical means and involve shaking the tree and collecting the fruit thereof. Unlike most forestry operations, for example, olives are capable of regrowth and this process of harvesting and regrowth continues over the useful life of the tree. The olive tree is an asset or advantage of a lasting character that will endure for the benefit of the Grower over the life of the Project. In a 'fruit or tree' analysis, the olive tree is the 'tree' and the olive product are like a fruit or nut tree. The cost to a Grower of acquiring the olive tree seedlings are capital.

85. In *FC of T v. Osborne* (1990) 21 ATR 888; 90 ATC 4889 Pincus J said at ATR 895; ATC 4895:

> 'It appears to be consistent with the trend of these authorities to hold that, in general, costs incurred in establishing a plantation of fruit or nut trees, at least up to the stage of getting seedlings established in the ground, are capital expenses.'

and

> 'Here, in my opinion, the taxpayer cannot succeed, for the costs of preparing the ground for planting the nut trees cannot be deducted under s51(1), being excluded by the words "except to the extent to which they are losses or outgoings of capital, or of a capital … nature." '

The part of the fee paid for clearing the land, preparing the ground for planting of the trees, the planting of trees, and research into planting, land preparation and seedlings is considered capital or capital in nature. However, some of these capital expenses can fall for consideration under specific deduction provisions relevant to the carrying on of a business of primary production. These issues are dealt with later.

Ongoing occupation and management fees

86. The occupancy and management fees associated with the olive grove 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. They will thus be deductible under the first limb of section 8-1, to the extent that they are not capital or of a capital nature (see further below). Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. There is no evidence that the quantum of the expenditure is such as to call into question its proper character. The tests of deductibility under the first limb of section 8-1 are met.

87. The amount incurred for these expenses is limited by the agreements to the amounts actually paid. The occupation fee of the prior year fee as increased by CPI is payable on or before the last day of the preceding Accrual Period or Initial Period, The Initial Period applies for 12 months from the date of issue of each applicant's interest, the next accrual period will, in accordance with the Project Deed, be the brief period from the end of the Initial Period until the next 30 June. The occupation fee payable on the last day of the Initial Period will, therefore, be a proportionate amount for the brief accrual period. Another fee will be payable on 30 June 2001 for the following Accrual Period. Both of these fees will be deductible in the year ended 30 June 2001.

88. Similarly, the ongoing management fee ($1,750 per annum as increased by CPI) is payable on the first day after the Initial Period for the period to 30 June 2000 or 2001 (depending on the year of income the grower is accepted into the project) and then quarterly in advance. Project Management Costs are also payable. The management fees and other costs are payable as mentioned, unless there are insufficient funds in the Participant's account, in which case the management fees and other costs will be charged against the Growers account and paid from future income, at the end of the relevant Accrual Period, those

are the amounts that are due and payable for that Accrual Period (i.e., 30 June in all periods after the Initial Period). The Initial Period applies for 12 months from the date of issue of each applicant's interest, there will be a payment on the day after the Initial Period and then a quarterly fee payable in advance for the period commencing 1 July 2001.

89. A taxpayer will have incurred an expense when it makes payment, including a voluntary payment or a prepayment (see *FC of T v. Raymor (NSW) Pty Ltd* 90 ATC 4461 at 4467; 21 ATR 458 at 464). (For the purposes of this Ruling a 'prepayment' has the same definition as that in paragraph 4 of Taxation Ruling TR 94/25). Where a loss has not been realised or an outgoing has not been made, a presently existing pecuniary liability, at the end of the relevant income year, will be a necessary prerequisite to an expense being 'incurred' for the purposes of section 8-1 (*Coles Myer Finance Limited v. FC of T* 93 ATC 4214; (1993) 25 ATR 95; *Nilsen Development Laboratories Pty Ltd & Ors v. FC of T* 81 ATC 4031; (1981) 11 ATR 505 (*Nilsen*)). In this respect, it is not sufficient that the liability to pay is pending, threatened or expected, no matter how certain it is in the year of income that the loss or outgoing will occur in a future year (*Nilsen*).

90. The liability of the Participant for ongoing occupation fees, management fees and other costs, respectively, are payable regardless of the income from the project. As a consequence, the amounts 'incurred' in relation to these expenses will always be the amount charged or paid as the case may be. There will be no 'presently existing pecuniary liability' that will produce a greater deduction for the Participants than the amount immediately paid from the Growers Income account.

Borrowing costs deductibility

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

Section 82KZM - Prepaid expenditure for small business taxpayers

92. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure incurred by a 'small business taxpayer' that would otherwise be immediately deductible, in full, under section 8-1. 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.

93. Under the Management Agreement, the initial Management Fee will be incurred upon execution of the Agreement. This fee is charged for providing services to Growers for a period of 13 months from the date of execution of the Agreement. For this Ruling's purposes, 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. The fee is expressly stated to be for a number of specified services. There is evidence this fee is for services to be provided within 13 months of the fee being incurred.

94. Thus, for the purposes of this Ruling, it is accepted that no part of the initial Management Fee is for the Manager to do 'things' that are not to be wholly done within 13 months 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 expenditure for the Management Fee by Growers who are 'small business taxpayers'.

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 occurred, and does not apply to the Project.

97. The deduction available to Growers for the Management Fee will be determined in accordance with the rules contained in section 82KZMB. Because the quantum of the Management Fee is lower in the second and subsequent years, the capping provisions contained in section 82KZMC will have no practical effect on the deduction available. For Growers who invest after 30 June 2000 82KZMB will not apply as the services will be provided within the income year.

98. During the transitional period the amount of the deduction available to Growers is determined using the formula in subsection

82KZMB(3) and the percentages shown in the table in subsection 82KZMB(5).

Proposed changes to prepayment rules

99. 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.

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

- under the arrangement, the taxpayer's allowable deductions 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.

101. The arrangement relating to the Project and described at paragraph 13 to 36 of this product ruling is within the description of a 'tax shelter arrangement'. Therefore, the Management Fee and the Occupation Fee incurred by Growers who invest in the Project after 11 November 1999 will be deductible over the period the services are provided. The formula for this apportionment is expected to be the same as that currently shown in subsection 82KZMD(2).

Capital allowance provisions

102. As referred to in preceding paragraphs, the part of the initial fee paid for landcare operations, facilities to conserve or carry water, preparing the ground for planting of the trees, the planting of trees, research into planting, land preparation and seedlings, is considered capital or capital in nature. However, some of these capital expenses can fall for consideration under specific deduction provisions relevant

to the carrying on of a business of primary production. These are considered below.

Subdivision 387-A: landcare operations

103. Capital expenditure incurred by a person carrying on a primary production business in respect of various measures primarily and principally for the prevention of land degradation qualifies for a 100% deduction in the year in which the expenditure is incurred, under Subdivision 387-A. The expenditure that qualifies includes, among other things, the eradication of plant growth detrimental to the land (see section 387-60).

104. In order for the expenditure to qualify as a deduction under section 387-55, a business must be being carried on at the time the expenditure was incurred. A taxpayer incurring such expenditure need not be the owner of the land so long as it is used at that time for carrying on a primary production business. In this case, there will generally be no delay between the signing of the agreements and the commencement of 'business operations'. Accordingly, a Grower's business of primary production will generally have commenced at the time that the expenditure was incurred. The necessary requirements under Subdivision 387-A will thus have been met in this respect.

105. However, where all that occurs in an income year is that a person has been accepted into the Project as a Grower, but no business operations have been commenced on their behalf, they will not be accepted as having commenced a primary production business and no deduction under Subdivision 387-A will be allowable for that, or any other year of income.

106. The amount of $880 of the initial management fee of $22,150 incurred by a Grower is identified as capital expenditure for the purposes of section 8-1 as being attributable to the eradication of plant growth detrimental to the land. A deduction under section 387-55 for this amount will be allowed in the year in which a Participant enters into contractual arrangements with the Manager and commences to carry on a primary production business.

Subdivision 387-B: conserving or conveying water

107. Capital expenditure incurred by a person on the construction, acquisition and installation of plant, equipment and structural improvements to be used primarily and principally for the purpose of conserving or conveying water for use in a primary production business, qualifies for a write-off over a three year period (i.e. 33 1/3 % with no pro-rating required). Taxpayers incurring this

expenditure need not be the owners of the land to claim the deduction, so long as they are in the business of primary production.

108. In this arrangement there will generally be no delay between the signing of the agreements and the commencement of 'business operations' on behalf of the Grower. Accordingly, a Grower's business of primary production will generally commence at the time the expenditure is incurred. The requirements of Subdivision 387-B have been met in this respect.

109. Expenditure applicable to the conserving or conveying of water for the Olive Groves that meets the requirements of section 387-130 amounts to $1,791. For a Grower entering into the project by 30th June 2000 and commencing to carry on a primary production business by that date, a deduction of $597 will be allowable under section 387-125 for the income year ending 30th June 2000. Subsequent deductions of $597 will be allowable in each of the income years ending 30th June 2001 and 30th June 2002. For a Grower entering into the Project after 30th June 2000, a deduction will be allowable under section 387-125 for $597 for the income year ending 30th June 2001. Deductions of $597 will be allowable in each of the years ending 30th June 2002 and 30th June 2003

Subdivision 387-C horticultural write-off

110. Subdivision 387-C allows capital expenditure incurred in establishing horticultural plants to be written off where the plants are used in a business of ‘horticulture’. Under subsection 387-170(3), the definition of ‘horticulture’ covers the cultivation of olive trees.

111. The write off commences from the time the trees are used or held ready for use for the purpose of producing assessable income in a horticultural business (see sections 387-165 and 387-170). The write off rate will be 13% per year, assuming an effective life of the plants of greater than 13 but less than 30 years (see section 387-185). HPL advise that the olive trees will be harvested within four years of planting. The write off deductions will, for a Grower who has been accepted into the Project by 30 June 2000 and whose primary production business has commenced, start in the fourth year of the Project, on the basis it is then the olive trees enter their first commercial season and hence begin to be used for the purpose of producing assessable income in a horticultural business.

112. Costs of establishing horticultural plants may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or the clearing of land. The relevant expenditure of a grower

identified as attributable to the establishment of the olive trees is the seedling fee of $500 and $1,439 of the $22,150 initial fee.

113. For a Grower entering into the Project by 30 June 2000 no deduction will be allowable for the year ended 30 June 2000. Deductions will be available in each of the years ended 30 June 2004 and thereafter.

Section 82KL

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

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

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

Part IVA

117. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

118. The Heydon Park Olive 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 olive grove that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

119. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of olive products. There are no facts that would suggest that Participants have the opportunity of obtaining a tax advantage other than the tax

advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not arm's length, that any adverse tax consequences result. Further, having regard to the eight matters to be considered under paragraph 177D(b) based on the arrangement identified, it cannot be concluded on the information available that Participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Examples

Example 1: Obligation to prepay expenditure arising on or after 21 September 1999 and before 1pm AEST 11 November– applies to taxpayers who are not small business taxpayers and are carrying on a business:

120. Joseph Gardener has been in business for a number of years and has calculated his average turnover for the 1999/2000 income year to be greater than $1 million. Therefore, he is not a small business taxpayer and is subject to the 21 September 1999 changes to the tax laws relating to prepaid expenditure. Joseph enters into a contract with Pinetree Pty Ltd to manage his one hectare interest in the No 2 Pine Plantation. Joseph's management contract is executed on 20 October 1999 for management services to be provided from 1 June 2000. Under the contract, the first five year's management fees, payable in advance on 1 June each year for services to be provided for the following 12 months, are $6,000 in the first year and $1,200 for each of the following four years. Joseph is unable to deduct the whole of his prepaid management fees in the years in which they are incurred. The fees are instead deductible over the eligible service period over which the management services will be provided. However, as the law currently stands, Joseph is able to take advantage of certain transitional rules that 'shade-in' the effect of the changes to the prepayment laws.

For 1999/2000 Joseph can claim a deduction of $4,899 for expenditure incurred on or before 30 June 2000 on management fees. This amount is calculated as A + B where:

$$A = \text{Management fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$= \$6{,}000 \times \frac{30}{365} = \$493$$

B = (Management fee *less* A) X 80%

= ($6,000 - $493) X 80% = $4,406

The balance of the $6,000 management fees that were prepaid on 1 June 2000 (i.e., $1,101) is carried forward and can be claimed as a deduction in the 2000/2001-income year.

For 2000/2001, Joseph can claim a deduction of $1,861 for expenditure incurred on or after 1 July 2000 and on or before 30 June 2001 on management fees. This amount is calculated as A + B + C where:

$$A = \$1{,}200 \times \frac{30}{365} = \$99$$

B = ($1,200 - $99) X 60% = $661

C = $1,101

Note that the third component (Part C) is the amount carried forward from 1999/2000. As in the first year, the balance of the $1,200 management fees prepaid on 1 June 2001 (i.e., $440) is carried forward and can be claimed as a deduction in the 2001/2002 income year. It should also be noted that in certain circumstances, not present in most projects with product rulings, ‘capping provisions’ will apply in the second and subsequent transitional years. These are complex and are not explained in this example.

Similarly, for 2001/2002, Joseph can claim a deduction of $980 for expenditure incurred on or after 1 July 2001 and on or before 30 June 2002 on management fees. This amount is calculated as A + B + C where:

$$A = \$1{,}200 \times \frac{30}{365} = \$99$$

B = ($1,200 - $99) X 40% = $441

C = $440

Note that the third component (Part C) is again the amount carried forward from 2000/2001. As in the first two years, the balance of the $1,200 management fees prepaid on 1 June 2002 (i.e., $660) is carried forward and can be claimed as a deduction in the 2002/2003-income year.

Example 2: Obligation arising after 1pm AEST 11 November 1999 to prepay expenditure – applies to all taxpayers investing in 'tax shelter arrangements':

121. Assume the same facts as above except that the management agreement is executed after 11 November 1999. Assume also that the No 2 Pine Plantation is a 'tax shelter arrangement'. For the Management fee of $6,000 incurred on 1 June 2000 for management services to be provided between that date and 31 May 2001, Joseph can claim a deduction for the 1999/2000 income year determined in the following way:

$$\text{Management fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$\$6{,}000 \times \frac{30}{365} = \$493$$

In the following year Joseph can claim the balance of the $6,000 prepayment (i.e., $5,507) because that is the year in which the services are to be provided. The second and third year's management fees are calculated using the same method.

Detailed contents list

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

Commissioner of Taxation
5 April 2000

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

PR 1999/95; TD 93/34; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TR 97/D17

Subject references:

- afforestation expenses
- carrying on a business
- commencement of business
- fee expenses
- forestry
- interest expenses
- management fees expenses
- plantation forestry
- product rulings
- public rulings
- primary production
- primary production expenses
- producing assessable income
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 82KL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1936 6-5
- ITAA 1997 8-1
- ITAA 1997 25-25
- ITAA 1997 27-5
- ITAA 1997 27-30
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 387-55
- ITAA 1997 387-125
- ITAA 1997 387-165
- ITAA 1997 387-170(3)
- ITAA 1997 387-185
- ITAA 1997 Subdiv 387-A
- ITAA 1997 Subdiv 387-B
- ITAA 1997 Subdiv 387-C
- ITAA 1997 Subdiv 960-Q
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-350
- ITAA 1997 960-355
- TAA 1953 Pt IVAAA
- Copyright Act 1968

Case references:

- Amalgamated Zinc (de Bavay's) Ltd v. FC of T (1935) 54 CLR 295
- Charles Moore & Co (WA) Pty Ltd v. FC of T (1956) 95 CLR 344
- Colonial Mutual Life Assurance Society Ltd v. FC of T (1953) 89 CLR 428
- Coles Myer Finance Limited v. FC of T 93 ATC 4214; (1993) 25 ATR 95
- FC of T v. Brand (1995) 31 ATR 326; 95 ATC 4633
- FC of T v. Maddalena (1971) 2 ATR 541; 71 ATC 4161
- FC of T v. Osborne (1990) 21 ATR 888; 90 ATC 4889
- FC of T v. Raymor (NSW) Pty Ltd (1990) 21 ATR 458; 90 ATC 4461
- FC of T v. Riverside Road Lodge Pty Ltd (in Liq) (1990) 23 FCR 305; (1990) 21 ATR 499; 90 ATC 4567
- FC of T v. South Australian Battery Makers (1978) 140 CLR 645
- Fletcher & Ors v. FC of T (1991) 22 ATR 613; 91 ATC 4950
- Lodge v. FC of T (1972) 128 CLR 171; (1972) 3 ATR 254; 72 ATC 4174
- Nilsen Development Laboratories Pty Ltd & Ors v. FC of T 81 ATC 4031; (1981) 11 ATR 505 (Nilsen

- NMRSB Ltd et al v. FC of T 38 ATR 308 98; ATC 4188
- Magna Alloys & Research Pty Ltd v. FC of T (1980) 49 FLR 183; 11 ATR 276; 80 ATC 4542
- Ronpibon Tin NL and Tongkah Compound NL v. FC of T (1949) 78 CLR 47
- Steele v. DC of T [1999] HCA 7
- Softwood Pulp & Paper Ltd v. FC of T (1976) 7 ATR 101 ; 76 ATC 4439
- Sun Newspapers Ltd v. FC of T (1938) 61 CLR 337

ATO references:
NO 99/16937-1
BO
FOI number: I 102422
ISSN: 1441-1172