



PR 2000/63 - Income tax: Almond Orchards Australia Robinvale 2000

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Product Ruling

Income tax: Almond Orchards Australia Robinvale 2000

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Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this ruling relates. In this Ruling this arrangement is sometimes referred to as Almond Orchards Australia Robinvale 2000, or just simply as 'the Project'.

Tax law(s)

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

- section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 27-5 (ITAA 1997);
- section 27-30 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM (ITAA 1936);
- section 82KZMB (ITAA 1936);
- section 82KZMC (ITAA 1936);
- section 82KZMD (ITAA 1936);
- Part IVA (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 the 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, the 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 this ruling.

9. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 46) is carried out in accordance with details described in the Ruling. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:

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

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Date of effect

11. This Ruling applies prospectively from 31 May 2000, the date this Ruling is made. However, the Ruling does not apply to taxpayers

to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

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

Previous Rulings

14. This Ruling replaces Product Ruling PR 2000/48, which is withdrawn on and from the date this Ruling is made. Subject to changes in the law relating to certain prepayments, Product Ruling PR 2000/48 will continue to apply to investors who entered into the Project on or before 21 May 2000.

Arrangement

15. The arrangement that is the subject of this Ruling is described below. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Draft prospectus for Almond Orchards Australia Robinvale 2000 received 15 February 2000;
- **Draft Project Constitution** prepared by Almond Orchards Australia Limited ('AOAL', 'the Manager', or 'the Responsible Entity') received 10 February 2000;

- **Draft Allotment Agreement** between AOAL and the Growers, received 15 February 2000;
- **Draft Management Agreement** between AOAL and the Growers, received 15 February 2000;
- Draft Almond Orchard Management Agreement between the Manager and Select Harvests Limited ('Select') and Almond Management Australia Pty Ltd ('AMA'), received 15 February 2000;
- Draft Custodian agreement between AOAL and Sandhurst Trustees Limited ('the Custodian'), received 4 November 1999;
- Draft Almond Orchard Lease between Kyndalyn Park Pty Ltd and the Custodian, received 28 October 1999;
- Draft Sub-Lease between the Custodian and the Manager, received 28 October 1999;
- Draft Licence Agreement between AMA and the Custodian, received 15 February 2000;
- Draft Sub-Licence Agreement between the Custodian and AOAL, received 15 February 2000;
- Draft Compliance Plan for the Responsible Entity, received 10 February 2000;
- Product Ruling request received 4 November 1999 and amendment to Product Ruling request received 25 January 2000;
- **Loan Agreement** between Growers and AOAL received 23 November 1999;
- Additional correspondence from the AOAL and BDO Nelson Parkhill dated 23 November 1999, 30 November 1999, 2 December 1999, 10 December 1999, 13 December 1999, 21 December 1999, 6 January 2000, 11 January 2000, 17 January 2000, 20 January 2000, 25 January 2000, 8 February 2000, 14 February and 15 February 2000, 6 April 2000, 12 April 2000, 15 May 2000 and 18 May 2000.

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

16. The documents highlighted are those Growers enter into. For the purposes of this Ruling there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a

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Grower, or any associate¹ of the Grower will be party to, which are part of the arrangement to which this Ruling applies other than any finance agreement to which paragraph 45 below applies. The effect of these agreements is summarised as follows.

17. The arrangement is called Almond Orchards Australia Robinvale 2000. Growers entering the Project will occupy, under licence, land owned by Kyndalyn Park Pty Ltd, 70 kms south of Mildura on the Murray River. The land has been leased to the Custodian, which has, in turn, subleased the land to the Manager. The Manager grants a licence to each Grower, by way of an Allotment Agreement, to conduct almond-growing activities on the land.

18. There are up to 1000 Allotments of 0.4 hectares on offer. Following execution of the Allotment and Management Agreements 100 trees per Allotment will be planted. The Manager as the Responsible Entity will operate the Project.

19. Growers will engage AOAL as the Manager to perform services including the establishment and maintenance of the Orchard and the annual harvesting and marketing of the almonds produced. This Ruling only applies to those parties utilising the services of AOAL. The Manager will engage Select to professionally manage the Orchard and sell the entire production of the Orchard for the life of the Project.

Years 1 to 3 payments

20. For Growers accepted into the Project on or before 30 June 2000 the fees for one allotment for the first three years are:

	Year ended 30 June 2000	Year ended 30 June 2001	Year ended 30 June 2002
Management and administration fees	4,400	1,600	1,500
Farm expenses	1,132	1,489	1,792
Allotment licence fee	1,368	1,396	1,457
Tree establishment	1,625	-	-
Total	\$8,525	\$4,485	\$4,749

¹ In this Ruling 'associate' has the meaning as defined in section 318 of the ITAA 1936

Note

- The fees for the year ended 30 June 2000 are incurred on application and are for work to be done by 31 August 2000.
- The above fees do not include a GST component, but a GST component is payable in addition to these fees for those fees which are for the year ended 30 June 2001 and subsequent years.

21. The Manager forecasts that a Grower could expect to achieve an internal rate of return of approximately 14% before tax. The term of the Project will be for 15 years. AOAL has a right to buy the Growers' trees at the end of the sixteenth year of the Project.

Project Constitution

22. A Grower must pay \$17,759 over a period of three years in order to acquire an interest in the Project (cl 4). The Responsible Entity is required to maintain a register of the Growers (cl 10). There are no withdrawal rights under the Project (cl 11.1). A Grower has the right to assign their Interest only in the circumstances set out in Constitution and on the terms and conditions of the Allotment Agreement and Management Agreement (cl 13).

23. Growers are able to remove the Responsible Entity by taking action under the Corporations Law.

24. Each Grower is vested with the following assets:

- the trees on the Grower's Allotment (cl 8.3(a));
- the Almonds Attributable to the Grower's Allotment (cl 8.3(b)); and
- the Grower's Interest in the Project (cl 8.3(c)).

Compliance Plan

25. The objective of the Compliance Plan is to ensure the interests of the Growers are protected. The Responsible Entity must ensure that the Constitution and the Compliance Plan meet the relevant requirements of the Corporations Law (cl 3.1). The Responsible Entity must ensure that all property of the Project is clearly identified and held separately from any other property of the Responsible Entity or other managed investment schemes (cl 4.1). All Project property will be held by the Custodian (cl 4.1(a)). The Compliance Plan outlines the various reports and reconciliations which will be provided to each Grower by the Manager.

Allotment Agreement

26. The Manager grants each Grower a licence to:
- use and occupy the Allotment for the purpose of developing, planting, growing, maintaining and harvesting the trees; and;
 - use the Water Licences and Internal Irrigation system to irrigate their Allotments.
27. A fee of \$1,368 for the first year is payable to the Responsible Entity for this licence (cl 7.1(a)). Subsequent years' fees are specified in Schedule 2 to the Allotment Agreement.
28. The Responsible Entity has a right to require the Grower to sell its trees at the end of the Term of the Licence (cl 3.2(a)). The Agreement details the Grower's and the Responsible Entity's obligations for use of the Allotment under the licence (cl 5 and cl 6). The Responsible Entity may assign its rights and interests under this Agreement (cl 9.1).
29. AOAL or an associate thereof, will buy the water licences and pay for the installation of the internal irrigation system to provide the water supplied as part of this agreement (Refer the Licence Agreement).

Management Agreement

30. Pursuant to the Management Agreement, AOAL is engaged to develop, maintain and generally manage the Project. The fees payable to AOAL for the provision of these services are set out at cl 5. Growers enter into this Agreement until 30 June 2015. AOAL is entitled to delegate any of its duties and functions for the better performance of its obligations (cl 8.1).
31. In the first financial year of the Project AOAL is to establish the Grower's trees, maintain the trees once they are established, and provide management and administrative services to the Growers (cl 4.2).
32. The establishment services to be provided by the Manager in the first year include, among other things:
- prepare the Allotment for planting;
 - supply and plant the rootstock;
 - supervise the planting of the trees; and

- prepare and implement an irrigation, drainage and water management plan (cl 4.1).

33. The farming services to be provided by the Manager in the first year include, among other things:

- provide irrigation, fertilisation and nutrients to the trees;
- eradicate any pests or diseases if required; and
- prepare a business plan and annual budget for the Project (cl 4.2 (a)).

34. The administration and management services to be provided by the Manager in the first year include, among other things:

- assisting Growers to complete loan applications;
- preparing reports to Growers on the location of their allotments and the work to be done on the Allotment; and
- reviewing the sales and marketing plan for the Project;
- supervising Select's work (cl 4.2 (b)).

35. For the second and subsequent years the Manager is responsible for farming services, administration and management services, processing and marketing services (cls 4.3(a), 4.3(b), 4.4 and 4.5).

36. Growers have the right to elect to have any almonds harvested from their farm made available to them to sell or deal with as they determine (cl 4.3(a)(xvii)).

37. The Manager will pool for sale all produce of each Grower's business with that of each other Grower and will market and sell all such produce (cl 4.5). The proceeds of the pooled sales will be paid to the Custodian for crediting to the account of each Grower on a proportional basis (cl 15 of the Management Agreement and cl 22 of the Constitution). Where the produce from a Grower's Allotment is of sufficiently reduced quality or quantity, that Grower's share of the pooled sale proceeds may be reduced (cl 4.5(c) of the Management Agreement and clause 22.1 of the Constitution). Income of the Project is to be held on behalf of the Growers by the Custodian and to be applied in payment of the Growers' obligations under the Management and Allotment Agreement. Any net income remaining after the payment of these fees is to be distributed to Growers (cl 22 of the Constitution).

38. The Grower may terminate the Management Agreement in certain instances, including where the Manager defaults in the performance of its duties (cl 10.1).

39. All costs and expenses incurred by the Manager in carrying out its duties are to be borne by it and the Grower has no further obligation to make any payment, save those under cls 5.1 to 5.4 of the Management Agreement (cl 5.5).

40. If in any year of the Project the income resulting from the sale of produce is insufficient to meet the annual Management and Allotment fees of that year, participants are still liable to pay the shortfall pursuant to cl 9.5(e) of the Constitution.

41. There are no sale agreements in place for the almonds that will be produced and harvested under the Project. Growers are paying, as part of the management fees, an amount to AOAL for it to market and sell the almonds (cl 4.3(a)(xviii)).

Almond Orchard Management Agreement

42. Pursuant to its right to delegate any functions required of it, AOAL has contracted with Select to undertake the obligations under the Management Agreement to establish the Orchard in the first year and undertake all necessary horticultural work in future years. An Almond Orchard Management Agreement exists between the Manager, Select and AMA, detailing those services to be undertaken by Select in each year.

43. Select is required to acquire rootstock for the Growers in the Project by 31 May 2000. Select has contracted to plant those trees by 31 August 2000, subject to the planting being undertaken in appropriate climatic and horticultural conditions (cls 4.1(a) and (c)). Select is then required to undertake cultivation, maintenance and management services over the life of the Project (cl 4.3).

44. Select is required to harvest the almonds on behalf of the Growers (cl 4.4) and process those almonds (cl 5). Select guarantees the sale of those almonds by the end of the season following harvest and will endeavour to maximise the price obtained for the sale (cl 6.1). Select is entitled to charge fees for the processing and marketing of the almonds at an agreed rate per kilogram of processed Almonds (cls 12.1, 12.2 and 13.1) as well as any drying fee that may be applicable (cl 5.6). A bonus fee of 10% of the amount by which the net income from sales for a financial year exceeds forecast may be payable (cl 14A).

Finance

45. Growers can fund their investment in the Project themselves or borrow from an independent lender.

46. This Ruling does not apply if a Grower enters into a finance agreement with 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 (other than AOAL) 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 applies;
- the loan or rate of interest is non-arm's length;
- repayments of 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

Allowable deductions

47. For a Grower who invests in the project, the amount of the deductions available for some expenses will depend upon the date the investment is made and, in some cases, whether or not they are small business taxpayers.

IMPORTANT: Paragraph 48 (relating to 'small business taxpayers') and paragraphs 49 to 50 (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 54 to 56 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.

Deductions for Growers who are ‘small business taxpayers’

48. For a Grower who is a ‘**small business taxpayer**’ and invests in the Project on or before 30 June 2000, the deductions shown in the Table below will be available for the years ended 30 June 2000 to 30 June 2002.

	Year ended 30 June 2000	Year ended 30 June 2001	Year ended 30 June 2002
Management and administration fees	4,400 see note below	1,600 see note below	1,500 see note below
Farm expenses	1,132 see note below	1,489 see note below	1,792 see note below
Allotment licence fee	1,368 see note below	1,396 see note below	1,457 see note below
Purchase and planting of trees	0	0	0
Total	\$6,900	\$4,485	\$4,749

Note:

- (i) Legislative change means that the full deduction will not be allowed in the year ended 30 June 2000 for Growers who are not ‘small business taxpayers’. See paragraphs 49 to 50 and the Example at paragraph 98.

Deductions for Growers who are not ‘small business taxpayers’

49. For a Grower who invests in the Project on or 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 the deduction in respect of the Maintenance 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). (The Example at paragraph 98 illustrates the application of this method).

50. In calculating the deduction available, the term ‘expenditure’ refers to expenditure for prepaid Management fees and Maintenance fees (shown in the Table below) that are otherwise allowable under section 8-1 whose ‘eligible service period’ ends not more than 13 months after being incurred by the taxpayer and which are not

‘excluded expenditure’. The ‘eligible service period’ (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

	ITAA 1997	Expenditure incurred by taxpayers who are not ‘small business taxpayers’.		
Fee type	section	Year 1	Year 2	Year 3
		30/6/2000	30/6/2001	30/6/2002
Management and administration fees	8-1	\$4,400 - see Note below	\$1,600 - see Note below	\$1,500 - see Note below
Farm expenses	8-1	\$1,132 - see Note below	\$1,489 - see Note below	\$1,792 - see Note below
Allotment Licence fee	8-1	\$1,368 - see Note below	\$1,396 - see Note below	\$1,457 - see Note below

Note:

- (i) The amounts shown in the table above for taxpayers who are not ‘small business taxpayers’ are **NOT** deductible in full in the year incurred. The deduction for each of the fees must be determined using the formulae shown below. The project manager will inform affected taxpayers of the number of days in the ‘eligible service period’ in the expenditure year. This figure is necessary for the tax deduction for each of the fees to be calculated.

Year 1: Expenditure incurred on or before 30 June 2000

Available deduction = A + B

Where:

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

$$B = (\text{Expenditure less A}) \times 80\%$$

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

Available deduction = A + B + C

Where:

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

$$B = (\text{Expenditure less } A) \times 60\%$$

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

$$\text{Available deduction} = A + B + C$$

Where:

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

$$B = (\text{Expenditure less } A) \times 40\%$$

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

Purchase and planting of trees

51. The costs of purchasing and planting trees are capital in nature. A deduction is allowable under Subdivision 387-C at the rate of 13% per annum, commencing from the time the trees enter their first commercial season. For Growers who enter the Project on or before 30 June 2000 it is likely the first commercial season will be in the financial year ended 30 June 2003. The Manager will advise Growers of details of amounts that can be claimed in this respect.

Goods and Services Tax

52. 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.

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

53. 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;

- section 82KZMB applies to expenditure by Growers who are not small business taxpayers and are carrying on a business;
- 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.

Proposed new laws

Proposed changes to prepayment rules

54. On 11 November 1999, the Government announced a number of changes to the deductibility of certain prepaid expenditure incurred in respect of certain agreements. Legislation introduced into Parliament, but not yet enacted, provides that these changes will not apply if the relevant expenditure falls within one of the Exceptions to the proposed provisions. Provided the provisions are enacted as introduced, expenditure incurred by investors in this Project will be within Exception 5 to proposed section 82KZME.

55. Where Exception 5 applies to expenditure that has an 'eligible service period' ending not more than 13 months after the expenditure is incurred and is deductible under section 8-1:

- deductions for 'small business taxpayers' will be allowable in full in the year that the expenditure is incurred; and
- the amount and timing of deductions for taxpayers who are not 'small business taxpayers' will be determined under sections 82KZMB and 82KZMC of the ITAA 1936.

56. The practical effect of expenditure being within Exception 5 is that the deduction described in paragraphs 48 to 50 of this Product Ruling will not be affected by the proposed changes to the prepayment rules.

Explanations

Section 8-1

57. Consideration of whether the Management fees, Farm expenses and Allotment licence fees are deductible under section 8-1

begins with an examination of paragraph 8-1(1)(a). To be deductible under this paragraph:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under paragraph 8-1(1)(b) if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether paragraph 8-1(1)(b) applies. However, that does not preclude the application of the paragraph 8-1(1)(a) and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

58. An outgoing or a loss incurred in carrying on a business for the purpose of gaining or producing assessable income is deductible under the general deduction provisions of section 8-1, provided it is not expenditure or a loss of capital or of a capital, domestic or private nature. A business includes a 'primary production business', which is defined under subsection 995-1(1) to include a business of propagating and cultivating plants. Where there is a business, or a future business of growing almonds for sale at a profit, the gross sale proceeds from the sale of almonds from the Project will constitute assessable income under section 6-5. 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, and maintaining of almond trees and the harvesting of the almonds.

59. Under the Management Agreement, Growers engage AOAL to farm their Allotment on their behalf. They also have the right to have the harvested almonds made available to themselves to sell or utilise how they wish. The purpose for which the participant utilises the almonds will then be a determining factor as to whether the amounts incurred on any Management fees, Farm expenses or Allotment licence fees will be an allowable deduction.

Is the Grower in business?

60. Generally, a Grower will be carrying on a business of growing almonds where:

- they have an identifiable interest in specific growing almond trees coupled with a right to harvest and sell the almonds resulting from those trees;
- the horticulture activities are carried out on their behalf; and
- the weight of the general indicators of a business, as developed by the Courts, points to them carrying on such a business.

61. By weighing up all of the attributes of the Project it is accepted that Growers in the Project 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, mean such things as surveying of the land, installation of the irrigation items, and other preplanting work, all conducted as part of a co-ordinated and concerted plan to grow and harvest almonds for sale at a profit.

62. For this Project investors have, under the Allotment Agreement, rights in the form of a licence over an identifiable number of growing trees, consistent with the intention to carry on a business of growing almonds.

63. Under the Management Agreement, Growers appoint AOAL, as Manager, to provide services such as preplanting and planting of almond trees, the installation of irrigation, and all horticultural operations necessary to develop a mature fruit bearing tree.

64. Growers only have the right to use the land in question for almond-growing purposes. AOAL may come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over AOAL, as evidenced by the Agreements, is sufficient. Under the general terms of the Project, Growers are entitled to receive regular progress reports on AOAL's activities. Growers are able to terminate arrangements with AOAL in certain instances, such as cases of default. The horticulture activities described in the Management Agreement are carried out on the Growers' behalf. Growers control their investment.

65. The general indicators of a business, as developed by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description in this Ruling for all these indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms

that does not depend in its calculation on the fees in question being allowed as a deduction.

66. Growers will engage the professional services of a Manager who holds itself out as having the appropriate credentials. There is a means to identify which trees Growers have an interest in. The services are based on accepted horticultural practices and are of the type ordinarily found in horticulture ventures that would commonly be said to be businesses.

67. Growers have a continuing interest in the trees from the time they are acquired until the termination of the Project. The horticulture 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' horticulture activities will constitute the carrying on of a business.

Deductibility of expenses

68. The Management, Farm expenses and Allotment licence fees, 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 paragraph 8-1(1)(a), 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. The fees are not considered to be grossly excessive. The tests of deductibility under paragraph 8-1(1)(a) are met. The exclusions do not apply, except as set out below.

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

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

70. 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

71. In this product ruling the term ‘small business taxpayer’ is relevant for the purposes of certain prepaid expenditure.

72. 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’.

73. 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.

74. ‘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 82KZM - Prepaid expenditure for ‘small business taxpayers’

75. 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 to be done within 13 months after the day on which the expenditure is incurred.

76. Management, Maintenance and Allotment Licence fees are incurred on execution of the Management and Allotment Agreements. In addition, a fee for the use of the Water licences is payable in the first year. In each instance, the fees are charged for providing services to a Grower only for the period of 13 months from the time they are incurred. The fees are expressly stated to be for a number of specified services. In effect, the Manager is promising to provide significantly more services, in terms of value in the first year of the Project, compared to years two and three.

77. No explicit conclusion can be drawn from the arrangement’s description, that the fees on the first year have been inflated to result in reduced fees being payable for subsequent years. There is no evidence that might suggest the services covered by the fee could not be provided within 13 months of incurring the expenditure in question. Thus, for the purposes of this Ruling, no part of the initial Management fee or the fee for use of the Water licence is for BRIL

doing ‘things’ that are not to be wholly done within 13 months of each fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditures identified above that are incurred by a ‘small business taxpayer’ in each of the financial years ended 30 June 2000 to 30 June 2002.

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

78. 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.

79. Management fees, Farm expenses and Allotment Licence fees are incurred on execution of the Management and Allotment Agreements. In each instance, the fees are charged for providing services to a Grower by 30 June of the year of execution of the Agreement. The fees are expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement’s description that the fee has been inflated to result in reduced fees being payable for subsequent years.

80. No explicit conclusion can be drawn from the arrangement’s description, that the fees in the first year have been inflated to result in reduced fees being payable for subsequent years. There is no evidence that might suggest the services covered by the fee could not be provided within 13 months of incurring the expenditure in question. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fees is for AOAL doing ‘things’ that are not to be wholly done within 13 months of each fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditures identified above that are incurred by a ‘small business taxpayer’ in each of the financial years ended 30 June 2000 to 30 June 2002.

81. 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

82. The changes announced by the Government, but not yet enacted, to apply from 11 November 1999 will affect all taxpayers that participate in certain agreements and prepay expenditure for up to 13 months. It is proposed that deductions otherwise allowable under section 8-1 of the ITAA 1997 will 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.

83. However, those changes will not apply where the expenditure incurred under the agreement is within one of the Exceptions to the proposed provisions.

84. Exception 5 provides that the expenditure must not be under an agreement to which a product ruling applies, describing expenditure under the agreement as being allowable as a deduction. The product ruling must be made:

- (a) on or before 1pm (by legal time in the Australian Capital Territory) on 11 November 1999; or
- (b) in response to an application for a product ruling where:
 - (i) the application was received by the Commissioner on or before the time specified in paragraph (a); and
 - (ii) the Commissioner acknowledged receiving the application.

85. This product ruling is made in response to an application received by the Commissioner on or before 1pm on 11 November 1999 and acknowledged. Expenditure incurred by investors in the Project will, therefore, be within Exception 5 if the proposed new law is enacted as introduced into Parliament.

Expenditure of a capital nature

86. Any part of the expenditure of a Grower entering into the horticulture business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. It is apparent from the Project's Agreements that certain payments made are attributable to the acquisition of capital assets. These include preplanting costs and the cost of establishing the trees. However, expenditures of this nature can fall for consideration under specific deduction provisions of the ITAA 1997 relevant to the carrying on of a business of primary production.

87. The Manager, AOAL, has identified the relevant expenditures that are of a capital nature. A Grower entering into the Project incurs and pays a separate amount to AOAL for these capital items (refer cl 5 of the Management Agreement). These amounts are detailed at paragraph 20 of this Ruling.

Subdivision 387-C: horticultural provisions

88. The capital costs relating to establishing the almond trees are deductible as a 'write-off', over time, under Subdivision 387-C. This Subdivision 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 almond trees.

89. 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).

90. 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 that it is then that the almond trees enter their first commercial season and, hence, begin to be used for the purpose of producing assessable income in a horticultural business.

91. 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.

92. AOAL has identified that the relevant expenditure attributable to the establishment of the almond trees is \$1,625. This amount will be subject to the horticultural provisions and allowable as a deduction under Subdivision 387-C.

93. For a Grower entering into the Project by 30 June 2000, no deduction will be allowable for the years ended 30 June 2000, 30 June 2001 and 30 June 2002. There will be an amount deductible for the year ended 30 June 2003 in accordance with paragraph 51.

Alternative view

94. The applicant has indicated disagreement with the ATO view that the almond trees do not commence to be used for the purpose of producing assessable income in a horticultural business until their first

commercial season, and has submitted an alternative view that the almond trees commence to be so used immediately after their planting.

Section 82KL

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

Part IVA

96. For Part IVA to apply there must be a ‘scheme’ (section 177A); a ‘tax benefit’ (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Project will be a ‘scheme’ commencing generally on the date when the Prospectus was issued. The Growers will obtain a ‘tax benefit’ from entering into the scheme, in the form of the deduction for the initial fee, allowable under section 8-1, that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

97. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the trees. Further, there are no features of the Project, for example, such as the Management fees and Farm expenses fee being ‘excessive’, and uncommercial, predominantly financed by a non-recourse loan, and resulting in insufficient ‘real money’ coming into the Responsible Entity’s hands, that might suggest the Projects were so ‘tax driven’, and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Example

98. Obligation to prepay expenditure arising on or after 11:45am AEST 21 September 1999 – applies to taxpayers who are not small business taxpayers and are carrying on a business:

Joseph Gardener 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

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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 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 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:

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

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

$$B = (\text{Management fee less } A) \times 80\%$$

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

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 as 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:

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

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

$$C = \$1,101$$

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:

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

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

$$C = \$440$$

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.

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Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 97/11;
 TR 97/16; TR 98/22; TD 93/34;
 PR 1999/95

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- producing assessable income
- product rulings
- public rulings

- schemes and shams
- taxation administration
- tax avoidance

- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(1)(b)

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA(3)(c)
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- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
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- ITAA 1997 387-165
- ITAA 1997 387-170
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