PR 2000/67 - Income tax: Mountain River Foods Project - Prospectus No. 1

Product Ruling
Income tax: Mountain River Foods Project – Prospectus No. 1

Contents Para

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

Terms of use of this Product Ruling

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

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 'Mountain River Foods Project - Prospectus No. 1' or just simply as 'the Project', or the 'product'.

Tax law(s)

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

- section 8-1 *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 27-5 (ITAA 1997);
- section 27-30 (ITAA 1997);
- section 82KK, *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KL (ITAA 1936);
- section 82KZL (ITAA 1936)
- section 82KZM (ITAA 1936);
- section 82KZMA (ITAA 1936);
- section 82KZMB (ITAA 1936);
- section 92 (ITAA1936); and
- 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 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 become superseded. If requested, when the

relevant law(s) are enacted, the Commissioner will formalise the non-binding information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

Class of persons

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

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

Qualifications

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

9. The class of persons defined in the Ruling may rely on its contents, provided the arrangement is carried out in accordance with details described in the Ruling.

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

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

Note: Without limiting the generality of the term, a material difference may arise in relation to a variation in the facts of the arrangement described in the Ruling. It may also arise in circumstances where the person otherwise included in the class of persons enters into the arrangement as described, but also enters into transactions or arrangements (including financing arrangements) that, when viewed as a whole with the arrangement described in the Ruling, will produce a different taxation consequence for the arrangement. This might include, for example, where the Grower borrows to enter into the arrangement by way of a limited or non-recourse loan and the overall consequence might be that the arrangement is one that would have attracted the application of a tax avoidance provision.

11. 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

12. This Ruling applies prospectively from 7 June 2000, the date the Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangements prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the person's involvement in the arrangement.

Arrangement

15. The arrangement that is the subject of this Ruling is described below. This description is based on the following correspondence and draft documents. The correspondence and draft documents, or relevant parts of them, as the case may be, form part of and are to be

read with this description. The relevant correspondence and draft documents or parts of documents incorporated into this description of the arrangement are:

- Application for Product Ruling dated 17 January 2000;
- Constitution of Mountain River Land Limited (MRLL);
- Prospectus for The Mountain River Dried Foods Project No 1;
- **Constitution of The Mountain River Dried Foods Project No 1, which covers Members/Growers who join with other Members/Growers to form the Mountain River Dried Foods Partnership**;
- Compliance Plan of The Mountain River Dried Foods Project No 1, which applies to ARG Management Limited (ARGML);
- Technical Management Agreement between ARGML and Mountain River Dried Foods Pty Limited (MRDF);
- Farm Management Agreement between MRDF and RG Rural Services Pty Limited (RGRLS);
- Processing Agreement between (MRDF) and Golden Valley Dried Foods Limited (Golden Valley);
- Brand Licence Agreement between ARGML (on behalf of the Partnership) and Golden Valley;
- Letter dated 29 March 2000 from the ATO to Horwath (NSW) Pty Ltd;
- Letter of reply to the ATO dated 18 April 2000 from Horwath (NSW) Pty Ltd; and.
- Letter from Australian Securities and Investments Commission, dated 28 July 1999, in relation to section 115 of the Corporations Law.

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

16. The document highlighted above is that in which the Growers enter into. For the purpose of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be party to, other than any finance agreements to which paragraph 29 refers. The effects of the documents listed above are summarised in paragraphs 19 to 32.

Ruling only applies to Growers who join with other Growers and form the Partnership

17. It is expected that most Growers will elect to enter into the Partnership.

18. However, if Growers do not enter the Partnership their circumstances may be unique and their tax affairs will likely be different from those Growers who enter the Partnership. Growers who do not enter the Partnership do not fall within the defined "class of persons" for the purposes of this Ruling. This Ruling only applies to a Grower who enters the Partnership.

Overview

19. This arrangement is called Mountain River Dried Foods Project — Prospectus No 1.

Location	**Part of a 608.1 hectare property called "Lochnay", approximately 32 kms west of the town of Texas near the New South Wales/Queensland border.**
Type of business each participant is carrying on	Commercial growing of fruit (tomatoes) and vegetables, as well as carrying on a business of processing and drying fruit and vegetables for the processed food market.
Number of hectares under cultivation	Minimum 48 hectares, up to 180 if subscriptions expand beyond 500.
Name used to describe the Project	Mountain River Foods Project – Prospectus No 1.
Size of the leased area	0.1 hectares.
Expected production (tonnes per hectare)	Tomatoes – 100 Capsicums – 15 Butternuts – 30 Spinach – 4 Mixed – 15 Wheat – 8.75 Peas – 11.25
Term of the investment	18 years
Initial cost	$10,500
Initial cost on a per hectare basis	$105,000
Ongoing costs	As per paragraph 28

20. Under the arrangement, an investor may purchase "A" class shares in MRLL. (Note that the Project will not proceed unless the minimum subscription of 500 applications is achieved.) If the investor purchases the minimum number of shares, being 300 x $1 "A" class shares, the investor will obtain a right to occupy and farm an identified area of cleared land of approximately 0.1 hectares to be purchased by MRLL by exercise of options to purchase specific parts of the property. A member will pay monies to MRLL on account of the subscription price of shares and the first Allotment Fee.

21. At the time of application each member may (but is not required to) elect to exercise their right to occupy their Farm Allotment and become a "Grower" or MRLL may occupy and farm that portion of land for the benefit of all members. Each Grower may also elect to operate their own business of growing fruit and vegetables under the specific conditions set out in the MRLL Constitution. Alternatively, the member may elect to join with other members/growers to form the Mountain River Dried Foods partnership. The partnership will appoint ARGML to manage the partnership's business and engage other contractors as needed. The partnership will be formed under an Australian law, and therefore will not be subject to section 115 of the Corporations Law (which, with the exception of those partnerships formed under an Australian law, limits a partnership to 20 members).

22. The partnership will outlay monies under the arrangement for management fees payable to ARGML and brand name licence fee payable to Golden Valley. In years after 30 June 2000, the partnership will commence to pay allotment fees to MRLL. MRLL also has options to acquire land situated in Toogoolawah near Brisbane, Queensland. MRLL will only exercise the number of options that are necessary for the Project's requirements.

Rights of shareholders (Members)

23. The rights of shareholders are set out in MRLL's Constitution. In particular:

- a member shall have a right to occupy a section of the land owned by MRLL and specified in the Company's Constitution, subject to that member (known as a Grower) paying an Allotment Fee to MRLL;
- a Grower shall be entitled to use the agricultural infrastructure necessary for the Grower's business, including but not limited to access to water supply, storage areas and access roads.

- the "A" class shares will convert to ordinary shares on 30 June 2018. At that time, the Grower will no longer have a right to farm the land and his/her interest will be the rights attaching to that Member's ordinary shares in MRLL. The taxation consequences, flowing from the events occurring at that time, do not form part of this Ruling; and
- a Grower may conduct that Grower's business personally, appoint an agent or contractor to manage the business, or join with other Growers to form the Mountain River Dried Foods Partnership and appoint ARGML to manage the business in accordance with the Constitution of the Mountain River Dried Foods Project - Prospectus No 1.

Project Constitution (Growers)

24. Under the Project Constitution, which incorporates the management agreement between the Partnership and ARGML, the Manager agrees to carry out duties that relate to:

- soil conditioning, fertilising and drainage of the land;
- planting, maintaining, processing and marketing on the Partnership's behalf during the first 12 months of the Project; and
- ongoing management, harvesting, processing and marketing.

25. Under the Constitution, ARGML will manage the partnership's business and engage appropriate contractors with relevant expertise in order to achieve its undertakings.

Fees

26. The expenditure to be paid by a Grower to MRLL (the land owner) principally relates to the following period:

Upon Application

$1.00 paid on 300 x $1 "A" class shares	$300
Allotment fee payable to MRLL	$200

27. The expenditure to be paid by a Grower to the partnership is a Partnership Contribution for the payment of its expenditure.

Upon Application

Partnership Contribution by each Grower	$10,000

Expenditure of the Partnership

28. The expenditure of the partnership under the Project Constitution relates to the following periods:

Upon Application

Management fee payable to ARGML	$9,150
Brand licence fee	$650
Responsible entity fee payable to ARGML	$200

Year 1 (Year ended 30 June 2001)

Allotment fee payable to MRLL	Nil
Management fee payable to ARGML	Nil
Brand licence fee	Nil
Responsible entity fee payable to ARGML	Nil

Year 2 to 18 (Year ended 30 June 2002 to 30 June 2018)

Allotment fee payable to MRLL	$150 payable annually by each partner in advance and indexed for CPI movements
Management fee payable to ARGML	50% of partnership gross income from the sale of fresh produce and processed products, payable on a pro rata basis monthly in arrears by the partnership.
Brand licence fee payable to Golden Valley	5% of gross income from the sale of fresh produce and processed product, payable monthly in arrears by the partnership.
Responsible entity fee payable to ARGML	$100,000 by the partnership plus $50 for each Partner in the partnership subject to a maximum fee of $200,000. For each subsequent year, the fee is indexed for CPI movements. In both circumstances it is payable quarterly in advance.

Finance

29. Finance is not provided under the arrangement and is therefore outside the scope of this Ruling. This Ruling does not apply if a Grower enters into a finance arrangement with any of the following features:

- there are split loan features of the type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project are involved, or become involved, in the provision of finance to Growers 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' are or will be granted to a borrower, for the purposes of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- repayments of principal and payments of interest are linked to 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 means, and whether directly or indirectly) back to the lender, or any associate of the lender;

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- terms or conditions are not arms length.

Income

30. Under the arrangement, income will be received by the partnership from two types of business. Income from the sale of fresh produce will be derived from a business of primary production. Income from the sale of processed products will be derived from a business involving non-primary production activities.

31. ARGML has undertaken to advise Growers each year of the apportionment between the two types of income.

Trading stock

32. Where ARGML performs all functions on behalf of the partnership, fresh produce will remain trading stock of the partnership.

Ruling

Goods and Services Tax

33. 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

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

IMPORTANT: Paragraph 35 (relating to 'small business taxpayers') and paragraphs 36 and 37 (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 50 and 51 relating to proposed changes to the prepayment rules. Growers who invest in the Project after 1pm, AEST, 11 November 1999 may be affected by these changes.

Growers who are Small Business Taxpayers

35. For a Grower who is a **'small business taxpayer'** and invests in the Project 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.

Fee type	*ITAA* 1997 Section	Deductions for small business taxpayers only		
		Period to 30/6/2000	Year 1 30/6/2001	Year 2 30/6/2002
Management fee (paid by the partnership)	8-1	$9,150– see Note (i) below	Nil	as per the percentages shown in paragraph 28
Brand licence fee (paid by the partnership)	8-1	$650	Nil	as above
Responsible entity fee (paid by the partnership)	8-1	$200	Nil	as above
Allotment fee (paid by Growers)	8-1	$200	Nil	as above

Notes:

(i) Legislative change means that the full deduction will not be allowed in the year ended 30 June 2000 to Growers who are not 'small business taxpayers'. See paragraphs 36, 37 and Example 1.

(ii) Proposed legislative change applying to expenditure incurred after 1pm, AEST, 11 November 1999 means that for all Growers the full deduction may not be allowed in the year ended 30 June 2000. See the non-binding advice in paragraphs 50 and 51 and Example 2.

Growers who are not Small Business Taxpayers

36. 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 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 85 illustrates the application of this method). The brand licence fee, responsible entity fee and allotment fee are deductible in full, as they are 'excluded expenditure' under subsection 82KZMA(4).

37. 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 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 on or after 1 July 2000 and 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 before 30 June 2002

Available deduction = A + B + C

Where :

Number of days of eligible service period

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

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

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

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

38. 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 50 and 51);**
- section 82KZMB applies to expenditure by Growers who are not small business taxpayers and are carrying on a business **(but also see paragraphs 50 and 51)**;
- 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.

Allotment fee

39. Growers who invest in the Project before 30 June 2000, pay the Allotment fee to MRLL and join with other Growers to form the Mountain River Dried Foods Partnership, which in turn pays a management fee to ARGML for management services to be provided during the first 12 months of the Project, a brand licence fee to Golden Valley and a responsible entity fee to ARGML to act as the responsible entity during the first 12 months of the Project, will personally be entitled to a deduction of $200 for the Allotment fee under the section 8-1 of the ITAA 1997 for the year ended 30 June 2000.

Management fee

40. The management fee is payable by the Partnership to ARGML, for ARGML to carry out the on going duties relating to the proper and efficient management of the Partnership's business. The management fee is an allowable deduction under section 8-1.

Brand licence fee

41. The brand licence fee is levied annually by Golden Valley so that ARGML, on behalf of the Partnership, can have its produce marketed under the "Rivergold Foods" brand name and trademark as controlled by Golden Valley. A deduction is allowed under section 8-1.

Responsible entity fee

42. The responsible entity fee relates to the ongoing costs incurred by ARGML on behalf of the partnership in acting as the responsible entity under the Project. These ongoing costs are revenue in nature and are deductible under section 8-1.

Section 82KK

43. Section 82KK does not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA

44. The provisions of Part IVA will not be applied to the arrangement described in this Ruling.

Trading stock

45. Where ARGML performs all functions for Grower/Processors, the trading stock provisions will apply. The fresh product or processed products remain the trading stock of the Partnership.

Income

46. Income derived from the sale of fresh produce is primary production income. Income from the sale of processed products is income from non-primary production activities.

47. The sales income from the sale of produce on behalf of the Partnership will be derived on the accruals basis.

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

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

Proposed new laws

Proposed changes to prepayment rules

50. On 11 November 1999, the Government announced a number of changes to the deductibility of certain prepaid expenditure incurred in respect of 'tax shelter arrangements'. Provided the proposed changes are enacted as announced, the Project will be a 'tax shelter arrangement' and all Growers, including 'small business taxpayers', who invest in the Project after 1pm, AEST, 11 November 1999, will be subject to these changes.

51. For these Growers the amount of deduction available in respect of the Management Fee is calculated using the formula shown below (see also Example 2 at paragraph 86). In the calculation, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 of the ITAA 1997 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.

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

The excess remaining after the application of this formula is deductible in the year that the services to which the excess relates are performed.

Note to promoters and advisers

52. Product rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of the announcement requiring prepayments in respect of 'tax shelter' arrangements to be deductible over the period services are provided.

Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Explanations

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

53. 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 on or after 1 July 2000.

54. 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

55. In this product ruling the term 'small business taxpayer' is relevant for the purposes of certain prepaid expenditure.

56. 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'.

57. 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.

58. '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

59. Consideration of whether management fees are deductible under section 8-1 begins with section 8-1(1)(a). This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer' s assessable income;
- the outgoings are not deductible under section 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 himself to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

Growers carrying on a business

60. The growing of fruits and vegetables can constitute the carrying on of a primary production business. Where there is a business, or a future business, the gross sale proceeds from the sale of the fresh produce from the Partnership will constitute gross assessable income in its 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 and maintaining of the fruits and vegetables and the harvesting, processing and marketing of the produce.

61. For this Project, Growers have rights in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of growing fruits and vegetables for commercial exploitation. The Growers under the Constitution have joined together to form the Mountain River Dried Foods Partnership and have novated their rights to the Partnership. The Partnership also has the right to process and market the fresh produce and the processed products. Under the Constitution, the Partnership has appointed ARGML to provide services related to the cultivation of fruit and vegetables and the processing and marketing of fruit and vegetable products. From the information provided, the Partnership controls its investment in the Project.

62. The Partnership will not use the land for any purpose other than the growing of fruits and vegetables. It will appoint ARGML to perform the obligations and duties imposed on it under the Constitution. The Partnership's degree of control over ARGML, as

evidenced by the Compliance Plan and Constitution of the Project, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Partnership's activities. In addition, they are able, through the Partnership to terminate arrangements with ARGML in certain instances, such as cases of default or neglect. The business activities described in the Constitution are carried out on the Partnership's behalf.

63. 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 discussed in that Ruling. 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 on its calculation on the fees in question being allowed as a deduction.

64. Growers have a continuing interest in the Project through the Partnership until 30 June 2018. The activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Partnership's activities of cultivating fruits and vegetables and marketing their products will constitute the carrying on of a business.

65. The activities that ARGML, as Manager, is required to undertake are listed in the Project Constitution (see schedule 5 of the Constitution). Most of these activities are of a revenue nature, although some will be of a capital nature. Project costing obtained from ARGML outline how the management fees will be spent. All of these monies will be spent on items that are of a revenue or capital nature.

66. The management fee paid by the Grower is for activities that are of a revenue nature. In accordance with paragraph 8-1(2)(a) of the ITAA 1997, the management fee is not an allowable deduction to the extent that it is a loss or outgoing of capital or of a capital nature. However, some other specific provision may permit a deduction for what would otherwise be non-deductible capital expenditure. The management fee is deductible under section 8-1 as shown in the table at paragraph 35.

Section 82KZM - Prepaid expenditure for small business taxpayers

67. 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.

68. Under the Management Agreement, the initial Management Fee, Brand Licence fee, and Responsible Entity fee will be incurred upon execution of the Agreement. This fee is charged for providing services to Growers for a period of not more than 13 months from the date of execution of the Agreement. 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.

69. 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'.

70. Similar considerations apply to the Allotment Fee which, under the Allotment Agreement, is payable on or before 31 May each year for a period from the 1 June of that year to 31 May of the following year. Again, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure for the Allotment Fee by Growers who are 'small business taxpayers'.

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

71. 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.

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

73. The deduction available to Growers for the Management fee, Brand Licence fee, Responsible Entity fee and the Allotment fee will be determined in accordance with the rules contained in section 82KZMB.

74. 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

75. 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.

76. 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 (eg., 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.

77. The arrangement relating to the Project and described at paragraph 15 to 32 of this product ruling is within the description of a 'tax shelter arrangement'. Therefore, the Management Fee, Brand Licence fee, Responsible Entity fee and the Allotment Fee incurred by Growers who invest in the Project after 1pm AEST 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).

Section 82KK

78. Section 82KK deals with schemes designed to postpone a tax liability where there are dealings between associated parties.

79. Provided that the only association between the Member (as a Partner in the Partnership), ARGML and MRLL arises from the agreements referred to herein and in the Project Constitution, section 82KK should not apply to deny a deduction in respect of any prepaid expenditure incurred by the Partnership under any of those agreements.

Part IVA

80. For Part IVA to apply there must be a 'scheme' (section 177A of ITAA 1936); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Mountain River Dried Foods Project No 1 is a 'scheme' commencing when the Prospectus was issued. However, it is not possible to conclude that Grower/Processors will enter into the scheme with the dominant purpose of obtaining a tax benefit.

81. Growers/Processors to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting and sale of the fruit and vegetables.

Trading stock

82. Taxation Ruling TR 94/13 considers trading stock in relation to various marketing arrangements as they apply to cotton growers.

83. Under the Project's Constitution, raw fruit and vegetables are 'pooled' prior to sale and processing. When this pooling occurs, ARGML will hold the produce on behalf of the Partnership prior to sale.

84. Where the Partnership agrees with ARGML to have its fruit and vegetables 'pooled', the Partnership will have dispositive power over the fruit and vegetables and will be in possession of trading stock.

Examples

Example 1: Obligation to prepay expenditure arising on or after 11:45am AEST 21 September 1999 and before 1pm AEST 11 November 1999– applies to taxpayers who are not small business taxpayers and are carrying on a business:

85. 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 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 = (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':

86. 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:

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

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

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

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

Commissioner of Taxation
7 June 2000

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
IT 175; TR 92/1; TR 92/20;
TR 94/13; TR 97/11; TR 97/16;
TD 93/34; TR 98/22; PR 1999/95;

Subject references:
- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- primary production
- primary production expenses
- producing assessable income

- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:
- ITAA 1936 82KK
- ITAA 1936 82KL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMB
- ITAA 1936 82KZMB(2)
- ITAA 1936 82KZMB(3)
- ITAA 1936 82KZMB(5)
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1936 92
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(1)(b)
- ITAA 1997 8-1(2)(a)
- ITAA 1997 27-5
- ITAA 1997 27-30
- ITAA 1997 Subdiv 960Q
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350

ATO references:
NO 99/16970-2
BO
FOI number: I 1020850
ISSN: 1441-1172