

PR 2000/88 - Income tax: Neem Australia Project No.1

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 This document has changed over time. This is a consolidated version of the ruling which was published on *25 June 2001*



Product Ruling

Income tax: Neem Australia Project No.1

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	44
Proposed new laws	50
Explanations	54
Detailed contents list	93

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.*

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

No guarantee of commercial success

Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

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

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Neem Australia Project No.1, or just simply as 'the Project'.

Tax law(s)

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

- section 6-5 (*Income Tax Assessment Act 1997* (ITAA 1997));
- section 8-1 (ITAA 1997);
- section 27-5 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM and 82KZMB - 82KZMD (ITAA 1936); 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 the announcement and others are proposed to apply from nominated dates in the future.

4. Although this Ruling mentions certain of those announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally binding advice in respect of those changes cannot be given until the relevant law(s) are enacted.

5. However, if the changes become law, the operation of that law will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded. If requested, when the relevant law(s) are enacted, the Commissioner will formalise the non-binding information shown in this Ruling by issuing a new product Ruling that describes the operation of those law(s).

6. This ruling does not deal with the application of the Goods and Services Tax (GST).

Class of persons

7. 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'.

8. 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

9. The Commissioner rules on the precise arrangement identified in this ruling. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

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

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Date of effect

11. This Ruling applies prospectively from 12 July 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).

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 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 arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 6 April 2000;
- The Neem Australia Project No.1 Draft Prospectus, dated 30 June 2000;
- **Constitution for the Neem Australia Project No.1 between Primary Securities Ltd [the 'Responsible Entity'], Primary Securities Ltd ['the Bare Trustee'] and the Grower, undated;**
- **Draft Management Agreement between Plantation Developments Pty Ltd [the Manager], Primary Securities Ltd [the 'Responsible Entity'], Primary Securities Ltd ['the Bare Trustee'] and the Grower, dated 4 April 2000;**
- **Draft Licence between David Richard McDonald [Licensor], Primary Securities Ltd [the 'Responsible Entity'], and the Grower, dated 24 March 2000;**
- **Draft Licence between Australian Property Enterprises Pty Ltd [Licensor], Primary Securities**

Ltd [the ‘Responsible Entity’], and the Grower, undated;

- **Draft Neem Produce Sale Agreement between Primary Securities Ltd [the ‘Responsible Entity’], Primary Securities Ltd [‘the Bare Trustee’], Neem Products Australia Pty Ltd [the Buyer], Gillard Turner & O’Brien Pty Ltd T/as Custodian & Funds Management Services [the Custodian] and the Grower, dated 24 March 2000;**
- Further correspondence dated 15 April 2000, 20 April 2000, 21 April 2000, 26 May 2000, 14 June 2000, 21 June 2000, 23 June 2000, 26 June 2000, 29 June 2000 and 30 June 2000.

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

15. The documents highlighted are those the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be a party to, with the exception of finance agreements, to which paragraphs 42 to 44 apply. The effect of these agreements is summarised as follows.

Overview

16. These arrangements are called the Neem Australia Project No.1.

Location	North Queensland, 330 kilometres south-west of Cairns and Lakeland between Mareeba and Cooktown, North Queensland.
Type of business each participant is carrying on	To carry on a commercial venture for the collection of Neem Tree produce and the sale of that produce for a period of 12 years.
Number of hectares under cultivation	120 hectares
Name used to describe the product	Neem Australia Project No.1

PR 2000/88

Size of each Woodlot	0.3 hectares
Number of Neem trees per hectare	400
Expected production	9000 kilograms/Woodlot per annum
The term of the investment in years	12 years.
Initial cost	\$8,800
Initial cost per hectare	\$29,333
Ongoing costs	Annual Management Fees and Licence Fees.

17. Growers accepted under the Draft Prospectus dated 30 June 2000 enter into a Management Agreement and a Licence Agreement. The Licensors agree to licence to the Grower an identifiable area of land called a 'Woodlot', until the Project is terminated on 30 June 2012. Each Woodlot is 0.3 hectares in size.

18. The Project Land is situated in the Gilbert River region of North Queensland, approximately 330kms south-west of Cairns and Lakeland, between Mareeba and Cooktown in North Queensland. David Richard McDonald owns one portion of the land and Australian Property Enterprises Pty Ltd owns another portion of the land.

19. The Licensors will grant a licence to the Grower to use one or more Woodlots for the purpose of growing Neem trees and farming the produce from the trees.

20. The Draft Prospectus states that there is no minimum subscription. Each investor may subscribe for a minimum of one Woodlot. The Manager will plant a minimum of 120 Neem trees per Woodlot (400 per hectare) during the period up to 30 June 2001 following the execution of the Management Agreement and Licence Agreement.

21. Possible projected returns for Growers have been provided for the project. The draft Prospectus states that the Project is a 12 year term commercial forestry venture and is subject to the risks and liabilities attendant on such projects. These risks include drought, flood, fire, acts of God and insect infestation. Plantation Developments Pty Ltd has outlined the risks in the Draft Prospectus and has stated in the Prospectus that participation in the Project is intended to be of a long term nature in commercial forestry, and therefore subject to the attendant risks and should be considered speculative. Based on the information on page 21 of the Draft Prospectus, a Grower could expect to achieve an internal rate of return of 24.75% per Woodlot. Growers will execute a Power of Attorney enabling the Responsible Entity, Primary Securities Ltd, to act on their behalf as required when they make an application for a Woodlot.

Constitution

22. The Constitution for the project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Responsible Entity will keep a register of Growers. Growers are entitled to assign their Grower's Interest in certain circumstances. As stated in paragraph 7 above, this ruling only applies to those Growers who have a purpose of staying in the arrangement for the full term of the Project. The Licence and Management Agreements will be executed on behalf of a Grower following them signing the Application and a Power of Attorney Form in the Prospectus. Growers are bound by the Constitution and the Licence and Management Agreements by virtue of their participation in the Project.

Compliance Plan

23. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Law. Its purpose is to ensure that the Responsible Entity meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

Interest in Land

24. A licence is granted by the Land Owners, David Richard McDonald and Australian Property Enterprises Pty Ltd, to the Growers under the terms of the Licence Agreement (cl.2.1). Growers are granted an interest in land in the form of a licence to use their Woodlots for the purpose of cultivating trees and collecting produce from the trees (Recital C). Growers must pay a license fee of \$220 per Woodlot per annum to the Licensors payable on application, and payable annually in arrears commencing on 30 June 2002. This fee will be indexed annually. The term of a Grower's licence is from the Commencement Date until 30 June 2012.

Management Agreement

25. Each Grower enters into a Management Agreement with the Manager. The termination of the project is 30 June 2012 and once payment of proceeds from the sale of produce derived from the trees during the term and all accounts and reports in relation thereto have been given as provided in the agreement (cl.3). Growers contract with the Manager to prepare Woodlots and plant and tend to the trees according to the principles of good forestry. Growers pay a Management Fee of \$6,429.50 in Year One, \$495 in Year Two and

\$495 per Woodlot or 10% of the Prescribed Portion of Gross Receipts for each such period, whichever is the greater, for each financial year thereafter.

26. The Manager will carry out the following services under this agreement:-

- prepare and grade the Woodlots in a proper and skilful manner pursuant to the Management Plan;
- embark on such operations as may be required primarily and principally to prevent or combat land degradation in relation to the Woodlots;
- select and purchase plantable trees which, to the best of the knowledge and belief of the Manager, are high yielding and being of the specie or species as set out in the Management Plan, and plant the Trees so selected on the Woodlots in healthy condition in accordance with the Management Plan;
- tend to the Trees according to the principles of good forestry, including watering, pruning, fertilising and fumigating as the Manager deems appropriate to promote Tree growth and yields;
- maintain such fences as exist on the Plantation to prevent damage by wildlife and protect the placements of Trees;
- keep the Woodlots in good and substantial repair and condition and conduct activities on them in a commercial manner in keeping with accepted silviculture industry standards; and
- do such things as may reasonably be required to eradicate, exterminate and keep the Woodlots and the Plantation free from disease, rodents, vermin, noxious weeds, rabbits, insect pests and all other pests of any kind, that may impact on the growth and performance of the Trees.

27. The Manager will be responsible for paying for the cost of a public risk insurance policy in respect of the Plantation (cl. 5(m)).

28. A Grower can terminate the Management Agreement where the Manager goes into liquidation or if a receiver is appointed of the undertaking of the Manager or where the Manager has failed to satisfy any substantial duty imposed on it under the agreement and the Manager has failed to comply with a notice that has been served on it by the Grower. (cl.16).

29. The Manager will provide a report to Growers no later than 30 September each year summarising the operations performed on the Plantation and a report within 60 days after the sale of any Produce on behalf of the Grower setting out details of the sale of the Produce. (cl.12).

Planting

30. During the period up to 30 June 2001 the Manager will be responsible for planting the Neem Trees on the licenced area. After 30 June 2001, the Manager will tend to the Trees according to the principles of good forestry. The services to be provided by the Manager over the term of the project are outlined in the Management Agreement (Cl 5).

Harvesting

31. The Manager will collect as and when deemed appropriate in keeping with sound Neem forestry practice, to produce the best results for the Grower (cl 8).

32. The Manager will be responsible for the collection of the Produce in the nets and/or heavy duty weed mats. The Collection will take place as and when deemed appropriate by the Manager in keeping with sound Neem forestry practice, to produce the best results for the Grower.

33. A Grower may make an election by 30 June 2001 to sell their own Produce Collected from their Woodlot. Where no election is made, the Grower enters into the Neem Produce Sale Agreement whereby all Produce Collected from the grower's Woodlot is purchased by Neem Products Australia Pty Ltd.

34. Where an election has not been made, the Receipts from the sale of the Neem Produce will be paid into the Trust Account and held on behalf of the Grower by the Bare Trustee in the name of the Custodian. Receipts received by the Bare Trustee are to be distributed in the following order of priority:

- to pay the Adjusted Prescribed Proportion on the costs of sale as advised by the Manager;
- to pay to the Responsible Entity such amount as the Responsible Entity on the advice of the Manager reasonably estimates may be required within the following 12 months to pay for any estimated Project Fees which will become payable by the Grower;

- to pay to the Manager for any outstanding fees, costs or interest owing by the Grower to the Manager under the Management Agreement;
- to pay to the Licensors any outstanding Licence Fee or other Fees, costs, interest or expenses owing by the Grower to the Licensors under the Licence Agreements, and then
- to the Grower provided that if the aggregate sum to be distributed is less than \$1,000, then at the discretion of the Responsible Entity, distribution to Growers may be postponed. (cl 12 of Constitution).

Fees

35. The total Fee payable in the first year under the Management Agreement for the Project is \$8,580 per Woodlot. This fee includes the Management Fee of \$6,429.50 which is payable on application. The balance of the Fee is made up of fees for Supply of Organic Neem Trees of \$528, Irrigation costs of \$825, Landcare expenses of \$462, Land Clearing expenses of \$203.50 and Planting costs of \$132 which are all payable on application (schedule to the Management Agreement). These services will be commenced after the Grower has been accepted into the Project and will be completed on or before 30 June 2001.

36. A Management Fee of \$495 is payable for services to be carried out in the period commencing 1 July 2001 until 30 June 2002 and is payable on 30 June 2002.

37. For the years 1 July 2002 until 30 June 2012, a Management Fee of \$495 or 10% of the Prescribed Proportion of Gross Receipts, which ever is the greater, is payable annually in arrears for the periods 1 July to the following 30 June commencing on 30 June 2003 and thereafter on 30 June each year.

38. A Licence Fee of \$220 per year, indexed annually by 2.5%, is payable in arrears on 30 June of each year by the Grower.

39. The Independent Forester's report, at pages 31 - 36 of the Draft Prospectus, states that the expertise of the International Neem Advisory Panel, as well as the ideal selection of the Plantation and professional management, should result in a successful Plantation and a rewarding investment for Growers.

40. All of the fees referred to above include GST.

Finance

41. All Growers are required to fund their investment in the Project themselves or borrow from an independent lender.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- 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 the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of 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, directly or indirectly) back to the lender, or any associate of the lender; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers;
- entities associated with the Project, are involved or become involved, in the provision of finance to Growers for the Project.

43. There is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance to the Growers for any purpose associated with the Project.

Ruling

Section 6-5

44. Gross sale proceeds derived from the sale of Neem produce from the Project will be assessable income of the Growers, under section 6-5 of ITAA 1997.

PR 2000/88**Section 27-5**

45. For a Grower who invests in the Project, section 27-5 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 a decreasing adjustment that a Grower has.

Section 8-1

46. For a Grower who invests in the Project by 30 June 2001, the following deductions will be available for the years ended 30 June 2001 to 30 June 2003:

Deductions available each year

Fee Type	ITAA 1997 Section	Year 1 30/6/2001	Year 2 30/6/2002	Year 3 30/6/2003
Management Fee	8-1	\$6,429.50	\$495	\$495
Licence Fee	8-1	\$220	\$220 (subject to indexation)	\$220 (subject to indexation)
Tree Establishment Costs	387-165	Nil	Nil	see note (i) below
Irrigation	387-125	\$275 see note (ii) below	\$275	\$275
Landcare	387-55	\$462	Nil	Nil

Note: all amounts include GST.

(i) A deduction under section 387-165 for expenditure on acquiring and planting the Trees is calculated on the basis of the Trees, as horticultural plants, entering their first commercial season in the year ended 30 June 2003 and a Grower determining, under section 387-175, that they have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years. This results in a write-off rate of 13%. The amount to be written off under this provision is \$797.50.

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

Division 35 – Deferral of losses from non-commercial business activities**Section 35-55 – Commissioner’s discretion**

46.1. For a Grower who is an individual and who entered the Project on or after 3 March 1999 and prior to any withdrawal of this Product Ruling the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2002 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be carried on in a manner that is not materially different to the arrangement described in this Ruling.

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

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

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

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

Sections 82KZM and 82KZMB-D

47. For a Grower who invests in the Project the following provisions of the ITAA 1936 have applications as indicated:

- i. the expenditure by Growers does not fall within the scope of section 82KZM;
- ii. the expenditure by Growers does not fall within the scope of sections 82KZMB-82KZMD.

Section 82KL

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

Part IVA

49. 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

Losses from non-commercial business activities

50. Provisions introduced into Parliament, but not yet enacted, will mean that in some circumstances, losses arising from a business activity will not be allowed as deductions in the year that they arise. These provisions will only apply from 1 July 2000 to individual taxpayers (including individual taxpayers in general law partnerships) carrying on a business activity. They will not apply however, to an individual with a loss from a primary production business activity where their non primary production assessable income for the income year (excluding any net capital gain) is less than \$40,000 (proposed subsection 35-10(4)).

51. Under proposed subsection 35-10(2), where an individual taxpayer's business activity does not meet one of the objective tests set out in proposed sections 35-30, 35-35, 35-40 and 35-45 then, unless the Commissioner exercises the discretion in proposed section 35-55, a loss arising in an income year from the taxpayer's business activity cannot be claimed as a deduction in that year. A loss, in this context, refers generally to the excess of a taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

52. The Project's agreements, its (draft) prospectus, and its cash flow projections, show that Growers are expected to incur losses relating to interests in the Project during the Project's early years and, that none of the objective tests are expected to be met in those years. However, provided that a Grower's business activity under the Project is carried on during the income years specified below in the manner described in the Arrangement, the Commissioner will exercise his discretion under proposed paragraph 35-55(1)(b).

53. Provided the provisions are enacted as introduced, subject only to the above condition relating to the Arrangement (discussed below at paragraphs 91 and 92), exercise of the discretion will mean Growers

can deduct losses arising from their interest(s) in the Project in the years that such losses arise.

Explanations

Section 6-5 ITAA 1997: assessable income

54. Gross sale proceeds derived from the sale of Neem produce from the Project will be assessable income of the Growers, under section 6-5 of ITAA 1997.

55. Once harvested, a Grower's produce will be trading stock of the Grower. As a consequence, if produce is on hand at the end of the income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of ITAA 1997.

56. Each Grower will be notified by Plantation Developments Pty Ltd of the respective amounts to be brought to account in proportion to their total holding in the Project, in accordance with part 2-25 and Taxation Ruling IT 2001.

Sections 27-5 ITAA 1997 - Goods and Services Tax

57. Section 27-5 of the ITAA 1997 operates to deny a deduction, that would be otherwise available under section 8-1, to the extent that the loss or outgoing incurred (on or after 1 July 2000) includes an amount relating to an input tax credit to which a Grower is entitled or a decreasing adjustment that a Grower has.

Section 8-1 ITAA 1997

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

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoing is not deductible under paragraph 8-1(1)(b) if it is incurred when the business has not commenced; and
- where 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 paragraph 8-1(1)(a) in determining whether the outgoing in question would have a sufficient connection with activities to produce assessable income of the taxpayer.

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

60. Generally, a Grower will be carrying on a horticultural business where:

- the Grower has an identifiable interest in specific trees coupled with a right to collect and sell the produce from the trees;
- the horticultural activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business, as used by the Courts, point to the carrying on of a business.

61. Under the Licence Agreement, 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 a commercial horticultural project. Under the Management Agreement, Growers appoint Plantation Developments Pty Ltd, as Manager, to carry out silviculture farming in accordance with the agreement. The agreements give Growers full right, title and interest in the tree produce and the right to sell the produce for their benefit.

62. Under the Management Agreement, Growers appoint the Manager to provide services such as purchase and plant Trees in a healthy condition on the Woodlots, the installation of irrigation, and to tend to the Trees according to the principles of good forestry. The Manager is also responsible for collecting and selling the produce. The specific cost of these services provided in the initial period is \$8,580.

63. The Licence gives Growers an identifiable interest in specific trees and a legal interest in the land by virtue of a licence. Growers enter into a Produce Sale Agreement for the sale of their produce.

64. Growers have the right to use the land in question for the cultivation of trees and the collection of produce and to have the Manager enter the land to carry out its obligations under the Management Agreement. The Growers' degree of control over the Manager, as evidenced by the Agreement and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Manager's activities. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of neglect, failure to satisfy any substantial duty or the Manager going into liquidation. The activities described in the Management Agreement are carried out on the Growers' behalf.

65. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, 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 with appropriate credentials. The services are based on accepted silviculture practices and are of the type ordinarily found in horticultural activities.

67. Growers have a continuing interest in the trees from the time they are acquired until they reach the end of the most productive period of their life. There is a means to identify which trees Growers have an interest in. The horticultural activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' horticultural activities will constitute the carrying on of a business.

68. The management fees and licence fees associated with the horticultural activities will relate to the gaining of income from this business and, hence, have a sufficient connection to the operations by which this income (from the sale of Neem produce) is to be gained from this business. They will, thus, be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The amount deductible in the first year under section 8-1 is \$6649.50 after removing the capital component identified in the fee.

Expenditure of a capital nature

69. Any part of the expenditure of a Grower entering into a horticultural 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. In this Project, the costs of irrigation, trees and landcare operations are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, expenditure of this nature can fall for consideration under specific capital write-off provisions of the ITAA 1997.

Subdivision 387-B ITAA 1997: irrigation expenditure

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

71. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant or lessee, a deduction would be available to the Growers in the Project at a rate of 33.3% per annum for the cost of the irrigation system.

Section 387-165 ITAA 1997: horticulture expenditure

72. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. 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 clearing land. Under subsection 387-170(3), the definition of 'horticulture' includes the cultivation of Neem trees. For the purpose of this Subdivision, a lessee or licensee of land carrying on a business of horticulture is treated as owning the plants growing on that land rather than the actual owner of the land.

73. The write-off commences from the time the trees are used or held ready for use for the purpose of producing assessable income in commercial horticulture. The write-off deductions will commence when the trees enter their first commercial season. Where the trees are planted in or about late September/early October 2000, it is projected that these trees will become commercially productive after a period of 2 years. The Manager will advise the Grower of this event.

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

75. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the trees will have an effective life in excess of 13 years. The write-off rate for horticultural plants with an effective life of 13 to 30 years is 13%.

Section 387-55 ITAA 1997: landcare Expenses

76. Section 387-55 allows a deduction for capital expenditure that is incurred on a Landcare Operation for land in Australia that is being used for carrying on a business of primary production or rural land in Australia that is used for carrying on a business for the purpose of producing assessable income from the use of that land.

77. 'Landcare Operation' for land includes an operation primarily and principally for the purposes of eradicating or exterminating from the land animals that are pests or eradicating, exterminating or the destruction of weed or plant growth detrimental to the land. It also includes constructing surface or subsurface drainage works on the land if the construction is primarily and principally for the purpose of controlling salinity or assisting in drainage control.

78. Under the Management Agreement, the Grower incurs expenditure for the destruction of weeds on the Woodlots and to keep the land free from disease, vermin, noxious weeds, rabbits, insect pests and all other pests. The Grower is accepted as carrying on a business of primary production and these expenses will be deductible under section 387-55 of the ITAA 1997 in the year they are incurred.

Sections 82KZM and 82KZMB - 82KZMD ITAA 1936

79. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full under section 8-1 of the ITAA 1997. The section applies to certain expenditure incurred under an agreement in return for doing of a thing under the agreement that is not wholly done within the same year of income as the execution of the relevant agreement.

80. Under the Licence and Management Agreements, fees of \$8,800 per Woodlot will be incurred on the execution of those Agreements. The fees are charged for providing services to a Grower by 30 June of the year of execution of the Agreement. The fee is 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.

81. There is also no evidence that might suggest the services covered by the fee could not be provided in the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Project Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure incurred by the Grower. New sections 82KZMB, 82KZMC and 82KZMD also have no application to this Project since the services to be provided in respect of the initial fee are completed in the same year of income as the expenditure is incurred (see paragraph 82KZMA(3)(c)).

Section 82KL ITAA 1936

82. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits'. In the project, insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA ITAA 1936

83. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Project will be a 'scheme', commencing when the Prospectus is issued. The Growers will obtain an initial '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.

84. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting of produce from the trees. The Independent Forester's Report contained in the Prospectus states that the expertise of the International Experts Advisory Panel, as well as the ideal site location of the Plantation and professional management, should result in a successful Plantation. There are no features of the Project that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Proposed changes to losses from non-commercial business activities

85. Under the rule in proposed subsection 35-10(2), a deduction for losses incurred by individuals (including individuals in general law partnerships) from certain business activities will not be allowable in an income year unless:

- one of four statutory objective tests is met; or
- the Commissioner exercises a discretion to allow the losses.

86. In broad terms, the statutory tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

87. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities of a similar kind. And, under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the losses are from primary production business activities and the individual taxpayer has other assessable income for the income year of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of taxpayers they are beyond the scope of this Product Ruling and are not considered further.

88. Information provided with the application for this Product Ruling indicates that investors in the Project are unlikely to pass one of the statutory tests until the income year ended 30 June 2005 and therefore, unless the Commissioner exercises a discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer the loss from the business activity to a future year.

89. The discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for individual investors who acquire interests in the Project, the

Commissioner has determined that it would be unreasonable not to exercise the discretion in paragraph 35-55(1)(b).

90. The discretion in paragraph 35-55(1)(b) may be exercised where:

- (i) the business activity has started to be carried on; and
- (ii) there is an objective expectation that the business activity of an individual taxpayer with an interest in the Project will either pass one of the statutory tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

91. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above in the manner described in the Arrangement, the Commissioner's discretion will not have been exercised as one of the key conditions in paragraph 35-55(1)(b) will not have been met.

92. In deciding to exercise his discretion, should the proposed new law be enacted as introduced into Parliament, the Commissioner has relied upon:

- the report of the independent forester and additional expert or scientific evidence provided with the application by the Responsible Entity.

Detailed contents list

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

	Paragraph
What this Product Ruling is about	1
Tax law(s)	2
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	16
Constitution	22
Compliance Plan	23
Interest in Land	24

Management Agreement	25
Planting	30
Harvesting	31
Fees	35
Finance	41
Ruling	44
Section 6-5	44
Section 27-5	45
Section 8-1	46
Division 35 – Deferral of losses from non-commercial business activities	46.1
Section 35-55 – Commissioner’s discretion	46.1
Sections 82KZM and 82KZMB-D	47
Section 82KL	48
Part IVA	49
Proposed new laws	50
Losses from non-commercial business activities	50
Explanations	54
Section 6-5 ITAA 1997: assessable income	54
Sections 27-5 ITAA 1997 – Goods and Services Tax	57
Section 8-1 ITAA 1997	58
Expenditure of a capital nature	69
Subdivision 387-B ITAA 1997: irrigation expenditure	70
Section 387-165 ITAA 1997: horticulture expenditure	72
Section 387-55 ITAA 1997: landcare expenses	76
Sections 82KZM and 82KZMB – 82KZMD ITAA 1936	79
Section 82KL ITAA 1936	82
Part IVA ITAA 1936	83
Proposed changes to losses from non-commercial business activities	85
Detailed contents list	93

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Commissioner of Taxation

12 July 2000

Previous draft:

Not previously issued in draft form.

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 97/11;
TR 97/16; TD 93/34; IT 175;
TR 92/20; IT 2001

Subject references:

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

Legislative references:

- ITAA 1997 8-1
 - ITAA 1997 27-5
 - ITAA 1997 Div 35
 - ITAA 1997 35-10
 - ITAA 1997 35-10(4)
 - ITAA 1997 35-30
 - ITAA 1997 35-35
 - ITAA 1997 35-40
 - ITAA 1997 35-45
 - ITAA 1997 35-55
 - ITAA 1997 35-55(1)
 - ITAA 1997 35-55(1)(b)
 - ITAA 1997 387-55
 - ITAA 1997 387-125
 - ITAA 1997 387-165
 - ITAA 1936 82KL
 - ITAA 1936 82KZM
 - ITAA 1936 82KZMB
 - ITAA 1936 82KZMC
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 - ITAA 1936 Pt IVA
 - TAA 1953 Pt IVAAA
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