



PR 2000/90 - Income tax: Kaarimba Fresh Fruit Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *12 July 2000*



Product Ruling

Income tax: Kaarimba Fresh Fruit Project

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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.

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 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 laws' identified below apply to the defined class of person, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Kaarimba Fresh Fruit Project, or just simply as 'the Project'.

Tax law(s)

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

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 8-1 (ITAA 1997);
- section 27-5 (ITAA 1997);
- section 35-10 (ITAA 1997);
- section 35-55 (ITAA 1997);
- section 42-15 (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 (ITAA 1936);
- Part IVA (ITAA 1936).

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

4. The Government is currently evaluating further changes to the tax system in response to the Ralph Review of Business Taxation and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. 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 any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. The class of persons to whom this Ruling applies is those who enter into either of the arrangements described below on or after the date this Ruling is made. They will have a purpose of staying in the relevant 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'. 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. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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

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Date of effect

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

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely 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, this 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 material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling Kaarimba Fresh Fruit Project ('the Project') received by the Australian Taxation Office ('ATO') 20 April 2000;
- Project's Information Memorandum received by the ATO 20 April 2000, undated;
- Marketing Agreement between Eastfield Orchards Pty Ltd ('Marketer') and Prentice Orchards ('Orchard Manager'), received by the ATO 20 April 2000, undated;

- **Zee Sweet Grower Agreement** between Zee Sweet Pty Ltd and the Grower received by the ATO 2 June 2000, undated;
- Additional correspondence from applicant's legal adviser received by the ATO 6 June 2000;
- Guarantee and Indemnity Agreement between the Lessor and the Guarantor received by the ATO 2 June 2000, undated;
- Amended **Lease and Management Agreement** between Andrew James Prentice and Linda Gaye Prentice ('Lessor') and Prentice Orchards Pty Ltd ('Orchard Manager') and the Grower, received by the ATO 30 June 2000, undated;
- Letter of Offer for business finance between the Lessor and the lending Bank dated 18 May 2000;
- Facsimiles from the applicant's legal adviser received by the ATO 16, 21 and 22 June 2000;
- E-mailed Taxation Opinion and Addendum to the Information Memorandum from the applicant's legal adviser received by the ATO 4 July 2000.

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

15. The documents highlighted above are those that the Growers enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be party to, other than those to which paragraphs 44 applies. The effect of these agreements are summarised as follows:

Overview

16. The arrangement is called the 'Kaarimba Fresh Fruit Project' which, in this document, is referred to as 'the Project'.

Location	The Project Growers will lease land from Andrew James Prentice and Linda Gaye Prentice at Kaarimba approximately 20 kilometres north of Shepparton, Victoria.
Type of business each Participant is carrying on	Commercial growing of fruit trees.

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Number of hectares under Cultivation	80 hectares												
Name used to describe the Project	Kaarimba Fresh Fruit Project												
Size of the Leased Area	2.5 hectares (minimum of two per subscription)												
Number of trees per hectare	1,960 approximately												
Expected production	For year eight of the Project: Apples 62 tonnes/ha Pears 39 tonnes/ha Peaches & Nectarines 60 tonnes/ha Plums & Pluots 52.4 tonnes/ha Cherries 22 tonnes/ha Apricots 36 tonnes/ha												
The term of the investment	12 years ending 30 June 2012												
Cost per leased area	<table><tr><th>1 Leased Area</th><th>2 Leased Areas</th></tr><tr><td>30 June 2001</td><td>78,760 157,520</td></tr><tr><td>30 June 2002</td><td>81,725 163,449</td></tr><tr><td>30 June 2003</td><td>49,308 98,615</td></tr></table> For years ending 30 June 2001 to 2003 Growers subscriptions are paid quarterly. Amounts shown do not include GST.	1 Leased Area	2 Leased Areas	30 June 2001	78,760 157,520	30 June 2002	81,725 163,449	30 June 2003	49,308 98,615				
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30 June 2001	78,760 157,520												
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Cost on a per hectare basis	<table><tr><td>30 June 2001</td><td>\$31,504</td></tr><tr><td>30 June 2002</td><td>32,690</td></tr><tr><td>30 June 2003</td><td>19,723</td></tr><tr><td></td><td>-----</td></tr><tr><td></td><td>\$83,917</td></tr><tr><td></td><td>=====</td></tr></table> For years ending 30 June 2001 to 2003 Growers subscriptions are paid quarterly. Amounts shown do not include GST.	30 June 2001	\$31,504	30 June 2002	32,690	30 June 2003	19,723		-----		\$83,917		=====
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	\$83,917												
	=====												
Minimum Subscription	The Project does not require a minimum Grower participation before proceeding. However this is not a Project to which the prospectus requirements of the Corporations Law apply. The offer in the Unregistered Prospectus is made to, and applications will only be accepted from, persons that satisfy the exceptions of section 708 of the Corporations Law.												

Ongoing costs per Leased Area	All ongoing costs are paid by Growers within the cost per leased area.
Other costs	Growers are charged for ongoing management and operating costs, machinery rental, irrigation, trees, trellising, and rent. All of these charges are included in the costs shown as cost per leased area and cost on a per hectare basis. Growers may be required to make further contributions in a year or years after year 4 of the Project in the event that sales revenue does not exceed orchard costs.

17. The Orchard is situated at Kaarimba, approximately 20 kilometres north of Shepparton, Victoria a premium fruit growing region. The Project will establish and operate a stone and pome fruit orchard of approximately 157,000 trees on a planted area of 80 hectares over a period of 12 years. The Orchard will be divided into 32 Leased Areas, each of 2.5 hectares.

18. Growers entering into the Project will enter into a Lease and Management Agreement and will lease a minimum of 2 Leased Areas (5 hectares) from the Lessor until the period ending 30 June 2012 at a cost of \$2000 per year for the 2 Leased Areas, in arrears. Pursuant to the Lease and Management Agreement the Grower's name is matched with a readily identifiable parcel of land, identified in schedule 1 attached to the Lease and Management Agreement.

19. Under the Lease and Management Agreement the Grower will also contract with the Orchard Manager for the establishment, management and harvesting of the fruit for the duration of the Project. The management fee for the period ending 30 June 2001 is \$19,825 per 2 Leased Areas. The management fee thereafter is \$8,750 per 2 Leased Areas payable in arrears for management services to be done in that year.

20. Growers may also contract with the Orchard Manager to market the fruit or they may elect to market the fruit themselves. The Orchard Manager will enter into an agreement with associated entity, Eastfield Orchards Pty Ltd, for the marketing of the fruit of the Project for non-electing growers.

21. Fruit tree varieties to be planted in the Project comprise a mix of new and proven varieties of:

- Apples
- Peaches
- Nectarines
- Cherries
- Pears

- Plums
- Pluots
- Apricots

22. All trees will be grown on an open V Tatura Trellis system to maximise fruit yield.

23. The orchard has a reliable source of good quality water and will include a computerised micro-irrigation system to ensure efficient use of water to grow high yielding trees.

24. Projected returns for Growers are outlined in the Information Memorandum. The projected returns depend on a range of assumptions and do not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Project. Growers will execute a power of attorney enabling the Orchard Manager to act on their behalf as required when they make an application for Leased Areas.

25. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

26. The Manager does not propose to accept applications to the Project after 30 September 2000. Applications will only be accepted where the exception requirements of section 708 of the Corporations Law will be complied with. Section 708 specifies certain requirements that a Grower must satisfy and/or certain requirements relating to the level of Grower participation in the Project.

Lease and management agreement

27. Under the Lease and Management Agreement Growers enter into a lease from the Commencement Date and ending at 30 June 2012.

28. The Growers will make payments towards the Project under the Lease and Management Agreement. These payments are for lease and management fees, irrigation, orchard operational costs, machinery rental, trellising and trees. Such payments will be for services provided in the year of payment with no prepayment for services to be provided after the year end.

29. The Lessor grants each Grower a lease of a minimum of two leased areas (set out in a Clause 3 of the Lease and Management Agreement) and each Grower:

- will not use or permit any other person to use the leased area for any purpose other than that of commercial horticulture and the Project;

- will not erect any building or construction (whether temporary or permanent) on the leased area, except with the approval of the Lessor and for the purpose of commercial horticulture and the Project; and,
- will not use, or permit any other person to use the leased area for residential, recreational or tourist purposes.

30. In return, each Grower may peaceably possess and enjoy the leased areas during the term of the lease without any interruption or disturbance from the Lessor or any other person lawfully claiming through the Lessor, cls 8. The Grower is also entitled to use Common Areas for the purposes incidental to the use of the Leased Areas for the purposes of the Project.

31. Each Leased Area will be identified by a reference number on a plan of the Orchard and together with all other Leased Areas of all Growers, (schedule 1 and 2 of the agreement).

32. At the completion, or sooner determination of the term of the lease, each Grower will peaceably surrender and yield up to the Lessor the leased area and fixtures, free and clear of rubbish, and in good and substantial repair, order and condition.

33. At the completion of the Project, the Lessor shall acquire the Trees, Trellis and Irrigation Systems installed on the Leased Areas for an amount fixed at \$50,000 per two Leased Areas (exclusive of GST). The Lessor shall pay the purchase price to the Grower on or before 31 December 2012, (cls25 & 26).

34. Each Grower appoints the Orchard Manager to establish and maintain the orchard and the Project on the leased area(s), and to arrange the harvest of the fruit grown on the leased area(s). The Grower is required to pay Orchard Operational costs for each Financial Year in arrears, which relate to expenses and costs incurred for goods and services provided in that Financial Year (cls 25). The Orchard Operational Costs include but are not limited to the following services:

- (a) In the 2000/2001 Financial Year, tree training, chemical and fertilizer consumption, operational staff expenses, soil management costs, rates, communication costs, consumables, horticultural supplies, insurance and motor vehicle expenses.
- (b) In the Financial Years 2001/2002 to 2011/2012 inclusive, tree training, chemical and fertilizer consumption, operational staff expenses, soil management costs, rates, communication costs, general horticultural expenses, insurance, motor vehicle

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expenses, spraying, pruning, maintenance and other horticultural costs and supplies.

35. The Orchard Manager is required to perform these Services according to good horticultural practices and may provide these services directly or through consultants or other specialists engaged at the Orchard Manager's expense (cls19). The Orchard Manager will have commenced the Services outlined in item 3, Schedule 1 on the Commencement Date and the Annual Management fee shall accrue monthly or part thereof in arrear, as outlined in clause 27 for services performed in that Financial Year. The Orchard Manager will obtain insurance against public risk in respect of the orchard. Growers may take out such additional insurance, as they require at their own expense.

36. Unless Growers have elected to market their produce themselves, the Lease and Management Agreement authorises the Orchard Manager to market the produce of their leased areas as agent of the Growers. The Orchard Manager will enter into an agreement with associated entity, Eastfield Orchards Pty Ltd, to carry out the marketing of the fruit for Growers who do not elect to market their own fruit.

Fees

37. The Growers will make the following payments per two leased areas over the first 4 years of operation:

	Year 1 30 June 2001	Year 2 30 June 2002	Year 3 30 June 2003	Year 4 30 June 2004
Rent	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,060
Management Fees	\$ 19,825	\$ 8,750	\$ 8,750	\$ 8,325
Orchard Operational Costs	\$ 87,405	\$108,344	\$ 54,269	\$ 40,265
Machinery Rental	\$ 515	\$ 3,715	\$ 5,800	\$ 5,974
Trees	\$ 20,585	\$ 17,980	\$ 17,980	\$ 17,980
Irrigation System	\$ 25,690	\$ 12,845	0	0
Trellis System	\$ 1,500	\$ 9,815	\$ 9,815	\$ 9,815
Total Grower Payments	\$157,520	\$163,449	\$ 98,614	\$ 84,419

(GST exclusive amounts)

38. The Growers will make the following payments per two leased areas in subsequent years for the remainder of the twelve year project period:

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	Year 5 30 June 2005	Year 6 30 June 2006	Year 7 30 June 2007	Year 8 30 June 2008	Year 9 30 June 2009	Year 10 30 June 2010	Year 11 30 June 2011	Year 12 30 June 2012
Rent	\$2,122	\$2,185	\$2,251	\$2,319	\$2,388	\$2,460	\$2,534	\$2,610
Management Fees	\$8,575	\$8,832	\$9,097	\$9,370	\$9,651	\$9,940	\$10,239	\$10,546
Orchard Operational Costs	\$34,213	\$61,428*	\$63,271*	\$65,169*	\$67,124*	\$69,138*	\$71,212*	\$73,349*
Machinery Rental	\$6,153	\$6,338	\$6,528	\$6,724	\$6,926	\$7,133	\$7,347	\$7,568
Trees	\$17,980	0	0	0	0	0	0	0
Trellis System	\$9,815	0	0	0	0	0	0	0
Total Grower Payments	\$78,858	\$78,783	\$81,147	\$83,582	\$86,089	\$88,671	\$91,332	\$94,073

(GST exclusive amounts)

Note: that the Orchard Costs for Year 6 to 12 are projected costs only and the actual Orchard Operational Costs for those Financial Years shall be determined by Grower approved budgeted amounts submitted by the Orchard Manager.

39. GST will be applicable to services provided by the Manager after 1 July 2000. The Lease and Management Agreement states that the GST is to be added to the amount of fees detailed above.

40. Trees are received and planted in 2 stages. First stage at end of year ending 30 June 2001 and second stage at end of year ending 30 June 2002. The Orchard Manager has negotiated that the cost of trees be paid by instalments per the above schedules.

41. The cost of the irrigation system will be incurred during the year ending 30 June 2001. The Orchard Manager will allow the Grower to pay for the system over 2 years.

42. The trellis system will be installed in two stages. Stage one of the trellis system will be purchased and installed by 31 December 2000 and stage two installed by 31 December 2001. The Orchard Manager will allow the Grower to pay for the system over 5 years.

43. The Lease and Management Agreement provides that the Orchard Manager may deduct from Grower sales revenue, orchard costs payable by Growers. Therefore, once fruit sales exceed orchard costs, Growers will not be required to make payments to orchard costs. Grower payment contributions are projected to cease in the year ending 30 June 2003.

Finance

44. Growers can fund the investment themselves or borrow up to 35% of Grower Project cost together with interest from the Lessor, Andrew and Linda Prentice.

45. The Lessor has arranged with a bank to borrow funds on security of a mortgage over the land comprising the Kaarimba Orchard.

46. Interest is payable on loans from the Lessor at the fixed rate of 10% per annum, quarterly in arrears.

47. Growers must repay all loans by the Lessor (including principal and interest) by the following instalments:

- \$40,000 per two leased areas on 30 June 2005
- \$105,000 per two leased areas on 30 June 2006
- \$94,304 per two leased areas on 30 June 2007

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- entities associated with the Projects with the exception of the arrangement as detailed in paragraphs 41 – 44, are involved in the provision of finance for the Projects;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrowers risk;
- additional benefits will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the project into a ‘scheme’ to which Part IVA may apply;
- the loan or rate of interest is non-arms length;
- repayments of the principal and interest are linked to the derivation of income from the Projects;
- the funds borrowed, or any part of them, will not be available for the conduct of the Projects but will be transferred (by any mechanism) back to the lender or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

49. Other than the arrangement referred to in paragraph 41 to 44 there is no agreement, arrangement or understanding between any entity or party associated with the Projects and any financial or other institution for the provision of any finance to the Growers for any purpose associated with the Projects.

Ruling

Section 6-5 – assessability of income from the Project

50. For a Grower who invests in the Project, all income received or receivable by them from the sale of their fruit will be assessable income to them under section 6-5 of the ITAA 1997.

Sections 27-5 - Goods and Services Tax

51. The Goods and Services Tax will be applicable to services provided by the Project Manager on or after 1 July 2000 and, in

accordance with the documentation for the arrangement, should be added to the amount of fees detailed below for such services. Also, sections 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 35-55 - losses from non-commercial business activities

52. For the income years ending 30 June 2001 to 30 June 2003 the Commissioner will decide under paragraph 35-55(1)(b) that the rule in section 35-10 does not apply to the business activity comprised by a Grower's involvement in this Project, provided that the Project is carried out in the manner described in this Ruling.

53. 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 (see paragraph 69 in the Explanations part of this ruling, below).

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

Section 8-1 - allowable deductions

55. For Growers who enter into the Project on or before 30 September 2000, subject to any effects of the Goods and Service Tax (refer to paragraph 51 above), the deduction shown in the Table below will be available for the years ended 30 June 2001 to 30 June 2003:

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Fee Type	ITAA 1997	Refer Note	Year 1 30 June 2001	Year 2 30 June 2002	Year 3 30 June 2003
Lease Fee	8-1	See note (i) below	\$2,000	\$2,000	\$2,000
Management Fee	8-1	See note (i) below	\$19,825	\$8,750	\$8,750
Operating Costs	8-1	See note (ii) below	\$87,405	\$108,344	\$54,269
Machinery Rental	8-1	See note (ii) below	\$515	\$3,715	\$5,800
Interest	8-1	See note (iii) below	as incurred	as incurred	as incurred

(All figures shown are exclusive of GST)

Notes:

- (i) A Grower incurs the Lease and Management fees for the period ending 30 June 2001 at the time the Lease and Management Agreement commences. These fees for the period ending 30 June 2001 accrue monthly in arrears and are payable in instalments as outlined in schedule 4 of the Lease and Management Agreement.
- (ii) A Grower incurs the Operating and Machinery Rental costs for the period ending 30 June 2001 at the time the Lease and Management Agreement commences. These fees for the period ending 30 June 2001 accrue monthly in arrears and are payable in instalments as outlined in schedule 4 of the Lease and Management Agreement.
- (iii) Where a Grower borrows funds in order to fund their obligation to pay the Annual Contributions for the period ending 30 June 2001 and incurs interest on such borrowing for the period to 30 June 2001, that interest will be an allowable deduction for the period ending 30 June 2001.

Deductions for capital expenditure

56. For Growers who enter into the Project on or before 30 September 2000, subject to any effects of the Goods and Service Tax (refer to paragraph 51 above), the deduction for capital expenditure shown in the Table below will be available for the years ended 30 June 2001 to 30 June 2003:

Deductions for capital expenditure Per 2 Leased Areas					
Fee Type	ITAA 1997	Refer Note	Year 1 30 June 2001	Year 2 30 June 2002	Year 3 30 June 2003
Depreciation on Trellising	42-15	See note (iv) below			
Irrigation	387-125	See note (v) below	\$12,845	\$12,845	\$12,845
Horticulture Expenditure	387-185	See note (vi) below			

- (iv) The deduction for trellising will depend upon whether or not the Grower is a 'small business taxpayer'. For Growers who are **'small business taxpayers'** and who comply with the conditions in section 42-345, the tax deduction is determined using the rates in section 42-125 and the formula in either subsection 42-160(1), 'diminishing value method', or subsection 42-165(1), 'prime cost method'. Depending upon the method the Grower selects to use, the rate for calculating the tax deduction will be 13% prime cost method or 20% diminishing value method.
- For Growers who are **not 'small business taxpayers'** the deduction for depreciation of trellising is determined using the formula in either subsection 42-160(3), 'diminishing value method', or subsection 42-165(2A), 'prime cost method'. Those formulae use 'effective life' rather than specified rates to determine the deduction for depreciation.
- The deduction allowed for the year ended 30 June 2001 will depend upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising. The Orchard Manager is to advise Growers of relevant details to calculate their depreciation deduction for the year ended 30 June 2001 and 2002.
- (v) Fees paid under the Lease and Management Agreement in relation to irrigation will constitute an allowable deduction to the Grower under section 387-125. A deduction 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 two years. The irrigation system is to be installed in Year 1. The deductions available in Years 1 to 3 have been calculated on the basis of one third of the capital expenditure incurred of \$38,535 in Year 1.

- (vi) A deduction under section 387-165 for expenditure on establishing the trees will be calculated on the basis of the trees, as horticultural plants, stage 1 will enter their first commercial season in the year ending 30 June 2003. Stage 2 is expected to enter their first commercial season in the following year. A Grower will determine, under section 387-175, that the trees will 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%.

Section 82KL, 82KZM and Part IVA

57. The following provisions of the ITAA 1936 have application for a Grower as indicated:

- (i) section 82KL does not apply to deny any deductions otherwise allowable;
- (ii) the expenditure by Growers who are small business taxpayers for things to be done wholly within 13 months of the expenditure being incurred is not within the scope of section 82KZM;
- (iii) the relevant provisions of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 6-5 – assessability of income from the Project

58. For a Grower who invests in the Project, all income received or receivable by them from the sale of their fruit will be assessable income to them under section 6-5 of the ITAA 1997.

Sections 27-5 - Goods and Services Tax

59. 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

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

61. 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’.

62. 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 of the ITAA 1997 is less than \$1,000,000.

63. ‘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 of the ITAA 1997).

Section 8-1 – management, lease, operational and rental costs

64. Consideration of whether Management fees, Lease and Orchard Operational Costs are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

Growers carrying on a business

65. An orchard scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from fruit from the scheme will constitute gross assessable income under section 6-5. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will include the planting, tending, maintaining and harvesting of the fruit trees as well as the distribution and marketing of the fruit.

66. Generally, a Grower will be carrying on a business of an orchard where:

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

67. For this Project, Growers have, under the Lease and Management Agreement, rights in the form of a Lease over an identifiable area of land consistent with the intention to carry on a business of a commercial orchard. Under these agreements, Growers appoint Prentice Orchards Pty Ltd, as Orchard Manager, to provide services such as planting, tending, pruning, training, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. The Orchard Manager is also responsible for the harvesting of the produce from the trees. Growers can also use the Orchard Manager to market and sell the produce from the trees.

68. The Lease and Management Agreement gives Growers an identifiable interest in specific trees and Growers have a legal interest in the land by virtue of this Agreement.

69. Growers have the right to use the land in question for horticultural purposes and to have Prentice Orchards Pty Ltd come onto the land to carry out its obligations under the Lease and Management Agreement. The Growers' degree of control over Prentice Orchards Pty Ltd, as evidenced by the agreements, is sufficient. Under the Project, Growers are entitled to receive on or before 30 June each Financial Year a certificate for the proceeds of the sale of fruit from the Orchard Manager as well as regular reports of the orchard's activities from the auditors. Growers are able to terminate arrangements with Prentice Orchards Pty Ltd in certain

instances, such as cases of default or neglect. The activities described in the Lease and Management Agreement are carried out on the Growers' behalf.

70. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. The independent horticultural report in the Prospectus considers the Project is realistic and commercially viable. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections in the Information Memorandum 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.

71. Growers will engage the professional services of the Orchard Manager with appropriate credentials. These services are based on accepted horticultural practices and are of the type ordinarily found in orchards that would commonly be said to be businesses.

72. The Lease and Management Agreement must specify the separate and distinct allotment or allotments as allocated by the Orchard Manager. Growers have a continuing interest in the trees from the time they are acquired or leased until they reach the end of the most productive period of their life. The orchard's 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 Grower's orchard activities will constitute the carrying on of a business.

Interest deductibility

73. Growers can fund the investment themselves or borrow up to 35% of Grower Project costs through a loan arranged through the Lessor. The interest fees incurred will be in respect of a loan to finance the establishment of the orchard, and its development in the first 3 years of the Project, which will continue to be directly connected with the gaining of 'business income' from the Project. These fees will, thus, also have sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them.

Division 35 - losses from non-commercial business activities

74. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law partnership) from certain business activities will not be allowable in an income year unless:

- the 'Exception' in subsection 35-10(4) applies; or
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

75. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

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

77. In broad terms, the objective 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).

78. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2003. Growers who acquire more than one

interest in the Project may however, pass one of the tests in an earlier income year.

79. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

80. The first arm of 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 an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the term of this Product Ruling.

81. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner 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 will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

82. 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 (see paragraph 53), in the manner described in the Arrangement (see paragraphs 15 to 48), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

83. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent horticulturalist and additional independent soil tests provided with the application by the Orchard Manager;
- the binding marketing contract(s) with the (named independent) Marketer for the sale of the fruit setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the grapes are grown;
- independent, objective, and generally available information relating to the horticultural industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product

Ruling application submitted by the Responsible Entity;

- other expert opinion independently obtained by the Commissioner that specifically relates to the Project;

Section 82KZM - prepaid expenditure for small business taxpayers

84. 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.

85. Grower will not incur the initial Management Fee before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted (the date the investment is made). This fee is charged for providing services to Growers for a period to June 2001 from the date of execution of the Agreement. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years. The fee is expressly stated to be for a number of specified services. There is evidence this fee is for services to be provided within the same year of income, as the expenditure in question is incurred.

86. Thus, for the purposes of this Ruling, it is accepted that no part of the initial management fee is for the Project Manager to do '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 for the management fee by Growers who are 'small business taxpayers'.

87. Similar considerations apply to the Lease fee which, under the Lease and Management Agreement, are payable by instalments each year for which the services are provide in that year. Again, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure for the Lease fee by Growers who are 'small business taxpayers'.

Deductions for capital expenditure**Section 42-15 - depreciation of trellising**

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

89. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose of producing assessable income where they are the owner or quasi-owner of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, absolutely owned by the owner of the land.

90. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where the lessee is considered to be the owner of those improvements. Income Tax Ruling IT 175 sets out the Australian Taxation Office's (ATO's) views on this issue. Where a licensee is considered to own the improvements under a state law, as detailed in the Ruling, or where he/she have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the licensee is entitled to claim depreciation for the fixture.

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

92. The depreciation deduction available to a Grower who is a 'small business taxpayer' and who complies with the conditions contained in section 42-345 is calculated using the cost of the trellising and a rate of 13% prime cost or 20% diminishing value. These accelerated rates of depreciation are shown in section 42-125 and apply to plant with an effective life of between 13 and 30 years.

93. Growers who are not 'small business taxpayers' or are 'small business taxpayers' who do not satisfy the conditions in section 42-345 will have entered the Project after 11:45am, by legal time in the ACT, 21 September 1999, and will not be able to claim accelerated depreciation on plant used in the Project because of section 42-118. The deduction for such Growers is based on the effective life of the plant. Subdivision 42-C provides the choice of methods available for determining the effective life of plant.

94. A Grower accepted into the Project enters into a lease for a right to occupy certain land upon which they are entitled to grow fruit

to conduct a horticultural business. Subject to the terms and conditions of the Lease and Management Agreement, the Lessor will purchase the Trees, Irrigation and Trellising system within the Grower's Leased Area.

95. The Project Manager will advise Growers the date the trellising is installed and begins to be used for the purpose of producing assessable income. Therefore, the cost that relates to the acquisition and installation of trellises on the land will be eligible for depreciation deduction by the Growers, who are small business taxpayers, under section 42-125. Growers, who are not small business taxpayers, will be eligible for a depreciation deduction under subsections 42-160(3) or 42-165(2A).

Subdivision 387-B - expenditure on conserving or conveying water

96. 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.

97. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or licensee who is conducting a primary production business on land in Australia, a deduction would be available to the Growers in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

Subdivision 387-C - horticultural provisions

98. Subdivision 387-C allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. A lessee or licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land.

99. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant with an effective life of 13 to 30 years, as in this Project, that rate is 13%.

Section 82KL - recouped expenditure

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

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

102. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Here, there may be a loan provided to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA - general tax avoidance provisions

103. 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).

104. The Kaarimba Fresh Fruit Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 55 to 56 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

105. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the fruit. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Detailed contents list

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Commissioner of Taxation

12 July 2000

Previous draft:

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Related Rulings/Determinations:

IT 175; TR 92/1; TR 92/20;
 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 Pt IVA
 - ITAA 1936 177A
 - ITAA 1936 177C
 - ITAA 1936 177D
 - ITAA 1936 177D(b)
 - ITAA 1997 6-5
 - ITAA 1997 8-1
 - ITAA 1997 8-1(2)(a)
 - ITAA 1997 27-5
 - ITAA 1997 35-10
 - ITAA 1997 35-10(2)
 - ITAA 1997 35-10(3)
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 - ITAA 1997 Subdiv 42-C
 - ITAA 1997 42-15
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 - ITAA 1997 42-165
 - ITAA 1997 42-165(2A)
 - ITAA 1997 42-345
 - ITAA 1997 Subdiv 387-A
 - ITAA 1997 387-55
 - ITAA 1997 387-60
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| - ITAA 1997 387-125 | - ITAA 1997 Subdiv 960-Q |
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| - ITAA 1997 387-165 | - ITAA 1997 960-350 |
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