PR 2001/135 - Income tax: Neem Australia Project No.1

Product Ruling
Income tax: Neem Australia Project No.1

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Previous Ruling**, **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. 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 participants 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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants 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, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants 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 refers. 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 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Division 70 (ITAA 1997);
- Division 328 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KZL (ITAA 1936);
- Section 82KZME (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling, all fees and expenditure referred to include Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a 'Grower') to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered for GST and hold a valid tax invoice.

Changes in the Law

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 taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating 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 participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and 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. 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 the Ruling. 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. The Ruling will be withdrawn or modified.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright,

Date of effect

11. This Ruling applies prospectively from 17 October 2001, 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 2004. 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 arrangement specified below. 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 person's involvement in the arrangement.

Previous Ruling

14. This Ruling replaces Product Ruling PR 2001/94, which is withdrawn on and from the date this Ruling is made (17 October 2001). Product Ruling PR 2001/94 will continue to apply to investors who entered into the Project on or before 17 October 2001.

Arrangement

15. The arrangement that is the subject of this Ruling is specified below. This arrangement incorporates the following documents:

- Application for Product Ruling dated 6 April 2000;
- The Neem Australia Project No.1 Prospectus, dated 23 August 2000;
- The Neem Australia Project No. 1 Supplementary Prospectus dated 17 July 2001;
- The Neem Australia Project No. 1 Supplementary Prospectus dated 21 September 2001;
- **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, undated;**
- **Draft Licence between David Richard McDonald ['Licensor'], Primary Securities Ltd [the 'Responsible Entity'], and the Grower, undated;**
- **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, 30 June 2000, 13 February 2001, 11 June 2001, 10 July 2001, 11 July 2001, 13 July 2001, 30 August 2001 and 3 October 2001.

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.

16. The documents highlighted are those 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. The effect of these agreements is summarised as follows.

Overview

17. This arrangement is 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
Size of each Woodlot	0.3 hectares
Number of Neem trees per hectare	400
Expected production	9,000 kilograms/Woodlot per annum
The term of the Project	12 years
Initial cost	$8,800
Initial cost per hectare	$29,333
Ongoing costs	Annual Management Fees and Licence Fees.

18. Growers accepted under the Prospectus 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.

19. 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.

20. 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.

21. The 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 during the period up to 31 December 2001 following the execution of the Management Agreement and Licence Agreement.

22. 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

23. 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

24. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Act. 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.

Licence to use the Land

25. 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 a licence to use their Woodlots for the purpose of cultivating trees and collecting produce from the trees (Recital C). Growers must pay a licence fee of $220 for the period from commencement until 30 June 2002 on application or by 18 November 2001 if the application is subject to finance. For each year thereafter a licence fee of $220 is payable in arrears commencing on

30 June 2003. This fee will be indexed annually. The term of a Grower's licence is from the Commencement Date until 30 June 2012.

Management Agreement

26. 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 the Woodlots and plant and tend to the trees according to the principles of good forestry. Growers pay a Management Fee of $6,429.50 for the period from commencement to 31 December 2001 and $495 for the period 1 January 2002 to 30 June 2002. For each financial year thereafter, a management fee equal to $495 per Woodlot or 10% of the Prescribed Portion of Gross Receipts, whichever is the greater, is payable.

27. 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;
- procure suitable irrigation, fencing, drainage and shelter for the Neem trees;
- 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.

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

29. 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).

30. 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

31. The Manager will be responsible for planting the Neem Trees on the licenced area during the period up to 31 December 2001. After 31 December 2001, the Manager will attend 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

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

33. 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.

34. Growers may elect, on or before 21 October 2001 to sell their own produce. 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.

35. 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

36. 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. 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. These fees are payable on application or on or before 18 November 2001 if the application is subject to finance (Schedule to the Management Agreement). The Manager will commence these services after the Grower has been accepted into the Project and complete these services on or before 31 December 2001.

37. A Management fee of $495 is payable on or before 30 June 2002, for services to be performed in the period 1 January 2002 to 30 June 2002.

38. For each financial year commencing 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.

39. Growers must pay a licence fee of $220 for the period from commencement until 30 June 2002 on application or by 18 November 2001 if the application is subject to finance. For each year thereafter a licence fee of $220, indexed annually by 2.5%, is payable in arrears on 30 June of each year by the Grower, commencing on 30 June 2003.

Finance

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

41. This Ruling does not apply if the finance arrangement entered into by the Grower 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;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, are involved or become involved in the provision of finance to Growers for the Project.

42. 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

Application of this Ruling

43. This Ruling applies only to Growers who are accepted to participate in the Project on or before 21 October 2001 and who have executed a Management Agreement and a Licence Agreement before that date. The Growers' participation in the Project must constitute the carrying on of a business of primary production.

The Simplified Tax System ('STS')

Division 328

44. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

45. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'

Assessable Income

Section 6-5

46. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

47. The Grower recognises ordinary income from carrying on the business of horticulture at the time that income is derived.

Trading stock

Section 70-35

48. A Grower who is not an 'STS taxpayer' may, in some years, hold Neem produce that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Grower must include the amount of that excess in assessable income.

49. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Grower may claim the amount of that excess as an allowable deduction.

Deductions for Management fees and Licence fees

Section 8-1

50. A Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1	$6,924.50 ($6,429.50 + $495) – see Note (i) (below)	Amount must be calculated – see Notes (i), (ii) & (iii) (below)	Amount must be calculated – see Notes (i), (ii) & (iii) (below)
Licence Fee	8-1	$220 – see Note (i) (below)	$220 (indexed) – see Notes (i) & (ii) (below)	$220 (indexed) – see Notes (i) & (ii) (below)

Notes:

(i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits). See example at paragraph 122.

(ii) The Management fees and the Licence fees shown in the Management Agreement and the Licence Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will

not be wholly done in the same income year as the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 92 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

(iii) For the years commencing 1 July 2002 until 30 June 2012, a Management Fee of $495 or 10% of the Prescribed Portion 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.

Deductions for capital expenditure

Division 40

51. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g., irrigation), 'landcare operations' and horticultural plants. All deductions shown in the following Table are determined under Division 40.

Fee type	**ITAA 1997 section**	**Year ended 30 June 2002**	**Year ended 30 June 2003**	**Year ended 30 June 2004**
Water facilities (e.g., irrigation)	40-515	$275 - see Notes (iv) & (v) (below)	$275 - see Notes (iv) & (v) (below)	$275 – see Notes (iv) & (v) (below)
Landcare operations	40-630	$462 - see Notes (iv) & (vi) below		
Establishment of horticultural plants	40-515	Amount must be calculated - see Notes (iv) & (vii) (below)	Amount must be calculated – see Notes (iv) & (vii) (below)	Amount must be calculated – see Notes (iv) & (vii) (below)

Notes:

(iv) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to

be adjusted as relevant for GST (e.g., input tax credits). See example at paragraph 122.

(v) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

(vi) Any capital expenditure incurred for 'landcare operations' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630.

(vii) Neem trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the Neem trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the Neem trees have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the Neem trees enter their first commercial season (section 40-530, item 2). The Project Manager will inform Growers of when the Neem trees enter their first commercial season.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5

52. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

53. The Grower recognises ordinary income from carrying on the business of horticulture at the time the income is received (paragraph 328-105(1)(a)).

Trading stock

Section 328-285

54. A Grower who is an 'STS taxpayer' may, in some years, hold Neem produce that will constitute trading stock on hand. Where, for such a Grower, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than $5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

55. Alternatively, a Grower who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

Deductions for Management fees and Licence fees

Section 8-1 and section 328-105

56. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1 & 328-105	$6,924.50 ($6,429.50 + $495) – see Notes (viii) & (ix) (below)	Amount must be calculated – see Notes (viii), (ix), (x) & (xi) (below)	Amount must be calculated – see Notes (viii), (ix), (x) & (xi) (below)
Licence Fee	8-1 & 328-105	$220– see Notes (viii) & (ix) (below)	$220 (indexed) – see Notes (viii), (ix) & (x) (below)	$220 (indexed) – see Notes (viii), (ix) & (x) (below)

Notes:

(viii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits). See example at paragraph 122.

(ix) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above, which is not paid

in the year in which it is incurred, will be deductible in the year in which it is actually paid.

(x) Where a Grower who is an 'STS taxpayer', pays the Management fees and the Licence fees in the relevant income years shown in the Licence Agreement and Management Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 92, unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

(xi) For the years commencing 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 June, commencing on 30 June 2003 and thereafter on 30 June each year.

Deductions for capital expenditure

Subdivision 328-D and Subdivisions 40-F and 40-G

57. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g. irrigation), 'landcare operations' and horticultural plant. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F and in relation to 'landcare operations' under Subdivision 40-G. If the 'water facility' or 'landcare operation' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328. Deductions for the horticultural plant must be determined under Subdivision 40-F.

58. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities or 'landcare operations' under Subdivisions 40-F or 40-G and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and

is claimed under Division 328, the deduction is determined as discussed in Notes (xiii) and (xiv) below.

59. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than $1000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

Fee type	**ITAA 1997 section**	**Year ended 30 June 2002**	**Year ended 30 June 2003**	**Year ended 30 June 2004**
Water facilities (e.g., irrigation)	40-515	$275 – see Notes (xii) & (xiii) (below)	$275 – see Notes (xii) & (xiii) (below)	$275 – see Notes (xii) & (xiii) (below)
Landcare operations	40-630	$462 – see Notes (xii) & (xiv) (below)		
Establishment of horticultural plants	40-515	Amount must be calculated - see Notes (xii) & (xv) (below)	Amount must be calculated - see Notes (xii) & (xv) (below)	Amount must be calculated - see Notes (xii) & (xv) (below)

Notes:

(xii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits). See example at paragraph 122.

(xiii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than $1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS

taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2002 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

(xiv) Any capital expenditure incurred for 'landcare operations' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-G (although expenditure on some items of plant can only be deducted under Division 328). For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than $1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable is determined by multiplying its 'cost' by half the relevant STS 'pool rate'. At the end of the year, it is allocated to the relevant STS pool and in subsequent years, the full 'pool rate' will apply. If the expenditure is not on a 'depreciating asset', the expenditure is fully deductible under Subdivision 40-G.

(xv) Neem trees are 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under

licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the Neem trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the Neem trees have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the Neem trees enter their first commercial season (section 40-530(2)). The Project Manager will inform Growers of when the Neem trees enter their first commercial season.

Tax outcomes that apply to all Growers

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

Section 35-55 – Commissioner's discretion

60. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 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 will decide for the income year ending 30 June 2002 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

61. 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 110 in the Explanations part of this ruling, below).

62. 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 the Grower's 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.

63. 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 commercially viable. An assessment of the Project or the product from this perspective has not been made.

Sections 82KZME – 82KZMF, 82KL, and Part IVA

64. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Licence Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 87 to 100;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Is the Grower carrying on a business?

65. For the amounts set out in the Tables above to constitute allowable deductions the Grower's horticultural activities as a participant in the Neem Australia Project No.1 must amount to the carrying on of a business of primary production. These horticultural activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

66. For schemes such as that of the Neem Australia Project No.1, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of such a business. As Taxation Ruling TR 2000/8 discusses, these have been established in court decisions such as *FCT v. Lau* 84 ATC 4929.

67. Generally, a Grower will be carrying on a business of horticulture, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's trees are established;

- the Grower has a right to harvest and sell the produce each year from those trees;
- the horticultural activities are carried out on the Grower's behalf; and
- the horticultural activities of the Grower are typical of those associated with a horticulture business; and
- the weight and influence of general indicators point to the carrying on of a business.

68. In this Project, each Grower enters into a Management Agreement with Plantation Developments Pty Ltd and Primary Securities Ltd and a Licence Agreement with either David Richard McDonald and Primary Securities Ltd or Australian Property Enterprises Pty Ltd and Primary Securities Ltd.

69. Under the Licence Agreement each individual Grower will have rights over a specific and identifiable area of 0.3 hectares of land. The Licence Agreement provides the Grower with an ongoing interest in the specific trees on the licenced area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out horticultural activities, and for no other purpose. The licence allows the Project Manager come onto the land to carry out its obligations under the Management Agreement.

70. Under the Management Agreement the Project Manager is engaged by the Grower to establish and maintain a woodlot on the Grower's land during the term of the Project. The Project Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the woodlot on the Grower's behalf.

71. In establishing the woodlot, the Grower engages the Project Manager to purchase and install water facilities (e.g., irrigation), to carry out 'landcare operations' and to acquire and plant Neem trees on the Grower's woodlot. During the term of the Project, these assets will be used wholly to carry out the Grower's horticulture activities. The Project Manager is also engaged to harvest and sell, on the Grower's behalf, the produce grown on the Grower's woodlot.

72. 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.

73. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the project will derive assessable income from the sale of the Neem produce that will return a 'before-tax' profit, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

74. The pooling of the Neem produce grown on the Grower's woodlot with the Neem produce of other Growers does not detract from a view that the Grower is carrying on a business of horticulture. Each Grower's proportionate return from the sale of the pooled Neem produce will reflect the proportion of the Neem produce contributed from their woodlot.

75. The Project Manager's services and the installation of these assets on the Grower's behalf are based on accepted horticultural practices. They are of the type ordinarily found in horticultural ventures that would commonly be said to be businesses. While the size of the Grower's allotment is relatively small, it is of a size and scale that would allow it to be commercially viable, particularly when it is part of a larger overall project such as the Neem Australia Project No. 1 (see Taxation Ruling IT 360).

76. The Grower's degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's woodlot and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

77. 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. For the purposes of this Ruling, the Growers' horticulture activities in the Neem Australia Project No. 1 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

78. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

79. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of management fees and licence fees

Section 8-1

80. Consideration of whether the initial management fees and licence fees 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 a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer is contractually committed 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.

81. The licence fees and management fees associated with the horticulture activities will relate to the gaining of income from the Grower's business of horticulture (see above), and hence have a sufficient connection to the operations by which income (from the regular 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 fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Possible application of prepayment provisions

82. Under the Management Agreement and the Licence Agreement neither the management fees nor the licence fees are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

83. However, where a Grower chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 87 to 100) will apply to determine the amount and timing of the deductions regardless of

whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

Timing of deductions

84. In the absence of any application of the prepayment provisions, the timing of deductions for the management fees or the licence fees will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

85. If the Grower is not an 'STS taxpayer', the management fees and the licence fees are deductible in the year in which they are incurred.

86. If the Grower is an 'STS taxpayer' the management fees and the licence fees are deductible in the income year in which they are paid, or are paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Prepayment provisions

Sections 82KZL to 82KZMF

87. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., The performance of management services or the licencing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

88. For this Project only section 82KZL (an interpretative provision) and sections 82KZME and 82KZMF are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF. These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

89. Where the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

90. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either :
  - (a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
  - (b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

91. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than $1,000. Such expenditure is immediately deductible.

92. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

93. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the

agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Application of the prepayment provisions to this Project

94. In this Project, an initial management fee of $6,429.50 and an initial Licence Fee of $220 per woodlot will be incurred on execution of the Management Agreement and the Licence Agreement. The Management Fee and the Licence Fee are charged for providing management services or licencing land to a Grower by 31 December of the year of execution of the Agreements. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

95. In particular, the management fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the initial management fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

96. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee, and the fees for subsequent years, is for the Project Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Licence Agreement, licence fees are payable annually in arrears, commencing 30 June 2003, for the licence of the land during the expenditure year.

97. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 36 to 39, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

*Growers who **choose** to pay fees for a period in excess of that required by the Project's agreements*

98. Although not required under either the Management Agreement or the Licence Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 97 above, section 82KZMF will apply to

apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

99. For these Growers, the amount and timing of deductions for any relevant prepaid Management Fees or prepaid Licence Fees will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

100. However, as noted above, prepaid fees of less than $1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

Interest deductibility

101. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

102. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in sections 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

103. Therefore, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to use the formulae in subsection 82KZMF(1) to determine any tax deduction that may be allowable. The formulae is the same as that shown in paragraph 92 above.

Expenditure of a capital nature

Division 40 and Division 328

104. Any part of the expenditure of a Grower 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, expenditure attributable to water facilities, 'landcare operations', and horticultural plant is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

105. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

106. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 51 and 59 (above) in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

107. 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;
- 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.

108. 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.

109. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity, or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

110. 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.

111. 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).

112. 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 allocation of one woodlot in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2005. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

113. 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.

114. 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, 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.

115. Information provided with this Product Ruling indicates and a Grower who acquires the minimum allocation of one woodlot in the Project is expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2003. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2002. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

116. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the

income years specified above (see paragraph 60), in the manner described in the Arrangement (see paragraphs 15 to 42). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b)m, that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

117. 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 expert and independent forester
- independent, objective, and generally available information relating to the horticultural industry.

Section 82KL - recouped expenditure

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

Part IVA - general tax avoidance provisions

119. 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).

120. The Neem Australia Project No.1 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 50, 51, 56 and 59 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.

121. 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 their Neem produce. 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 at arm's length or, if any parties are not dealing 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.

Example

Entitlement to GST input tax credits

122. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2002 to 30/6/2002
$4 400*

Carrying out of upgrade of power for your vineyard
as quoted
$2 200*

Total due and payable by 1 January 2002
$6 600 (includes GST of $600)

*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

1/11 x $4400 = $400.

Hence her outgoing for the management fee is effectively $4400 *less* $400, or $4000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

1/11 x $2200 = $200.

Hence her outgoing for the power upgrade is effectively $2200 *less* $200, or $2000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as $4000 (not $4400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as $200 (one tenth of $2000 only, not one tenth of $2200).

Detailed contents list

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

Commissioner of Taxation
17 October 2001

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
PR 1999/95; TR 2000/8; TR 92/1; TR 97/11; TR 97/16; TD 93/34; TR 92/20; TR 98/22; IT 360

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 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(1)(b)
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 27-5
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
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