

PR 2001/170 - Income tax: Lake Aquaculture Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 December 2001*



Product Ruling

Income tax: Lake Aquaculture Project

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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**, **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.

Potential participants 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.

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 persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Lake Aquaculture Project, or simply as 'the Project'.

Tax laws

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 328 (ITAA 1997);
 - Section 70-15 (ITAA 1997);
 - Section 70-35 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Section 82KZM (ITAA 1936);
 - Sections 82KZMA - 82 KZMD (ITAA 1936);
 - Section 82KZME - 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 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 specified 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.

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apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

11. This Ruling applies prospectively from 19 December 2001, 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 that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this 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.

Arrangement

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

- Application for a Product Ruling, dated 27 November 2000;
- Prospectus for the Lake Aquaculture Project, dated 17 January 2001;

- Supplementary Prospectus for the Lake Aquaculture Project, dated 31 January 2001;
- Supplementary Prospectus for the Lake Aquaculture Project, dated 11 May 2001;
- Supplementary Prospectus for the Lake Aquaculture Project, dated 17 September 2001;
- Supplementary Prospectus for the Lake Aquaculture Project, undated, received on 5 December;
- **Draft copy of Licence Agreement between the Grower and John Alan Clancey and Rosalind Eve Clancey ('Licensors'), undated, received on 30 November 2001;**
- **Draft copy of Licence Agreement between the Grower and Wexsouth Pty Ltd ('Licensors'), undated, received on 30 November 2001;**
- **Draft copy of Lease Agreement between the Grower and Wexttred Pty Ltd ('Lessor'), undated, received on 30 November 2001;**
- **Draft copy of Management Agreement between the Grower and ARG Management Limited ('Manager'), undated, received on 5 December 2001;**
- Draft copy of Project Management Agreement between the Manager and The Lake Company Pty Ltd ('Project Manager'), undated, received on 30 November 2001;
- Draft copy of Custodian Agreement between the Manager and Australian Rural Group Limited ('the Custodian'), dated 18 January 2001;
- Draft copy of Compliance Plan for the Lake Aquaculture Project, undated, received on 9 May 2001;
- **Constitution for the Lake Aquaculture Project ('Constitution'), dated 7 September 2000;**
- Draft copy of Variation of Constitution for the Lake Aquaculture Project, undated, received on 5 December 2001;
- Draft copy of Constitution for the Manager, undated, received on 29 November 2001;
- Certificate Of Registration of a Company for the Manager, dated 25 August 1999;

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- Aquaculture Lease for oyster farm numbers 73.248, 74.001 and 82.066 located at Wonboyn River in the name of John Alan Clancey and Rosalind Eve Clancey, received on 23 May 2001;
- Aquaculture Lease for oyster farm numbers 80.150 and 84.151 located at Wonbyn River in the name of John Alan Clancey and Rosalind Eve Clancey, received on 30 November 2001;
- Aquaculture Lease Transfer Form between Wexsouth Pty Ltd and owners to purchase Aquaculture Lease for oyster farm numbers 94.021, 94.022, 95.026, 80.012, 81.128 and 70.405, undated, received on 24 April 2001;
- Aquaculture Permit for Oyster Lease numbers 73.248, 74.001, 80.150, 82.066 and 84.151 located at Wonboyn Lake in the name of The Lake Company Pty Ltd, dated 10 July 2000;
- Subletting Agreement between the John Alan Clancey and Rosalind Eve Clancey and The Lake Company Pty Ltd for oyster farm numbers 80.150 and 73.248 located at Wonbyn River, undated, received on 18 July 2001;
- Letter and attachments to ATO from the applicant's representative, dated 25 March 2001, 12 July 2001;
- Documents provided to the ATO from the applicant's representative during a meeting held on 24 April 2001;
- Facsimile and attachments to ATO from the applicant's representative, dated 8 May 2001, 23 May 2001 (2), 25 May 2001, 14 June 2001 (2), 18 July 2001, 30 November 2001 (3);
- E-mail and attachments to ATO from the applicant's representative dated 23 May 2001, 24 June 2001, 25 July 2001, 14 November 2001, 21 November 2001, 23 November 2001, 30 November 2001, 1 December 2001, 4 December 2001.

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

15. The documents highlighted are those that the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

Overview

17. These arrangements are called the Lake Aquaculture Project.

Location	Oyster Leases at Wonboyn Lake, Tuross Lake and Wagonga Inlet in New South Wales.												
Type of business each participant is carrying on	Commercial Aquaculture of Sydney Rock Oysters (<i>Saccostrea commercialis</i>).												
Number of Interests offered	500												
Size of an Interest	110 Baskets.												
Size of a minimum allocation	Two Interests (which is the equivalent of 220 Baskets).												
The term of the Project	11 years from the date of commencement.												
Initial cost per Interest	\$11,186												
Initial cost per minimum allocation	\$22,372												
Ongoing annual fees per Interest	<p>For the second year of the Project , commencing on the first anniversary of the Grower entering into the Project, the Growers must pay the following annual fees per Interest:</p> <table> <tr> <td>Licence Fee</td> <td>\$</td> <td>220.00</td> </tr> <tr> <td>Lease Fee</td> <td>\$</td> <td>220.00</td> </tr> <tr> <td>Management Fee</td> <td>\$</td> <td>770.00</td> </tr> <tr> <td>Oyster Stocking Fee</td> <td>\$</td> <td>247.50</td> </tr> </table> <p>For the third and subsequent years, the above fees are indexed annually.</p>	Licence Fee	\$	220.00	Lease Fee	\$	220.00	Management Fee	\$	770.00	Oyster Stocking Fee	\$	247.50
Licence Fee	\$	220.00											
Lease Fee	\$	220.00											
Management Fee	\$	770.00											
Oyster Stocking Fee	\$	247.50											
Other costs	<p>The Manager will be entitled to be reimbursed for all costs incurred by it in harvesting, marketing and selling the oysters.</p> <p>The Manager will be entitled to an incentive bonus of 50% of the increase, if the total sales (CPI Adjusted) over an</p>												

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	<p>eight month growing period exceed the projected returns (also CPI Adjusted).</p> <p>The Manager if required by the Grower will arrange for insurance against pollution damage on behalf of the Grower.</p>
Minimum Subscription	50 Interests.

The Project

18. This arrangement is called the Lake Aquaculture Project.
19. Growers entering into the Project will participate in the Aquaculture industry as a Grower of Sydney Rock Oysters (*Saccostrea commercialis*) by cultivation for sale.
20. The Oyster Farms will be located on Oyster Leases at Wonboyn Lake, Tuross Lake or Wagonga Inlet in New South Wales.

Interest applied for

21. The minimum allocation that a Grower may obtain in the Project is two Interests (which is the equivalent 220 Baskets). Additional Interests are available in multiples of one Interest (which is the equivalent of 110 Baskets).
22. The project comprises 500 Interests.
23. No application will be accepted unless the Minimum Subscription of 50 Interests has been reached.
24. Applications by Growers for an Interest in the Project will be accepted up to 31 December 2001, for a Commencement Date of 31 December 2001.
25. Any Grower endeavouring to enter the Project after 31 December 2001 will not be accepted as they will not be able to commence activities by the expiry date of the current Prospectus, i.e., 17 January 2002, as Commencement Dates are limited to 31 December, 31 March, 30 June and 30 September.
26. The application price for the minimum allocation of two Interests) is \$22,372.
27. Provided Minimum Subscription is reached, after acceptance of an Application Growers will enter into a Licence Agreement, Lease Agreement and a Management Agreement with parties to obtain:
 - a limited licence to permit the Grower to establish a Longline Basket System in which Sydney Rock Oysters

will be cultivated pursuant to an Oyster Lease held by the Licensors;

- a non-exclusive lease of a Longline System of Baskets and other equipment with the Lessor to house the oysters during the cultivation phase; and
- an agreement with the Manager which shall, on behalf of the Grower, enter into arrangements with the holder of an Aquaculture Permit to establish and maintain an Oyster Farm and to harvest and sell the oysters for the duration of the project.

28. The term of the Licence Agreement, Lease Agreement and Management Agreement is 11 years, commencing on 31 December 2001.

29. Within a 6 month establishment period after a Growers application is accepted, the initial stocking of Growers Baskets will be completed.

30. After an approximate 8 month growing period following the initial stocking of Baskets, the one third of oyster stock that have reached maturity will be harvested and sold. There will then be a restocking to replace the one third of oysters sold and the approximate 8 month growing cycle recommences.

31. Thereafter, the harvest, sale and restocking of oysters will occur approximately every 8 months until the end of the 11 year term of the Project.

32. Upon expiration of the term of the agreements, the Growers Interests in the Licence Agreement, Lease Agreement and Management Agreement will lapse and all oyster stock in the Baskets at the end of the agreements shall be sold at market prices prevailing at the time and after expenses incurred in the sale have been deducted, the balance shall be paid to the Growers.

Fees – On application

33. For a Grower whose application is accepted on or before 31 December 2001, the application price for the minimum allocation of two Interests is \$22,372, plus \$11,186 for each additional Interest. The application price for each Interest is allocated as follows:

- Licence Fee \$ 220.00
- Lease Fee \$ 220.00
- Management Fee \$ 9,487.50
- Oyster Stocking Fee \$ 1,258.50

- **Total** **\$11,186.00**

Licence Agreement

34. Under the Licence Agreement, Growers enter into a licence so that they may conduct the Sydney Rock Oyster farming business on Oyster Leases at either Wonboyn Lake, Tuross Lake or Wagonga Inlet in New South Wales for a licence term of eleven years from the Commencement Date of the Agreement. The Licensors are the owners of Oyster Leases issued by NSW Fisheries.

35. Clause 1 of the Licence Agreement provides that the Grower shall have the right to enter upon the 'Licensed Area' and establish therein the Longline Basket System in which Sydney Rock Oysters may be cultivated and grown for harvesting and sale during the period of the Licence.

36. The licence right is conditional on the Grower arranging for the holder of an Aquaculture Permit issued by NSW Fisheries to cultivate and grow for harvest and sale the oysters on behalf of the Grower.

37. The Licence Fee for each Interest in year 1 of the Project is \$220 (minimum two Interests) (cl 4.4(a) of the Constitution). In subsequent years Growers are liable to pay a Licence Fee annually in advance, as calculated according to cls 4.4(ab) & 4.4(b) of the Constitution.

Lease Agreement

38. Under the Lease Agreement, Growers enter into a lease of all the equipment required to carry on Sydney Rock Oyster farming operations for a lease term of eleven years from the Commencement Date of the Agreement.

39. The Lease Fee for each Interest in year 1 of the Project is \$220 (minimum two Interests) (cl 4.5(a) of the Constitution). In subsequent years Growers are liable to pay a Lease Fee annually in advance, as calculated according to cls 4.5(ab) & 4.5(b) of the Constitution.

Management Agreement

40. Under the Management Agreement, Growers will engage the Manager for a term of eleven years from the Commencement Date of the Agreement to carry out the Management Services and to purchase oyster stock.

Management Services

41. Management Services are defined at clause 1 as the selection and cultivation of Sydney Rock Oysters and the provision of management and maintenance of those oysters in a Longline Basket System utilising the Baskets and other facilities and equipment leased by the Grower pursuant to the Lease Agreement to be established in the area of the Oyster Lease the subject of the Licence Agreement in accordance with good aquaculture practice, and without limiting the generality of the foregoing Management Services includes the following:

- (i) stocking the Grower's Baskets with oysters at the Oyster Stocking Rate;
- (ii) management of the development of the oysters;
- (iii) ensuring the oysters are in good health and free from pests and diseases;
- (iv) providing administration and accounting systems;
- (v) the provision of a written report in relation to the progress of the oysters to the Growers; and
- (vi) the provision of advice and assistance to the Grower generally in relation to the general management thereof in accordance with the best practices of the aquaculture industry.

42. The Grower has requested the Manager and the Manager has agreed to arrange for the holder of an Aquaculture Permit to cultivate, harvest and sell the oysters for the duration of the project.

43. The Management Fee for each Interest in year 1 of the Project is \$9,487.50 (minimum two Interests) (cl 4.2(a) of the Constitution). In subsequent years Growers are liable to pay an Annual Management Fee annually in advance, as calculated according to cls 4.2(b) & 4.2(c) of the Constitution.

Purchase of oyster stock

44. The Manager will purchase oysters for Growers and stock the Grower's Baskets with oysters as per the Oyster Stocking Rate (cl 1.1(i)) of the Management Agreement. The Oyster Stocking Rate is defined at Item 5 and Item 9 of the Schedule to the Management Agreement and will provide for initial stocking and subsequent re-stocking of Growers Baskets.

PR 2001/170*Initial stocking*

45. Within 6 months of the date of a Growers application, a Grower with a minimum allocation of two Interests will have 220 Baskets fully stocked with oysters. The initial stocking rate for each Interest is as follows:

<i>No of Baskets</i>	<i>Time to Harvest</i>	<i>Approx Oysters per Basket</i>
15	24 months	346.27
33	16 months	149.55
<u>62</u>	8 months	75.40
110		

Subsequent re-stocking

46. On completion of initial stocking, within approximately each 8 months therefrom until the end of the 11 year term of the Management Agreement, the following re-stocking for each Interest will occur:

<i>No of Baskets</i>	<i>Time to Harvest</i>	<i>Approx Oysters per Basket</i>
15	24 months	346.27

47. In addition, for each Interest the following harvesting and transfer of stock between Baskets will occur:

- a) Oysters in the 62 Baskets, which will then be mature, will be harvested and sold at prevailing market prices;
- b) Oysters in the 33 Baskets, will then be of a size which will mature in 8 months, will be transferred to the 62 Baskets from which the mature oysters have been removed;
- c) Oysters in the 15 Baskets, which will then be of a size which will mature in 16 months, will be transferred to the 33 Baskets from which the oysters referred to in (b) have been removed; and
- d) Oysters of a size which will mature within 2 years will be placed in the 15 Baskets from which the oysters referred to in (c) have been removed.

48. The Oyster Stocking Fee for each Interest in year 1 of the Project is \$1,258.50 (minimum two Interests) (cl 9(c) of the Management Agreement) and comprises the following:

- A Startup Oyster Stocking Fee of \$1,011 for initial stocking; and

- A Replacement Stocking Fee of \$247.50 for subsequent re-stocking.

49. The Startup Oyster Stocking Fee of \$1,011 is a once only payment on application for the initial stocking of each Interest of 110 Baskets within the 6 month period commencing on the Commencement Date, being 31 December 2001.

50. The Replacement Oyster Stocking Fee of \$247.50 is payable on application and then annually for the re-stocking of each Interest of 15 Baskets that will occur approximately each 8 months after the initial stocking and up until the end of the 11 year term of the Management Agreement. The Replacement Oyster Stocking Fee of \$247.50 provides for the restocking of 22.5 Baskets at a rate of \$11 each. Under the trading stock provisions, where any of the 22.5 Baskets are not re-stocked with oysters at the end of the financial year in which a Grower incurs the Replacement Oyster Stocking Fee, a deduction will not be allowed for these un-stocked Baskets. A deduction will only be available at the rate of \$11 a Basket for each Basket that is restocked with oysters and on hand at the end of the financial year in which a Grower incurs the Replacement Oyster Stocking Fee (section 70-15).

51. In subsequent years Growers are liable to pay the Oyster Stocking Fee (Replacement Oyster Stocking Fee) for the restocking of 22.5 baskets, annually in advance, as calculated according to cl 9(c) of the Management Agreement.

52. The Grower further engages the Manager to act as the Growers sole and exclusive agent to market and sell the oysters under clause 6 of the Management Agreement.

53. Oyster proceeds will be pooled between all Growers whose participation commences in the same period and each Grower will be entitled to a pro-rata share of the proceeds (cl 6.(c) of the Management Agreement).

54. The Manager will be entitled to be reimbursed for all costs incurred by it in harvesting, marketing and selling the oysters (cl 6(a) of the Management Agreement).

55. The Manager will be entitled to an incentive bonus of 50% of the increase, if the total sales (CPI adjusted) over an eight month growing period exceed the projected returns (also CPI adjusted) (cl 6(b) of the Management Agreement).

Harvest income

56. The Gross Income from the sale of the oysters will be paid to the Manager. Each Grower's proportional share of the costs of harvest, marketing and selling the oysters and any bonus to the

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Manager will be deducted from the Gross Income and the balance of Net Income shall be apportioned based on the number of Baskets leased by the respective Growers. In addition, annual Management Fees payable may be deducted from the Growers share of Net Income.

The Growers share of Net Income will be distributed at the end of the first three months after acceptance of a Grower's application and each three months thereafter.

Fees

57. In consideration of the services performed and the rights granted under the terms of the Licence Agreement, Lease Agreement and Management Agreement, the fees payable by a Growers for each Interest (minimum two Interests) will be as follows.

58. For year 1 of the project the following fees are payable on lodging the application:

- \$220 Licence Fee;
- \$220 Lease Fee;
- \$9,487.50 Management Fee; and
- \$1,258.50 Oyster Stocking Fee.

59. For year 2 of the project the following fees are payable on the first anniversary of the Grower entering into the project:

- \$220 Licence Fee;
- \$220 Lease Fee;
- \$770 Management Fee; and
- \$247.50 Oyster Stocking Fee.

60. For year 3 and each subsequent year of the project, the following fees are payable:

- A \$220 Licence Fee indexed annually - determined in accordance with the formula contained in Item 3 B of the Schedule of the Licence Agreement;
- A \$220 Lease Fee indexed annually - determined in accordance with the formula contained in Item 5 of the Schedule of the Lease Agreement;
- A \$770 Annual Management Fee indexed annually - determined in accordance with the formula contained in Item 8 of the Schedule of the Management Agreement; and

- A \$247.50 Oyster Stocking Fee indexed annually - determined in accordance with the formula contained in Item 9 of the Schedule of the Management Agreement.

61. In summary, for year 3 and each subsequent year of the project the formulas used to determine the License, Lease, Annual Management and Oyster Stocking Fees provides for each specific fee for the year of income to be based on the fee for the immediately preceding year increased by movements in the Consumer Price Index.

62. The Manager will be entitled to be reimbursed all costs incurred by it in harvesting, marketing and selling the oysters.

63. The Manager will be entitled to an incentive bonus (which will be deducted from the proceeds from the sale of the oysters) of 50% of the increase, if the total sales (CPI adjusted) over an eight month growing period exceed the returns (also CPI adjusted) projected in the Prospectus pursuant to which the Grower applies to participate in the Project. This can be achieved by:

- (i) an average sale price exceeding 42.5 cents per oyster (CPI adjusted);
- (ii) a reduction in the 8 month growing cycle; or
- (iii) a reduction in the loss projection of 15% because of good aquaculture husbandry.

64. The Manager if required by the Grower will arrange for insurance against pollution damage on behalf of the Grower.

Finance

65. Growers can fund their participation in the Project themselves or borrow from an independent lender.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;

- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, are involved or become involved, in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

67. This Ruling applies only to Growers who are accepted to participate in the Project on or before 31 December 2001. Those Growers must have executed a Management Agreement, a Lease Agreement, and a Licence Agreement on or before that date. This Product Ruling does not apply to Growers who are accepted into the Project after 31 December 2001. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

Minimum Subscription

68. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 50 Interests is achieved.

The Simplified Tax System ('STS') - Division 328

69. For a Grower participating in the Project, the recognition of income and the timing of tax deductions 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

70. 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.

Prepaid fees

71. For the income years ended 30 June 2002 and 30 June 2003, the Management Fees and Lease Fees incurred by Growers who are accepted into this Project are subject to the prepayment rules in sections 82KZME and 82KZMF.

72. If the income and expenditure projections supplied by the applicant for this Product Ruling are met for the income year ended 30 June 2004, assessable income derived by Growers under the agreement will exceed allowable deductions attributable to the agreement. In those circumstances, sections 82KZME and 82KZMF will not apply for that income year (paragraphs 82KZME(1)(b) and 82KZME(3)(a)). Instead, the timing and amount of deductions for the prepaid Management Fees, prepaid Lease Fees and prepaid Licence Fees will be determined under sections 82KZMA and 82KZMD (for Growers who are not 'STS taxpayers') or sections 328-105 and 82KZM (for Growers who are 'STS taxpayers'). The application or otherwise of these prepayment rules are explained in paragraphs 106 to 130.

73. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred.

Tax outcomes for Growers who are not 'STS taxpayers'**Assessable Income - Section 6-5**

74. 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.

75. The Grower recognises ordinary income from carrying on the business of cultivating and selling oysters at the time that income is derived.

Trading stock - Section 70-35

76. During the term of the Project a Grower who is not an 'STS taxpayer' will hold oysters 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.

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.

During each year of the Project the Manager will provide the Grower with sufficient information to enable the Grower to determine the value of trading stock on hand at the end of the relevant income year.

Deductions for Management Fees, Lease Fees, Licence Fees, and trading stock - Section 8-1

77. For each Interest acquired, 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	Amounts must be calculated – See Notes (i) & (ii) (below)	Amounts must be calculated – See Notes (i) & (ii) (below)	Amounts must be calculated – See Notes (i) (ii) & (v) (below)
Lease Fee	8-1	\$220 – See Notes (i) & (iii) (below)	\$220 – See Notes (i) & (iii) (below)	\$220 – See Notes (i) (iii) & (v) (below)
Licence Fee	8-1	\$220 – See Notes (i) & (iii) (below)	\$220 – See Notes (i) & (iii) (below)	\$220 – See Notes (i) (iii) & (v) (below)
Oyster Stocking Fee	8-1 & 70-15	See Notes (i) & (iv) (below)	See Notes (i) & (iv) (below)	See Notes (i) (iv) & (v) (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): Division 27. See Example 1 at paragraph 146.
- (ii) For Growers who are not 'STS taxpayers' the prepaid Management Fees shown in the Table/paragraphs 57 to 61 above are not deductible in full in the year incurred.
- (iii) For the income years ended 30 June 2002 and 2003 the deduction for the Management Fees must be determined using the following formula (subsection 82KZMF(1)):

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

The Project Manager will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred. (See Example 2 at paragraph 147).

If the income and expenditure projections supplied by the applicant for this Product Ruling are met for the income year ended 30 June 2004, a Grower's assessable income from the agreement may exceed allowable deductions attributable to the agreement. If that occurs, the formula in subsection 82KZMF(1) does not apply. Instead, for that year (and other years where assessable income exceeds allowable deductions), the prepayment rules in sections 82KZMA and 82KZMD will apply. (Note: Sections 82KZMB and 82KZMC will be repealed for years of income starting after 21 September 2002 and, therefore, will have no application.)

Under these provisions, the prepaid Management fee for years of income starting after 21 September 2002 is also apportioned over the period the management services are provided. The relevant formula, contained in subsection 82KZMD(2), is the same as that in subsection 82KZMF(1) set out above. Therefore, the tax effect is the same as for the income years ended 30 June 2002 and 30 June 2003.

- (i) Although the Lease Agreement and the Licence Agreement require the Lease fee and the Licence fee to be prepaid, for a Grower who acquires the minimum allocation the amount of each of these prepaid fees is less than \$1,000. For the purposes of this Project,

amounts of less than \$1,000 are 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is paid (see Example 3 at paragraph 148).

- (ii) However, where a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's prepaid Lease fee and prepaid Licence fee may be \$1,000 or more. Such Growers **MUST** determine the deduction for the prepaid Lease fee on the same basis as the prepaid Management Fees.
- (iii) The Oyster Stocking Fee is the cost of acquiring a Grower's trading stock. It is deductible in the year in which the trading stock is on hand (section 70-15). Each income year during the term of the Project the Manager will inform the Grower when oysters are on hand for the purposes of section 70-15.
- (iv) For the third and subsequent years, this fee is indexed annually.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income - Section 6-5

78. 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.

79. The Grower recognises ordinary income from carrying on the business of cultivating and selling oysters at the time the income is received (paragraph 328-105(1)(a)).

Trading stock - Section 328-285

80. During the term of the Project a Grower who is an 'STS taxpayer' will hold oysters that will constitute trading stock on hand. Where, the difference between the value of all of a Grower's trading stock at the start of an income year and a reasonable estimate of it at the end of an income year, is less than \$5,000, the Grower does not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

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)).

During each year of the Project the Manager will provide the Grower with sufficient information to enable the Grower to determine the value of trading stock on hand at the end of the relevant income year.

Deductions for Management Fees, Lease Fees, Licence Fees, and trading stock - Section 8-1 and section 328-105

81. For each Interest acquired, 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	Amounts must be calculated – See Notes (vi) & (vii) (below)	Amounts must be calculated – See Notes (vi) & (vii) (below)	Amounts must be calculated – See Notes (vi) (vii) & (x) (below)
Lease Fee	8-1	\$220 - see Notes (vi) & (viii) (below)	\$220 - see Notes (vi) & (viii) (below)	\$220 - see Notes (vi) (viii) & (x) (below)
Licence Fee	8-1	\$220 - see Notes (vi) & (viii) (below)	\$220 - see Notes (vi) & (viii) (below)	\$220 - see Notes (vi) (viii) & (x) (below)
Oyster Stocking Fee	8-1 & 70-15	See Notes (vi) & (ix) (below)	See Notes (vi) & (ix) (below)	See Notes (vi) (ix) & (x) (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 1 at paragraph 146.
- (ii) For a Grower who is an 'STS taxpayer', the prepaid Management Fees shown in the Table/paragraphs 57 to 61 above may not be deductible in full in the year in which they are paid by, or on behalf of, the 'STS taxpayer'.

For the income years ended 30 June 2002 and 2003 the deduction for Management Fees must be determined using the following formula (subsection 82KZMF(1)):

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Expenditure	X	$\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$
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The Project Manager will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred. (See Example 2 at paragraph 147).

If the income and expenditure projections supplied by the applicant for this Product Ruling are met for the income year ended 30 June 2004, a Grower's assessable income under the agreement may exceed allowable deductions attributable to the agreement. If that occurs, the formula in subsection 82KZMF(1) does not apply. Instead, for that year (and other years where assessable income exceeds allowable deductions) a Grower who is an 'STS taxpayer' can claim an immediate deduction under section 328-105 for the amount of the Management fee paid or paid on behalf of the Grower. Where the fees are incurred as required by the Project's agreements, section 82KZM will not apply to apportion this amount (see paragraphs 124 to 130).

- (i) Although the Lease Agreement and the Licence Agreement require the Lease fee and the Licence fee to be prepaid, for a Grower who acquires the minimum allocation of two Interests the amount of each of these prepaid fees is less than \$1,000. For the purposes of this Project, amounts of less than \$1,000 are 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is paid (see Example 3 at paragraph 148).

However, where a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's prepaid Lease fee and prepaid Licence fee may be \$1,000 or more. Such Growers **MUST** determine the deduction for these prepaid fees on the same basis as the prepaid Management Fees.

- (ii) The Oyster Stocking Fee is the cost of acquiring a Grower's trading stock. It is deductible in the year in which the trading stock is on hand (section 70-15). Each income year during the term of the Project the Manager will inform the Grower when oysters are on hand for the purposes of section 70-15.
- (iii) For the third and subsequent years, this fee is indexed annually.

Tax outcomes that apply to all Growers

Interest deductibility

82. The deductibility or otherwise 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 rule on the deductibility of expenditure where all details and related documentation have been provided to, and examined by the Tax Office. However all Growers who borrow funds in order to participate in the Lake Aquaculture Project, should read the discussion of the prepayment rules in paragraphs 106 to 130 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

Section 35-55 – Commissioner's discretion

83. 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 years ending 30 June 2002 and 30 June 2003 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.

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

- the 'exception' in subsection 35-10(4) applies (see paragraph 134 in the Explanations part of this ruling, below);
- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45;
- the Grower's business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

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

86. 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.

Section 82KL, and Part IVA

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

- 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?

88. For the amounts set out in the Tables above to constitute allowable deductions the Grower’s aquaculture activities as a participant in the Lake Aquaculture Project must amount to the carrying on of a business of primary production.

89. Where there is a business, or a future business, the gross proceeds from the sale of the oysters will constitute gross assessable income in their own right. The generation of ‘business income’ from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

90. For schemes such as that of the Lake Aquaculture Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929.

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

- the Grower has an identifiable Lease interest in the Longline Baskets in which the Grower's oysters are cultivated and grown, and a limited use Licence granted by the Licensor that holds the Oyster Lease;
- the Grower has a right to harvest and sell the oysters from those baskets;
- the aquaculture activities are carried out on the Grower's behalf;
- the aquaculture activities of the Grower are typical of those associated with a business of aquaculture; and
- the weight and influence of general indicators point to the carrying on of a business.

92. In this Project, each Grower enters into a Management Agreement, a Lease Agreement and a Licence Agreement.

93. Under the Lease Agreement each individual Grower will have rights over a specific and identifiable number of Longline Baskets. The Lease Agreement provides the Grower with an ongoing interest in the specific oysters in the leased Baskets for the term of the Project. Under the lease the Grower must use the Baskets in question for the purpose of carrying out aquaculture activities, and for no other purpose. The lease allows the Manager to utilise the Longline Baskets to carry out its obligations under the Management Agreement.

94. Under the Management Agreement the Manager is engaged by the Grower to establish and maintain an oyster farm in the Grower's identifiable area using the Growers Longline Baskets during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the oyster farm on the Grower's behalf.

95. The Manager is also engaged to harvest, market and sell, on the Grower's behalf, the oysters grown on the Grower's oyster farm.

96. 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 Project's description for all the indicators.

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97. 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 oysters 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.

98. Each Grower's proportionate share of the sale proceeds of the pooled oysters will be based on the number of Baskets leased by the respective Grower's.

99. The Project Manager's services are also consistent with general aquaculture practices. They are of the type ordinarily found in aquaculture ventures that would commonly be said to be businesses. While the size of an oyster farm is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

100. 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 oyster farm 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.

101. The aquaculture 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' aquaculture activities in the Lake Aquaculture Project will constitute the carrying on of a business.

The Simplified Tax System - Division 328

102. 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.

103. 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, Lease Fees and Licence Fees - Section 8-1

104. Consideration of whether the initial Management Fees, Lease 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.

105. The Management Fees, Lease Fees and Licence Fees associated with the aquaculture activities will relate to the gaining of income from the Grower's business of cultivating and selling oysters (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of the oysters) 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.

Prepayment provisions

106. 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 (eg. the performance of management services or the leasing 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.

107. For projects such as the Lake Aquaculture Project, the prepayment rules in sections 82KZME and 82KZMF will usually apply. In an income year where sections 82KZME and 82KZMF do

not apply because one or more of the requirements of those provisions are not met, deductions for prepaid expenditure are considered under sections 82KZMA and 82KZMD (for taxpayers who are not 'STS taxpayers') or, alternatively, under section 82KZM (for taxpayers who are 'STS taxpayers').

Sections 82KZME and 82KZMF

108. 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. These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

109. 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)).

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

- (a) the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- (b) 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
- (c) either :
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (ii) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

111. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who may borrow funds from a financier in order to participate in the Project. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest

deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, in an income year where the requirements of section 82KZME are met, the deductions allowable will be subject to apportionment under section 82KZMF.

112. 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.

113. For those income years in which the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure unless the 'excluded expenditure' exception applies. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided:

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

114. 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 sections 82KZME and 82KZMF to Growers in this Project

115. In each year of the Lake Aquaculture Project the expenditure of all Growers meets the requirements of subsection 82KZME(2). However, while the arrangement in this Project meets the requirements of subsection 82KZME(3) for the income years ended 30 June 2002 and 30 June 2003, it may not meet the requirement in paragraph 82KZME(3)(a) for the income year ended 30 June 2004. In that year, the income and expenditure projections provided by the applicant indicate that assessable income from the agreement will exceed allowable deductions attributable to the agreement. If this occurs, section 82KZMF and the formula in subsection 82KZMF(1) will have no application for that income year.

116. For the income years ended 30 June 2002 and 30 June 2003, all Growers will calculate deductions for prepaid Management Fees

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using the formula in subsection 82KZMF(1) (see above). The prepaid Management fee for the income year ended 30 June 2002 is \$9,487.50 per Interest and for the income year ended 30 June 2003 it is \$770 per Interest. Each Grower is required to take a minimum allocation of two Interests.

117. For the income years ended 30 June 2002 and 30 June 2003, for all Growers who acquire the minimum allocation of two Interests, the prepaid Lease fee of \$220 per Interest and the prepaid Licence fee of \$220 per Interest will be 'excluded expenditure' (subsection 82KZME(7)). A Grower who is an 'STS taxpayer' can claim an immediate deduction for those fees in the income year in which they are paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for those fees in the income year in which they are incurred.

118. However, where a Grower acquires more than the minimum allocation of two Interests in the Project, the quantum of the prepaid Lease Fees, or prepaid License Fees, may be \$1,000 or more. Where this occurs, for the income years ended 30 June 2002 and 30 June 2003, the deduction allowable for those amounts will also be subject to apportionment according to the formula in subsection 82KZMF(1).

Prepaid fees for the income year ended 30 June 2004 for a Grower who is not an 'STS taxpayer'

119. The following paragraphs assume that the income and expenditure projections provided by the applicant will be met. However, if those projections are not met and the allowable deductions attributable to the agreement exceed assessable income under the agreement in the income year ended 30 June 2004, the following paragraphs have no relevance and deductions for prepaid fees in that year will be calculated under sections 82KZME and 82KZMF (see paragraphs 108 to 118).

120. Where a Grower is not an 'STS taxpayer', deductions for the prepaid Management fee, the prepaid Lease fee and the prepaid Licence fee for the income year ended 30 June 2004 are calculated under sections 82KZMA and 82KZMD. The transitional arrangements in sections 82KZMB and 82KZMC will have no application to the income year ended 30 June 2004 as sections 82KZMB and 82KZMC are repealed once the transitional period expires.

121. Section 82KZMA sets out the requirements that must be met before section 82KZMD will apply to apportion deductions for amounts incurred for prepaid fees that are not 'excluded expenditure'. For the purposes of this Ruling it is accepted that Growers in the Lake Aquaculture Project who are not 'STS taxpayers' will meet the

requirements of section 82KZMA in the income year ended 30 June 2004.

122. In that income year, for a Grower who acquires the minimum allocation of two Interests in this Project, the prepaid Management fee of \$770 (CPI adjusted) per Interest will be subject to apportionment using the formula in subsection 82KZMD(2). That formula, which is shown below, is the same in all respects as the formula in subsection 82KZMF(1). Therefore, for Growers who are not 'STS taxpayers', the deductions for the prepaid Management Fees for the income year ended 30 June 2004 will be determined in the same way as for the income years ended 30 June 2002 and 30 June 2003. The formula in subsection 82KZMD(2) is:

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

123. For a Grower with the minimum allocation of two Interests, the prepaid Lease fee of \$220 (CPI adjusted) per Interest and the prepaid Licence fee of \$220 (CPI adjusted) per Interest are 'excluded expenditure'. 'Excluded expenditure' is not subject to apportionment (subsection 82KZMA(4)). Therefore, the prepaid Lease Fees and the prepaid Licence Fees will be deductible in full in the income year ended 30 June 2004. However, where a Grower acquires more than the minimum allocation of two Interests in the Project, the quantum of each of these fees may be \$1,000 or more and apportionment under sections 82KZMD(2) will be necessary.

Prepaid fees for the income year ended 30 June 2004 for a Grower who is an 'STS taxpayer'

124. The following paragraphs assume that the income and expenditure projections provided by the applicant will be met. However, if those projections are not met and allowable deductions attributable to the agreement exceed assessable income from the agreement in the income year ended 30 June 2004, the following paragraphs will have no relevance and deductions for prepaid fees in that year will be calculated under sections 82KZME and 82KZMF (see paragraphs 108 to 118).

125. For a Grower who is an 'STS taxpayer', the prepaid Management fee of \$770 (CPI adjusted) per Interest, the prepaid Lease fee of \$220 (CPI adjusted) per Interest and the prepaid Licence fee of \$220 (CPI adjusted) per Interest for the income year ended 30 June 2004 are deductible when they are paid by, or on behalf of, the Grower (paragraph 328-105(1)(b)).

126. However, paragraph 328-105(1)(b) does not apply if another provision would allow the deduction at a different time (section

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328-105(2). For 'STS taxpayers' the prepayment rules in section 82KZM are such a provision and may, in certain circumstances, apply to a Grower in this Project.

127. Section 82KZM will apply to apportion prepaid expenditure otherwise deductible under section 8-1 where:

- the expenditure is not 'excluded expenditure'; and either
- the 'eligible service period' for the expenditure is longer than 12 months; or
- the 'eligible service period' for the expenditure is 12 months or shorter but ends after the last day of the year of income after the one in which the expenditure was incurred.

128. Where section 82KZM applies, the deduction for the expenditure is apportioned over the 'eligible service period' using the formula in subsection 82KZM(1). The formula is:

$$\frac{\text{Period in year}}{\text{Eligible service period}}$$

The 'period in year' is the number of days in the whole or the part of the 'eligible service period' that occurs in the year of income. The meaning of 'eligible service period' is explained in paragraph 114 (above).

129. For the income year ended 30 June 2004, the prepaid Management fee of \$770 (CPI adjusted) per Interest is not 'excluded expenditure' because Growers must apply for a minimum of two Interests. However, under the terms of the Project's Management agreement, the fee is charged for providing management services during the ensuing 12 months only. Therefore, for the income year ended 30 June 2004, the prepaid Management fee does not fall within section 82KZM and is deductible when the Grower pays it or it is paid for the Grower. However, section 82KZM will have application if a Grower chooses to prepay the Management fee for a period longer than 12 months.

130. For a Grower who takes the minimum allocation of two Interests, the prepaid Lease fee of \$220 (CPI adjusted) and the prepaid Licence fee of \$220 (CPI adjusted) are 'excluded expenditure'. Both fees will be deductible in full in the income year ended 30 June 2004. However, if a Grower chooses to prepay those fees for a period of longer than 12 months and the quantum of each of these fees is \$1,000 or more, apportionment under 82KZM will be necessary.

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

131. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2) a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

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

132. 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.

133. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

134. For the purposes of applying Division 35, 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.

135. In broad terms, the 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, or an interest in real property, (excluding any private dwelling) is used on a continuing basis in carrying on the business activity in that year (section 35-40); or

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- (d) at least \$100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

136. 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 two Interests in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2006. Growers who acquire more than two Interests in the Project may however, find that their activity meets one of the tests in an earlier income year.

137. 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.

138. 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) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

139. Information provided with this Product Ruling indicates that a Grower who acquires the minimum participation of two Interests in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2004. 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 2003. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

140. 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 83), in the manner described in the Arrangement (see paragraphs 14 to 66). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), 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.

141. 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 aquaculture expert and additional expert evidence provided with the application by the Responsible Entity;
- independent, objective, and generally available information relating to the oyster industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity; and
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project.

Section 82KL - Recouped expenditure

142. 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

143. 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).

144. The Lake Aquaculture Project 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 69 to 81 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.

145. 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 oysters. 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.

Examples

Example 1 – Entitlement to ‘input tax credit’

146. Margaret, who is registered for GST, participates in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of \$5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees however, is reduced by the amount of any ‘input tax credit’ to which she is entitled. The Project Manager provides Margaret with a ‘tax invoice’ showing its ABN and the ‘price of the taxable supply’ for management services as \$5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 less \$500).

Example 2 – Apportionment of Fees

147. Murray decides to participate in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a ‘Power of Attorney’ allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

Management fee x $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

$$\$5,000 \text{ X } \frac{26}{365}$$

= **\$356** (this is Murray's total tax deduction in 2001 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \text{ X } \frac{339}{365}$$

= **\$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2002 income year).

$$\$1,200 \text{ X } \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2002 income year).

\$4,643 + \$85 = \$4,728 (The sum of these two amounts is Murray's total tax deduction for management fees in 2002).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

Example 3 – Apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'

148. On 1 June 2001 Kevin applies for an interest into the Western Bluegum Project, a Prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of \$3,600 and first year lease fee of \$500 on 15 June 2001.

Kevin, who is not registered nor required to be registered for GST calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

Management fee

Even though he paid the \$3,600 in the 2001 income year, because there are no 'days of eligible service period' in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2001.

Lease fee

Because the \$500 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2001.

In the **2002 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\begin{array}{r} \$3,600 \text{ X } \frac{365}{365} \\ \hline \end{array}$$

= **\$3,600** (this represents the whole of the first year's management fee prepaid in the 2001 income year but not deductible until the 2002 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

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Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

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

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- producing assessable income
- product rulings
- public rulings
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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