


PR 2001/174 - Income tax: Coralee Olives Project Stage 1

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Product Ruling

Income tax: Coralee Olives Project Stage 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**, **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.

Participants must form their own view about the commercial and financial viability of the product. This involves 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 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. Participants may wish to seek assurances from the promoter that the arrangement has been carried out as described in this Product Ruling.

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.

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 relates. In this Ruling this arrangement is sometimes referred to as the Coralee Olives Project Stage 1, or simply as 'the Project'.

Tax laws

2. The tax law dealt with in this Ruling is:
- Division 35 of the *Income Tax Assessment Act 1997* ('ITAA 1997').

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 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 those persons who were accepted into the Project on 23 December 1999. 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 have terminated or who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from the Project.

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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Date of effect

11. This Ruling applies prospectively from 19 December 2001 for Growers who, on 23 December 1999, entered into the specified arrangement that is set out below. 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 2002. The Ruling continues to apply, even following its withdrawal, in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specified arrangement that is set out below on 23 December 1999. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

14. The arrangement that is the subject of this Ruling is described below. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Application for Product Ruling dated 7 May 2001;
- Information Memorandum issued by Coralee Olive Farms Pty Ltd;
- The **Licence Agreement** attached to the Information Memorandum. This agreement is between Coralee Olive Farms Pty Ltd ('COFPL') and the Grower;
- The **Management Agreement** attached to the Information Memorandum. This agreement is between Coralee Management Pty Ltd ('CMPL') and the Grower ;
- **Deed Poll** executed by COFPL;
- **Deed Poll** executed by CMPL;
- The Third Agreement between COFPL and CMPL; and
- Correspondence and attachments from the applicant's Tax Adviser dated 22 August 2001, 17 September 2001 and 5 December 2001.

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

15. The documents highlighted are those which Growers entered into or became a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, that a

Grower, or any associate of the Grower, is or was a party to. The effect of these agreements is summarised as follows.

Overview of the Project

16. The arrangement is the Coralee Olives Project Stage 1. The salient features of the Project are shown in the table below.

Location	Koch Road, West Narcoorte Ranges, South Australia
Type of business each participant is carrying on	Commercial growing and cultivation of olive trees for eventual harvesting and selling of olives
Number of hectares under cultivation	200
Minimum subscription	50 hectares
Minimum size of each Grove on offer	One (1) hectare
Number of trees per hectare	320
The term of the Project	20 years
Initial cost of a hectare allotment (see paragraph 34)	\$22,000

The Project Land

17. COFPL is the owner of 694 hectares of land at Koch Road, West Naracoorte Ranges, of which it offered 200 hectares for licence to Growers who wished to establish an olive Grove. Under the arrangement a Grower must have acquired 1,000 "A" class shares in COFPL for each 1 hectare of land licenced by them.

18. The "A" class shares in COFPL will convert to ordinary shares on 31st October 2020. At that point in time, the Grower surrenders the Grove including all fruit and other benefits of and from the trees to COFPL. The Grower will no longer have a right to farm the land and the Grower's interest will be the rights attaching to that Grower's ordinary shares in COFPL.

19. All Growers participating in the Project entered into a Licence Agreement and Management Agreement on 23 December 2001. Information provided with the Application indicates that while the minimum area of land, called a Grove, that can be licenced to a Grower was one hectare, there were no Growers who subscribed to less than 5 Groves in the Project.

Licence Agreement

20. Under the Licence Agreement, COFPL grants the Grower a non-exclusive licence in respect of a Grove for the sole purpose of cultivating, nurturing, maintaining and growing olive trees and harvesting olives from those trees. The licenced area is specified in Item 6 of the Schedule.

21. The Licence Agreement also provides that COFPL agrees to perform the Establishment Activities and provide Water Management to the Grove. Establishment Activities include clearing of the Grove, planting of the trees and supply and installation of irrigation system. COFPL acknowledges that the Trees and all Fruit are and remain the property of the Grower throughout the term of the agreement.

22. The Grower commits under the Licence Agreement to manage the Trees and the Grove in accordance with Best Practice throughout the term of the Agreement. Best Practice as defined by the Licence Agreement means the methods from time to time which are appropriate and generally accepted by horticultural experts for the efficient:

- fertilisation, pruning and cultivation of trees;
- harvesting of the fruit;
- management of erosion and nutrient replenishment of the Grove; and
- discharge generally of the Grower's obligations under the Licence Agreement in relation to the Grove and Trees.

23. With COFPL's consent, the Grower's duties that involve managing the Trees and the Grove can be delegated to any Manager. Through the Licence Agreement, COFPL consents to the Grower appointing CMPL as the Manager.

24. In consideration of COFPL granting the licence, performing the Establishment Activities and providing Water Management, the Grower pays COFPL Licence Fee, Establishment Costs and Water Fee, respectively.

25. The Licence Agreement is conditional upon COFPL entering into licences with Growers in relation to no less than 50 hectares of the Project Land within three months of Commencement Date. Information provided by the Applicant indicates that the minimum subscription of 50 hectares was reached on 23 December 1999.

26. The Licence Agreement provides the grounds for terminating this agreement. Under clause 11.1(b) of the Licence Agreement COFPL can terminate the Licence Agreement if fifty per cent (50%) or more of the Olive trees on the Project Land die or are destroyed. COFPL has executed a Deed Poll which provides that, subject to either of the conditions stipulated in clause 3 of the Deed Poll, COFPL will not be entitled to terminate any Licence Agreement by virtue of clause 11.1(b) of any such Licence Agreement.

Management Agreement

27. Under the Management Agreement the Grower appoints and CMPL accepts that appointment, to act as the Grower's Manager during the Term for the purposes of the Licence Agreement. A Grower who enters into a Management Agreement with CMPL is referred to under this agreement as Managed Investor. **This Ruling only applies to Managed Investors.**

28. CMPL commits to perform the following in accordance with the terms of the Management Agreement:

- pay, on behalf of Growers, the Establishment Costs, Water Fees and the pro-rata amount of the Project Overheads to COFPL;
- perform the Grower's duties as set-out in the Licence Agreement;
- undertake the Harvest Activities;
- undertake the Sales Activities
- re-plant diseased or dead olive trees;
- negotiate with COFPL on the Grower's behalf in relation to any and all dealings arising out of the Licence Agreement; and
- insure the Grove for any public risk or risk to other person.

29. In consideration for CMPL performing the preceding services, each Grower is liable to pay the Initial Payment, Management Fee, Harvest Costs, Sale Costs and Bonus for excess yield.

30. Under the Management Agreement, the olives from each Grower's olive Grove will be pooled and sold on behalf of the Managed Investors. Growers will be entitled to the proceeds from the sale of the olives without reference to the olive type, quality or volume. Sale proceeds will be derived by each Grower based on the numbers of licenced areas held as a proportion of total Managed Investor licenced areas. Any share of unsold produce at the end of a financial year will constitute trading stock of the Grower.

31. The Management Agreement provides the grounds for terminating this agreement. Under clause 10.1(b) CMPL can terminate the Management Agreement if fifty per cent (50%) or more of the Olive trees on the Project Land die or are destroyed. CMPL has executed a Deed Poll which provides that CMPL will not be entitled to terminate any Management Agreement by virtue of clause 10.1(b) of any such Management Agreement.

The Third Agreement

32. CMPL agrees to perform the following within the terms of the Third Agreement:

- perform the Establishment Activities;
- maintain boundary fences and windbreaks associated with the Project Land, manage soil erosion and other land care activities on those parts of the Project Land that are not planted with Olives, and control feral Olives on the Project Land and on land adjacent to the Project Land;
- indemnify COFPL in respect of costs associated with complying with orders of Authorities in relation to the Scheme, the Project Land or Water Management; and
- provide and supervise the Water Management.

33. In consideration for CMPL performing the preceding services, COFPL consents to CMPL being a Manager for the purposes of the Licence Agreement and therefore be entitled to be paid by Growers, amongst other amounts, the Initial Payment and the Management Fee. COFPL and CMPL acknowledge that the Initial Payment incorporates payments by Managed Investors attributable to the Establishment Activities and the Management Fee incorporates payments by

Managed Investors attributable to Water Management to be performed by CMPL under this Agreement and the Project Overheads.

Project Fees

34. The fees payable for the years ending 30 June 2000 to 30 June 2002 for a one hectare olive Grove are shown in the table below.

Fee type	30 June 2000	30 June 2001	30 June 2002
Share purchase	\$1,550		
Initial Payment	\$15,850		
Licence fee	\$450	previous year's fee indexed	previous year's fee indexed
Management fee	\$4,150	previous year's fee indexed	previous year's fee indexed
Total	\$22,000		

Finance

35. Growers funded their investment in the Project themselves, or borrowed from an independent lender.

36. 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.

Ruling

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

Section 35-55 – Commissioner’s discretion

37. For a Grower who is an individual and who entered the Project on 23 December 1999 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2003 that the rule in section 35-10 does not apply to this business activity. This is provided that the Project has been, and continues during the remainder of the term of the Project, to be carried on in a manner that is not materially different to that described in the arrangement that is set out in paragraphs 14 to 36 of this Product Ruling.

38. 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 44 in the Explanations part of this ruling, below); or
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- 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).

39. Where, the exception in subsection 35-10(4) applies, or 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.

40. 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.

Explanations

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

41. 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.

42. 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.

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43. 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.

44. 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 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.

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

46. A Grower who was accepted into and who has participated in the Project since 23 December 1999 is carrying on a business activity that is subject to these provisions.

47. Information provided with the application for this Product Ruling and additional information provided since, indicates that a Grower who acquired 5 Groves in the Project is unlikely to have their business activity pass one of the tests until the income year ended 30 June 2004. Growers who acquired more than 5 Groves in the Project may however, find that their activity meets one of the tests in an earlier income year.

48. 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.

49. 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.

50. The information provided by the applicant indicates that a Grower who acquired 5 Groves 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 has decided 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 for these Growers beyond the year ended 30 June 2003.

51. The applicant has stated that the business activity comprised by a Grower’s involvement in this Project has started to be carried on, and will continue to be carried on in a manner that is not materially different to that described in the arrangement that is set out in paragraphs 14 to 36 of this Product Ruling. If, however, the Project is not carried on during the income years specified above (see paragraph 37), in the manner described in the arrangement, this Ruling may be affected. 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.

52. In deciding to exercise the discretion in paragraph 35-55(1)(b) the Commissioner has relied upon:

- the report regarding the result of the soil survey that was undertaken on behalf of Coralee Olive Grove Development through SA Rural Services; and
- independent, objective, and generally available information relating to the industry which substantially supports cash flow projections and other claims,

including prices and costs, in the Product Ruling application submitted by the Applicant.

Detailed contents list

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

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Commissioner of Taxation

19 December 2001

Previous draft:

Not previously issued in draft form

- tax shelters
- tax shelters project

Related Rulings/Determinations:

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt IVA
- 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
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)

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

ATO references:

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