

PR 2001/2 - Income tax: Australian Grains Fund

 This cover sheet is provided for information only. It does not form part of *PR 2001/2 - Income tax: Australian Grains Fund*

 This document has changed over time. This is a consolidated version of the ruling which was published on *10 January 2001*



Product Ruling

Income tax: Australian Grains Fund

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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 as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

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

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

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

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

Terms of Use of this Product Ruling

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

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of person, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Australian Grains Fund, AGF, or just simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL of the ITAA 1936;
 - Section 82KZM of the ITAA 1936;
 - Sections 82KZME to 82KZMF of the ITAA 1936;
 - Part IVA of the ITAA 1936;
 - Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 8-1 of the ITAA 1997;
 - Section 17-5 of the ITAA 1997;
 - Division 27 of the ITAA 1997;
 - Division 35 of the ITAA 1997;
 - Subdivision 387-A of the ITAA 1997;
 - Subdivision 960-Q of the ITAA 1997; and
 - Section 995-1 of the 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.

Business Tax Reform

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

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation advisor 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 purposes of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant Agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling.

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 16 to 46) is carried out in accordance with details described in the Ruling.

11. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

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

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Manager, Legislative Services
AusInfo
GPO Box 1920
Canberra ACT 2601

Date of effect

13. This Ruling applies prospectively from 10 January 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).

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

Withdrawal

15. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material

difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

16. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Final Prospectus prepared for Australian Grains Fund Limited ('AGF' or 'the Manager') in August 2000;
- Constitution of Australian Grains Fund dated 24 February 2000;
- Constitution of the Australian Grains Fund Limited dated 13 February 1999;
- Deed Poll made by Australian Grains Fund Limited on 31 March 2000;
- Compliance Plan for Australian Grains Fund Limited as Responsible Entity dated 24 February 2000;
- Australian Grains Fund Agency Agreement-Custodian dated 6 April 2000;
- Deed of Licence to Occupy between Australian Rural Group ('ARG') and AGF - as agent for the grower - undated;
- **Draft Management Agreement between AGF and AGF as agent for each Grower dated 18 April 2000;**
- **Licence to Occupy granted by the Custodian to each Grower;**
- Letter from the Applicant's Chartered Accountants and Business Advisers dated 30 November 2000;
- Option deeds over those properties required to meet minimum subscription;
- Farm work-sheets by type of grain;
- Project summary and year-by-year revenue and cost projections based on specific crop rotation; and
- Draft Supplementary Prospectus received 21 December 2000.

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17. Every Grower must enter into the contractual documents highlighted above. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be party to, which are a part of the arrangement. The effect of these agreements is summarised in the following paragraph.

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

Overview

18. The salient features of the Australian Grain Fund project are:

Name used to describe the project	Australian Grain Fund
Location	Options held over specific land at Parkes, Condobolin and Euabalong in NSW and at Donald and Sea Lake in Victoria
Type of business each participant carrying on	Grain particularly wheat, barley, canola and chick peas in rotation
Number of hectares under production	8,198 at minimum subscription
Minimum subscription	1,640 crop units
Size of each crop unit	5 hectares (in combination of one 2ha zone plus 3 x 1ha zones)
Term of the project	10 crop years spanning 11 income tax years
Initial cost per crop unit	\$3,363.47
Initial cost per hectare	\$672.69
Ongoing costs per annum	Will vary. Approximate average \$2,900 for crop seed purchase, planting, tending, harvesting and marketing costs

19. This arrangement is called the Australian Grains Fund. Participants enter into the arrangement to conduct a primary production business of growing grains. The Custodian leases the Project land from the owners under a head lease; the Custodian then grants the Growers a licence to occupy the land as 5-hectare Crop Units. As advised in the Supplementary Prospectus to be provided by the manager to all growers, these crop units will be divided up into one 2 hectare zone and three zones of 1 hectare each, and situated in various geographical locations primarily located throughout the Australian Wheat Belt of the East Coast of Australia and Western Australia. Growers will own the crops grown on their Crop Unit(s).

The Project is designed to manage, although not eliminate, the Growers' risks from adverse environmental factors, for example by the use of "Weather Derivatives" (insurance against sub-optimal weather conditions), Grain Derivatives (which are Forward Sale Agreements, Options and Futures) and by the geographic spread of locations in which the Grain is grown. Participation in the Project will include:

- (a) The Grower entering into a licence to occupy arrangement with the Custodian to occupy a minimum of 5 hectares (in identical combination with every other grower) and covenant with the Manager to grow grain on the land. Each Grower's land will be spread over a number of different areas within the land leased by the Custodian for the Project;
- (b) The Grower entering into a 'Management Agreement' with AGF for services including the annual planting and maintenance of the grain crops on the Crop Unit(s), annual harvesting, marketing and delivery of the current year crop and preparation and replanting of the land with the following year's crop.
- (c) Payment to the Australian Grains Fund project of a subscription of \$3,363.47 per 5 hectare Crop Unit to cover the first year's expenses, payable for year 1 on acceptance of the Grower's application, comprising \$363 for the licence to occupy, and \$3,000.47 to cover production costs, risk management fees, management and administration fees and marketing costs.
- (d) Subsequent annual fees are to be met from the harvest of the crop in the previous growing season. Projected revenue and costs (GST exclusive) are disclosed in the Draft Supplementary Prospectus. The actual fee payable each period is to be advised by the manager six weeks prior to planting. As stated in cl 13.10 of the Prospectus, circumstances may arise where additional funds are required from the Growers. This may arise where the proceeds from the harvest do not meet the anticipated production costs of the next years harvest period.

20. The costs are based on 8,198 hectares of land being under management. AGF has options to lease 100,000 hectares of additional land. AGF have determined that in years one to five none of the available land leased and managed will be fallow (non-producing). However, in years six to ten, one hectare of a Crop Unit (20%) of the available land that is leased and managed will be fallow.

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21. The grain crops will be harvested as per the defined crop rotation as follows:

	Zone A 2 hectares	Zone B 1 hectare	Zone C 1 hectare	Zone D 1 hectare
Year 1	Wheat	Barley	Canola	Chick Peas
Year 2	Canola	Chick Peas	Barley	Wheat
Year 3	Barley	Wheat	Chick Peas	Canola
Year 4	Chick Peas	Canola	Wheat	Barley
Year 5	Wheat	Barley	Canola	Chick Peas
Year 6	Canola / Fallow	Chick Peas	Barley	Wheat
Year 7	Fallow / Barley	Wheat	Chick Peas	Canola
Year 8	Chick Peas	Fallow	Wheat	Barley
Year 9	Wheat	Barley	Fallow	Chick Peas
Year 10	Canola	Chick Peas	Barley	Fallow

Each grower will have the same crops planted in identical proportions with every other grower. There will only be one harvest per year - a winter crop - and the remainder of the year will be spent ensuring that the land is able to produce optimum yield in the following winter season.

22. The manager will notify each Grower approximately six weeks prior to planting of the geographic location and grid reference of each of the crops to be planted on each one-hectare zone of their crop unit.

23. Growers must also purchase a minimum of 400 redeemable preference shares at \$1.25 in the Manager (AGF). However, if when the application is received all preference shares have been subscribed, the subscription money for the shares will be refunded in full to the Grower. In addition, the Manager may redeem the Preference Shares at the issue price between 30 June 2002 and 30 June 2004. Any preference shares not redeemed by the Manager will convert to ordinary shares in the Manager on 1 July 2004.

24. The project will commence no later than 31 May 2001, subject to the minimum number of 1,640 Crop Units being issued by the Manager. For 2001 Growers, applications must be lodged and approved by this date in order to obtain an income tax deduction in respect of the 2001 calendar year harvest. Where applications are received and approved after this date, the Grower will not be able to participate in the project until the 2002 calendar year. Accordingly no deductions will be available for the year ending 30 June 2001 for Growers who subscribe between 1 June 2001 and 30 June 2001 as no work will be performed on their Crop Units during that period.

25. A Remuneration System designed by an external third party provides for the Manager to receive 50% of any harvest proceeds in

excess of the proceeds forecast in the Prospectus and Draft Supplementary Prospectus. Growers will receive the remaining 50% of such excess. The anticipated yield levels using IHD Opti-Crop methods and the annual increments for each crop are as follows:

CROP	YIELD tonnes per hectare per annum	INCREMENT tonnes per hectare per annum
Wheat	3.50	0.05
Barley	3.25	0.03
Canola	2.05	0.01
Chick peas	1.50	0.01

26. Growers will arrange their own finance to make some or all of the subscription fees of \$3,363.47 and any subsequent annual management fees. No entity associated with the project is involved in the provision of finance for the Project. Any finance arrangements undertaken by the entities associated with the Project, including the Manager, Custodian, Landowner and related entities, are outside the arrangement to which this Ruling applies.

27. The project is to start no later than 31 May 2001. It is expected that the first grain crop will be harvested in approximately November 2001. This results in taxpayers making a loss for taxation purposes in the first year of the Project (2000/2001 for growers who invest by 31 May 2001 and 2001/2002 for growers who invest after 1 June 2001), as the associated revenue is not derived until the following income year. During the remainder of the year, the Manager will take steps to ensure that the land is in optimum condition in preparation for the following crop planting. Accordingly the management fee covers the whole yearly crop cycle.

28. Possible projected returns for Growers are outlined on pages 28 and 29 of the Prospectus and in the Draft Supplementary Prospectus. The projected returns have been based on a range of assumptions made by AGF. There is no assurance or guarantee whatsoever in respect of the future success of, or financial returns associated with, the project.

Fees

Years 1 to 3 hectare rate

29. The fees payable by a participant in the project in the first year for a five hectare Crop Unit is fixed at \$3,363.47. The fees as shown for Years 2 and 3 are indicative of the anticipated costs however actual costs will be advised by the Manager in February each year prior to planting (refer para 22 above).

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	Year 1 Hectare rate	Year 2 Hectare rate	Year 3 Hectare rate
Licence to occupy	\$66.00	\$66.00	\$66.00
Crop Management	\$30.00	\$30.00	\$30.00
Cultivation	\$11.12	\$4.86	\$5.00
Sowing	\$37.21	\$31.74	\$33.96
Fertiliser	\$47.00	\$79.25	\$63.17
Herbicide	\$80.00	\$79.82	\$79.17
Contract harvesting	\$51.80	\$54.96	\$46.00
Labour	\$19.25	\$22.70	\$22.01
Fuel	\$2.50	\$2.50	\$2.50
Transport to Port	\$94.50	\$86.41	\$95.05
Crop insurance	\$11.94	\$18.95	\$16.27
Board and Research Levies	\$16.24	\$10.68	\$10.81
Risk Management	\$32.52	\$23.84	\$20.96
Weather Swaps	\$13.40	\$13.40	\$13.40
Compliance and Scheme audit fees	\$3.66	\$3.66	\$3.66
Custodian fees	\$1.95	\$1.95	\$1.95
Management fees	\$53.45	\$53.28	\$51.29
Marketing costs	\$38.00	\$0.00	\$0.00
Total for 1 ha	\$611.54	\$586.00	\$564.20
Total for 5 ha	\$3,057.70	\$2,930	\$2,821.00
GST	\$305.77	\$293	\$282.10
TOTAL COST	\$3,363.47	\$3,223	\$3,103.10

Notes:

- (i) Production Costs (total costs as above less management and marketing fees) are calculated on the basis of Department of Agriculture NSW figures for Winter 1999 and 2000 in the Southern Region of NSW and service quotations obtained by the Manager assuming 8,198 hectares under cultivation.
- (ii) Management fees are calculated as 10% of Production Costs.
- (iii) Cost per tonne for loading grain at Port is deducted from converted US prices to arrive at the price at Port. These freight costs are determined using actual costs at Port Kembla.

(iv) Pricing and other risk management costs are quoted prices from Australian Risk Management (“ARM”). Pricing risk management assumes that the Scheme marketing will proceed using the following instruments:

- Grain Pools 50%
- Forward Contracts 20%
- Basis Contracts 30%

Project Constitution

30. Participants who enter into a Management Agreement with AGF will be covered by the Project Constitution. Participants, by entering into the Management Agreement, agree to the terms of the Project Constitution that sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. Growers are entitled to assign their Grower’s interest in certain circumstances (cl 13). The Licence to Occupy and Management Agreement will be executed on behalf of a Grower following the signing of the Application Form and Power of Attorney in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

Compliance Plan

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

Interest in Land

32. A Licence to Occupy the relevant Crop Unit(s) is granted to each Grower by the Custodian. Accordingly, Growers are granted an interest in land and are able to access, use and occupy their Crop Unit(s) to carry on their business of primary production (cl 5.2 of Licence Agreement). Growers must pay an annual rental of \$363 per 5 hectare Crop Unit. This fee is indexed annually (cl 7.2) and the Licence Agreement ends when the Project is terminated (cl 2.2).

Management Agreement

33. Each Grower enters into this Agreement with the Manager for a period of ten years, or lesser time if the termination of the

investment deed occurs on an earlier date (cl 17.1). Growers and the Manager have the right to terminate the Management Agreement in case of default or insolvency (cl 18 and 19). The management fees are payable by the Grower annually in advance (cl 12.2) and cover a twelve-month crop cycle.

34. The management services to be provided by AGF are described in detail at Schedule 2 to the Management Agreement. These include, amongst other things:

- procure seed and plant and tend to the Grain in the Crop Unit (a);
- maintenance and cultivation of the Grain (e);
- marketing and selling the Grain (h);

and all will be carried out by the end of the first 13 months of the project (cl 5.2).

35. AGF is entitled to delegate all or any of the functions to be performed by it pursuant to the Management Agreement, subject to the Constitution (cl 26).

36. Pursuant to its right to delegate any functions required of it, AGF has contracted with an external, independent contractor to undertake the obligations under the Management Agreement to establish and manage the Grain crop. A contract exists between AGF and the independent contractor detailing those services to be undertaken by the independent contractor. Under the contract, the independent contractor will undertake all pre-planting, planting and maintenance activities necessary to fulfil that part of the project.

37. AGF will pool for sale all produce of each Grower's business with that of each other Grower and will market and sell all such produce. The proceeds of the pooled sales will be paid to the Custodian for dividing and crediting to the account of each Grower on a proportional basis without reference to quality, volume, prices or any other factor in relation to the Grower's Grain or those of any other Grower (cl 7). If any part of the Grower's Crop Unit is damaged by fire or wind storm, the proceeds of the insurance will be added to the pool of the project's harvest proceeds (cl 14.6).

38. Income of the Project is to be held in trust for the Growers in a Growers' Account by the Custodian, however the Manager has the right to retain or be paid out of the Growers' Account amounts in payment of the Growers' obligations under the Management Agreement.

39. The Grower is liable for all costs and expenses incurred by the Manager in carrying out its obligations and for the payment of any Goods and Services Tax applicable to the supply of the services under

this agreement. The Manager will deduct payment for these costs, or provision for any such payments, out of the harvest proceeds (cl 12.8).

40. If in any year of the Project the income resulting from the sale of produce is insufficient to meet the annual management fee, occupancy fee or other costs of that year, participants are still liable to pay the shortfall and the Manager may charge interest on any overdue amounts or transfer all rights and title to the Grower's Crop Unit to a third party, in addition to any other legal remedy available to the Manager (cl 13.2).

41. There are no sale agreements in place for the Grain that will be produced and harvested under the Project. Growers are paying, as part of the management fees, an amount to AGF for it to market and sell the Grain (cl 12.9 (c)).

Other Fees Payable by a Participant

42. A participant in the Australian Grains Fund will be bound by the Management Agreement, Licence to Occupy and Project Constitution. These documents detail, amongst other things, the fees and charges for which an investor is liable. In addition to the fees that have been detailed above, an investor may be liable, in certain circumstances, for other fees and charges, which are not able to be currently quantified. These include the possibility of the Manager charging for any taxes and duties (or price increases through inflation) required to be paid by the Project (cl 25.4, Project Constitution).

Finance

43. Growers can fund their investment in the Project themselves or borrow from an independent lender. Finance arrangements organised directly by a Grower with independent lenders are outside the arrangement to which this Ruling applies.

44. The Responsible Entity has engaged the services of Laton Finance Pty Ltd ('Laton'), a company not associated with AGF or any associates of AGF, to broker loans from a number of independent financiers, to cover the fees payable to the Responsible Entity. There is no other arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of finance to the Growers in connection with the Project. Neither AGF nor any party associated with the Project will receive any commission from Laton in respect of any loans brokered by Laton for Growers.

45. The loans brokered by Laton will be on normal commercial terms, they will be both in form and substance full recourse, and borrowers will be obliged to make the regular repayments regardless

of any income being derived from the Project. AGF will be putting in funds directly as a result of these loans, on the Grower being accepted as a borrower. AGF will not be putting any of these funds on deposit with Laton, or any of the financiers in question, or any associated persons, but will substantially use these funds, subject to the Custodian's approval, in carrying out its obligations under the Management Agreement.

46. This ruling does not apply if a Grower enters into a finance arrangement with any of the following features:

- there are split loan features of the type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project are involved, or become involved, in the provision of finance to Growers for the Project;
- 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 a borrower, for the purposes of Section 82KL, or the funding arrangements transform the Project into a "scheme" to which Part IVA applies;
- repayments of principal and payments of interest are linked to 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 are transferred (by any means, and whether 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.

Ruling

Assessable Income

47. A Grower's share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

Minimum subscription

48. A Grower will not incur any fees below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted (the date the investment is made). Under the prospectus, a Grower's application will not be accepted nor will the Project proceed until the minimum subscription of 1640 interests is achieved. Tax deductions are not allowable until these requirements are met.

Deductions where a Grower is not registered nor required to be registered for GST**Allowable deductions 2001 Winter Growers**

49. A Grower may claim tax deductions using the method in paragraphs 52 and 53, where the Grower:

- participates in the Project by 31 May 2001 to carry on the business of growing grain;
- incurs the fixed fee of \$3,363.47 in Year 1 and the fee as advised by the Manager six weeks prior to planting in each subsequent year; and
- is neither registered nor required to be registered for GST.

In this Project, the tax deductions allowable for the Management Fees must be calculated by applying the formula to the amount incurred each year by the Grower. The application of this method is shown in Example 2 at paragraph 105.

Fee type	ITAA 1997 section	Year ended 30 June 2001	Year ended 30 June 2002	Year ended 30 June 2003
Management fees	Section 8-1	Amount must be calculated – see notes (i) & (iv) below	Amount must be calculated – see notes (i) & (iv) below	Amount must be calculated – see notes (i) & (iv) below
Licence Fees	Section 8-1	\$363 – see notes (ii) & (iv) below	\$363 – see notes (ii) & (iv) below	\$363 – see notes (ii) & (iv) below
Interest	Section 8-1	As incurred – see notes (ii), (iii) & (iv) below	As incurred – see notes (ii), (iii) & (iv) below	As incurred – see notes (ii), (iii) & (iv) below

Allowable deductions 2002 Winter Growers

50. A Grower may claim tax deductions using the method in paragraphs 52 and 53, where the Grower:

- participates in the Project between 1 June 2001 and the date the Prospectus or Supplementary Prospectus expires (i.e., no later than 30 June 2002) to carry on the business of growing grain;
- incurs the fixed fee of \$3,363.47 in Year 1 and the fee as advised by the Manager six weeks prior to planting in each subsequent year; and
- is neither registered nor required to be registered for GST.

In this Project, the tax deductions allowable for the Management Fees must be calculated by applying the formula to the amount incurred each year by the Grower. The application of this method is shown in Example 2 at paragraph 105.

Fee type	ITAA 1997 section	Year ended 30 June 2002	Year ended 30 June 2003
Management fees	Section 8-1	Amount must be calculated – see notes (i) & (iv) below	Amount must be calculated – see notes (i) & (iv) below
Licence Fees	Section 8-1	\$363 – see notes (ii) & (iv) below	\$363 – see notes (ii) & (iv) below
Interest	Section 8-1	As incurred – see notes (ii), (iii) & (iv) below	As incurred – see notes (ii), (iii) & (iv) below

Notes:

- (i) The Management fees are **NOT** deductible in full in the year incurred. The deduction for each year's fees must be determined using the formula at the end of paragraph 53. The Project Manager will inform each Grower of the management fee and 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 105.
- (ii) Amounts of less than \$1,000 will be 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (See Example 3 at paragraph 106). Deductibility of amounts of \$1,000 or

more, such as may occur where a Grower acquires a number of interests in the Project, will be determined on the same basis as the prepaid Management fees, i.e., using the formula shown at the end of paragraph 53.

- (iii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Laton Finance Pty Ltd is outside the scope of this Ruling. However, all Growers who finance their participation in the Project other than with Laton Finance Pty Ltd should read carefully the discussion of the prepayment rules in paragraphs 80 - 82 below as those rules may be applicable if interest is prepaid.
- (iv) Where a Grower **chooses** to prepay fees beyond 13 months, sections 82KZME and 82KZMF will not apply to set the amount and timing of that Grower's tax deductions. Instead, unless the expenditure is 'excluded expenditure', the amount and timing of the tax deductions is determined under either subsection 82KZM(1) or subsection 82KZMD(2) (see paragraphs 83 to 85). To apportion the expenditure over the eligible service period, these provisions, which apply respectively to 'small business taxpayers' and taxpayers who are not 'small business taxpayers', effectively use the same formula as that shown at the end of paragraph 53.

Deductions where a Grower is registered or required to be registered for GST

51. Where a Grower who is registered or required to be registered for GST:

- participates in the Project to carry on the business of growing grain;
- incurs the fixed fee of \$3,363.47 in Year 1 and the fee as advised by the Manager in February each year; and
- is entitled to an input tax credit for the fees,

then the tax deductions calculated will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 104.

Section 8-1 – Prepaid fees

52. Expenditure incurred by a Grower who participates in the Project is subject to the prepayment rules contained in sections

82KZME and 82KZMF. Therefore, a Grower who prepays fees that are otherwise allowable under section 8-1 **cannot** claim a tax deduction for the full amount of the fees in the year in which the expenditure is incurred unless it is 'excluded expenditure' (see note (ii) above).

53. As the Management Fee covers the whole year, the amount and timing of tax deductions allowable each year for such fees must be determined using the formula in subsection 82KZMF(1). In that formula, which is shown below, the 'eligible service period' means, generally, the period over which the services are to be provided.

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

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

Section 35-55 – Commissioner's discretion

54. For a Grower who is an individual and who enters the Project before 31 May 2001, the rule in section 35-10 may apply to the business activity comprised by his/her involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income year ending 30 June 2001, 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.

55. For a Grower who is an individual and who enters the Project after 1 June 2001, the rule in section 35-10 may apply to the business activity comprised by his/her involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income year ending 30 June 2002, that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies (see paragraph 92 in the Explanations part of this ruling, below).

57. Where the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to his/her 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.

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

Section 82KL

59. Section 82KL does not apply to deny the deduction otherwise allowable.

Part IVA

60. 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

Section 8-1

61. Consideration of whether the leasing fees, management fees, annual replanting costs and other costs as detailed above are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings 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 taxpayers contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether the second limb applies. However, that does not preclude the application of the first limb and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

62. A grain scheme can constitute the carrying on of a business. Where there is a business, or a future business, the Gross Harvest Proceeds each year from grain from a Crop Unit comprising the Project will constitute gross assessable income in its own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the grain each year from the Crop Unit.

63. Generally, a Grower will be carrying on a business of primary production where:

- the Grower has an identifiable interest in specific growing grain coupled with a right to harvest and sell the grain each year;
- the primary production activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

64. For this Project Growers have rights under the Licence to Occupy Agreement in the form of a licence to occupy an identifiable area of land consistent with the intention to carry on a business of growing grain. Under the Management Agreement, Growers engage the Project Managers to acquire seeds and plant out the seeds on the licenced land and provide ongoing services to care and maintain the grain. Growers are considered to have control of their operations.

65. The Licence to Occupy Agreement provides Growers with more than a chattel interest in the grain. The Project documentation contemplates Growers will have an ongoing interest in the grain.

66. Growers have the right to use the land in question for primary production purposes and to have the Project Manager come onto the land to carry out its obligations under the Management Agreement. The Grower's degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Project Manager's activities. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect. The primary production activities described in the Management Agreement are carried out on the Grower's behalf.

67. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

68. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify which grain Growers have an interest in.

69. Growers have a continuing interest in the grain from the time they are acquired until the cessation of the Project. The primary production activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Grower's primary production activities will constitute the carrying on of a business.

70. The licence fees and management fees associated with the primary production activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which income (from the regular sale of grain) is to be gained from the 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.

Sections 82KZME and 82KZMF – Prepaid fees

71. Expenditure prepaid by Growers for management fees and licence fees meets the requirements of subsections 82KZME(1) and (2) and the expenditures are incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies to the expenditures, the amount and timing of tax deductions for those expenditures are determined under section 82KZMF.

72. In relation to the requirements of subsection 82KZME(1) and (2), the prepaid management and licence fees incurred by a Grower who participates in the Project:

- are otherwise deductible under section 8-1; and

- have ‘eligible service periods’ (for each of the fees) that end not more than 13 months after the Grower incurs the expenditure; and
- are incurred in return for the doing of a thing under the agreement that is not wholly to be done within the expenditure year.

The ‘eligible service period’ (defined in subsections 82KZL(1)) means, generally, the period over which the services are to be provided.

73. In relation to an ‘agreement’ referred to in subsection 82KZME(3), the Project is an ‘agreement’ (this being a broad concept under subsection 82KZME(4)), where, during the term of this Product Ruling:

- the Grower’s allowable deductions attributable to the Project for each expenditure year exceeds the Grower’s assessable income from the Project (if any) for the expenditure year;
- the Grower does not have day-to-day control over the operation of the Project; and
- there is more than one Grower participating in the Project.

74. The prepaid management fees incurred by Growers do not fall within any of the 5 exceptions to section 82KZME and, therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF overrides section 8-1 and apportions the management fees over the period that the services for which the prepayment is made are performed.

75. The prepaid licence fees, being amounts of less than \$1,000 in each expenditure year, constitute ‘excluded expenditure’ as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) ‘excluded expenditure’ is not subject to section 82KZMF and is, therefore, deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of prepaid licence fees is \$1,000 or more, then the deduction allowable for those amounts will also be subject to apportionment under section 82KZMF.

Interest deductibility

(i) Growers who use Laton Finance Pty Ltd as the finance provider

76. Some Growers may finance their participation in the Project through a loan facility with Laton Finance Pty Ltd. Under the terms

of the Loan Agreement to be entered into between those Growers and Laton Finance Pty Ltd, interest may be paid in advance each year.

77. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of licence and management fees. The interest incurred for the year ended 30 June 2001 and in subsequent years of income will be in respect of a loan to finance the Project business operations of growing grain and is therefore directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1, subject to the operation of sections 82KZME and 82KZMF.

78. The loan agreement under which the interest is incurred is directly related to all of the activities that are carried out under the Project, and so is a part of the 'agreement' (subsection 82KZME(4)). Consequently, as with the management fees and the licence fees, the interest will satisfy the requirements of subsection 82KZME(1), and be subject to section 82KZMF, unless one of the exceptions applies. For a Grower acquiring a single interest in the Project any prepaid interest may be less than \$1,000 and therefore 'excluded expenditure' such that Exception 3 (subsection 82KZME(7)) will apply. In such cases the interest is deductible in full in the year in which it is incurred.

79. However, as with the licence fee, where a Grower acquires more than one interest in the Project and the quantum of the interest is \$1,000 or more, the tax deduction each year must be determined in the same manner as the management fees, using the formula in subsection 82KZMF(1).

(ii) Growers who DO NOT use Laton Finance Pty Ltd as the finance provider

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

81. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in section 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass

activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

82. Therefore, unless the prepaid interest is ‘excluded expenditure’, where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to determine any tax deduction using the formula in subsection 82KZMF(1). The relevant formula is shown above in paragraph 53 and the method is explained in Example 2 at paragraph 105.

Prepayments where the eligible service period exceeds 13 months

83. Although not required under the Arrangement described in this Product Ruling, some Growers may choose to prepay some or all of their fees for periods longer than the agreements require. Specifically, this will occur when the ‘eligible service period’ relating to the prepaid amount ends more than 13 months after the Grower incurs the expenditure. Where the ‘eligible service period’ exceeds 13 months, sections 82KZME and 82KZMF will not apply, as the requirement of paragraph 82KZME(1)(b) is not met.

84. Instead, for a Grower who is a ‘small business taxpayer’ (see paragraphs 86 to 88), subsection 82KZM(1) applies to apportion the expenditure and determine the amount and timing of the deductions. Alternatively, for a Grower who is not a ‘small business taxpayer’, subsection 82KZMD(2) applies to apportion the expenditure and determine the amount and timing of the deductions.

85. Both of these provisions, although slightly different in form, apportion deductible expenditure over the ‘eligible service period’ in the same way as the formula contained in paragraph 53 (above). However, expenditure, which is ‘excluded expenditure’, is an exception to both provisions (subparagraph 82KZM(1)(b)(ii) and subsection 82KZMA(4) respectively). A tax deduction for ‘excluded expenditure’ can be claimed in full in the year in which the expenditure is incurred.

Small business taxpayers

86. A ‘small business taxpayer’ is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either his/her ‘average turnover’ for the year is less than \$1,000,000 or his/her turnover recalculated under section 960-350 is less than \$1,000,000.

87. ‘Average turnover’ is determined under section 960-340 by reference to the average of the taxpayer’s ‘group turnover’. The group

turnover is the sum of the ‘value of business supplies’ made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

88. Whether a Grower is a ‘small business taxpayer’ depends upon the circumstances of each Grower and is beyond the scope of this Product Ruling. It is the responsibility of each Grower to determine whether or not they are within the definition of a ‘small business taxpayer’.

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

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

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

90. 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.

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

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

93. In broad terms, the objective tests require:

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

94. 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 Growers are unlikely to pass one of the objective tests in the first financial year of their participation in the Project.

95. 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.

96. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the term of this Product Ruling.

97. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

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

98. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above, in the manner described in the Arrangement (see paragraphs 16 to 46), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

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

Section 82KL

100. 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

101. 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).

102. The Australian Grain Fund Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions 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.

103. 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 grain. 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’

104. Margaret, who is registered for GST, invests 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

105. Murray decides to invest 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 $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

$$\$5,000 \times \frac{26}{365}$$

= **\$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:

$$\$5,000 \times \frac{339}{365}$$

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

$$\$1,200 \times \frac{26}{365}$$

= **\$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'

106. 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:

$$\begin{array}{r} \$3,600 \quad \times \quad \frac{365}{365} \\ \hline \end{array}$$

= **\$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.

Detailed contents list

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Commissioner of Taxation

10 January 2001

<i>Previous draft:</i>	- ITAA 1936 82KZME
Not previously issued in draft form	- ITAA 1936 82KZME(1)
	- ITAA 1936 82KZME(1)(b)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZME(2)
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1936 82KZME(3)
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1936 82KZME(4)
TR 2000/8, PR 1999/95	- ITAA 1936 82KZME(7)
	- ITAA 1936 82KZMF
<i>Subject references:</i>	- ITAA 1936 82KZMF(1)
- carrying on a business	- ITAA 1936 Pt IVA
- commencement of business	- ITAA 1936 177A
- fee expenses	- ITAA 1936 177C
- interest expenses	- ITAA 1936 177D
- management fees expenses	- ITAA 1936 177D(b)
- producing assessable income	- ITAA 1997 6-5
- product rulings	- ITAA 1997 8-1
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- schemes and shams	- ITAA 1997 Div 27
- taxation administration	- ITAA 1997 27-5
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	- ITAA 1997 35-10
<i>Legislative references:</i>	- ITAA 1997 35-10(2)
- ITAA 1936 82KL	- ITAA 1997 35-10(3)
- ITAA 1936 82KZL	- ITAA 1997 35-10(4)
- ITAA 1936 82KZL(1)	- ITAA 1997 35-30
- ITAA 1936 82KZM	- ITAA 1997 35-35
- ITAA 1936 82KZM(1)	- ITAA 1997 35-40
- ITAA 1936 82KZM(1)(b)	- ITAA 1997 35-45
- ITAA 1936 82KZM(1)(b)(ii)	- ITAA 1997 35-55
- ITAA 1936 82KZMA(4)	- ITAA 1997 35-55(1)
- ITAA 1936 82KZMC	- ITAA 1997 35-55(1)(a)
- ITAA 1936 82KZMD	- ITAA 1997 35-55(1)(b)
- ITAA 1936 82KZMD(2)	- ITAA 1997 Subdiv 387-A

- ITAA 1997 Subdiv 960-Q
 - ITAA 1997 960-335
 - ITAA 1997 960-340
 - ITAA 1997 960-345
 - ITAA 1997 960-350
 - ITAA 1997 995-1
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