PR 2001/23 - Income tax: The Boundary Bend Estate (J.V.Three) Project

Product Ruling
Income tax: The Boundary Bend Estate (J.V.Three) Project

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' 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 Boundary Bend Estate (J.V.Three) Project, or 'the Project'.

Tax law(s)

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

- section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 27 (ITAA 1997);
- section 35-55 (ITAA 1997);
- section 43-10 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZM (ITAA 1936);
- sections 82KZMB to 82KZMD(ITAA 1936);
- sections 82KZME to 82KZMF (ITAA 1936);
- section 91 (ITAA 1936);
- section 92 (ITAA 1936);
- Part IVA (ITAA 1936); and
- Division 51 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

Business Tax Reform

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

application of this Ruling, and to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

5. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

6. 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 'Participants'.

7. 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 the Project.

Qualifications

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

9. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:

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

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior

Date of effect

11. This Ruling applies prospectively from 21 March 2001, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on 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

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

Arrangement

14. The arrangement that is the subject of this 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:

- Application for a Product Ruling dated 8 November 2000;
- Draft Boundary Bend Estate (J.V. Three) Olive Development Information Memorandum 2001 prepared for Olive Management Pty Ltd;
- Draft **Joint Venture Agreement** between the Participants and Junction Nominees (No. Three) Pty Ltd ('the Trustee') and Olive Management Pty Ltd ('the Project Manager'), dated 1 November 2000;
- Draft **Olive Grove Management Agreement** between the Participants and the Project Manager, dated 1 November 2000;
- Draft Contract of Sale of the Land between B B Olives Pty Ltd and the Trustee, undated; and
- Letter and attachments from Tax Adviser dated 17 December 2000, 6 March 2001 and 8 March 2001.

Note: certain information 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 Participants enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Participant, or any associate of a Participant, will be a party to, which are part of the arrangements to which this Ruling applies. The effect of these agreements is summarised as follows.

Overview

16. This arrangement is called The Boundary Bend Estate (J.V.Three) Project.

Location	The property is situated in the northwestern region of Victoria, close to the River Murray border with New South Wales and 100km east and south of Mildura. The subject property is Lot 4 and part of Lot 5 on Plan of Subdivision No. 442841K comprising 280 hectares and being part of the land in Certificate of Title Volume 10535 Folio 502 subject to the variation provisions contained in the Land Contract.
The Joint Venture Business	Commercial growing of a number of varieties of olives

Number of hectares under cultivation	Minimum subscription of $3.62 million sufficient for 100 hectares. The maximum subscription is $18.1 million sufficient for 500 hectares. **This Product Ruling does not apply unless minimum subscription is achieved by 31 May 2001.**
Term of the project	15 years
Minimum Cost for a Participant (refer to paragraphs 26 to 29)	Initial capital contribution of $181,000 payable as follows: Upon application $10,000; 30th June 2001 $79,000; 1st Dec 2001 $15,000; 1st June 2002 $25,000; 1st Dec 2002 $25,000; and 1st June 2003 $27,000.
Other Costs	Further capital contribution to the Joint Venture may be required.
Interest in the Project	Proportionate interest in the Joint Venture Property that includes the land, water rights attached to the ownership of the land, olive trees and olives produced from the olive trees.

The Project Land

17. The land on which the Project will be established will be purchased by Junction Nominees (No. Three) Pty Ltd who will hold the land on bare trust for the Participants. The copy of the Contract of Sale of the land provides that the sale is conditional upon the Trustee being satisfied not later than 31 May 2001 that the minimum subscription has been reached.

18. All Participants shall receive an allocation of ordinary shares in the Trustee in proportion to their equity in the Joint Venture.

The Joint Venture Agreement

19. Participants to the Joint Venture will be persons who fall within the provision of section 708(8) of the Corporations Law. The Joint Venture will be an unincorporated joint venture and shall not be recognised as partnership under general law (Cl 2). The Participants will hold their respective interests in the Joint Venture Property as tenants in common in the shares specified in Schedule One of the Joint Venture Agreement (Cl 6.1).

20. Olive Management Pty Ltd will be contracted by the Joint Venture as the initial Project Manager (Cl 16.1). As one of the Participants, the Project Manager will not be obliged to make the initial capital contribution of $181,000. (Cl 11.2)

21. The Joint Venture Agreement establishes a Committee of Management consisting of Representatives. The manner of appointment and removal of Representatives and the procedural matters in running the Committee are provided in the Joint Venture Agreement (Cls 10 & 14). While the Committee is charged with the management of the affairs of the Joint Venture, the day to day management must be delegated to the Project Manager (Cl 15). The Committee approves the annual projects and budgets based on the Project Manager's recommendations (Cl 22). The Joint Venture may resort to external borrowing subject to terms and conditions approved by the Committee (Cl 29.1). A Participant may dispose of its interest in the manner provided in the Joint Venture Agreement (Cl 30).

The Olive Grove Management Agreement

22. The Olive Grove Management Agreement binds the Project Manager to procure, at the cost and expense of the Participants, the establishment of an olive grove (Cl. 3.1). The establishment works include as follows:

- preparation of that part of the Land which is capable of being used for the satisfactory growing of olive trees (to be determined by the Project Manager in accordance with good horticultural practices);
- choosing healthy olive tree varieties for planting;
- planting olive trees on the Land and staking and spacing each in a manner which accords with good horticultural practices and in order that the olives from the trees may be commercially harvested; and
- overseeing the installation of irrigation and supply systems (Cl 3.2).

23. The Project Manager is also obliged to have mature olives harvested and loaded for transport in accordance with good horticultural practices (Cl 6.1) and to market and sell the olives at a price decided by a majority vote of an olive price sub-committee (Cl 7).

24. In consideration of the Project Manager providing its technical knowledge, expertise and know-how to and for the benefit of the Project, each Participant must pay the Project Manager at the execution of this agreement $3,000 for the period up to 30 June 2001. For subsequent financial years, each Participant will pay the Project

Manager an amount agreed between the Project Manager and the Participants or, in the absence of agreement, the sum of $3,000 indexed to the increase in the Melbourne Consumer Price Index (all Groups) during the preceding period of twelve months. This latter amount must be paid by 1 July in advance in each year (Cls 10.1 & 10.2).

25. The Olive Grove Management Agreement may be terminated by either party in accordance with Clause 13.

Fees

26. Based on the Financial Forecast provided with the Application, the allocation of the $181,000 initial capital contribution is shown in the table below.

Fee type	30/6/2001	30/6/2002	30/6/2003	30/6/2004
Management fee	$3,000.00	$3,000.00	$3,000.00	$3,000.00
General operating costs	$8,442.00	$16,024.83	$18,404.50	$17,726.07
Irrigation	$29,075.00	$0.00	$0.00	$0.00
Trees	$8,062.00	$14,625.60	$0.00	$0.00
Roads	$625.00	$0.00	$0.00	$0.00
Land purchase	$9,750.00	$0.00	$0.00	$0.00
Water purchase	$0.00	$15,000.00	$10,000.00	$10,000.00
Capital raising	$11,265.00	$0.00	$0.00	$0.00
Totals	**$70,219.00**	**$48,650.43**	**$31,404.50**	**$30,726.07**

27. This allocation was based on costs estimated for a 200-hectare olive grove development. The Information Memorandum equates the initial capital contribution to a 2.5% interest in the Joint Venture property and this interest represents about 4.5 hectares.

28. It should be noted that Participants' capital contribution to the expenditures of the Joint Venture will be in proportion to their respective equity in the Joint Venture. Therefore, with the exception of the management fee, these amounts may vary depending on the actual number of Participants who are accepted into the Joint Venture, and depending on the level of actual expenditure incurred by the Joint Venture.

29. All services to be provided to the Joint Venture in return for management fees, and services provided as part of 'General Operating

Expenses,' will be provided by 30 June 2001 provided minimum subscription is achieved by 31 May 2001.

Income

30. As per the Joint Venture Agreement, the income of the Project will be derived by the Participants. Participants will jointly own the products. The Joint Venture may have trading stock on hand at the end of an income year. It will be a partnership for tax law purposes, and will be required to lodge a partnership tax return.

Finance

31. Participants can fund their investment in the Project themselves, or borrow from an independent lender.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;
- 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 Participants for the Project.

Ruling

Partnership

33. Under the arrangement, the Joint Venture will carry on the business of growing olives and each joint venture participant will be in receipt of income jointly from the sale of olives. Therefore, the Joint Venture is a tax law partnership for the purposes of Division 5 of Part III of the ITAA 1936 (see definition of 'partnership' in section 995-1 of the ITAA 1997). The Joint Venture is not a partnership under general law. The Joint Venture will be required to lodge a partnership return for each year of income, as required by section 91 of the ITAA 1936.

34. Each Participant will be a partner in a partnership and in accordance with section 92 of the ITAA 1936, where the Participant is a resident, will be required to include his or her individual interest in the net income of the partnership in his or her assessable income. Where the Participant is a non-resident, he or she is required to include in his or her assessable income, his or her individual interest in the net income of the partnership as is derived from a source in Australia.

35. Each Participant will be entitled to a deduction under section 92 of so much of his or her individual interest in any loss of the partnership as is attributable to a period when he or she was a resident. Where the Participant is a non-resident, he or she will be entitled to a deduction for so much of his or her individual interest in the partnership loss as is attributable to a period when he or she was a resident.

Section 8-1

36. The table below shows the deductions available under section 8-1 of the ITAA 1997 for the Joint Venture, calculated on a single Participant basis, and assuming the Joint Venture incurs the expenditure set out in the table in paragraph 26.

Fee type	Year 1 (yr ended 30/6/2001)	Year 2 (yr ended 30/6/2002)	Year 3 (yr ended 30/6/2003)
Management fee	$3,000.00	$3,000.00	$3,000.00
General operating costs	$8,442.00	$16,024.83	$18,404.50

Notes:

(i) The expenditures in the table above are estimates for a Participant who enters the Project on or before 1 June 2001.

(ii) For Participants who are accepted into the Project after 1 June 2001, the total Participant contribution will not translate into deductible amounts as far as the partnership general operating costs are concerned. The Project Manager will notify each Participant of the deductible and non-deductible components of the general operating costs.

(iii) A deduction for management fees and general operating costs is not allowed under section 8-1 before the minimum subscription is reached, the Participant's application is accepted and the Joint Venture and Olive Grove Management Agreements executed. Until this point there is not an 'outgoing incurred' by the Participant.

(iv) Actual Joint Venture expenditures may vary from projected expenditures. The Project Manager will notify each participant if this is the case.

(v) If the Joint Venture **chooses** to prepay fees for the doing of things (e.g., the provision of management services) that will not be wholly done in the same income year as the fees are incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 84 to 88 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than $1,000, is an 'exception' to any prepayment rules that apply and is deductible in full in the year in which it is incurred.

Interest expense

37. The deductibility or otherwise of interest arising from agreements that Participants enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Participants who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 93 to 95 below as those rules may be applicable if interest is prepaid.

Capital expenditures

38. The deductibility of capital expenditures are shown in the table below.

Fee type	ITAA 1997 section	Year 1 (yr ended 30/6/2001)	Year 2 (yr ended 30/6/2002)	Year 3 (yr ended 30/6/2003)
Irrigation	387-125	$9,691.67 - see Note (vi) below	$9,691.67	$9,691.67
Trees	387-165	nil - see Note (vii) below	nil	nil
Roads	43-10, 43-20	Non-deductible (see Note viii below)		
Land purchase	8-1	Non-deductible (see Note ix below)		
Water purchase	8-1	Non-deductible (see Note ix below)		
Capital raising	8-1	Non-deductible (see Note ix below)		

Notes:

(vi) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.

A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on facilities to conserve or convey water. This is an alternative to claiming deductions under section 387-125.

(vii) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of olive trees for use in a horticultural business. The deduction is allowable when the olive trees as horticultural plants, enter their first commercial season. The olive trees have an ‘effective life’ for the purposes of section 387-185 of 30 years. This results in a write-off rate of rate of 7% prime cost. The Project’s Manager will inform Growers of when the olive trees enter their first commercial season.

(viii) Section 43-10 of the ITAA 1997 allows deduction for capital works. As the Joint Venture plans to construct dirt roads, this capital work is specifically excluded under section 43-20 of the ITAA 1997.

(ix) These expenditures are capital or capital in nature and therefore not allowable under section 8-1 ITAA 1997. Furthermore, these expenditures do not fall for consideration under any specific write-off provision of the ITAA 1936 and ITAA 1997.

Goods and Services Tax ('GST')

39. For simplicity, the figures quoted in the tables in paragraphs 36 and 38 are exclusive of GST. (In general, GST payable would be claimable by the GST registered partnership as part of creditable acquisitions in its Business Activity Statement. The amount of GST would not then be an allowable deduction to the partnership, in accordance with Division 27 of ITAA 1997.)

40. As the Joint Venture is a partnership for the purposes of Division 5 of Part III of the ITAA 1936, it is not possible for the Joint Venture to be approved as a GST Joint Venture under Division 51 of the GST Act. Rather the Joint Venture would simply register for GST purposes as a partnership.

41. For GST purposes, a Participant will be considered a partner in the tax law partnership, rather than a sole trader. No input tax credit will be available to the Participant for their payment of funds by way of the initial capital contribution and further capital contributions. Relevant input tax credits will be claimed in the Business Activity Statement of the partnership.

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

42. For an individual who is a Participant in the Joint Venture and who enters the Project during the year ended 30 June 2001 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2003 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- an individual's business activity arising from their participation in the Joint Venture 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 72 in the Explanations part of this ruling, below).

44. Division 35 applies the objective tests differently where an individual(s) carries on the relevant business activity as a partner at general law (refer to the Note in subsection 35-10(1) and to section 35-25). In this Project, Participants in the Joint Venture are considered to be partners under taxation law but are not partners at general law. Therefore, for the purposes of this Product Ruling, the provisions of Division 35 dealing with partnerships, have no application.

45. Where, either the business activity comprised by the Participant's involvement in this Project 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 Participant will not be required to defer to a later year:

- their share of any partnership loss attributable to their participation in the Joint Venture; and
- any other losses resulting from deductions attributable to their participation in the Joint Venture where those deductions are incurred by the individual Participant in his or her own right (e.g., allowable deductions for interest related to borrowings).

Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

46. Participants in the Joint Venture are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Participants should not see the Commissioner's decision to exercise the discretion in subsection 35-55(1) 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.

Sections 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF, 82KL and Part IVA

47. The following provisions of the ITAA 1936 have application as indicated to expenditures incurred as required by the Joint Venture and Olive Grove Management Agreements:

- the expenditures do not fall within the scope of section 82KZM (but see paragraphs 80 to 89);
- the expenditures do not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 80 to 89);
- the expenditures do not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 80 to 89);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 8-1

48. Consideration of whether the management fee and general operating costs are deductible under section 8-1, begins with paragraph 8-1(1)(a) 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 paragraph 8-1(1)(b) if they are incurred when the business has not commenced; and
- where all that happens in a year of income is a taxpayer contractually commits themself 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 paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

Is the joint venture participant carrying on a business?

49. A business includes a 'primary production business', which is defined under subsection 995-1(1) to include a business of propagating and cultivating plants. The growing of olive trees can constitute the carrying on of a primary production business.

50. Where there is a business, or a future business, the gross sale proceeds from the sale of the olives or olive products from the Project will constitute gross assessable income under section 6-5 of the ITAA 1997. 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 and maintaining of the olive trees and harvesting the produce.

51. The joint venture participant is considered to be carrying on a business of growing olive trees for eventual sale of olives or olive products from the Project if:

- the Participants have a collective interest in the production and gross income of the business;
- the horticultural activities are carried out on the Participant's behalf; and
- the weight of the general indicators of a business, as developed by the Courts, point to them carrying on a business.

52. Under the Joint Venture Agreement, the Participants delegate the day to day management to the Project Manager. Services to be provided by the Project Manager include planting, cultivating, tending, pruning, fertilising, spraying, maintaining and otherwise caring for the olive trees. The Joint Venture Agreement gives Participants in common, full right, title and interest in the land, the water rights attached to the ownership of the land, and the olive trees and their produce, and the right to have the olives and/or olive products sold for the Participants' benefit.

53. The Joint Venture Agreement does not specify an actual allocation of product according to each Participant's interest. The Joint Venture arrangement constitutes a partnership for income tax purposes (see the definition of 'partnership' in section 995-1 ITAA 1997). Consequently, Division 5 of Part III of ITAA 1936 applies to include as income, each participant's individual interest in the net income of the Joint Venture for each year of income.

54. Further, where a partnership loss is incurred by a partnership in a year of income, there shall be an allowable deduction to a partner in the partnership based on their individual interest in the partnership.

55. Accordingly, a partnership return will be required to be furnished for each year of income, as required by section 91 of the ITAA 1936. The Participants will be required to disclose their share of the partnership net income or loss in their returns of income as required by section 92 of the ITAA 1936.

56. 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 discussed in that Ruling. Participants in joint venture to whom this Ruling applies intend to derive assessable income from the Joint Venture Project. This intention is related to projections contained in the Draft Information Memorandum that suggest the Joint Venture Project should return a 'before tax' profit to the Participants, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

57. The Joint Venture will engage the professional services of a Project Manager who holds itself out as having the appropriate credentials. These services are based on accepted commercial agricultural practices and are of the type ordinarily found in ventures that would commonly be said to be businesses.

58. Participants have a continuing interest in the Project from the time they enter into the Joint Venture. The 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 Participants' activities of conducting in Joint Venture the growing of olive trees for producing olives or olive products for commercial sale will constitute the carrying on of a business.

Expenditure of a capital nature

59. Any part of the expenditure of the Joint Venture entering into a primary production business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. The Project documentation has identified these capital expenditures to be for irrigation, trees, roads, land purchase, water purchase and capital raising.

Subdivision 387-B: irrigation expenditure

60. Section 387-125 allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed by this Project would be covered by Subdivision 387-B.

61. Under subsection 387-150(3) these deductions are to be disregarded when working out the net income or partnership loss of the Partnership under section 90 of the ITAA 1936. Each Partner claims a deduction as agreed between them or an amount equal to their proportionate interest in the Partnership.

62. The expenditure identified as applicable to the conserving or conveying of water for the olive grove that meets the requirements of section 387-130 amounts, notionally, to $29,075 per participation.

Subdivision 387-C: horticultural plant expenditure

63. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. Under subsection 387-170(3), the definition of 'horticulture' includes the cultivation of olive trees.

64. Horticultural establishment expenditure may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or the clearing of land. The Joint Venture's cost of olive grove establishment has been identified, notionally, as $8,062 and $14,625.60 per participation for the years ended 30 June 2001 and 2002 respectively.

65. The rate of the write-off will be 7% per year on a prime cost basis, assuming the effective life of the trees is 30 years or more (section 387-185).

66. The write-off commences from the date the olive trees are used or held ready for use for the purpose of producing assessable income in a horticultural business (sections 387-165 and 387-170). It is anticipated that the olive trees will enter their first commercial season and, hence, begin to be used for the purpose of producing assessable income in a horticultural business in the year ended 30 June 2004. The Joint Venture's cost of olive grove establishment will be eligible for write-off deductions at a rate of 7% from this date.

Division 43: road expenditure

67. A deduction for structural improvements is available under Division 43 of the ITAA 1997. In this Project the road expenditure identified relates to the construction of dirt road. As this type of structural improvement is excluded under subsection 43-20(4), this expenditure cannot be written-off.

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

68. 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.

69. Section 35-25 provides that the objective tests in sections 35-30, 35-35, 35-40 and 35-45 apply differently where an individual(s) carries on a relevant business activity as a partner. It should be noted that the reference to a partner here is a reference to a partner in a general law partnership (refer to the Note to subsection 35-10(1)). As the effect of the Joint Venture Agreement is to create between the Participants, a partnership under taxation law but not at general law, section 35-25 will have no application for the purposes of this Product Ruling.

70. In this Product Ruling, for the income year in question, a loss refers to the individual's interest in the partnership loss that is attributable to their participation in the Joint Venture as well as any other losses resulting from deductions attributable to their participation in the Joint Venture where those deductions are incurred by the individual Participant in his or her own right (e.g., allowable deductions for interest related to borrowings).

71. 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.

72. 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 Participants who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

73. In broad terms, the objective tests require:

(a) at least $20,000 of assessable income in that year from the business activity (section 35-30);

(b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);

(c) at least $500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or

(d) at least $100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

74. The business activity comprised by the Participant's involvement in this Project is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Participant in the Joint Venture is unlikely to pass one of the objective tests until the income year ended 30 June 2004.

75. 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 Participant's involvement in the Project.

76. 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 a Participant in the Joint Venture 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) up to and including the year ended 30 June 2003.

77. 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.

78. This Product Ruling is issued on a prospective basis (i.e., before the business activity comprised by the Participant's involvement in this Project starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 42), in the manner described in the Arrangement (see

paragraphs 14 to 32), 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.

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

- the report of the independent horticulturalist and expert opinion provided with the application; and
- independent, objective, and generally available information relating to the olive industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application.

Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD and 82KZME – 82KZMF

80. The prepayments provisions of the ITAA operate to spread over more than one income year, a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

81. In this Project, the Management Fee of $3,000, calculated on a single Participant basis, will be incurred on execution of the Management Agreement. The Management Fee is charged for the provision of management services by 30 June of the year of execution of the Agreements. In particular, the Management Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Management Fee has been inflated to result in reduced fees being payable for subsequent years.

82. There is also no evidence that might suggest the management services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided the expenditure is incurred as required by the Olive Grove Management Agreement, then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

83. With regard to the Participants' contribution to general operating costs for 30 June 2001, this will be deductible in full if a Participant is accepted into the Project on or before 1 June 2001. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description that the budgeted general operating expenditure for the Joint Venture have been inflated to result in reduced contributions being made for subsequent years. There is also no evidence that might suggest that the Joint Venture will not incur the expenditure items identified.

If the Joint Venture chooses to pay fees for a period in excess of that required by the Project's agreements

84. Although not required under the Joint Venture and Olive Grove Management Agreements, the Joint Venture may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraphs 81 and 83 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

85. The amount and timing of tax deductions for any fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means generally, the period over which the services are to be provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and, where the 'eligible service period' exceeds 13 months, whether the Joint Venture is a 'small business taxpayer'.

86. Where the Joint Venture incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

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

87. In the formula, the 'eligible service period' means, generally, the period to which the services are to be provided.

88. Where the Joint Venture incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Joint Venture is a 'small business taxpayer' or section 82KZMD if the Joint Venture is not a 'small business taxpayer'. For a 'small business taxpayer' (see

paragraphs 90 to 92) the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same, or effectively the same as that shown in paragraph 86 above, concerning section 82KZMF.

89. A prepaid management fee of less than $1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(4) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than $1,000 is deductible in full in the year in which it is incurred.

Subdivision 960-Q - small business taxpayers

90. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than $1,000,000 or their turnover recalculated under section 960-350 is less than $1,000,000.

91. '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).

92. Whether the Joint Venture is a 'small business taxpayer' is beyond the scope of this Product Ruling. It is the responsibility of the Joint Venture to determine whether or not it is within the definition of a 'small business taxpayer'.

Interest deductibility

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

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

the Product Ruling, such as a loan to finance participation in the Project.

95. 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 Participant will be required to use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. Where a prepayment is for a more than 13 months, any tax deduction that may be allowable must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same, or effectively the same as that shown above in paragraph 86 above.

Section 82KL - recouped expenditure

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

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

98. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(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

99. 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).

100. The Boundary Bend Estate (J.V.Three) Project will be a 'scheme'. The Participants will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 36 and 38, 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.

101. Participants 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 olives and olive products. There are no facts that would suggest that Participants have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no financing involved or round robins present, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b), it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Detailed contents list

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

Commissioner of Taxation
21 March 2001

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
TR 94/13; TR 97/11; TR 97/16;
PR 1999/95; PR 1999/27; TR 92/1;
TR 92/20; TD 93/34; TR 98/22

Subject references:
- carrying on a business
- commencement of business
- fee expenses
- horticulture
- irrigation expenses
- management fees expenses

- primary production
- primary production expenses
- primary production income
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- tax administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:

- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(1)(b)
- ITAA 1997 8-1(2)(a)
- ITAA 1997 Division 27
- ITAA 1997 Division 35
- ITAA 1997 35-10
- ITAA 1997 35-10(1)
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-25
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- ITAA 1997 35-35
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- 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)
- ITAA 1997 Div 43
- ITAA 1997 43-10
- ITAA 1997 43-20
- ITAA 1997 43-20(4)
- ITAA 1997 387-A
- ITAA 1997 387-55
- ITAA 1997 387-60
- ITAA 1997 387-B
- ITAA 1997 387-125
- ITAA 1997 387-C
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- ITAA 1997 387-165
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- ITAA 1997 960-335
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- ITAA 1936 91
- ITAA 1936 92
- ITAA 1936 Div 5
- ITAA 1936 Part III
- ITAA 1936 Part IVA
- ITAA 1936 177A
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