

PR 2001/29 - Income tax: Tarwoona Olives Scheme No 1

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 This document has changed over time. This is a consolidated version of the ruling which was published on *28 March 2001*



Product Ruling

Income tax: Tarwoona Olives Scheme No 1

Contents	Para
What this Product Ruling is about	1
Date of effect	12
Withdrawal	14
Previous Ruling	15
Arrangement	16
Ruling	56
Explanations	68
Examples	135
Detailed contents list	137

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications sections**), **Date of effect**, **Withdrawal**, **Previous Rulings**, **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 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 Tarwoona Olives Scheme No.1, or simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Section 25-25 (ITAA 1997);
 - Division 35 (ITAA 1997)
 - Division 27 (ITAA 1997);
 - Section 387-55 (ITAA 1997);
 - Section 387-125 (ITAA 1997);
 - Section 387-165 (ITAA 1997);
 - Section 388-55 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Section 82KZM (ITAA 1936);
 - Section 82KZMB-82KZMD (ITAA 1936)
 - Section 82KZME (ITAA 1936);
 - Section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Farmer) 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 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.

5. 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

6. 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

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 'Farmers'.

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 55) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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- the Ruling will be withdrawn or modified.

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Date of effect

12. This Ruling applies prospectively from 28 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).

13. 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

14. 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 change in the arrangement or in the persons' involvement in the arrangement.

Previous Ruling

15. This Ruling replaces Product Ruling PR 2000/58, which is withdrawn on and from the date this Ruling is made. Subject to changes in the law relating to certain prepayments, Product Ruling PR 2000/58 will continue to apply to investors who entered into the Project on or before 27 March 2001.

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:

- Application for Product Ruling for the Tarwoona Olives Scheme No. 1, dated 19 February 2001;
- Prospectus dated 18 October 2000 prepared for Tarwoona Olives Scheme No 1;
- **Draft copy of the Tarwoona Olives Scheme No 1 Constitution** between North West Rural Services Co Limited ('NWRS'), Tarwoona Olives Co Limited ('TOC') and the Farmer, which also incorporates a Joint Venture Agreement between NWRS, TOC and each Farmer in the Joint Venture;
- Draft copy of Application for shares in TOC;
- Draft copy of Application for Finance, Principal and Interest Loan;
- Draft Custodian Agreement between Australian Rural Group Limited ('ARG') and NWRS, to appoint ARG as the Custodian of the Managed Investment Scheme;
- Draft copy of Loan Deed between Intagpro Pty Limited and the Borrower;
- Correspondence from Tarwoona Olives' tax professional adviser to the Australian Taxation Office ('ATO') dated 16 January 2001.

- Email transmission from Tarwoona Olives' tax professional adviser to the ATO dated 19 February 2001.

Note: certain information received from North West Rural Services Co Limited has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

17. The document described in bold in paragraph 16 above (Constitution) is the one the Farmers will enter into.

Overview

18. The salient features and effect of these arrangements are summarised below:

Location:	Property known as "Quinella" situated 53km from Gunnedah, NSW
Type of business each Farmer is carrying on:	Commercial growing of olive trees to produce olives
Number of hectares to be cultivated:	400 hectares
Minimum subscription:	200 interests
Size of each olive grove:	0.28 hectares
Number of trees per hectare:	250 trees
Term of the project:	25 years

19. This arrangement is called the Tarwoona Olives Scheme No 1 and is registered as a Managed Investment Scheme under the Corporations Law. By entering into the Joint Venture Agreement, a Farmer will conduct, in joint venture with others, the business of growing olive trees with the objective of producing olives or olive products over a period of 25 years from the commencement date for commercial sale. A Farmer will commence business by entering into a Joint Venture Agreement with NWRS ('the Manager'), TOC ('the Landowner') and other Farmers whereby NWRS will be engaged to manage the Joint Venture and the Farmers' interest in it for 25 years.

20. The Joint Venture Farmers will grow the olive trees on the property known as 'Quinella' situated 53km from Gunnedah, New South Wales. The relevant property will be leased to the Joint Venture Farmers by TOC, as landowner, via ARG. The property is approximately 493ha in size and 400ha will be used for the Project and additional land is available if necessary. Up to 1,200 interests in

the Joint Venture are on offer. The minimum investment per Farmer will be one participation or interest in the Joint Venture. Under the prospectus, a Farmer application will not be accepted and the Project will not proceed until the minimum subscription of 200 interests is achieved. Tax deductions are not allowable until these requirements are met. There is no maximum investment per Farmer in the Joint Venture.

21. Each Joint Venture Farmer in the Project is required to subscribe for an equity stake in TOC, the Landowner, or to nominate another person or entity to do so. The required equity stake being the minimum equity interest in TOC comprises ten (10) ordinary shares with a total cost of \$1,800. Additional equity of a multiple of ten (10) ordinary shares must be taken to equate to the number of participation interests in the Project.

22. The relevant property will be owned by TOC, which company will be owned as to sixty percent (60%) by Joint Venture Farmers or their nominated entities / persons in the same proportion as their Joint Venture participation.

23. Australian Rural Group Limited will act as Custodian of the Project for the Joint Venture Farmers.

24. Possible projected returns for Joint Venture Farmers are set out in the Prospectus. However, these are dependent upon a range of assumptions and NWRS does not give any assurance or guarantee whatsoever in respect of the future success of, or financial returns associated with, entering into the Joint Venture. Olive production is projected to commence in the year ending 30 June 2006. A harvest yield of 5,000 kilograms per hectare of olives in the fifth year of the Project increasing to 25,000 kilograms per hectare in year 13 onwards is anticipated. The Project is forecast to return (before allowing for any tax benefits) in excess of 12% averaged over the first 25 years.

25. All of the harvested olives will be sold to the highest bidder in the market.

Constitution and Joint Venture Agreement

26. In respect of the Project, a Farmer has an interest in specific property comprising the Managed Investment Scheme ('Scheme') property which is defined in the Constitution. ARG will act as Custodian of the Project for the Joint Venture Farmers. Farmers execute a power of attorney enabling NWRS to act on their behalf as required.

27. Farmers do not have any right to withdraw from the Scheme nor do they have a right to require their interest in the Scheme to be bought by the Manager or any other person or to have their interest in

the Scheme redeemed (Clause 11, Constitution). A Farmer's Scheme interest may be transferred, provided such transfer is a transfer of the entire unencumbered interest in the Scheme (Clause 16, Constitution). NWRS keeps a register of Farmers.

28. The Farmers intend to remain Scheme members until the Scheme is determined on 30 June 2025, unless it is wound up earlier (Clause 7, Constitution).

29. The Farmers will each enter into a Joint Venture Agreement to carry out the Project as a Joint Venture and to appoint NWRS to manage the Joint Venture. The Project as defined in the Joint Venture Agreement is essentially the business of planting, growing and cultivating olive trees to produce olives and olive products and the harvesting, marketing and sale of the olives and olive products produced therefrom.

30. TOC, being the Landowner, will grant to ARG, the Custodian, as agent for the Manager, a lease of the relevant land. The Manager will hold the interest in the land, being the lease, on behalf of the Joint Venture of Farmers to enable the plantation to be planted out with olive trees.

Fees

31. The fees and contributions payable are as summarised below:

Fee type	Year 1 (to 30/6/2001)	Year 2 (to 30/6/2002)	Year 3 (to 30/6/2003)	Year 4 (to 30/6/2004)
Management fee	\$7,271	\$1,780	\$1,834*	\$1,889*
Licence fees	\$220	\$220	\$227*	\$233*
Olive grove establishment fee	\$858	\$303		
Purchasing of shares	\$1,800			
Irrigation fee	\$2,255			
Erosion control fee	\$198			
Land clearing fee	\$105			
Total	\$12,707	\$2,803	\$2,061	\$2,122

* **Note:** Year 3 and year 4 management fee and licence fee are estimates assuming a CPI increase of 3% per annum.

32. In addition to the payment of fees summarised above, the farmer will contribute further fees to pay for the harvesting of olives comprising:

Harvest fee of the greater of:
<ul style="list-style-type: none"> • 20% of the gross sale proceeds; or
<ul style="list-style-type: none"> • \$0.27 per kilogram of olives harvested, commencing in the year of harvest and indexed annually by the CPI (all groups) Sydney

Management fees

33. A management fee of \$7,271 will be payable for each interest in the Joint Venture in respect of the first year of the Project. This fee which will be payable on settlement of the application in respect of the Joint Venture Farmer. The fee is payable in advance for services to be provided by the Manager for the period of twelve (12) months from the date of payment.

34. Management fees in years subsequent to the first year will be payable on the anniversary of the settlement date yearly in advance on the basis of \$1,780 for the 2nd year and then that amount increased by the Consumer Price Index (All Groups) Sydney in each subsequent year, until there are sufficient funds from income of the Joint Venture to enable management fees to be payable yearly in advance from those funds.

35. In addition to the annual management fee, the Manager shall be entitled to be paid harvest expenses as set out in the Joint Venture Agreement comprising an amount equal to the greater of:

- 20% of the gross sale proceeds; or
- \$0.27 per kilogram of olives harvested, commencing in the year of harvest and indexed annually by the CPI (All Groups) Sydney.

36. Out of this payment, the Manager will attend to payment of harvest expenses. Where such payment is insufficient to meet the harvest expenses, the harvest expenses shall be borne by the Farmers.

Lease rent contribution fees

37. The property necessary for the Project, and necessary fencing and machinery sheds and other structural improvements excluding

irrigation equipment, will be leased to the Farmers in years 1 and 2 for \$220 per interest in the Joint Venture, and in years 3 onwards for the previous year's lease rent contributions fee increased by the CPI (All Groups) Sydney per interest.

Joint Venture contributions

38. Each Joint Venture Farmer will be required to pay to the Manager the following upon settlement date of the Farmer's interest in the Joint Venture:

- an irrigation fee of \$2,255 per participation;
- an erosion control fee of \$198 per participation;
- an olive grove establishment fee of \$858 per participation; and
- a land clearing fee of \$105 per participation.

39. In addition, a further olive grove establishment fee of \$303 is due per participation at the commencement of the second year.

40. These fees must be applied by the Manager to undertake the necessary capital works for the benefit of the Joint Venture.

41. Each Joint Venture Farmer (or interests nominated by the Joint Venture Farmer) will be required to purchase shares in Tarwoona Olives Co Limited. A participation will require the payment of \$1,800 of capital to acquire 10 shares in the company, which payment will be required to be made on settlement date.

42. In the event that the gross income of the Joint Venture is insufficient in any year to meet payment of the relevant management fees and lease rent contribution fees, the shortfall will be met by the Joint Venture Farmers and not from gross income of future years.

Manager's services

43. The services to be provided by NWRS to the Joint Venture are specifically set out in the Joint Venture Agreement and they include:

- caring and maintaining the olive tree seedlings in the nursery during the first 12 month period;
- cultivating, fertilising and planting out the plantation with the required number of olive trees in a healthy condition per hectare;
- irrigating and applying water to the plantation to maintain the olive trees on the plantation in a healthy condition;

- pruning the olive trees as required from time to time in order to promote the growth and production of olives in accordance with good agricultural practice for growing olives;
- taking such reasonable measures as may be required to control the growth of weeds and other vegetable pests on the plantation upon which the olive trees are growing, including the cultivation of the plantation between the rows of olive trees;
- taking all reasonable measures in accordance with the principles of good husbandry and to the extent reasonably possible to deter and eradicate any insect, bird or animal pests from the plantation which may detract from the health and vigour of the olive trees or the yield of olive fruit therefrom;
- replacing at the expense of the Joint Venture any olive trees that die or become unproductive;
- applying manure, fertiliser, mulch and such other material as is necessary in accordance with good agricultural practice to encourage growth and fruiting of the olive trees;
- repairing and maintaining in a good condition all fences, stakes, accessways and other structural improvements and irrigation plant and equipment on the plantation;
- marketing and arranging sales of the olives produced from the plantation including entering into a contract or contracts to supply olives harvested from the plantation;
- effecting the necessary insurances;
- employing such staff and labour as are necessary for the aforesaid purposes;
- performing any of the duties of the Manager as required under the Joint Venture Agreement and the Scheme Constitution; and
- doing all other things that are necessary or incidental to carrying out the Project to produce a viable business of growing, marketing and sale of olives or olive produce.

44. The land clearing fee is payable by each Farmer to the Manager for the clearing of the plantation so that it is suitable for the planting out of olive trees.

45. The olive grove establishment fee is payable by each Farmer to the Manager for the purchase of the olive tree seedlings to establish the plantation, the cost of caring for the seedlings in the nursery and the planting out of the seedlings in the ground to be undertaken in the first and second years of the Project.

46. The irrigation fee is payable by each Farmer to the Manager for irrigation works to provide water reticulation to the olive trees on the plantation.

47. The erosion control fee is payable by each Farmer to the Manager for the provision of erosion control measures to the land.

48. The Manager, NWRS, will subcontract all proposed services and work to Intagpro Pty Limited, its holding company.

Planting

49. Olive seedlings will be purchased from various nurseries for the Project as and when required. It is proposed that the necessary number of young seedlings will be acquired by the Joint Venture from the nurseries and transferred to a special purpose built nursery of the Manager to be operated on the property. This nursery will be important to ensure the quickest possible growth under best practice agricultural management of the young seedlings. It is intended that the seedlings will, as they grow in the first year in this environment, be transferred to larger containers to ensure that they are strong and ready to be planted in the Joint Venture leased land in the second year of the Project.

50. The ground to take the seedlings in the second year will have been cleared and erosion controls implemented. Fertilisation and irrigation will have occurred throughout the first year to ensure the best possible soil structure to receive the strongest possible advanced seedlings. The land works will occur in the first year of the Project.

Finance

51. Farmers can finance their participation in the Joint Venture Project themselves, borrow from an unassociated lending body or take up an option offered by Intagpro Pty Limited (the Manager's holding company). Intagpro Pty Limited will, if a loan option is taken, advance funds of \$9,750 on the settlement date for each Joint Venture interest. Security is to be enforced over the Farmer's interest in the Project, i.e., the Farmer's interests in the Joint Venture including the rights obtained as a result of the various agreements entered into and payments made. Finance arrangements organised directly by the Farmer with independent lenders are outside the arrangement to which this Ruling applies.

52. A 10% interest rate will be charged payable yearly in advance totalling \$975 for each Joint Venture interest. This loan will be repayable in full over the first 12 months from settlement at the rate of \$812.50 per month. The first repayment is required to be made on the first day of the month following the date of settlement of the loan.

53. Further loans will be made over the second and subsequent years as detailed in the Loan Deed included in the Draft Prospectus. The further loans will only be made on the basis that interest is payable 12 months in advance and the additional loans are each repayable in the 12 months after the loan is made by equal monthly instalments.

54. The finance is provided as full recourse loans and Intagpro Pty Limited will pursue legal action against outstanding borrowers.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers;
- entities associated with the Project other than Intagpro Pty Limited, are involved or become involved, in the provision of finance to Farmers for the Project.

Ruling

Assessable income

56. A Farmer'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

57. A Farmer will not incur the fees shown in the Tables below before the minimum subscription for the Project is reached and the Farmer's application to enter the Project is accepted (the date the investment is made). Under the prospectus, a Farmer application will not be accepted and the Project will not proceed until the minimum subscription of 200 interests is achieved. Tax deductions are not allowable until these requirements are met.

Section 8-1

58. Expenditure incurred by a Farmer who participates in this Project that is otherwise deductible under section 8-1 falls within subsections 82KZME(9), (10) and (11). Such expenditure is an exception ('Exception 5') to the prepayment rules contained in sections 82KZME and 82KZMF. Therefore, the amount and timing of tax deductions for such expenditure is determined under section 82KZM where the Farmer is a 'small business taxpayer' (see paragraphs 86 to 101), or under sections 82KZMA-82KZMD where the Farmer is NOT a 'small business taxpayer'.

Tax deductions for a Farmer who is a 'small business taxpayer'

(i) Deductions where a Farmer is not registered nor required to be registered for GST

59. A Farmer may claim the tax deductions referred to in the Table below where the Farmer

- is a 'small business taxpayer';
- participates in the Project by 30 June 2001 to carry on the business of growing olives;
- incurs the fees shown in paragraphs 31 to 42; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 deductions	Year 2 deductions	Year 3 deductions
Management Fees	8-1	\$3,525– See Note (i) below	\$1,478 – See Note (i) below	\$1,834 – See Note (i) below
Lease Rent Contribution Fee	8-1	\$489 – See Note (i) below	\$367 – See Note (i) below	\$227 – See Note (i) below
Interest	8-1	As incurred – See Note (ii) below	As incurred – See Note (ii) below	As incurred – See Note (ii) below
Loan Application Fees	25-25	See Note (iii) below		
Erosion Control	387-55	\$398 - see note (iv) & (vi) below	Nil	Nil
Irrigation costs	387-125	\$1,518 - see note (v) & (vi) below	\$1,518 - see note (v)& (vi) below	\$1,518 - see note (v) & (vi) below
Tree establishment	387-165	Nil - see note (vii) below	Nil	Nil

Notes:

- (i) Where a Farmer who is a ‘small business taxpayer’ incurs the Management and Lease Fee as required respectively by the Management Agreement and the Lease Agreement those fees are deductible in full in the year incurred. However, if a Farmer **chooses** to prepay fees for the doing of things (eg, the provision of management services or the leasing of land) that will not be wholly done within 13 months of the fees being incurred, then the prepayments rules in section 82KZM of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraph 101 unless the expenditure is ‘excluded expenditure’. ‘Excluded expenditure’, being expenditure of less than \$1,000, is an ‘exception’ to the prepayment rules and is deductible in full in the year in which it is incurred.

- (ii) For a Farmer who is a 'small business taxpayer' interest incurred using the finance option offered by Intagpro Pty Ltd is deductible in full in the year in which it is incurred.

The deductibility or otherwise of interest arising from agreements that Farmers enter into with financiers other than Intagpro Pty Ltd is outside the scope of this Ruling. However, Farmers who are 'small business taxpayers' and who finance their participation in the Project other than with Intagpro Pty Ltd should read carefully the discussion of the prepayment rules in paragraph 90 to 92 below as those rules may be applicable if interest is prepaid for a period exceeding 13 months.

- (iii) Under section 25-25 of the ITAA 1997 loan application fees and/or other up-front borrowing costs for loans covered by this Ruling will be deductible over a 5-year period from the time the loan application is entered into.
- (iv) A deduction is allowable under section 387-55 for capital expenditure incurred for landcare operations. The deduction is allowed in the year that the expenditure is incurred.
- (v) 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.
- (vi) A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on landcare operations and/or facilities to conserve or convey water. This is an alternative to claiming deductions under sections 387-55 and 387-125.
- (vii) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the olive trees for use in a horticultural business. The deduction is allowable when the olive trees, as horticultural plants, enter their first commercial season. In calculating the deduction, a Farmer must use sections 387-175 and 387-185 to determine the 'effective life' of the olive trees. Olive trees are considered to have an 'effective life' of

‘30 years or more’ which provides a ‘write-off rate’ of 7%. The project manager will inform investors of when the olive trees enter their first commercial season.

(ii) Deductions where a Farmer is registered or is required to be registered for GST

60. Where a Farmer who is registered or is required to be registered for GST:

- is a ‘small business taxpayer’;
- participates in the Project by 30 June 2001 to carry on the business of growing olives;
- incurs the fees shown in paragraphs 31 to 42; and
- is entitled to an input tax credit for the fees

then the tax deductions shown in the Table above will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). See Example 1 at paragraph 135.

Tax deductions for a Farmer who is NOT a ‘small business taxpayer’

(i) Deductions where a Farmer is not registered nor required to be registered for GST

61. A Farmer may claim the tax deductions referred to in the Table below where the Farmer

- is NOT a ‘small business taxpayer’;
- participates in the Project by 30 June 2001 to carry on the business of growing olives;
- incurs the fees shown in paragraphs 31 to 42; and
- is not registered nor required to be registered for GST.

PR 2001/29

Fee type	ITAA 1997 Section	Year 1 deduction	Year 2 deduction	Year 3 deduction
Management Fees	8-1	Amount must be calculated – See Notes (viii) & (xi) below	Amount must be calculated – See Notes (viii) & (xi) below	Amount must be calculated – See Notes (viii) & (xi) below
Lease Rent Contribution Fee	8-1	\$489 – See Note (ix) & (xi) below	\$367 – See Note (ix) & (xi) below	\$227– See Note (ix) & (xi) below
Interest	8-1	As incurred – See Note (x) & (xi) below	As incurred – See Note (x) & (xi) below	As incurred – See Note (x) & (xi) below
Loan Application Fees	25-25	See Note (iii) above		
Erosion Control	387-55	\$398 - see note (iv) & (vi) above	Nil	Nil
Irrigation costs	387-125	\$1,518 - see note (iv) & (vi) above	\$1,518 - see note (iv) & (vi) above	\$1,518 - see note (iv) & (vi) above
Establishment of horticultural plants	387-165	Nil - see note (viii) above	Nil	Nil

Notes:

- (viii) A Farmer who is NOT a ‘small business taxpayer’ **cannot** claim the prepaid Management Fees in full in the years in which the fees are incurred. The tax deduction in each year must be calculated using the formula in subsection 82KZMB(3) (shown below). This formula apportions the tax deduction in each ‘expenditure year’ (ie, the year that the fees are incurred) using the number of days in the ‘eligible service period’. The ‘eligible service period’ means, generally, the period over which the management services are to be provided.

$$\text{Management's Fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of eligible service period}}$$

Because of the operation of the capping provisions in section 82KZMC, there is no additional deductible amount available in the 'expenditure year' from the Table in subsection 82KZMB(5). Instead, the balance of the Management Fee incurred each year is determined under subsection 82KZMC(4) and the formula in subsection 82KZMC(5). These provisions apportion the balance of the prepaid Management Fee incurred each year over the years in which the management services are to be provided (See Example 2 at paragraph 136)

Northwest Rural Services Co must provide the Farmer with the number of days of 'eligible service period' for the income year ended 30 June 2001 (i.e., the first 'expenditure year'). This figure is necessary to calculate the Farmer's tax deduction for both the income year ended 30 June 2001 and the other income years over which the management services will be provided.

- (ix) The Lease Fee, being an amount of less than \$1,000 each year constitutes 'excluded expenditure' and is deductible in full in the year in which it is incurred. However, if a Farmer who is NOT a 'small business taxpayer' acquires more than one interest, the quantum of the Lease Fee may be \$1,000 or more. Where this occurs, the Farmer must determine the tax deduction that is allowable by using the method shown above for the Management Fee (see Note (viii)).
- (x) A Farmer who is NOT a 'small business taxpayer' and who finances participation in the Project using the finance option offered by Intagpro Pty Ltd (described in paragraphs 51 to 55) is not required to prepay interest. The interest incurred is, therefore, deductible in full in the year in which it is incurred.

The deductibility or otherwise of interest arising from agreements entered into with financiers other than Intagpro Pty Ltd is outside the scope of this Ruling. However, all Farmers who finance their participation in the Project other than with Intagpro Pty Ltd should read carefully the discussion of the prepayment rules in paragraph 95 to 101 below as those rules may be applicable if interest is prepaid.

- (xi) A Farmer, who **chooses** to prepay the Management Fee, and/or the Lease Fee for a period exceeding 13 months, should read carefully the information shown in

paragraph 101 below. The tax deductions for prepaid fees with an 'eligible service period' exceeding 13 months must be determined using the formula shown in paragraph 101 unless the expenditure is 'excluded expenditure'.

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

62. Where a Farmer who is registered or required to be registered for GST:

- is NOT a 'small business taxpayer';
- participates in the Project by 30 June 2001 to carry on the business of growing olives;
- incurs the fees shown in paragraphs 31 to 42; and
- is entitled to an input tax credit for the fees

then the tax deductions calculated using the methods described and the amounts shown in the Table above will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). See Example 1 at paragraph 135.

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

Section 35-55 – Commissioner's discretion

63. For a Farmer who is an individual 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 2007 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.

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

- a Farmer'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 120 in the Explanations part of this ruling, below).

65. Where, either the Farmer'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 Farmer will not be required to defer any deductions attributable to their business activity in excess of any assessable income from that activity, ie, 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.

66. Farmers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Farmers 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.

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

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

- expenditure by a Farmer who is a 'small business taxpayer' does not fall within the scope of section 82KZM (but see paragraph 89 to 90);
- section 82KZMB applies to expenditure by a Farmer who is not a 'small business taxpayer' (but see paragraph 100);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 8-1

68. Consideration of whether the management fees and the lease fees are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and

- where all that happens in a year of income is that a taxpayer 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 in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

Is the Farmer carrying on a business?

69. An olive growing 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 olives from interests comprising the Project will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the olives each year from the interest. Generally, a Farmer will be carrying on a business of growing olives where:

- the Farmer has an identifiable interest in specific growing olive trees coupled with a right to harvest and sell the olives each year from the olive trees;
- the olive growing activities are carried out on the Farmer'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.

70. For this Project Farmers have rights under the Joint Venture Agreement in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing olives. Under the Joint Venture Agreement Farmers engage the Project Managers to acquire olive seedlings and plant out the seedlings on the land and to provide ongoing services to care and maintain the olive trees. Farmers are considered to have control of their operations.

71. The Joint Venture Agreement provides Farmers with more than a chattel interest in the olive trees. The Project documentation contemplates Farmers will have an ongoing interest in the olive trees.

72. Farmers have the right to use the land in question for olive growing purposes and to have the Project Manager come onto the land to carry out its obligations under the Joint Venture Agreement. The Farmers' degree of control over the Project Manager as evidenced by

the Joint Venture Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Farmers are entitled to receive regular progress reports on the Project Manager's activities. Farmers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect. The olive growing activities described in the Joint Venture Agreement are carried out on the Farmer's behalf.

73. 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. Farmers 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 Farmers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

74. Farmers will engage the professional services of a manager with appropriate credentials. There is a means to identify which olive trees Farmers have an interest in. These services are based on accepted viticulture practices and are of the type ordinarily found in olive growing ventures that would commonly be said to be businesses.

75. Farmers have a continuing interest in the olive trees from the time they are acquired until the cessation of the Project. The olive growing 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 Farmers' olive growing activities will constitute the carrying on of a business.

76. The lease fees and management fees associated with the olive growing 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 olives) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. However there are capital components of the management fee which are not deductible under section 8-1 as discussed below.

Expenditure of a capital nature

77. The activities the Manager is required to undertake are listed in the Joint Venture Agreement between the Farmer and Manager (see summary at paragraphs 43 to 48). Some of these activities are of a capital nature. Project costings obtained from NWRS's tax professional adviser outline how the Farmers' subscription monies will be spent. These monies, which principally consist of a management fee, will be spent on items that are of a revenue or capital

nature, while other expenditures are more properly classified as something else.

78. Under the Joint Venture Agreement, the management fee is an undissected lump sum in return for which the Farmer obtains services of both a revenue and capital nature. *Ronpibon Tin v. Federal Commissioner of Taxation* (1949) 78 CLR 47; (1949) 8 ATD 431 provides authority for the apportionment of the management fee in determining deductibility under section 8-1.

79. The joint judgment of the High Court in *Ronpibon Tin* stated that subsection 51(1) of the ITAA 1936 ‘contemplates apportionment’ and ‘there are at least two kinds of expenditure which require apportionment’. One of the described kinds of apportionable expenditure is a ‘single outlay or charge which serves both objects indifferently’, those objects being previously described as ‘expenditure in respect of things or services of which distinct and severable parts are devoted to gaining or producing assessable income and distinct or severable parts to some other cause’ (CLR at 59; ATD at 437). The management fee paid by the Farmers is an example of such an expenditure.

80. The management fee paid by the Farmer is for activities that are of a revenue and capital nature and, in accordance with paragraph 8-1(2)(a) of the ITAA 1997, the management fee is not an allowable deduction to the extent it is a loss or outgoing of capital or of a capital nature. That part of the management fee which is deductible under section 8-1 is shown in the table at paragraph 59 (for small business taxpayers) and in the table at paragraph 61 (for taxpayers who are not ‘small business taxpayers’).

81. From the information supplied by NWRS’s tax professional adviser, and having regard to the contractual terms of the various agreements, an estimation of the cost of various advantages that will directly accrue to the Farmers has been identified. Some of the costs and profits of the Manager’s business do not provide a direct advantage to the investor and these have been apportioned across the items that more directly provide advantages to the Farmers. In allocating these indirect costs to direct revenue and capital costs, the percentage that the indirect costs bear to direct costs is calculated as follows:

$$\frac{\text{Total projected overheads (indirect expenses) plus profit}}{\text{Total projected direct expenses}} \times \frac{100}{1}$$

82. The resulting percentage is a ‘mark-up’ figure that is applied to all direct costs. By applying the mark-up figure to all direct costs, all indirect costs and profits will be absorbed in the costs that more directly advantage the investor, ensuring that the entire sum of subscription monies in years 1 to 3 is referable to one advantage or another.

83. The marked-up revenue component of the management fee is the relevant deduction for management fees under section 8-1. Expenditures that are acceptable as being incurred for the purposes Subdivisions 387-A, 387-B and 387-C are also to be increased by the same mark-up percentage shown above. The expenditures that are deductible under Subdivisions 387-A, 387-B and 387-C are stated in the tables at paragraph 59 (for small business taxpayers) and at paragraph 61 (for taxpayers who are not 'small business taxpayers').

Sections 82KZME and 82KZMF and Exception 5

84. Unless one of the statutory exceptions applies, where the requirements of section 82KZME are met, section 82KZMF operates to set the amount and timing of deductions for expenditure that a taxpayer incurs in a year of income. Effectively, these provisions apportion the allowable tax deductions over the period during which the prepaid benefits will be provided.

85. This Product Ruling is issued in response to an application received by the Commissioner on or before 1pm (by legal time in the Australian Capital Territory) on 11 November 1999. Therefore, the Project is an arrangement to which Exception 5 (subsections 82KZME(9), (10) and (11)) applies. Because Exception 5 applies, sections 82KZME and 82KZMF do not apply to set the amount and timing of expenditure incurred by Farmers who participate in the Project. Expenditure incurred by a Farmer for the doing of a thing not to be wholly done within the expenditure year will therefore, be determined under section 82KZM (for a 'small business taxpayer') or sections 82KZMA – 82KZMD (for a taxpayer who is NOT a 'small business taxpayer').

Section 82KZM - Farmers who are 'small business taxpayers'

86. Section 82KZM operates 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. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred. The term 'small business taxpayer' is explained below in paragraphs 92 to 94.

87. The revenue part of the initial Management Fee ie \$3,525 per interest will be incurred on execution of the Joint Venture agreement. This fee is charged for providing services to a Farmer in the first 13 months of the project. This fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years.

88. There is also no evidence that might suggest the services covered by the fee could not be provided within 13 months of the expenditure in question being 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 13 months of the day on which the fee is incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure. The revenue part of the Management Fee is therefore deductible in full in the year it is incurred by a Farmer who is a 'small business taxpayer'.

89. A Farmer who is a 'small business taxpayer' also incurs expenditure on Lease Fees. These fees of \$220 (indexed) per interest are incurred on or before the 30 June each year for a lease over the land for the following 12 months. Therefore, the basic precondition for section 82KZM is also not satisfied for expenditure for these fees where they are paid annually as required by the relevant agreements. Therefore, Lease Fee are deductible in full in the year in which a Farmer who is a 'small business taxpayer' incurs them.

90. Although not required by the Joint Venture Agreement, some Farmers who are 'small business taxpayers' may choose to prepay fees for periods longer than that required by the Agreements. Where a prepayment is incurred and the 'eligible service period' is greater than 13 months then, contrary to the conclusion reached above, unless the expenditure is 'excluded expenditure' section 82KZM will apply. 'Excluded expenditure' being expenditure of less than \$1,000, (subsection 82KZL(1)) is an exception to section 82KZM.

91. Where the 'eligible service period' exceeds 13 months the formula in paragraph 82KZM(1)(c) (shown below) is used to apportion the tax deduction over the period that the benefits relating to the prepaid fees are provided.

Period in year
Eligible service period

Where:

Period in year is the number of days in the whole or the part of the eligible service period in the year of income;

Eligible service period is the number of days in the eligible service period.

Subdivision 960-Q - small business taxpayers

92. 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.

93. '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).

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

Section 82KZMA – 82KZMD - Farmers who are NOT 'small business taxpayers'

95. For a Farmer who is NOT a 'small business taxpayer', sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the 'expenditure year'). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

96. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Farmers investing in the Project transitional treatment applies to prepayments initially incurred in the year ended 30 June 2001. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service period ends more than 13 months after the date the expenditure was occurred.

97. Under the Joint Venture Agreement, the initial Management Fee is for services to be wholly done within 13 months of the fee being incurred. Therefore, the tax deduction available to a Farmer for the revenue portion of the Management Fee ie \$3,525 per interest will be determined in accordance with the rules contained in section 82KZMB and 82KZMC. The amount of the deduction available to Farmers in the 'expenditure year' (that is, the year ended 30 June 2001) is determined using the formula in subsection 82KZMB(3) and the table in subsection 82KZMB(5).

98. However, section 82KZMB is subject to the capping provisions in section 82KZMC. For Farmers who participate in the Project and incur the Management Fee in the year ended 30 June 2001, the 'later year amount' for the purposes of the table in subsection 82KZMB(5) is nil. Therefore, for the year ended

30 June 2001, the tax deduction for a Farmer who is NOT a 'small business taxpayer' will be the amount determined using the formula in section 82KZMB(3) only. The balance of the tax deduction is then determined under subsection 82KZMC(4) using the formula in subsection 82KZMC(5). For Farmers in this Project, the balance of the 13 month 'eligible service period' is in the year ended 30 June 2002, therefore the balance of the Management Fee is deductible in that year. Example 2 at paragraph 136 demonstrates the application of these provisions.

99. A Farmer who is NOT a 'small business taxpayer' also incurs expenditure on Lease Fees. These fees of \$220 (indexed) per interest are incurred on or before the 30 June each year for a lease over the land for the following 12 months. The Lease Fees constitute 'excluded expenditure' for a Farmer who is allocated one interest in the Project. 'Excluded expenditure' being expenditure of less than \$1,000, (subsection 82KZL(1)) is an exception to sections 82KZMB and 82KZMC. The Lease Fees are therefore deductible in full in the year in which a Farmer who is NOT a 'small business taxpayer' incurs them.

100. However, if a Farmer who is NOT a 'small business taxpayer' acquires more than one interest in the Project, the quantum of a the Lease Fees may be \$1,000 or more. Where this occurs, like the Management Fee discussed above, the amount and timing of the deduction allowable for the Lease Fees must be determined under sections 82KZMB and 82KZMC.

101. Although not required by the Joint Venture Agreement, some Farmers who are NOT 'small business taxpayers' may choose to prepay fees for periods longer than that required by the Agreements. Where a prepayment is made and the 'eligible service period' is greater than 13 months then section 82KZMB and 82KZMC do not apply. Instead, unless the expenditure is 'excluded expenditure' section 82KZMD will apply to apportion the tax deduction over the period that the benefits relating to the prepaid fees are provided. The relevant formula contained in subsection 82KZMD(2) is:

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

Interest deductibility

(i) Farmers who use Intagpro Pty Ltd as the finance provider

102. Farmers may finance their participation in the Project through a finance option offered by Intagpro Pty Ltd (see paragraphs 51 to 55 above). Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of lease and management fees.

103. 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 olive growing 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.

104. As the finance option offered by Intagpro Pty Ltd does not require a Farmer to prepay interest, section 82KZM or sections 82KZMA-82KZMD will not apply. The interest will be deductible in full in the year in which it is incurred.

105. However, a Farmer who, contrary to the requirements of the finance option offered by Intagpro Pty Ltd, **chooses** to prepay interest will be required to determine any tax deduction under section 82KZM (for a Farmer who is 'small business taxpayer') or sections 82KZMA-82KZMD (for a Farmer who is not a 'small business taxpayer') – see discussion above of these provisions.

(ii) Farmers who DO NOT use Intagpro Pty Ltd as the finance provider

106. The deductibility of interest incurred by Farmers who finance their participation in the Project through a loan facility with a bank or financier other than Intagpro 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.

107. While the terms of any finance agreement entered into between relevant Farmers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid, relevant Farmers will be required to determine any tax deduction under section 82KZM (for a Farmer who is 'small business taxpayer'), or sections 82KZMA-82KZMD (for a Farmer who is not a 'small business taxpayer') – see discussion above of these provisions.

Expenditure of a capital nature

108. Any part of the expenditure of a Farmer entering into an olive growing 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. In this Project, the costs of, landcare, irrigation, and the establishment of horticultural plants are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, this

expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

Land clearing

109. The land clearing fee that is identified and payable by a Farmer upon settlement of the Joint Venture, is capital expenditure and not allowable as a deduction under section 8-1. This amount will also have to be calculated using the formula discussed at paragraphs 77 to 83.

Subdivision 387-A - expenditure for landcare operations

110. Section 387-55 allows a taxpayer a deduction for capital expenditure incurred on a landcare operation for land used to carry on a primary production business. Farmers need not own the land to qualify for the deduction, so long as it is used by them to carry on a primary production business.

111. Subdivision 387-A allows a taxpayer who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on 'landcare operations'. The term 'landcare operation' is defined in section 387-60.

112. In accordance with the Joint Venture Agreement, an erosion control fee is payable by a Farmer upon settlement of the Joint Venture. This is considered to be capital expenditure incurred at a particular time on a 'landcare operation' for the prescribed purposes as set out in section 387-55. A landcare operation, as relevant to the Project, comprises constructing surface or subsurface drainage works on the land primarily and principally for controlling salinity or assisting in drainage control. In order to qualify for a deduction under section 387-55, a business must be carried on at the time the expenditure is incurred.

113. It is considered that a business has commenced at the time the expenditure is incurred. It is accepted that the execution of the Joint Venture Agreement is sufficient to constitute the commencement of a business. The business is considered to have commenced at the time the management fees are incurred by the Joint Venture Farmers. Further, it is considered that the erosion control fee is primarily and principally for the purpose of assisting in drainage control. Accordingly, the expenditure is deductible to a Joint Venture Farmer under section 387-55 in the year of income in which it is incurred.

114. However, a deduction under section 387-55 is denied where the Farmer is entitled to claim a landcare tax offset under section 388-55 and chooses to do so. A Farmer can only choose a landcare tax offset where:

- had the Farmer chosen a deduction instead of the tax offset, the Farmer's taxable income for the income year would have been \$20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Subdivision 387-B – irrigation expenditure

115. 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 would be covered by this Subdivision.

116. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or licensee who is conducting a primary production business on land in Australia, a deduction would be available to a Farmer in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

117. However, a deduction under section 387-125 is denied where the Farmer is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Farmer can only choose a water facility tax offset where:

- had the Farmer chosen a deduction instead of the tax offset, the Farmer's taxable income for the income year would have been \$20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Subdivision 387-C – olive trees and horticultural provisions

118. Section 387-165 allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. A lessee or licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land (section 387-210).

119. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its

first commercial season. The write-off rate is detailed in section 387-185. For a plant, such as the olive trees in this Project, with an effective life of 30 years or more, that rate is 7%.

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

120. 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.

121. 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.

122. 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.

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

124. 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).

125. A Farmer who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Farmer who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2007. Farmers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

126. 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 Farmer's participation in the Project.

127. 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 Farmer 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

128. 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.

129. This Product Ruling is issued on a prospective basis (ie, before an individual Farmer's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 63), in the manner described in the Arrangement (see paragraphs 16 to 55), 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.

130. 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 agricultural consultant and additional expert or scientific evidence provided with the application by the Responsible Entity;
- the binding Olive Sale contract(s) with Inglewood Olive Processors Pty Ltd for the sale of the olives setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the olives are grown; 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 submitted by the Responsible Entity.

Section 82KL - recouped expenditure

131. 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

132. 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).

133. The Tarwoona Olives Scheme No.1 will be a ‘scheme’. A Farmer will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 59 to 62 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.

134. Farmers 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 olives. There are no facts that would suggest that Farmers 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’

135. 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 - tax deductions for prepaid expenditure where Exception 5 applies and the Grower is NOT a ‘small business taxpayer’

136. Joseph decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The ABC Pineforest Project lodged an application for a Product Ruling on 20 October 1999 and the Ruling was issued by the Tax Office on 8 January 2000. Accordingly, Exception 5 applies to taxpayers who are accepted into the Project and incur prepaid expenditure under the arrangement.

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. 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. Joseph 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 Joseph that the minimum subscription has been reached and the Project will go ahead. Joseph’s agreements are duly executed and management services start to be provided on that date.

PR 2001/29

Joseph has extensive business interests and his average turnover for the 2000/2001 income year exceeds \$1 million. Therefore, he is not a 'small business taxpayer' and must calculate his tax deductions under the prepayment rules in sections 82KZMA-82KZMD.

Joseph, 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:

Managem't fee x $\frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of eligible service period}}$

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

= **\$356** (this is Joseph'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** Joseph 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 Joseph 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 Joseph in the 2002 income year).

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

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

Detailed contents list

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

	Paragraph
What this Product Ruling is about	1
Tax law(s)	2

Goods and Services Tax	3
Business Tax Reform	4
Note to Promoters and Advisers	6
Class of persons	7
Qualifications	9
Date of effect	12
Withdrawal	14
Previous Ruling	15
Arrangement	16
Overview	18
Constitution and Joint Venture Agreement	26
Fees	31
<i>Management fees</i>	33
<i>Lease rent contribution fees</i>	37
<i>Joint venture contributions</i>	38
Manager's services	43
Planting	49
Finance	51
Ruling	56
Assessable income	56
Minimum subscription	57
Section 8-1	58
Tax deductions for a Farmer who is a 'small business taxpayer'	59
<i>(i) Deductions where a Farmer is <u>not</u> registered nor required to be registered for GST</i>	59
<i>(ii) Deductions where a Farmer is registered or is required to be registered for GST</i>	60
Tax deductions for a Farmer who is <u>NOT</u> a 'small business taxpayer'	61
<i>(i) Deductions where a Farmer is <u>not</u> registered nor required to be registered for GST</i>	61
Deductions where a Farmer is registered or required to be registered for GST	62
Division 35 – deferral of losses from non-commercial business activities	63

PR 2001/29

Section 35-55 - Commissioner's discretion	63
Sections 82KZM, 82KZMB - 82KZMD, 82KL and Part IVA	67
Explanations	68
Section 8-1	68
Is the Farmer carrying on a business?	69
Expenditure of a capital nature	77
Sections 82KZME and 82KZMD and Exception 5	84
Section 82KZM - Farmers who are 'small business taxpayers'	86
Subdivision 960-Q - small business taxpayers	92
Sections 82KZMA - 82KZMD - Farmers who are NOT 'small business taxpayers'	95
Interest deductibility	102
<i>(i) Farmers who use Intagpro Pty Ltd as the finance provider</i>	102
<i>(ii) Farmers who DO NOT use Intagpro Pty Ltd as the finance provider</i>	106
Expenditure of a capital nature	108
Land clearing	109
Subdivision 387-A - expenditure for landcare operations	110
Subdivision 387-B - irrigation expenditure	115
Subdivision 387-C - olive trees and horticultural provisions	118
Division 35 - deferral of losses from non-commercial business activities	120
Section 82KL - recouped expenditure	131
Part IVA - general tax avoidance provisions	132
Examples	135
Example 1 - entitlement to 'input tax credit'	135
Example 2 - tax deductions for prepaid expenditure where Exception 5 applies and the Grower is NOT a 'small business taxpayer'	136
Detailed contents list	137

Previous draft:

Previously issued as PR 2000/58.

Related Rulings/Determinations:

PR 1999/95; 1999/21; TR 97/16;
TR 97/11; TD 93/34; TR 92/20;
TR 92/1

Subject references:

- afforestation expenses
- carrying on a business
- commencement of business
- fee expenses
- forestry
- interest expenses
- management fees expenses
- plantation forestry
- product rulings
- public rulings
- primary production
- primary production expenses
- producing assessable income
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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