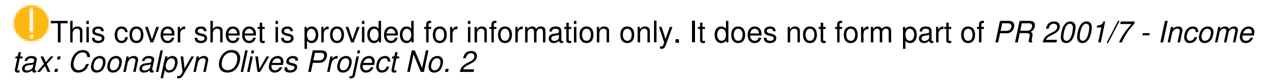
PR 2001/7 - Income tax: Coonalpyn Olives Project No. 2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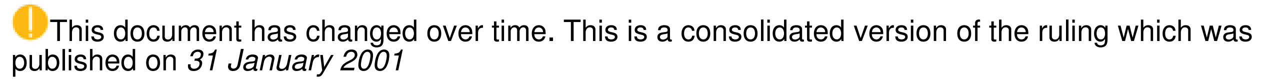
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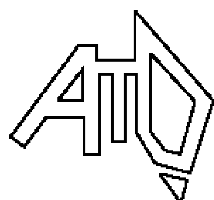

Australian
Taxation
Office

Product Ruling
Income tax: Coonalpyn Olives Project No. 2

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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.

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 these products as investments. Further, we give no assurance that the products are 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 products. 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 arrangements are 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 arrangements will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities in future years to confirm the arrangements have been implemented as described below and to ensure that participants in the arrangements 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 Coonalpyn Olives Project No. 2, 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)
- Division 27 (ITAA 1997);
- section 35-55 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 42-167 (ITAA 1997);
- section 43-10 (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 82KZMD (ITAA 1936);
- section 82KZME (ITAA 1936);
- section 82KZMF (ITAA 1936);
- section 97 (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered for GST and hold a valid tax invoice.

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 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the

arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

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

10. 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.

11. 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 written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, Ausinfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

12. This Ruling applies prospectively from 31 January 2001, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

15. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Application for Product Ruling dated 18 October 2000;
- Draft Prospectus No.2 prepared for the Coonalpyn Olives Project;
- **Coonalpyn Olives Project Constitution** ('Constitution') dated 30 April 1999;
- Deed of Variation to the Constitution dated 31 May 1999;
- Draft Deed Poll of Variation to the Constitution lodged with the Application;
- Draft Deed Poll of Variation to the Constitution sent on 14 December 2000;
- Draft Deed Poll of Variation to the Constitution sent on 22 December 2000;
- Major Services Agreement dated 7 June 1999 between Playford Management Ltd ACN 085 676 973 ('PML') and Coonalpyn Olives Pty Ltd ACN 085 358 747 ('COPL');
- Draft Deed of Variation to the Major Services Agreement;
- Draft Farm Management Agreement between COPL and Rowntree Orchard Management Pty Ltd ACN 083 098 711;
- Farm Management Plan dated January 2001;
- Undated Olive Tree Supply Agreement between Agrolive Pty Ltd and PML, executed by PML;
- Trust Deed for the Coonalpyn Olives Unit Trust ('Trust Deed') between the Founder and PML;
- Deed of Variation to the Trust Deed dated 31 May 1999;

- Executed but undated Deed Poll of Variation to the Trust Deed;
- Olive Crushing Agreement dated 7 June 1999 between PML and The Australian Olive Oil Company Pty Ltd ACN 074 352 515;
- Undated Deed of Variation to the Olive Crushing Agreement executed by PML;
- Olive Oil Sale Agreement dated 7 June 1999 between PML and The Australian Olive Oil Company Pty Ltd ACN 074 352 515;
- Undated Deed of Variation to the Olive Oil Sale Agreement executed by PML;
- Olive Oil Sale Agreement dated 23 June 2000 between The Australian Olive Oil Company Pty Ltd and Peerless Holdings Pty Ltd;
- Draft Custody Agreement between PML and Cardinal Financial Securities Limited ACN 058 650 212;
- Undated Reimbursement Agreement between PML and Coonalpyn, executed by PML;
- Undated Project Interest Option Agreement between PML and Coonalpyn, executed by PML; and
- Correspondence and attachments from the Tax Advisor dated 14 November 2000, 4 December 2000, 12 December 2000, 13 December 2000, 14 December 2000, 17 December 2000, 18 December 2000, 22 December 2000 and 24 January 2001.

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

16. The documents highlighted are those Growers enter into or become a party to. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, to which the Grower, or an associate of the Grower, will be a party to. The effect of these agreements may be summarised as follows.

Overview of the Project

17. The arrangement is called the Coonalpyn Olives Project No. 2.

Location	Approximately 15 kilometres by road east of Coonalpyn, South Australia

Type of Business each participant is carrying on	Commercial growing and cultivation of olive grove/s for the purpose of producing olive oil
Number of Hectares to be cultivated	299 hectares
Size of each Olive Grove	between 0.24 and 0.26 hectare
Number of trees per hectare	330
Term of the Project	25 years

Interests applied for

18. All persons applying to participate in the Project must apply for an Investment Unit. Each Investment Unit will be a 'stapled' unit comprising 1 Grower Unit and 1 Unit in The Coonalpyn Olives Unit Trust. The Responsible Entity, PML, proposes to offer 1,057 Investment Units. Additional Investment Units may be acquired by COPL at a discount. **This Ruling will not apply to Investment Units provided at a discount or otherwise than as described below**.

The Project Land

19. PML, as trustee of The Coonalpyn Olives Unit Trust, has already acquired land near Coonalpyn, South Australia. The total area purchased was 2,197 hectares, of which 500 hectares have been identified as being suitable for establishing an olive plantation. Information provided with the application suggest that 201 hectares have been allocated under a separate offer. The balance of 299 hectares will be planted under the arrangement to which this ruling applies. If all of the 1,057 Investment Units to be offered are taken up under this Project, a further 99,000 olive trees (approximately) will be planted.

20. Growers have the choice of whether the Unit in the Unit Trust is to be held by them, or an associated party.

The Project Constitution

21. Participants in the Project become bound by the terms of the Constitution, by executing an application in which they agree to be bound by its terms (cls 1.2 and 2.1). On PML entering their name in the Project Register they become accepted as a Grower for the purposes of this Ruling. They will also become entitled to use a specified area of land (their 'Olive Grove'), to carry on a business of growing olive trees, and harvesting, processing and selling any resulting olives for the production of olive oil (cls 19 to 31). Under

clause 19.4, property in the harvested olives passes to the Grower at the time of harvest.

22. As Growers, they have the choice of whether or not the Grower Unit is to be a Managed Grower Unit (cl 29.1). If a Grower chooses a Managed Grower Unit, then PML is appointed as the Grower's agent to carry on the business.

23. This Ruling will only apply to Growers whose names are entered in the Project Register and who choose to use the services of PML.

24. The rest of this description of the arrangement only covers Growers who acquire Managed Grower Units.

25. There is no separate Management Agreement for this Project. Instead, the terms under which PML is to provide management services to the Growers holding Managed Grower Units, are set out in clauses 32 to 38 of the Constitution. In fact, the Constitution is intended to set out in full the legal relationships between a Grower and PML, on acceptance of the Grower into the Project.

26. Where the Grower appoints PML, they enter into a management arrangement with PML for a period of between 23 and 24 calendar years, commencing on the day the Olive Grove is allotted (cl 32 and definition of 'Duration'). PML is then responsible for the establishment of an olive tree plantation on their behalf, and the ongoing maintenance of those trees, the harvesting and processing of olives from those trees, and the marketing and selling of the olive oil. The Grower, and therefore PML as their agent, must plant no less than 82 olive trees, of only specific varieties, on each Olive Grove (cls 29).

27. PML may subcontract its obligations under this arrangement to another party. PML has contracted with COPL in this regard.

28. Under clause 34.1 PML will be responsible for maintaining records of the activities carried out on behalf of the Growers. Growers may inspect these records at any time. PML is, under clause 34.2, to supply the following reports to each Grower at least once a year:

- the state of health of the olive trees;
- the expected crop levels;
- previous crop and oil yield levels (after first harvest);
- revenue generated; and
- expenses incurred.

29. A Grower may terminate their agreement with PML in certain situations:

- where PML commits a breach of any of its obligations and the default is not remedied within 10 Business Days of receiving notice of the breach (cl 38.2); or
- where a meeting of members, complying with section 252J of the Corporations Law, passes a motion, by at least 50% of the total number of votes, to do so (cl 39.2).

30. Apart from these situations, neither the Grower nor the Unit holder has any right to withdraw from the Project.

31. Any stakes affixed to the land on behalf of a Grower will remain the property of the Grower (cl 19.5) and the Constitution grants the Grower the right to remove these stakes at the end of the Project. There will be one main stake per tree, with each stake treated as a unit of plant.

32. Each Grower's name will be entered in a Growers Register. Each Grower's name will be matched with a 'uniquely identified' Olive Grove (cl 13.5), and they will be advised of the exact location of this by reference to the 'GRO' plan lodged with the South Australian Land Titles Office.

Project Fees

33. Clause 12.2.5 of the Project Constitution specify the application fees. These fees for a Managed Grower Unit are as follows.

Fee Type	Amount
One Unit Trust	$434
Grant of Use Fee for the first four years	$318
Landcare Works	$1,497
Stakes	$546
Building Infrastructure	$216
Irrigation	$2,955
Plant and Equipment	$432
Management Fee for the services in the period up to 30/6/2001	$1,573
Management Fee for the services in the period 1/7/2001 to 30/6/2002	$2,378
Management Fee for the services in the period 1/7/2002 to 30/6/2003	$924
Management Fee for the services in the period 1/7/2003 to 30/6/2004	$1,342
Consumables	$2
Design	$302

Planting Costs	$1,118
Total	**$14,037**

Note: The Total amount differs with the total amount due and payable in paragraph 34 below due to rounding-off of GST payable.

34. The above fees are due and payable as follows (clause 12.2.6):

- $9,423 payable on lodging application;
- $2,206 payable on or before 30 June 2002;
- $923 payable on or before 30 June 2003; and
- $1,484 payable on or before 30 June 2004.

35. After the initial application fees have been applied in the above manner, fees payable in subsequent years are to be met, in the first instance, from the Grower's proceeds from sale of olive oil (cl 36.3.1). However, to the extent that the annual management fee and/or Grant of Use fee cannot be discharged in this manner, Growers will continue to be liable personally for any balance owing to PML.

36. Growers may also be made liable personally to contribute additional amounts of capital in respect of their Unit in the Unit Trust, under clause 4.5.1 of the Trust Deed.

37. Liability for the fees totalling $14,037 does not become a presently existing liability until such time as a Grower completes and lodges their Application Form and PML issues the appropriate interests. At this time, a Grower will have incurred an amount totalling $14,037.

Deriviation of income

38. Growers with Managed Grower Units appoint PML to be their exclusive agent to process olives, and market and sell the olive oil produced from their Olive Groves (cl 32).

39. PML may, at its discretion, mix all or some of the olives from each Grower's Olive Grove for subsequent processing and sale (cl 32.7). PML may also reject and dispose of any olives which it deems unsuitable for the production of extra virgin oil (cl 32.8).

40. Growers will be entitled to the proceeds from the sale of the olive oil without reference to olive type, quality or volume. However, sale proceeds will be derived by each Grower based on the number of Grower Units held (cl 32.10).

Finance

41. The Applicant has informed the ATO that no financing arrangement will be included as part of this Project. Neither the

Applicant, any of the arrangement entities, or any associated entities will:

- be involved in providing finance to investors;
- introduce investors to external sources of finance from parties unrelated to the arrangement; or
- promote any 'preferred financier'.

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

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

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

Ruling

Assessable Income

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

45. Growers presently entitled to income from The Coonalpyn Olives Unit Trust, who are not under a legal disability, must include the appropriate amount in their assessable income under section 97 of the ITAA 1936.

Section 8-1

46. A Grower may claim tax deductions shown in the Table below for the years ending 30 June 2001 to 30 June 2003 where a Grower:

- participates in the Project by 15 April 2001 to carry on the business of growing olives (refer to paragraphs 47 to 54 for a Grower who participates after 15 April 2001 but on or before 30 June 2001);
- incurs the fees shown in paragraph 33; and
- is not registered nor required to be registered for GST.

Fee type	ITAA 1997	Year 1	Year 2	Year 3
	section	30/6/2001	30/06/2002	30/06/2003
Grant of Use Fee for the first four years	8-1	$299 - see note (i) below	nil	nil
Management Fee for the period up to 30/6/2001	8-1	$1,573 - see note (ii) below	nil	nil
Management Fee for the period 1/7/2001 to 30/6/2002	8-1	nil	$2,378 - see note (iii) below	nil
Management Fee for the period 1/7/2002 to 30/6/2003	8-1	$924 - see note (iv) below	nil	nil
Consumables	8-1	nil	$1 - see note (v) below	nil

Notes:

(i) The Applicant has identified that $19 of the $318 Grant of Use fee for the first four years will be an expenditure that is capital or capital in nature and therefore not allowable under section 8-1 ITAA 1997. Furthermore, this expenditure does not fall for consideration under any specific write-off provision of the ITAA 1936 or ITAA 1997.

This amount is incurred at the time of accepting a Grower into the Project. Amounts of less than $1,000 will be 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (see Example 3 at paragraph 136). Deductibility of amounts of $1,000 or more, such as may occur where a Grower acquires four or more Managed Grower Units in the Project, will be determined by using the formula shown in paragraph 77.

(ii) For a Grower who participates into the Project by 15 April 2001, Management fee for the period up to 30 June 2001 is not prepaid and therefore is deductible in full in the year incurred.

(iii) This amount is incurred at the time of acceptance of a Grower into the Project. For a Grower who participates into the Project by 15 April 2001, the expenditure will be for the doing of things that are not to be wholly done within 13 months after the day on which the expenditure will have been incurred. Thus, the expenditure is subject to the prepayment rules contained in sections 82KZM and 82KZMD (see paragraphs 83 to 85).

The application of these sections involve identifying the 'eligible service period' in relation to this amount, and for the year ending 30 June 2002, the number of days of that 'eligible service period' that occur in this income year. This results in the amount $2,378 being deductible in the year ending 30 June 2002 as shown in the above Table.

(iv) This amount is incurred at the time of accepting a Grower into the Project. Amounts of less than $1,000 will be 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (see Example 3 at paragraph 136).

Where a Grower acquires two or more Managed Grower Units in the Project, deductibility of the expenditure is subject to the prepayment rules contained in sections 82KZM and 82KZMD (see paragraphs 83 to 85). The application of these sections on prepaid expenditures will mean that for a Grower who acquires two Managed Grower Units, the amount of $1,848 (2 x $924) incurred in the year ending

30 June 2001 will be deductible in the year ending 30 June 2003.

(v) Deductibility of expenditure on consumables has been based on the treatment set out in Taxation Ruling IT 333. The figures shown in the table are for illustrative purposes only. PML will advise Growers of the actual figures.

47. Where a Grower:

- participates in the Project after 15 April 2001 but on or before 30 June 2001 to carry on the business of growing olives;
- incurs the fees shown in paragraph 33; and
- is not registered nor required to be registered for GST;

then unless the management fee is ‘excluded expenditure’ as defined in subsection 82KZL(1), that Grower will not be able to claim the management fees as shown in the Table in paragraph 46 above.

48. Instead, the amount and timing of the deduction for management fees will be subject to the prepayment rules of the ITAA 1936. The applicable provisions depend on the ‘eligible service period’ which means, generally, the period over which the services are to be provided.

49. If the ‘eligible service period’ ends not more than 13 months after the Grower incurs the expenditure, then the prepayment rules contained in sections 82KZME and 82KZMF will apply.

50. The amount and timing of tax deductions allowable each year for management fees must be determined using the formula in subsection 82KZMF(1) which is shown below.

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

51. If the ‘eligible service period’ ends more than 13 months after the Grower incurs the expenditure, then the prepayment rules contained in sections 82KZM and 82KZMD will apply.

52. Subsection 82KZM(1) enables a Grower, who is a ‘small business taxpayer’, to claim a proportion of the expenditure in each year of the eligible service period. The deductible proportion is ascertained with the formula:

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

where:

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

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

53. A Grower, who is not a 'small business taxpayer' will calculate their deduction using the formula in subsection 82KZMD(2). The formula is similar to the one shown in paragraph 50.

54. In this Project, the tax deductions allowable for the Management Fees (detailed at paragraph 33) must be calculated by applying the relevant formula to the amount incurred each year by the Grower. The application of this method is shown in the Examples 2 and 3 at paragraphs 135 and 136, respectively.

Interest expense

55. The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 86 to 88 below as those rules may be applicable if interest is prepaid.

Tax deductions for capital expenses

56. A Grower who participates in the Project will also be entitled to the following tax deductions:

Fee type	**ITAA 1997 section**	**Year 1 30/6/2001**	**Year 2 30/06/2002**	**Year 3 30/06/2003**
Landcare	387-55	$1,497 - see notes (vi) & (x) below	nil	nil
Stakes	42-15	see note (vii) below		
Plant & equipment	42-15	see note (vii) below		
Building	43-10	$5 - see note (viii) below	$5	$5
Irrigation	387-125	$985 - see notes (ix) & (x) below	$985	$985

Plant costs	387-165	nil - see note (xi) below	nil	nil

Notes:

(vi) 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.

(vii) The tax deduction for depreciation of stakes, plant and equipment will depend upon whether or not the Grower is a 'small business taxpayer' (see paragraphs 100 to 102 below).
For a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the tax deduction for depreciation of plant and equipment is determined using the rates in section 42-125 and the formula in either subsection 42-160(1) ('diminishing value method') or subsection 42-165(1) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the plant and equipment and the extent to which the plant and equipment is installed ready for use during the year. The Project's Manager is to advise Grower of relevant details to calculate their depreciation deductions for the year ended 30 June 2001.

Under section 42-167 a Grower who is a 'small business taxpayer' is also entitled to an immediate tax deduction for 100% of the cost of stakes being plant the cost of which is $300 or less.

Note: The depreciation deductions for 'small business taxpayers' discussed above apply until the introduction of the Simplified Tax System on 1 July 2001 (see paragraphs 96 to 98).

For a Grower who is NOT a 'small business taxpayer' or who is a 'small business taxpayer' who does not satisfy the conditions in section 42-345, the tax deductions for depreciation of stakes, plant and equipment is determined using the formula in either subsection 42-160(3) ('diminishing value method') or subsection 42-165(2A) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of

days in the income year in which the Grower owned an interest in stakes, plant and equipment and the extent to which each is installed ready for use during the year. The formulae use 'effective life' rather than specific rates to determine the deduction for depreciation. The Project's Manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Note: This is only applicable to plant acquired after 21 September 1999 (see paragraphs 105 and 106).

A Grower who is NOT a 'small business taxpayer' has the option of allocating the stakes to a 'low value pool' and calculating the depreciation deduction under section 42-470 using the diminishing value method (see paragraphs 108 to 111 below). Note: This choice is only available from 1 July 2000.

(viii) A deduction is allowable under section 43-10 for capital works constructed for income producing purposes. The rate of deduction is 2.5% of the construction expenditure and is allowed on the basis that the capital works are completed by 30 June 2001.

(ix) 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.

(x) 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.

(xi) 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. The Project's Manager anticipates that approximately 70% of the

trees to be planted will enter their first commercial season in October 2003.

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

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

- participates in the Project by 15 April 2001 to carry on the business of growing olives;
- incurs the fees shown in paragraph 33; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables in paragraphs 46 and 56 (above) will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 134.

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

- participates in the Project after 15 April 2001 but on or before 30 June 2001 to carry on the business of growing olives;
- incurs the fees shown in paragraph 33; and
- is entitled to an input tax credit for the fees,

then the tax deductions for grant of use fees and consumables shown in the Table in paragraph 46, for management fees that are calculated by applying the prepayment rules as discussed in paragraphs 47 to 54 and for capital expenditure shown in the Table in paragraph 56 (above) will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 134.

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

59. For a Grower 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 2004 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.

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

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies (see paragraph 122 in the Explanations part of this Ruling, below).

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

62. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in 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.

Section 82KL

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

Part IVA

64. 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

65. Consideration of whether the management fee and the grant of use fee 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 Grower carrying on a business?

66. A commercial olive growing business can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the sale of olives produced from the Olive Grove areas 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 include the tending, maintaining and harvesting of the olive trees.

67. Generally, a Grower will be carrying on a business of olive growing where:

- the Grower has an identifiable interest in specific trees coupled with a right to harvest and sell the olives;
- the growing, tending, harvesting and marketing activities are carried out in a business like way either by the Grower or on behalf of the Grower; and
- overall, the weight and influence of the general indicators used by the Courts point to the person carrying on a business.

68. For this Project, Growers have (under the Constitution) rights to farm an identifiable area of land consistent with the intention to carry on a business of growing olives. Under the Constitution, Growers appoint PML to provide services such as planting, cultivating, tending, fertilising, spraying, watering, maintaining and otherwise caring for their olive trees. Growers are considered to have control of their investment.

69. The Constitution gives Growers an interest in the olives grown on their behalf and the right to have those olives processed and olive

oil sold for their benefit. The Project documentation contemplates that Growers will have an ongoing interest in the growing crops. The crops belong to the Growers in the sense that they have the right to use the land on which they are growing and a profit à prendre in respect of the produce, which confers an equitable interest in the crops upon the Grower.

70. Growers have the right to use their Olive Grove areas for agricultural purposes and to have PML come onto the land to carry out its obligations under the Constitution. The Grower's degree of control over PML, as evidenced by the Constitution and supplemented by Corporations Law, is sufficient. Growers are able to terminate the arrangements with PML in certain instances, such as default in performance of its duties and failure to rectify the default. The agriculture activities described in the Constitution are, therefore, carried out on the Growers' behalf.

71. The general indicators of a business, as developed 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. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

72. Growers will engage the professional services of a Manager who holds itself out as having the appropriate credentials. There is a means to identify which trees Growers have an interest in. These services are based on accepted agricultural practices and are of the type ordinarily found in farming ventures that would commonly be said to be businesses.

73. Growers have a continuing interest in the trees from the time they are acquired and planted on their behalf. The agricultural 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 Growers' agricultural activities will constitute the carrying on of a business.

74. The fees associated with the agricultural activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income (from the sale of the crop produce) is to be gained from this business. They will, thus, be deductible under section 8-1, except to the extent they are capital, or of a capital nature. Capital components of the fees have been separately identified in clause 12 of the Constitution. No additional capital component, or 'non-income producing purpose' in incurring the fees, is identifiable from the arrangement. The tests of

deductibility under section 8-1 are met. The exclusions in subsection 8-1(2) do not apply, other than in relation to the capital exceptions noted above.

Section 8-1: Prepaid Fees

75. The amount and timing of deductions for any prepaid management fee or use of grove fees otherwise deductible under section 8-1 will depend on 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.

76. Where a Grower participating in this Project incurs expenditure in respect of the doing of things (e.g., the performance of management services), prior to the commencement of the eligible service period, the prepaid expenditure is not necessarily deductible in the year in which it is incurred. Rather, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment.

77. Where a Grower participating in this Project incurs an expenditure that meets the requirements of subsections 82KZME(1) and (2) and the expenditure is incurred under an 'agreement' as described in subsection 82KZME(3), then section 82KZMF will apply in the manner set out in the formula below.

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

78. In relation to the requirements of subsections 82KZME(1) and (2), the prepaid management and grant of use fees incurred by a Grower who participates in the Project:

- are otherwise deductible under section 8-1; and
- have 'eligible service periods' (for each of the fees) that end not more than 13 months after the Grower incurs the expenditure; and
- are incurred in return for the doing of a thing under the agreement that is not wholly to be done within the expenditure year.

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

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

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

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

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

83. Where the 'eligible service period' exceeds 13 months sections 82KZME and 82KZMF will not apply, as the requirement of paragraph 82KZME(1)(b) is not met.

84. Instead, for a Grower who is a 'small business taxpayer' (see paragraphs 100 to 102) subsection 82KZM(1) applies to apportion the expenditure and determine the amount and timing of the deductions. Alternatively, for a Grower who is not a 'small business taxpayer' subsection 82KZMD(2) applies to apportion the expenditure and determine the amount and timing of the deductions.

85. Both of these provisions, although slightly different in form, apportion deductible expenditure over the 'eligible service period' in the same way as the formula contained in paragraph 77 (above). However, expenditure, which is 'excluded expenditure', is an exception to both provisions (subparagraph 82KZM(1)(b)(ii) and subsection 82KZMA(4) respectively). A tax deduction for 'excluded expenditure' can be claimed in full in the year in which the expenditure is incurred.

Interest deductibility

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

87. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in 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.

88. Therefore, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. The relevant formula is shown above in paragraph 77 and the method is explained in the Examples at paragraphs 135 and 136.

Expenditure of a capital nature

89. Any part of the expenditure of a Grower 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, stakes, plant and equipment, building and planting are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, these expenditure fall for consideration under specific write-off provisions of the ITAA 1997.

Subdivision 387-A - Expenditure for landcare operations

90. 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. Growers 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.

91. Landcare operation for land includes work on erecting fences primarily and principally for the purpose of excluding animals from an

area affected by land degradation to prevent or limit extension of that degradation and to help reclaim the area. It also includes work on constructing drainage works primarily and principally for the purpose of controlling salinity or assisting in drainage control, and work primarily and principally for the purpose of eradicating pests and plants detrimental to the land.

92. In this Project there will be no delay between the execution of the relevant agreements and the commencement of 'business operations' on the Grower's behalf. Accordingly, a Grower's primary production business will have commenced at the time the expenditure in question has been incurred, and the requirements of section 387-55 will have been satisfied.

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

- had the Grower chosen a deduction instead of the tax offset, the Grower'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.

Section 42-15: depreciation of stakes and plant and equipment

94. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose or purposes of producing assessable income where they are the owner or quasi-owner of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, absolutely owned by the owner of the land.

95. It is, however, accepted in certain circumstances that a person who has been granted the right to use an area of land is entitled to claim depreciation where they are considered to be the owner of those improvements. Taxation Ruling IT 175 sets out the views of the Tax Office on this issue. Where a lessee is considered to own the improvements under a state law, as detailed in the Ruling, or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the lessee is entitled to claim depreciation for the fixture.

96. Under section 42-15 Growers in the Project are entitled to depreciation deductions for capital expenditure in relation to the acquisition of stakes to support the growing trees and various items of plant and equipment, which will be used by PML in carrying out its obligations under the Constitution. The deduction available, however,

will depend upon the date the investment is made, when the plant is installed ready for use and whether or not a Grower is a 'small business taxpayer' (see paragraphs 100 to 102).

97. For plant acquired or constructed after 11:45 a.m. by legal time in the Australian Capital Territory on 21 September 1999, accelerated rates of depreciation are no longer available except to some 'small business taxpayers'. The Government has announced that 'small business taxpayers' who meet the conditions in section 42-345 will have access to accelerated rates of depreciation until the introduction of the proposed Simplified Tax System on 1 July 2001.

98. The immediate deduction for items of plant costing $300 or less has been removed from 1 July 2000, except for 'small business taxpayers'. The Government has announced that 'small business taxpayers' will be able to claim the immediate deduction until the introduction of the proposed Simplified Tax System.

99. The depreciation of stakes and plant and equipment as explained in this Product Ruling is based on existing legislation and may be subject to change.

Small business taxpayers

100. 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.

101. '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).

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

Depreciation deductions for Growers who are 'small business taxpayers'

103. Under section 42-167 a Grower who is a 'small business taxpayer' is entitled to a 100% depreciation deduction for expenditure on **stakes**, being items of plant with a cost of $300 or less. PML will advise Growers of the correct year if the stakes are not owned and

used for the purpose of producing assessable income during the year ended 30 June 2001.

104. The depreciation deduction for plant and equipment available to a Grower who is a 'small business taxpayer' and who complies with the conditions contained in section 42-345 is calculated using the formula in either subsection 42-160(1) or subsection 42-165(1). The depreciation deduction depends on the cost of the plant and equipment and the number of days the plant and equipment was owned by the Grower during the income year. It also depends on the extent to which the plant and equipment is installed ready for use during the year. PML will advise Growers of the details required for them to calculate their depreciation deductions for expenditure on these items.

Depreciation deductions for Growers who are NOT small business taxpayers

105. A Grower who is NOT a 'small business taxpayer' or is a 'small business taxpayer' who does not satisfy the conditions in section 42-345 will not be able to claim accelerated depreciation on stakes and plant and equipment used in the Project because of section 42-118. The depreciation deduction for such a Grower is calculated using the formula in either subsection 42-160(3) or subsection 42-165(2A).

106. The deduction depends on the cost of the stakes and plant and equipment, the number of days the plant was owned by the Grower during the income year and the 'effective life' of the plant (see paragraph 107). It also depends upon the extent to which the plant is installed ready for use during the year. The Project Manager will advise Growers of the date that the stakes and plant and equipments are installed and begin to be used for the purpose of producing assessable income.

Determination of effective life

107. Subdivision 42-C provides the choice of methods for determining the 'effective life' of plant. Growers can either self-assess the effective life of plant or use the effective life specified by the Commissioner.

Low value pool option

108. From 1 July 2000 the immediate 100% depreciation deduction for plant costing $300 or less has been replaced by a 'low value pool' arrangement for all taxpayers except 'small business taxpayers'

109. Under subsection 42-455(1), a Grower who is not a 'small business taxpayer' can choose to allocate 'low cost plant' to a 'low value pool' in the year of acquisition. 'Low cost plant' is plant costing less than $1,000. Once the choice is made to allocate 'low cost plant' to the pool, <u>all</u> 'low cost plant' acquired in that income year and subsequent income years must be included in the pool (subsection 42-460(1)).

110. A 'low value pool' is depreciated using a diminishing value rate of 37.5%. However, low cost plant is depreciated at 18.75% in the year it is allocated to the pool, irrespective of the date it is allocated. The value of plant included in or disposed of from such a pool will be added to or subtracted from the value of the pool.

111. Information provided with the Product Ruling Application suggests that the cost of a stake is significantly less than $1,000. Therefore, a Grower who is not a 'small business taxpayer' will have the option of including stakes in a 'low value pool'.

Capital Works - section 43-10

112. Under the Project Constitution, Growers incur expenditure on building infrastructure for use in the olive growing business. If the expenditure is incurred in relation to a construction expenditure area (section 43-75), it may be written off at 2.5% per annum from the date the relevant construction is completed. The Project Manager will advise Growers when an identified construction area is completed.

113. A Grower in the Project will incur a construction expenditure of $184. The Farmer will thus be entitled to a deduction of $5 per year commencing from and including the 2001 income year on the basis that the construction area will be completed by 30 June 2001. The deduction is available for each subsequent year until the construction expenditure is fully written off.

Subdivision 387-B – Irrigation expenditure

114. 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.

115. 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 Grower in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

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

- had the Grower chosen a deduction instead of the tax offset, the Grower'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 - Horticultural plant

117. 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).

118. 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 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

119. 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.

120. 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.

121. 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.

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

123. 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).

124. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2005. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

125. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b),

the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

126. The first arm of the discretion in paragraph 35-55(1)(a) relates to ‘special circumstances’ applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the income years ending 30 June 2001 to 30 June 2004.

127. 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.

128. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower’s business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 59), in the manner described in the Arrangement (see paragraphs 15 to 43), 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.

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

Section 82KL

130. 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

131. 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).

132. This Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 46 to 56 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.

133. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the olives. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Examples

Example 1 – Entitlement to 'input tax credit'

134. 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 x $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 – Prepaid expenditure and the apportionment of fees

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Management fee

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

Lease fee

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

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

$$\$3,600 \times \frac{365}{365}$$

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

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

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Related Rulings/Determinations:
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Subject references:
- carrying on a business
- commencement of a business
- interest expenses
- harvesting expenses
- management fees
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- tax benefits
- horticultural expenses

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