PR 2001/76 - Income Tax: Carina Park Almond Stage 3 Project

Product Ruling
Income tax: Carina Park Almond Stage 3 Project

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Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as Carina Park Almond Stage 3 Project, or just 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 70-35 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZM (ITAA 1936);
- sections 82KZMB - 82KZMD (ITAA 1936);
- section 82KZME (ITAA 1936);
- section 82KZMF (ITAA 1936); and
- Part IVA of the 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 arrangements described below on or after the date this Ruling is made. They will have a purpose of staying in the relevant 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, each of these persons, referred to as 'Growers', will have accepted an offer made under subsections 708(1)-(11) of the Corporations Law.

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

Qualifications

9. The Commissioner rules on the precise arrangements identified in the Ruling. If the arrangements described in the Ruling

are materially different from the arrangements that are actually carried out:

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

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Date of effect

11. This Ruling applies prospectively from 30 May 2001, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. 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 arrangements during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangements prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangements or in the persons' involvement in the arrangements.

Arrangement

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

- Application for Product Ruling;
- Draft Carina Park Almond Project Stage 3 Investment Offer Details prepared by Blaxland Rural Investments Limited ("BRIL");
- **Draft Allotment Agreement** to be entered into by each Grower and BRIL;
- **Draft Management Agreement** to be entered into by each Grower and BRIL;
- Almond Orchard Lease between Kyndalyn Park Pty Ltd as Lessor and Cardinal Financial Securities Limited as Lessee and BRIL as Guarantor, executed on 1 June 1999;
- Sublease Agreement between Cardinal Financial Securities Limited as Sublessor and BRIL as Sublessee, executed on 1 June 1999;
- Almond Orchard Management Agreement between Select Harvest Limited and BRIL; and
- Letters and attachments from the Tax Adviser dated 1 March 2001, 28 March 2001, 3 April 2001 and 17 May 2001.

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

15. In accordance with the above documents, a Grower who participates in the arrangement must have accepted an offer that was made under section 708 of the Corporations Law. **This Ruling does not apply unless the Grower:**

- has accepted a 'personal offer' under subsections 708(1)-(7) of the Corporations Law; or
- is a 'sophisticated investor' for the purposes of subsections 708(8)-(9) of the Corporations Law; or
- has accepted an offer made by a licensed dealer where the offer meets the requirements of subsection 708(10) of the Corporations Law; or

- is a 'professional investor' for the purposes of paragraphs (a), (b) or (h) of subsection 708(11) of the Corporations Law.

16. Each of these categories is explained in paragraphs 48 to 55 in the Explanations area of this Product Ruling.

17. 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. The effect of these agreements may be summarised as follows.

Overview of the Project

18. This arrangement is called the "Carina Park Almond Project Stage 3". There is no minimum subscription that needs to be reached before the Project proceeds.

Location	near Robinvale in Victoria bordering the Murray River 85 kms east of Mildura
Type of business each participant is carrying on	Commercial growing and cultivation of almond trees for eventual harvesting and selling of almonds
Number of hectares under cultivation	39
Size of minimum Grower's Allotment	0.4 hectare
Number of trees per hectare	250
The term of the Project	23 years
Initial cost per allotment	$4,725
Initial cost on per hectare basis	$11,813
Other costs	Processing and marketing fees

The Project Land

19. The Project Land is part of an area known as Carina Park and is owned by Kyndalyn Park Pty Ltd. The land has been leased to the Cardinal Financial Securities Limited, which has, in turn, subleased the land to BRIL.

20. Information provided with the Application described the land for this Project as survey blocks 26, 32, 33, 36, 37, 38 and 39 of Lot 1, Parish of Annuello, Volume 9481, Folio 981.

21. A Grower will participate in the Project by entering into an Allotment Agreement and Management Agreement with BRIL. The salient provisions of these agreements are described below.

Allotment Agreement

22. BRIL will grant a licence to each Grower, by way of an Allotment Agreement, to conduct almond-growing activities on the Land. Information provided with the Product Ruling Application states that a licence will include the trees, internal irrigation and stakes on the allotment.

23. Pursuant to clause 1.1 of the Allotment Agreement, BRIL grants each Grower a licence to:

- to use and occupy the Grower's Allotment for the purpose only of growing, maintaining and harvesting the Trees;
- the right to use the supplied irrigation system and draw water made available to the Allotment from the Water Licences or from any other source provided by BRIL to the extent required to irrigate the Grower's Trees; and
- to use in common with all other Growers the horticultural infrastructure on the Land required for the Project.

24. The Allotment Agreement will commence on the date BRIL accepts the Grower's application under the Offer Document for the Project and will continue until the termination of the Project at 30 June 2024 (cl. 2.1). BRIL's right to require the Grower to sell, transfer or assign to BRIL or its nominee the Grower's trees and allotment irrigation system on termination of the Project is detailed in clause 2.2.

25. The Grower's rights and obligations are set out in clause 4. Under this agreement, the Grower may, for the better performance of its obligations under this Agreement, employ any person as an agent (cl. 4.2).

26. BRIL's obligations are set out in clause 5. Clause 6.1 provides the amount of licence fees payable by a Grower. The table in paragraph 31 shows the fees for the first four years as contemplated by the Allotment Agreement.

Management Agreement

27. The Management Agreement sets out the terms and conditions of BRIL's appointment by the Grower as an independent contractor to

manage the Allotment (cl. 1). The Management Agreement will commence on the date BRIL accepts the Grower's application under the Offer Document for the Project and will continue until the termination of the Project at 30 June 2024 (cl. 2).

28. Clause 3.1 stipulates the management and administration duties of BRIL for the year ending 30 June 2001. Among others, these duties are as follows:

- manage the Grower's Allotment so that it will be suitable for the growing of almond trees;
- monitor the internal irrigation system for pressure, water quality, drip speed leakages, and layout of drip lines prior to transfer to Grower, repairs following first season use;
- inspect all trees for death or damage;
- destroy any trees which a reasonable horticulturist would destroy having regard to the best interests of the remaining unaffected trees and almonds on the Allotment and neighbouring land, and provide replants;
- realign stakes and irrigation lines, undertake a tree count to ensure full tree numbers are still alive and in good order;
- provide suitable irrigation, fertilisation and nutrients to the Trees as and when required in order to promote the production of almonds and to maximise yields;
- as far as reasonably possible keep the Grower's Allotment free from any competitive weeds or other vegetation which may affect growth or yield of the Trees;
- general commercial overview of the orchard development;
- eradicate as far as possible any existent weeds, pests, or diseases which may affect the growth of the almond trees;
- review the Grower's Allotment for any evidence of soil degradation or erosion and implement prevention methods and programs to improve soil quality;
- administration and compliance duties;
- maintain in good repair and condition existing buildings, machinery, fire-breaks, wind-breaks, access roads, tracks and fences which are required for managing and protecting the Grower's Allotment;

- embark on such operations as may be required to prevent or combat land and soil degradation on the Allotments and maintain soil quality on the Allotment;
- if consistent with the production of high quality almonds and, if required, then eradicate, as far as reasonably possible, any insects, pests or diseases which may affect the growth or yield of the Trees;
- comply with all laws and regulations relating to the use and occupancy of the Allotment and the actions being carried out on the Allotment; and
- comply with the Allotment Agreement for the Grower's Allotment (other than the payment of fees) (cls. 3.1(a) to (o)).

29. BRIL is also obliged to continue to manage and maintain the Grower's Allotment following the transfer of the trees to the Growers. BRIL will also:

- test the maturity of a sample of almonds at the appropriate time estimated by BRIL to determine whether the Trees are ready for harvesting;
- harvest the Trees on the Grower's Allotment at or around the time estimated by BRIL to maximise the return of produce from all of the Allotments established at or around the same time as the Grower's Allotment;
- transfer the harvested almonds to available facilities for processing;
- carry out the processing duties; and
- subject to the Grower's right to take and market produce following at least three months' written notice from the Grower to BRIL prior to a Production Period, market and sell the Almonds Attributable to the Grower's Allotment using reasonable endeavours to obtain the maximum price available (cls 3.2(a) to (n)).

30. Clause 4 of the Management Agreement provides for BRIL's remuneration in consideration of BRIL carrying out its duties under the Management Agreement.

Project fees

31. The fees per 0.4 hectare Allotment are shown in the table below.

Fee type	30 June 2001	30 June 2002	30 June 2003	30 June 2004
Licence fee	$770	$770	$770	$770
Fee for procuring and managing water licence	$440	$563	$574	$586
Management fee	$2,800	$4,754	$3,268	$2,385
Management and administration	$715			
Processing fee			$145 – see Note below	$562 – see Note below
Marketing fee			$30 – see Note below	$177 – see Note below
Total	$4,725	$6,087	$4,787	$4,480

Note: The processing and marketing fees are determined according to clauses 4.4, 4.5 and 4.6 of the Management Agreement.

32. The fees are due and payable on the dates shown in Schedule 1 of the Management Agreement. The Management Agreement provides that the fees are payable in the financial year for which services are performed (cl. 4.3(d)). Growers who choose the monthly or the quarterly options will be charged $220 and $110 annual administration fee, respectively.

Finance

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

34. BRIL will make available to Growers a finance facility from an institutional lender. BRIL has provided information on the terms of the financing arrangement of this facility.

35. 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

36. 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.

Trading stock

37. A Grower must account for trading stock on hand in accordance with section 70-35 of ITAA 1997.

Section 8-1

Deductions where a Grower is not registered or not required to be registered for GST

38. A Grower may claim tax deductions as outlined in the table below for the years ending 30 June 2001 to 30 June 2004 where the Grower:

- participates in the Project before 10 June 2001 to carry on the business of growing almond trees;
- incurs the fees shown in paragraph 31; and

- is not registered or is not required to be registered for GST.

Fee type	ITAA 1997 section	30 June 2001	30 June 2002	30 June 2003	30 June 2004
Licence fee	8-1	$770	$770	$770	$770
Fee for procuring and managing water licence	8-1	$440	$563	$574	$586
Management fee	8-1	$2,800	$4,754	$3,268	$2,385
Management and administration	8-1	$715			
Processing fee	8-1			$145	$562
Marketing fee	8-1			$30	$177
Total		$4,725	$6,087	$4,787	$4,480

39. Where a Grower incurs the fees shown in the table in paragraph 31 above as required by the Allotment Agreement and the Management Agreement, those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 82 to 86 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than $1,000, is an 'exception' to any prepayment rules that apply and is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of a prepaid fee is $1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown in paragraphs 82 to 86.

Interest expense

40. 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 91 to 93 below as those rules may be applicable if interest is prepaid.

Horticultural plant costs – subdivision 387-C

41. A deduction is allowable under section 387-165 of the ITAA 1997 for capital expenditure incurred by BRIL on acquiring and planting the trees for use in horticultural business. Trees that have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years, as in this Project, have a write-off rate of 13%. The period of write-off starts from the time the trees enter their first commercial season. Based on the advice provided by BRIL that it is likely that the first commercial season will be in the financial year ending 30 June 2003, the amount that can be written-off per allotment for the years ending 30 June 2001 to 30 June 2004 are shown in the table below.

Year of Income	Deduction under section 387-165 ITAA 1997
30 June 2001	nil
30 June 2002	nil
30 June 2003	$132
30 June 2004	$143

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

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

- participates in the Project before 10 June 2001 to carry on the business of growing almond trees;
- incurs the fees shown in paragraph 31; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the tables at paragraphs 38 and 41 will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 98.

Section 35-55 – losses from non-commercial business activities

43. 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 2006 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.

44. 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 71 in the Explanations part of this Ruling, below).

45. 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.

46. 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.

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

47. For a Grower who participates in the Project and incurs expenditure in accordance with the Allotment Agreement and Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

(i) the expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 79 to 87);

(ii) the expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 79 to 87);

(iii) the expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 79 to 87);

(iv) section 82KL does not apply to deny the deductions otherwise allowable; and

(v) 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 708 of the Corporations Law

48. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by the Grower under one of four categories in subsections 708(1)-(11) of the Corporations Law. These provisions set out situations where a prospectus or similar disclosure document is not required.

49. Under subsections 708(1)-(7) a Grower may participate in the project by accepting a 'personal offer' for an interest in the project. Offers under these provisions cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than $2 million dollars.

50. An offer will be a personal offer only where if it can be accepted by the person it is made to, and if the person is likely to be interested in the offer because of any previous contact, professional or other connection to the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 708(2)).

51. Offers made under other exclusions in section 708 (see below) are not counted for the purposes of the 20 investors limit.

52. Alternatively, a Grower who is a 'sophisticated investor' may accept an offer for interests in the project under subsections 708(8)-(10). Under subsection 708(8), an investor in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will be a 'sophisticated investor' where :

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least $500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least $500,000; or
- it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made that the person to whom the offer is made:

  (i) has net assets of at least $2.5 million; or

(ii) has a gross income for each of the last 2 financial years of at least $250,000 a year.

53. A Grower may also participate in the project where the offer is made by a licenced dealer under subsection 708(10). Under this provision the dealer must be satisfied that the person to whom the offer is made has previous experience in investing which allows them to assess the merits of the offer, the value of the interests in the project, the risks involved in accepting the offer, their own information needs and the adequacy of the information provided.

54. The licenced dealer must provide a written statement of reasons for being so satisfied. Where a Grower is accepted into the project under this provision he or she must sign an acknowledgment that they did not receive a prospectus in relation to the offer.

55. Under subsection 708(11) an offer may be made to and accepted by a person who is considered to be a professional investor. Growers who participate in the project under this provision will be, at the time the offer is made:

- a person who is a licensed or exempt dealer and who is acting as a principal;
- a person who is a licensed or exempt investment adviser and who is acting as a principal; or
- a person who controls at least $10 million for the purposes of investment in securities.

Section 8-1

56. It is appropriate, as a starting point, to consider whether the fees payable under the Allotment Agreement and Management Agreement are deductible under paragraph 8-1(1)(a). This consideration proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoing is not deductible under paragraph 8-1(1)(b) if it is incurred when the business has not commenced; and
- where taxpayers contractually commit 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 paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoing in question would have a

sufficient connection with activities to produce assessable income of the taxpayer.

Is the Grower carrying on a business?

57. A scheme that involves the growing of almonds 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 the almonds from the scheme will constitute assessable income under section 6-5. 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 of almond trees and harvesting of the almonds.

58. Generally, an investor will be carrying on a business of growing almonds where:

- the investor has an identifiable interest in specific growing trees coupled with a right to harvest and sell the almonds resulting from those trees;
- the horticulture activities are carried out on the investor'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.

59. For this Project Growers have, under the Allotment Agreement, rights in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of growing almonds.

60. Under the Management Agreement, Growers appoint BRIL, as Manager, to provide services such as tending, pruning, training, fertilising, replanting, spraying, maintaining and otherwise caring for the trees. BRIL will also be responsible for the harvesting, marketing and sale of the produce from the trees.

61. Growers only have the right to use the land in question for almond-growing purposes. BRIL may come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over BRIL, as evidenced by the Management Agreement, and supplemented by the Corporation Law, is sufficient. Under the general terms of the Project, Growers are entitled to receive regular progress reports on BRIL's activities. Growers are able to terminate arrangements with BRIL in certain instances, such as cases of default. The horticulture activities described in the Management

Agreement are carried out on the Growers' behalf. Growers control their investment.

62. 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 in this Ruling for all these indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Memorandum of Information 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.

63. 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 a specific interest in. These services are based on accepted horticultural practices and are of the type ordinarily found in horticultural ventures that would commonly be said to be businesses.

64. Growers have a continuing interest in the trees from the time they are acquired until the termination of the Project. The horticultural 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' horticultural activities will constitute the carrying on of a business.

65. The fees associated with the horticultural 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 almonds) is to be gained from the business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Subdivision 387-C - horticultural provisions

66. 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).

67. 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 almond tree in this Project, with an effective life of 13 to 30 years, that rate is 13%.

Division 35 - losses from non-commercial business activities

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

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

69. 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.

70. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

71. 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.

72. 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).

73. 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 Allotment in the Project is unlikely to pass one of the objective tests or produce a taxation profit until the income year ended 30 June 2007. Growers who acquire more than one Allotment in the Project may however, pass one of the tests in an earlier income year.

74. 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.

75. 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 2006.

76. 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.

77. 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 in the manner described in the Arrangement (see paragraphs 14 to 35), 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.

78. 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 information provided by BRIL

regarding 'stage 1' of the Carina Park Almond Project. BRIL has stated in its application that stage 3 is an extension of the Carina Park Almond Project which was offered through a Prospectus. This information is as follows:

- 12 Month Expert Report on the Carina Park Almond Project; and
- independent, objective, and generally available information relating to almond production and the Carina Park Almond Project in particular.

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

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

80. Under the Allotment Agreement and Management Agreement, the fees for 30 June 2001 as shown in the table in paragraph 31 will be incurred on the execution of that Agreement. The fees are charged for providing services to a Grower by 30 June 2001 where the Grower invests on or before 10 June 2001. In particular, the fees for licence and administration and management are expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that these fees have been inflated to result in reduced fees being payable for subsequent years.

81. There is also no evidence that might suggest the services covered by these fees could not be provided in the same year of income as the expenditures in question are incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the fees for licence and administration and management are for the doing of 'things' that are not to be wholly done within the year of income of these fees being incurred. On this basis, the basic precondition for the operation of the prepayment provisions is not satisfied and the fees will be deductible in the year in which they are incurred.

Growers who choose to pay fees for a period in excess of that required by the Project's agreements

82. Although not required under either the Allotment Agreement or Management Agreement, a Grower participating in the Project may

choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 80 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

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

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

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

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

86. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Grower is a 'small business taxpayer' or section 82KZMD if the Grower is not a 'small business taxpayer'. For a 'small business taxpayer' (see paragraphs 88 to 90) the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same, or effectively the same as that shown in paragraph 84 above, concerning section 82KZMF.

87. A prepaid fee of less than $1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(7) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than $1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of a prepaid fee is $1,000 or more, then the amount and

timing of the deduction allowable must be determined using the formula shown above.

Small business taxpayers

88. 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.

89. '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).

90. 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'.

Interest deductibility

91. 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.

92. 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.

93. 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. Where a prepayment is for more than 13 months, any tax deduction that may be allowable must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a

'small business taxpayer'). The relevant formula is the same, or effectively the same as that shown above in paragraph 84 above.

Section 82KL

94. 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

95. 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).

96. The Carina Park Almond Stage 3 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 38 and 41 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.

97. 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 almonds. 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.

Example

Example 1 – entitlement to 'input tax credit'

98. 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).

Detailed contents list

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

Commissioner of Taxation
30 May 2001

Previous draft:
Not previously issued in draft form

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

Subject references:
- carrying on a business
- commencement of business
- management fee expenses
- producing assessable income
- product rulings

- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(1)(b)
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 70-35
- ITAA 1997 387-165
- ITAA 1997 387-185
- ITAA 1997 387-210
- ITAA 1997 Subdiv 387-C
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
- ITAA 1936 82KH(1)
- ITAA 1936 82KL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- Corporations Law 708(1)
- Corporations Law 708(2)
- Corporations Law 708(3)
- Corporations Law 708(4)
- Corporations Law 708(5)
- Corporations Law 708(6)
- Corporations Law 708(7)
- Corporations Law 708(8)
- Corporations Law 708(9)
- Corporations Law 708(10)
- Corporations Law 708(11)
- Corporations Law 708(11)(a)
- Corporations Law 708(11)(b)
- Corporations Law 708(11)(h)

ATO References
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