



PR 2002/10 - Income tax: Soho Lemon Farm Project (revised arrangement)

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Product Ruling

Income tax: Soho Lemon Farm Project (revised arrangement)

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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 PR1999/95 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. 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.

Participants 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 participants 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, participants lose the protection of this Product Ruling. Participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'Tax law' identified below applies to the defined class of persons, who took part in the arrangement to which this Ruling relates. In this Ruling, this arrangement is sometimes referred to as the Soho Lemon Farm Project (revised arrangement), or just simply as 'the Project', or the 'product'.

Tax law

2. The tax law dealt with in this Ruling is:
- Division 35 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Changes in the Law

3. The Government is currently evaluating further changes to the tax system in response to the Ralph Review of Business Taxation and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.
4. Taxpayers who participated in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to Promoters and Advisers

5. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

6. The class of persons to whom this Ruling applies is those who entered into the arrangement described below between 16 June 1999 and 30 June 2000. They will have had a purpose of staying in the arrangement until it is completed (ie. 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'.

7. The class of persons to whom this Ruling applies does not include persons who have terminated or 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

8. The Commissioner rules on the precise arrangement identified in this Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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Date of effect

10. This Ruling applies prospectively from 30 January 2002 for Growers who entered into the specified arrangement as set out below between 16 June 1999 and 30 June 2000. 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).

11. 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 commenced, 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

12. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. Even following its withdrawal, this Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specified arrangement that is set out below between 16 June 1999 and 30 June 2000. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 10 September 2001;
- Prospectus dated 21 April 1999 and issued by Soho Lemon Management Limited (SLML) ('the Manager') (replaced by ARG Management Ltd on 18 August 2000);
- Draft Constitution of the Soho Lemon Farm Project;
- **Draft Management Agreement between a Grower and Soho Lemon Management Limited (replaced by ARG Management Ltd on 18 August 2000);**
- Head Lease between Tidak Saja Pty Ltd, the Landowner and SLML terminated on 9 April 2001;
- Replacement Head Lease between Pirawell Pty Ltd, the Landholder and ARG Management Ltd dated 9 April 2001;
- **Draft Plantation Lease between SLML (replaced by ARG Management Ltd on 18 August 2000), the Lessor, and the Grower;**
- Draft Custody Agreement;
- Draft Compliance Plan provided on 10 May 1999; and
- Additional correspondence received from the applicant dated 10 September 2001, 30 October 2001, 15 November 2001, 7 December 2001 and 11 January 2002.

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.

14. The documents highlighted in paragraph 13 in bold are those that may have been entered into by the Grower. There are no other agreements, whether formal or informal, and whether or not legally enforceable, to which the Grower or any associate of the Grower is, or was a party.

15. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

Overview

16. The Constitution established a managed investment scheme known as the Soho Lemon Farm Project (clause 2).

Location	Near Drysdale on the Bellarine Peninsula, Port Phillip Bay, in Victoria
Type of business each participant is carrying on	A long term commercial citriculture business.
Number of hectares under cultivation	Up to a maximum 77 hectares
Size of each Plantation Allotment	0.1 hectare
Number of lemon trees per hectare	880
Minimum number of Plantation Allotments	34
The term of the project in years	15 years
Initial cost per Grower	\$15,000.
Initial costs on a per hectare basis	\$150,000.
2 nd year's costs per Grower	\$828.
3 rd year's costs per Grower	\$1,679 plus GST if applicable.
Ongoing costs per Grower	Ongoing Management Fees, Rent and Rates.

17. The Prospectus for the Project, lodged with the ASIC on 21 April 1999, described the main features of the scheme. The Prospectus stated the Project, through the Manager, sought to raise \$19.2 million by offering participants ('Growers') the opportunity to

lease land on the Bellarine Peninsula, Victoria on which plantations of Lisbon lemon trees would be established on 128 hectares.

Approximately 880 trees were planted on each hectare of the Plantation Land.

18. The minimum fee is \$15,000 and the minimum area leased by a Grower was 0.1 hectare, which is referred to as a Plantation Allotment (clause 1.1(ab), Project Constitution).

19. The Manager may have accepted oversubscriptions subject to the availability of suitable land. The minimum amount to be raised under the Prospectus was \$500,000 which is equivalent to 34 Plantation Allotments. Minimum subscription was achieved.

20. The Project Constitution provided how a Grower acquired an interest in the Project. Once registered as the holder of an Interest, a Grower has no right to withdraw from the Project or to require the Responsible Entity to purchase its Interest (clause 9, Project Constitution).

The Plantation Lease

21. The Plantation Lease provided for a Grower to lease a minimum of 0.1 hectares of the Project Land from the Manager.

22. The Project Land was originally leased by the Manager from an entity known as Tidak Saja Pty Ltd through a Head Lease Agreement. The Project Land consisted of the whole of the land described in Certificate of Title Volume 10334 Folio 333 and part of the land described in Certificate of Title Volume 9249 Folio 248, which together comprise approximately 128 hectares (clause 1.1(ah), Plantation Lease). However this lease was terminated on 9 April 2001 when a new Head Lease was executed. The new Head Lease provided for the replacement Manager (ARG Management Ltd) to lease the Project Land from the new Landowner (Pirawell Pty Ltd). The Project Land was reduced in size to approximately 77.1ha and is described in the sale of land contract as Lot 2 of PS 44089D on part of land Vol 9249 Fol 248.

23. A Schedule in the Plantation Lease specified the Plantation Allotment(s) leased by a Grower, the annual rent payable of \$50 per allotment increasing by 2.5% per annum from 1 July 2003, and the term of the lease, which will be approximately 15 years terminating on 30 June 2014. Rent will be payable in advance on 30 June each year. A Grower is also liable for a portion of rates and taxes in relation to the Project Land.

24. The agreement set out the Grower's obligations, which included pruning of the lemon trees, irrigation and fertilisation, soil management and maintenance of any buildings, sheds, firebreaks,

windbreaks, fences, access roads or tracks on the Plantation Allotment (clause 10).

25. Growers engaged the Manager pursuant to the Management Agreement to develop and manage the Grower's Plantation and to harvest and sell the lemons on the Grower's behalf (clause 8.2, Plantation Lease).

The Management Agreement

26. The Management Agreement is between each Grower and the Manager. In consideration of the fees payable by the Grower, the Manager will provide to the Grower the services and obligations as provided in this Agreement in accordance with the Management Plan.

27. Under clause 4.1 of this Agreement, the Manager will implement the Management Plan and perform or cause to be performed the following Services in relation to the Plantation Allotment and the Plantation Trees in accordance with Best Citricultural Practice:

- earthworks including construction of bench rows, dams, channels, culverts and drains;
- establishment of windbreaks and construction of access roads and tracks;
- installation and maintenance of irrigation system;
- soil cultivation, planting, establishment and management of the Plantation Trees in accordance with the Management Plan;
- tending, maintaining and generally monitoring and caring for the Plantation Trees so as to ensure as far as is reasonable the health and vigour of the Plantation Crop;
- complying with and obeying all Acts and regulations, by-laws, orders, ordinances and rules made in respect of or applying to the use or occupancy of the Plantation Allotment and in particular provision of sufficient healthy lemon tree root stock to achieve the stocking rate set out in the Schedule;
- prompt repair of all damage done to any roads, tracks or fences on the Plantation Allotment or on abutting land resulting from the actions of the Manager or its contractors or their respective employees;
- securing of the entrances to the Plantation Allotment in order to prevent trespassers entering the Plantation

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Allotment and the taking of such other security measures as appears appropriate; and

- maintenance of insurance policies.

28. The Manager will also be responsible for the harvesting, marketing and sale of the plantation crop on behalf of the Grower. For this service, Growers will be liable for a marketing fee that is equal to ten per cent of the gross proceeds of sale of the plantation crop (clause 10).

Fees per Plantation Allotment

29. Having regard to the contractual terms of the Plantation Lease and Management Agreements, the fees payable in the first three years per 0.1 hectare by a participant in the Project are as follows:

	Year 1	Year 2	Year 3
Management fee	\$13,273	\$750	\$1,600
Irrigation	\$760	Nil	Nil
Plant costs	\$747	Nil	Nil
Windbreaks	\$144	Nil	Nil
Rent	\$50	\$50	\$50
Rates (estimate)	\$26	\$28	\$29
Total	\$15,000	\$828	\$1,679

Finance

30. Growers were able to fund the investment themselves or borrow from an unassociated lending institution. No entity or related entity involved in the Project is or was involved in the provision of finance for the Project.

31. This Ruling does not apply if the finance arrangement entered into by the Grower 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

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

Section 35-55 – Commissioner’s discretion

32. For a Grower who is an individual and who entered the Project between 16 June 1999 and 30 June 2000, 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 has decided for the income years ended 30 June 2001 to 30 June 2005 inclusive that the rule in section 35-10 does not apply to this business activity. This is provided that the Project has been, and continues during the remainder of the term of the Project to be carried on in a manner that is not materially different to the arrangement described above in this Ruling.

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

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 39 in the Explanations part of this Ruling, below).
- a Grower’s business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the Grower’s business activity produces assessable income for the income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or

- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

34. Where, the 'exception' in subsection 35-10(4) applies, the Grower's business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, 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.

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

Explanations

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

36. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2) a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

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

37. 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.

38. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

39. For the purposes of applying Division 35, 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 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 participated in the Project they are beyond the scope of this Product Ruling and are not considered further.

40. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) that 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, or an interest in real property, (excluding any private dwelling) 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 (excluding cars, motor cycles and similar vehicles) is used on a continuing basis in carrying on the business activity in that year (section 35-45).

41. A Grower, who was accepted into the Project between 16 June 1999 and 30 June 2000 and who has participated in the Project since the date of their acceptance into the Project, is carrying on a business activity that is subject to these provisions.

42. Information provided with the application for this Product Ruling and additional information provided since, indicates that a Grower who acquired 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 2008. Growers who acquired more than one interest in the Project may however, find that their business activity meets one of the tests in an earlier year.

43. 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 any loss that arises from the Grower's participation in the Project.

44. 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, 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;
- (ii) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

45. The information provided by the applicant indicates that a Grower who acquired the minimum allocation of one interest in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2006. The Commissioner has decided for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2005. Subsection 35-55(2) prevents the Commissioner exercising the discretion for these Growers beyond the year ended 30 June 2005.

46. The applicant has stated that the business activity comprised by a Grower's involvement in this Project has started to be carried on, and will continue to be carried on in a manner that is not materially different to that described in the Arrangement section of this Product Ruling. If however, the Project is not carried on during the income years specified above (see paragraph 32), in the manner described in the Arrangement section, this Ruling may be affected. Specifically, the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected because the Ruling no longer applies (see paragraph 8). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

47. In deciding to exercise the discretion in paragraph 35-55(1)(b) the Commissioner has relied upon:

- the financial projections and information contained in the Prospectus;
- updated financial position pertaining to an individual participant in the revised project; and
- independent, objective, and generally available information relating to the citrus industry.

Detailed contents list

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Commissioner of Taxation
30 January 2002

Previous Draft:

Not previously released in draft form

- management fees expenses
- non-commercial losses
- primary production expenses
- producing assessable income
- product rulings
- public rulings

Related Rulings/Determinations:

TR 92/1; TR 97/16; PR 1999/95, PR 1999/60

Subject references:

- citricultural expenses
- citriculture
- lemon trees

Legislative references:

- ITAA 1997 8-1
- ITAA 1997 Div 35
- ITAA 1997 35-10

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- 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 35-55(2)
 - ITAA 1936 Part IVA
 - ITAA 1936 82KL
-

ATO references:

NO: T2002/000963

BO:

ISSN: 1441 1172