



PR 2002/110 - Income tax: Kailis Organic Olive Groves

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 This document has changed over time. This is a consolidated version of the ruling which was published on 4 September 2002



Product Ruling

Income tax: Kailis Organic Olive Groves

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Potential participants 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 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.

Potential 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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential 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. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential 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 laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as 'Kailis Organic Olive Groves' or simply as 'the Project'.

Tax laws

2. The tax laws 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);
 - Division 35 (ITAA 1997);
 - Division 40 (ITAA 1997);
 - Division 70 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZL (ITAA 1936);
 - section 82KZME (ITAA 1936);
 - section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

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 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.

5. Taxpayers who are considering participating 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 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

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified 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. In this Ruling, each of these persons, referred to as 'Growers', will be wholesale clients for the purpose of the Corporations Act 2001 or will have accepted an offer which qualifies as a small scale offer for the purpose of the Corporations Act 2001.

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.

9. Growers who elect to market their own produce are excluded from the class of persons to whom this Ruling applies (see paragraphs 41 and 47).

Qualifications

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

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Date of effect

12. This Ruling applies prospectively from 4 September 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

13. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it 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

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2005. 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 arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal,

who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

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

- application for a Product Ruling for Kailis Organic Olive Groves dated 24 April 2002;
- Draft Information Memorandum for Kailis Organic Olive Groves - 2002/2003 Stage 2, dated 20 August 2002;
- Draft **Project Deed** for Kailis Organic Olive Groves, dated 20 August 2002;
- Draft **Lease and Management Agreement** between Organic Olive Management Ltd (the 'Manager'), Kailis Organic Olive Groves Ltd (the 'Lessor') and the Grower, dated 20 August 2002;
- Draft **Investment Agreement** between Organic Olive Management Ltd (the 'Manager'), Kailis Organic Olive Groves Ltd (the 'Lessor') and the Grower, dated 20 August 2002;
- additional correspondence from the Applicant dated 1 August 2002, 2 August 2002, 7 August 2002 and 21 August 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 the Freedom of Information legislation.

16. The documents highlighted are those that the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

17. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client or have accepted an offer that is a small scale offering. **This Ruling does not apply unless:**

- the Grower is a wholesale client as defined in section 761G of the Corporations Act 2001; or

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- not being a retail client, the Grower has accepted a 'personal offer' of a small scale offering for the purposes of the Corporations Act 2001.

18. Each of these categories is explained in paragraphs 72 to 79 in the Explanations area of this Product Ruling.

Overview

19. The salient features of the arrangement for Kailis Organic Olive Groves are:

Location	Preston Valley region of Western Australia.
Type of business each participant is carrying on	Commercial growing, and cultivation of olive trees, using organic farming techniques for the purpose of producing premium organic olives.
Number of hectares available for cultivation under this offer	206 hectares
Size of each leased area (Grove)	2 hectares
Minimum subscription	44 Groves (88 hectares)
Number of trees per hectare	333
Expected production	18,315 kg per hectare at full production.
Term of the Project	Approximately 20 years.
Initial cost per Grove	\$158,512 over 3 years comprising \$88,512 in the Project and \$70,000 for shares in KOOG Ltd.
Initial cost per hectare	\$79,256
Ongoing costs	Annual lease, management and harvesting fees. Optional insurance costs.

20. The Project is detailed in an Information Memorandum issued by Kailis Organic Olive Groves Ltd ('KOOG Ltd'). The Project will be conducted on land in the Preston Valley region of Western Australia described as:

- Wellington Locations 3706 Volume 1570 Folio 197, 3707 Volume 1573 Folio 883, 3708 Volume 1170 Folio 472 and 2524 Volume 1170 Folio 539.

21. The Lease and Management Agreement provides for an area of land called a 'Grove' to be sub-let to the Grower for a term of approximately 20 years. Each Grove is an area of 2 hectares. Each Grower will be provided with a plan identifying their leased grove(s).

22. This offer pertains to 206 hectares representing 103 Groves. There is a minimum subscription of 44 Groves which must be achieved by 31 March 2003. Under this offer, Growers may enter the Project in either the 2002/2003 income year (defined as a '2003 Grower' for the purposes of this Ruling) or the 2003/2004 income year ('2004 Grower'). Applications to become 2003 Growers must be accepted by 31 March 2003. Applications will not be accepted after 31 March 2004. **However, this Ruling only applies to 2003 Growers.**

23. Each Grower must also subscribe for 200,000 shares in KOOG Ltd at an issue price of \$0.35 per share, for a total cost of \$70,000.

24. Growers enter into a contract with the Project's Manager for the management of their Grove(s). The Manager will be responsible for establishing and cultivating the olive trees and for harvesting and marketing the olive produce on behalf of Growers unless a Grower elects to collect and sell their own produce. The Project will obtain organic certification and maintain organic status for the life of the Project.

25. Upon application, Growers will execute a Power of Attorney, enabling the Manager to act on their behalf as required. The Project is of a long term nature and subject to certain agricultural risks such as the weather, natural disasters and pest infestations, as well as financial and general commercial market risks.

Project Deed

26. The Project Deed is between KOOG Ltd (the 'Lessor'), Organic Olive Management Ltd (the 'Manager') and each Grower. The agreement sets out the key components of the Project together with the administrative rules under which the parties are required to operate.

27. It is a requirement of the agreement that Growers enter into a Lease and Management Agreement. A register of Growers will be maintained as part of the agreement. Growers are bound by the Project Deed by virtue of their participation in the Project.

Lease and Management Agreement

28. Growers participating in the arrangement will enter into a Lease and Management Agreement between Organic Olive Management Ltd (the 'Manager'), KOOG Ltd (the 'Lessor') and the Grower. Growers are granted an interest in land in the form of a lease to use their Grove for the purpose of conducting a commercial horticulture business. The term of the agreement is until the earlier of 30 June 2023 or the date that the final distribution of the sales proceeds of the 2022/2023 crop is made to the Grower, unless terminated earlier.

36. Each Member must pay Rent to the Lessor during the term of the Project in an amount specified at Items 3 and 5 of the Schedule to the Lease and Management Agreement (clause 4.1).

29. Growers contract with the Manager to cultivate and care for the olive trees in accordance with approved horticultural practices for the production of organically grown olives (clause 5.2). Growers pay a management fee on application and annual management fees thereafter.

30. Pursuant to the terms of the Lease and Management Agreement, the Grower appoints the Manager to perform services specified in the agreement (clause 13.1). The services are specified in Item 10 of the Schedule to the Lease and Management Agreement. The Manager will carry out the following services under this agreement:

- establish olive trees on the leased grove at a rate of not less than 333 per hectare;
- install and maintain the micro sprinkler or trickle irrigation system to the trees in the leased grove;
- cultivate, tend, train, prune, fertilise, replant, spray and otherwise care for the trees as and when required;
- keep in good repair access laneways within the leased grove;
- use all reasonable measures to keep the leased grove free from vermin, weeds, pests and diseases;
- maintain in good repair and condition adequate firebreaks in and about the leased grove;
- maintain the leased grove according to sound organic horticultural practices;
- replace any trees that fail to establish or that die during the first 3 years of the Project;

- harvest the olives grown on the leased grove each year and deliver them to the processor; and
- market and sell the olive produce on behalf of the Grower.

Costs of Participation

31. Under the Lease and Management Agreement, the following amounts are payable per 2 hectare Grove:

Fee Type	Year ended 30/6/2003	Year ended 30/6/2004	Year ended 30/6/2005
Management Fee	\$8,489.80	\$15,327.40	\$15,787.20
Irrigation	\$11,000.00		
Horticultural Plant Establishment	\$10,453.30		
Rent	\$1,208.90	\$2,988.70	\$3,077.80
Trellising & Staking	\$748.00		
Shares	\$50,000.00	\$20,000.00	
TOTALS	\$81,900.00	\$38,316.10	\$18,865.00

32. The amounts shown for the year ended 30 June 2003 are payable on Application. The total of \$81,900 is represented as:

- Management Fees of \$8,489.80 for services to be performed during the 'Initial Period' (being the period from the commencement date to 30 June 2003);
- Rent of \$1,208.90 for the Initial Period;
- \$22,201.30 for capital expenditure to be completed during the Initial Period; and
- Shares of \$50,000 (being 200,000 partly paid to \$0.25 cents).

33. A further instalment of \$20,000 is payable by 30 September 2003 for the purchase price of shares (200,000 @ \$0.10 cents).

34. Annual Management Fees and Rent are payable on or before 30 September in each relevant year after the Initial Period. For the year commencing 1 July 2005 and each year thereafter, the amounts payable will be indexed at the greater of 3% or the annual rate of inflation.

35. The Grower is required to pay an annual Harvesting fee by 30 June of each year of harvesting. The amount payable will be in accordance with sub-clause 22.1(2).

36. Where possible, Annual Management Fees, Rent and Harvesting fees will be deducted from the sales proceeds of each Grower's olives.

37. The Manager will maintain a public risk insurance policy in respect of the Grove at its own cost. If so requested by the Grower, the Manager will use its best endeavours to arrange insurance of the trees and olive produce on the leased grove against destruction or damage by fire. The Grower will bear the cost of such additional insurance (clause 21.3).

Planting

38. If minimum subscription is achieved by 31 March 2003, establishment of Growers leased groves will take place during the Initial Period.

39. For 2003 Growers, the Manager will plant out approximately 666 olive trees per Grove (333 per hectare) during the Initial Period. The species to be planted are detailed in the Information Memorandum. After the planting has been completed, the Manager will maintain the trees in accordance with sound horticultural practices. Any trees that fail to establish or die within the first 3 years of the Project will be replaced at the Manager's expense. The services to be provided by the Manager over the term of the Project are specified at paragraph 30 above.

Harvesting and Sale

40. The Grower shall at all times have full right, title and interest in the olive produce from the leased grove and the right to have the olive produce sold for their benefit (clause 9.3).

41. The Manager will be responsible for arranging the harvesting of the olive fruit at such time or times as in the opinion of the Manager will maximise the return to the Grower. Prior to 31 December in each year, each Grower may notify the Manager in writing that the Grower elects to collect and market their own produce (clause 18.1). This Ruling does not apply to Growers who make such an election.

42. The Manager will sell the olive produce on behalf of the 'Non-Electing Growers' for the highest practicable price and ensure that any agreement for the sale of the produce is in the best interests of the Grower (clause 19.2). The Manager shall enter into forward sales

agreements in respect of olives harvested from the Olive Groves if so instructed by a majority of owners of the Grove's interests (clause 3.4(5) of the Project Deed.

43. The Sale Proceeds of the olive produce will be paid into the Produce Fund. The Manager is entitled to retain a harvesting fee and after deducting any other amounts payable under clauses 20.3 and 20.5, the Non-Electing Growers will share the Net Sale Proceeds according to their Proportional Interest in the Project. The term 'Proportional Interest' is defined in clause 1 of the Lease and Management Agreement.

Finance

44. All Growers are required to fund their involvement in the Project themselves or borrow from an independent lender.

45. 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

Application of this Ruling

46. This Ruling applies only to Growers who are accepted to participate in the Project on or before 31 March 2003 and who have executed a Lease and Management Agreement on or before that date.

47. The Grower's participation in the Project must constitute the carrying on of a business of primary production. This Ruling does not apply to those Growers who elect to market their own produce or who enter into finance arrangements with the Manager or an associate of the Manager.

Minimum subscription

48. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the Information Memorandum, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 44 Groves is achieved. The minimum subscription is required to be achieved by 31 March 2003.

The Simplified Tax System ('STS')

Division 328

49. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

50. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not ‘STS taxpayers’**Assessable Income*****Section 6-5***

51. That part of the gross sales proceeds from the Project attributable to the Grower’s produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

52. The Grower recognises ordinary income from carrying on the business of horticulture at the time that income is derived.

Trading Stock***Section 70-35***

53. A Grower who is not an ‘STS taxpayer’ may, in some years, hold olives and/or olive products that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Grower must include the amount of that excess in assessable income.

54. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Grower may claim the amount of that excess as an allowable deduction.

Deductions for Management Fees and Rent***Section 8-1***

55. A 2003 Grower who is not an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses on a per Grove basis:

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Management Fee	8-1	\$8,489.80 See Notes (i) & (ii) below	\$15,327.40 See Notes (i) & (ii) below	\$15,787.20 See Notes (i) & (ii) below
Rent	8-1	\$1,208.90 See Notes (i) & (ii) below	\$2,988.70 See Notes (i) & (ii) below	\$3,077.80 See Notes (i) & (ii) below

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Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 132.
- (ii) The Management Fees and the Rent shown in the Lease and Management Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 106 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Deductions for capital expenditure

Division 40

56. A 2003 Grower who is not an "STS taxpayer" will also be entitled to tax deductions relating to the irrigation system (water facilities) and the establishment of the olive trees. All deductions shown in the following table are determined under Division 40.

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Irrigation	40-515	\$3,667 See Notes (i) above & (iii) below	\$3,667 See Notes (i) above & (iii) below	\$3,666 See Notes (i) above & (iii) below
Establishment of horticultural plants	40-515	Nil See Notes (i) above & (iv) below	Nil See Notes (i) above & (iv) below	Nil See Notes (i) above & (iv) below
Staking	40-25	Amount must be calculated – See Notes (i) above & (v) & (vi) below	Amount must be calculated – See Notes (i) above & (v) & (vi) below	Amount must be calculated – See Notes (i) above & (v) & (vi) below

Notes:

- (iii) Any **irrigation system**, dam or bore is a ‘water facility’ as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the ‘water facility’ in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).
- (iv) Olive trees are a ‘**horticultural plant**’ as defined in subsection 40-525(2). As Growers hold the land under a lease, one of the conditions in subsection 40-525(2) is met and a deduction for ‘horticultural plants’ is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the olive trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. The olive trees have an ‘effective life’ of greater than 30 years for the purposes of section 40-545. This results in a straight-line write-off at a rate of 7%. The deduction is allowable when the olive trees enter their first commercial season (section 40-530, item 2). The Manager will inform Growers of when the olive trees enter their first commercial season.

- (v) **Stakes** are a 'depreciating asset'. **Where a Grower acquires the minimum allocation of one Grove**, each Grower will hold an interest in staking which is a 'low-cost asset' and can be allocated to a 'low-value pool'. Once any 'low-cost asset' of a Grower is allocated to a 'low-value pool', all other 'low-cost assets' the Grower starts to 'hold' in that year or a later year must be allocated to that pool. If the Grower has already allocated an asset to a 'low-value pool', the staking assets would also have to be allocated to that pool. Otherwise, the Grower must decide whether to create a 'low-value pool'. If the assets are allocated to a 'low-value pool', the capital expenditure on the stakes will be deducted under the diminishing value methodology of the pool based on a rate of 18.75% in the year the staking is first used and a rate of 37.5% in subsequent years (section 40-440). If the assets are not allocated to a 'low-value pool', they can be written off based on the 'life' of the staking. As there has been no determination of the 'effective life' of stakes by the Commissioner, Growers must self-assess an 'effective life'. Staking is not installed until the olive trees are planted and no deduction for the decline in value is available until this installation occurs. Staking will be installed and first used during the year ended 30 June 2003. The Manager will advise Growers of the relevant date of installation to enable them to calculate the deduction.
- (vi) **Stakes** are a 'depreciating asset'. **Where a Grower acquires more than the minimum allocation of one Grove** each Grower's interest in the staking is a 'depreciating asset'. The 'cost' of the asset is the amount paid by each Grower. The decline in value of the asset is calculated using the formula in either subsection 40-70(1) ('diminishing value method') or subsection 40-75(1) ('prime cost method'). Both formulae rely on the 'effective life' of the staking. As there has been no determination of the 'effective life' of stakes by the Commissioner, Growers must self-assess an 'effective life'. Staking will be installed and first used during the year ended 30 June 2003. The Manager will advise Growers when that occurs to enable Growers to calculate the deduction for the decline in value.

Tax outcomes for Growers who are ‘STS taxpayers’**Assessable Income*****Section 6-5 and section 328-105***

57. That part of the gross sales proceeds from the Project attributable to the Grower’s produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

58. The Grower recognises ordinary income from carrying on the business of horticulture at the time the income is received (paragraph 328-105(1)(a)).

Treatment of Trading Stock***Section 328-285***

59. A Grower who is an ‘STS taxpayer’ may, in some years, hold olives and/or olive produce that will constitute trading stock on hand. Where, for such a Grower, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than \$5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

60. Alternatively, a Grower who is an ‘STS taxpayer’ may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

Deductions for Management Fees and Rent***Section 8-1 and section 328-105***

61. A 2003 Grower who is an ‘STS taxpayer’ may claim tax deductions for the revenue expenses in the following table. However, if for any reason, an amount shown in the Table below is not fully paid in the year in which it is incurred by a Grower who is an ‘STS taxpayer’ then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

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Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Management Fee	8-1 & 328-105	\$8,489.80 See Notes (vii) & (viii) below	\$15,327.40 See Notes (vii) & (viii) below	\$15,787.20 See Notes (vii) & (viii) below
Rent	8-1 & 328-105	\$1,208.90 See Notes (vii) & (viii) below	\$2,988.70 See Notes (vii) & (viii) below	\$3,077.80 See Notes (vii) & (viii) below

Notes:

- (vii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 132.
- (viii) Where a Grower who is an 'STS taxpayer', pays the management fees and the rent in the relevant income years shown in the Management Agreement and the Grove Lease, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment 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 paragraph 106, unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Deductions for capital expenditure***Subdivision 328-D and Subdivision 40-F***

62. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to staking, water facilities (e.g., irrigation) and olive trees. Deductions relating to the cost of staking must be determined under Division 328. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F. If the 'water facility' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under

Division 328. Deductions for the olive trees must be determined under Subdivision 40-F.

63. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities under Subdivisions 40-F and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Note (xii) below.

64. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Irrigation	40-515	\$3,667 See Notes (vii) above & (ix) below	\$3,667 See Notes (vii) above & (ix) below	\$3,666 See Notes (vii) above & (ix) below
Establishment of horticultural plants	40-515	Nil See Notes (vii) above & (x) below	Nil See Notes (vii) above & (x) below	Nil See Notes (vii) above & (x) below
Staking (one Grove)	328-180	\$748 See Notes (vii) above & (xi) below	Nil See Note (xi) below	Nil See Note (xi) below
Staking (multiple Groves)	328-185 & 328-190	Amount must be calculated – See Notes (vii) above & (xii) below	Amount must be calculated – See Notes (vii) above & (xii) below	Amount must be calculated – See Notes (vii) above & (xii) below

Notes:

- (ix) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of

Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2003 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

- (x) Olive trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the olive trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the olive trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the olive trees enter their first commercial season (section 40-530, item 2). The Manager will inform Growers of when the olive trees enter their first commercial season.
- (xi) **Stakes** are a 'depreciating asset'. **Where a Grower acquires the minimum allocation of one Grove**, each Grower will hold an interest in staking which is a 'low-cost asset' as defined in subsection 40-525(2). It cannot be allocated to the 'general STS pool' (section

328-180). A deduction equal to the amount of the Grower's expenditure for the staking is available in the income year in which they are used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset or has it 'installed ready for use' to produce assessable income.

- (xii) **Stakes** are a 'depreciating asset'. **Where a Grower acquires more than the minimum allocation of one Grove** each Grower's interest in the staking is a 'depreciating asset' which can be allocated to a 'general STS pool'. The 'cost' of the asset is the amount paid by each Grower. The tax deduction allowable is determined in the year ended 30 June 2003 by multiplying the 'cost' of the interest by half the 'general STS pool rate, i.e., by 15%. Each Grower's interest in the staking is allocated to their 'general STS pool' at the end of the year ended 30 June 2003 and that part of the 'cost' not deducted in the first year is added to the pool balance. In subsequent years, the full pool rate of 30% will apply.

Tax outcomes that apply to all Growers

Shares

65. The purchase price of shares in KOOG Ltd cannot be claimed as a tax deduction as it is of a capital nature.

Interest

66. The deductibility or otherwise 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. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 101 to 106 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Division 35 – Deferral of losses from non-commercial business activities***Section 35-55 – Commissioner’s discretion***

67. For a Non-Electing Grower who is an individual and who enters the Project during the year ended 30 June 2003 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 2003 to 30 June 2008 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.

68. 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 120 in the Explanations part of this ruling, below); or
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45.

69. 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.

70. 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.

Sections 82KZME – 82KZMF, 82KL and Part IVA

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

- expenditure by a Grower who participates in the Project does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 101 to 107);

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Corporations Act 2001

72. For this Ruling to apply, an offer for an interest in the Project must:

- have been made to, and accepted by a Grower, who qualifies as a wholesale client as defined in section 761G of the Corporations Act 2001; or
- be an offer which qualifies as a small scale offering as defined in section 1012E of the Corporations Act 2001.

73. Small scale offers and offers to wholesale clients do not require a prospectus or product disclosure statement.

74. A Grower in the Project may be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the person satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c));
- the 'professional investor test' (paragraph 761G(7)(d)).

75. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'product value test' 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.

76. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'individual wealth test' where, 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:

- has net assets of at least \$2.5 million; or
- has a gross income for each of the last 2 financial years of at least \$250,000 a year.

77. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'investor test' where:

- the person is a financial services licensee or:
- the person controls at least \$10 million for the purposes of investment in securities.

78. Alternatively, under section 1012E, a Grower may participate in the project by accepting a 'personal offer' for an interest in the project. Offers made under section 1012E 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 (subsection 1012E(2)).

79. An offer will be a 'personal offer' where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 1012E(5)).

Is the Grower carrying on a business?

80. For the amounts set out in the Tables above to constitute allowable deductions the Grower's horticulture activities as a participant in the Kailis Organic Olive Groves must amount to the carrying on of a business of primary production. These horticulture activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

81. For schemes such as that of the Kailis Organic Olive Groves, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929, (1984) 15 ATR 932.

82. Generally, a Grower will be carrying on a business of horticulture, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's olive trees are established;

- the Grower has a right to harvest and sell the olives each year from those olive trees;
- the horticulture activities are carried out on the Grower's behalf;
- the horticulture activities of the Grower are typical of those associated with a horticulture business; and
- the weight and influence of general indicators point to the carrying on of a business.

83. In this Project, each Grower enters into a Lease and Management Agreement. Under the agreement each individual Grower will have rights over a specific and identifiable area of land. The agreement provides the Grower with an ongoing interest in the specific olive trees on the leased area for the term of the Project. Under the lease the Grower must use the land in question for the purpose of carrying out horticultural activities and for no other purpose. The lease allows the Manager to come onto the land to carry out its obligations under the agreement.

84. Under the Lease and Management Agreement the Manager is engaged by the Grower to establish and maintain a Grove on the Grower's identifiable area of land during the term of the Project. The Manager has provided evidence that it has access to the appropriate professional skills and credentials to provide the management services to establish and maintain the Grove on the Grower's behalf.

85. In establishing the Grove, the Grower engages the Manager to install irrigation and to acquire and plant seedlings on the Growers Grove. During the term of the Project these assets will be used wholly to carry out the Grower's horticultural activities. The Manager is also engaged to harvest and sell, on the Grower's behalf, the olives grown on the Grower's Grove.

86. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the Project's description for all the indicators.

87. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of its olives and/or olive produce that will return a before-tax profit, i.e., a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

88. The pooling of olives grown on the Grower's Grove with the olives of other Growers is consistent with general horticultural practices. Each Grower's proportionate share of the sale proceeds of

the pooled olives will reflect the proportion of the olives contributed from their Grove.

89. The Project Manager's services and the installation of assets on the Grower's behalf are also consistent with general horticultural practices. The assets are of the type ordinarily used in carrying on a business of horticulture. While the size of a Grove is relatively small, it is of a size and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

90. The Grower's degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the *Corporations Act (Cth)* 2001, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Grove and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

91. 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. For the purposes of this Ruling, the Growers' horticultural activities in the Kailis Organic Olive Groves will constitute the carrying on of a business.

The Simplified Tax System

Division 328

92. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

93. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Management Fees and Rent

Section 8-1

94. Consideration of whether the initial Management Fees and Rent 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 is contractually committed 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.

95. The Management Fees and Rent associated with the horticultural activities will relate to the gaining of income from the Grower's business of horticulture (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of olives) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. 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.

Possible application of prepayment provisions

96. Under the Lease and Management Agreement neither the Management Fees nor the Rent are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

97. However, where a Grower chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 101 to 107) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Timing of deductions

98. In the absence of any application of the prepayment provisions, the timing of deductions for the Management Fees or the Rent will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

99. If the Grower is not an 'STS taxpayer', the Management Fees and the Rent are deductible in the year in which they are incurred.

100. If the Grower is an 'STS taxpayer' the Management Fees and the Rent are deductible in the income year in which they are paid, or are paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Prepayment provisions*Sections 82KZL to 82KZMF*

101. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. 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 will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

102. For this Project only section 82KZL (an interpretative provision) and sections 82KZME and 82KZMF are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

103. Where the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure

is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

104. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either :
 - a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

105. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

106. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

107. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Application of the prepayment provisions to this Project

108. For each Grove in this Project, an initial Management Fee of \$8,489.80, Rent of \$1,208.90, Staking of \$748, a fee for horticultural plant establishment costs of \$10,453.30 and \$11,000 for irrigation costs will be incurred on execution of the Lease and Management Agreement. The Management Fee and the Rent are charged for providing management services and leasing land to a Grower by 30 June of the year of execution of the agreement. Under the agreement, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

109. In particular, the Management Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the initial Management Fee has been inflated to result in reduced fees being payable for Management Fees in subsequent years.

110. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial Management Fee, and the fees for subsequent years, is for the Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Lease and Management Agreement, Rent is payable annually on 30 September for the lease of the land during the expenditure year.

111. On this basis, provided a Grower incurs expenditure as required under the Project's agreement, as set out in paragraphs 31 to 35, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

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

112. Although not required under the Lease and Management Agreement, a Grower participating in the Project may choose to prepay fees for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 111 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

113. For these Growers, the amount and timing of deductions for any relevant prepaid Management Fees or prepaid Rent will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

Expenditure of a capital nature***Division 40 and Division 328***

114. Any part of the expenditure of a Grower 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 amounts summarised in the Tables at paragraphs 56 and 64 above, are considered to be capital in nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

115. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

116. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 56 and 64 (above), in the Tables and the accompanying Notes.

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

117. 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.

118. 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.

119. 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.

120. 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' 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.

121. 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) 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) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

122. 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 Non-Electing Grower who acquires the minimum allocation of one Grove in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2009. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

123. 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.

124. 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 the business activity has started to be carried on and for that, or those income years;

- because of its nature, the business activity has not satisfied, or will not satisfy one of the tests set out in Division 35; and
- 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.

125. Information provided with this Product Ruling indicates that a Non-Electing Grower who acquires the minimum investment of one Grove 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 2009. The Commissioner will decide for 2003 Growers that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2008.

126. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 67), in the manner described in the Arrangement (see paragraphs 15 to 45). If so, this Ruling, and 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 10). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

127. 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 Agricultural Report reproduced in the Information Memorandum; and
- independent, objective, and generally available information relating to the olive industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Manager.

Section 82KL - recouped expenditure

128. 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

129. 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).

130. The Kailis Organic Olive Groves 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 55, 56, 61 and 64, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

131. 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 their olives and/or olive produce. 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 at arm's length or, if any parties are not dealing 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 GST input tax credits**

132. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her afforestation business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2002 to 30/6/2002	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2002 (includes GST of \$600)	<u>\$6,600</u>

*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

$$\frac{1}{11} \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4,400 *less* \$400, or \$4,000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

$$\frac{1}{11} \times \$2,200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2,200 *less* \$200, or \$2,000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2,000 only, not one tenth of \$2,200).

Detailed contents list

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

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Previous draft:

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*Related Rulings/Determinations:*IT 360; TR 92/1; TR 92/20;
TD 93/34; TR 97/11; TR 97/16;
TR 98/22; PR 1999/95; TR 2000/8

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Subject references:

- carrying on a business
- commencement of business
- primary production
- primary production expenses
- 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

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