



# ***PR 2002/28 - Income tax: Forest Rewards Tropical Citrus Project 2002***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *20 March 2002*



## Product Ruling

### Income tax: Forest Rewards Tropical Citrus Project 2002

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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**

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

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

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

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

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

#### **Terms of use of this Product Ruling**

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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

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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 the 'Forest Rewards Tropical Citrus Project 2002' or simply as 'the Project'.

### Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - Section 8-1 (ITAA 1997);
  - Section 17-5 (ITAA 1997);
  - Division 27 (ITAA 1997);
  - 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 these persons are referred to as 'Growers'.

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

**Qualifications**

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

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

## Date of effect

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11. This Ruling applies prospectively from 20 March 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).

12. 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

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13. 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

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

- Application for a Product Ruling for Forest Rewards Tropical Citrus Project 2002;
- Draft Prospectus for Forest Rewards Tropical Citrus Project 2002, undated;

- **Draft Constitution for Forest Rewards Tropical Citrus Project 2002 , undated;**
- **Draft Management Agreement for Forest Rewards Tropical Citrus Project 2002 between Forest Rewards Management Pty Ltd [Manager], Forest Rewards Ltd [Responsible Entity] and the Grower, undated;**
- **Draft Sub-Lease Agreement for the Forest Rewards Tropical Citrus Project 2002 between Forest Lands Pty Ltd [the ‘Lessor’]; Forest Rewards Ltd [the ‘Responsible Entity] and the Grower, undated;**
- **Draft Forest Rewards Tropical Citrus Project 2002 Terms Agreement between Forest Rewards Management Pty Ltd [the Manager] and the Grower, dated 22 January 2002;**
- Draft Lease Agreement between Forest Lands Pty Ltd and the Landowner, undated;
- Compliance Plan for the Forest Rewards Tropical Citrus Project 2002; and
- Additional correspondence dated 13 February 2002, 21 February 2002, 26 February 2002 and 1 March 2002.

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

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

16. 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**

17. This arrangement is called the Forest Rewards Tropical Citrus Project 2002.

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Location	15 Kilometres west of Kununurra, Western Australia
Type of business each participant is carrying on	Commercial growing, and cultivation of citrus trees for producing grapefruit.
Number of hectares offered for cultivation	50
Name used to describe the product	Forest Rewards Tropical Citrus Project 2002
Size of each Grove	0.2 hectares
Number of trees per hectare	317
The term of the investment	18 years
Initial cost	\$11,000
Initial cost per hectare	\$55,000
Ongoing costs	Management fees and rent. Optional Insurance

18. The Project will be registered as a Managed Investment Scheme under the Corporations Act. The Responsible Entity for this Project is Forest Rewards Ltd. The Project Land is situated approximately 15 kilometres west of Kununurra in the Ord River Irrigation Area of Western Australia.

19. Growers participating in the Project will enter into a Sub-Lease Agreement and a Management Agreement. Forest Lands Pty Ltd has leased the Project land from the Landowner and will sub-lease the Grove to the Grower to enable the Grower to carry on the business of a citrus orchard for the commercial production of red grapefruit. Under the Sub-Lease, Growers lease an area of land called a 'Grove' for a term of approximately 18 years. Each Grove is 0.2 hectares in size.

20. Under this offer, Growers may enter the Project in either the 2001/2002 income year (defined as '2002 Growers' for the purposes of this Ruling) or the 2002/2003 income year ('2003 Growers'). For 2002 Growers, applications must be received by the Responsible Entity by 31 May 2002. However, the Responsible Entity may accept late applications for 2002 Growers, but only where the establishment services are able to be completed by 30 June 2002, and the date of acceptance must not be later than 15 June 2002. Applications received after that date will be executed on or after 1 July 2002 and applicants will participate in the Project as 2003 Growers.

21. Under the Management Agreement, Growers appoint Forest Rewards Management Pty Ltd as Manager to manage their Grove. The Manager will be responsible for establishing and cultivating the citrus trees and harvesting and selling the produce. Growers may elect

to harvest and sell their own produce or the Manager will do so on their behalf.

22. There is no minimum subscription for this Project. Each investor may subscribe for a minimum of one Grove, at a cost of \$11,000 per Grove. A minimum of 317 trees will be planted on each Grove (1,585 per hectare).

23. Growers may pay the Subscription Money to the Manager in full or by instalments under a Terms Payment Option offered by the Manager. Growers will execute a Power of Attorney enabling the Manager to act on their behalf as required when they make an application for a Grove. This will include the execution of the Management Agreement, the Sub-Lease Agreement, and, where the Grower elects to pay fees by instalment, a Terms Agreement.

### **Constitution**

24. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Grower and to manage the Project. The Responsible Entity will keep a register of Growers (cl 1). The Sub-Lease and Management Agreements are annexed to the Constitution and will be executed on behalf of a Grower following them signing the Application and a Power of Attorney Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

### **Compliance Plan**

25. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Act. Under the Compliance Plan, a Compliance Committee will monitor to what extent the Responsible Entity meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

### **Interest in Land**

26. Forest Lands Pty Ltd, the Lessor, grants a sub-lease to the Grower under the terms of the Sub-Lease Agreement (cl 2). Growers are granted an interest in land in the form of a sub-lease to use their Groves for carrying on the business of running a Citrus Orchard (cl 4.1). Growers must pay rent annually to the Lessor. The term of a Grower's sub-lease is for a period of 18 years or such longer term as agreed by the parties to allow final harvest (Item 5, Schedule to the Sub-Lease Agreement).

## Management Agreement

27. Each Grower enters into a Management Agreement with the Manager for each Grove. The term of the Agreement is until the completion of the final harvest in year 18, or when payment of proceeds from the final harvest and the dispatch of all accounts and reports required under the Management Agreement has occurred.

28. Growers contract with the Manager to cultivate and care for the citrus trees consistent with good horticultural practice. Growers pay a Management Fee for each Grove on subscription for the 'Initial Period', being for 2002 Growers from the commencement date to 30 June 2002, and for 2003 Growers, from the commencement date to 30 June 2003. An annual management fee is payable each year thereafter.

29. The services to be provided by the Manager in the initial period include:

- carry out supervision, monitoring and inspection of irrigation infrastructure and sprinklers as considered necessary for the efficient supply of water;
- control pests and vermin;
- supervise and secure management of all works on the orchard; and
- periodic site visits.

30. The Manager will carry out the following ongoing services under this agreement:

- tend to the trees according to the principles of good agriculture, including such nutrient analysis, pruning, irrigating, fertilising and fumigating, as the Manager deems appropriate to promote tree growth and yields;
- use all reasonable measures to keep the Grove free from vermin, noxious weeds, pests and diseases;
- carry out supervision, monitoring and inspection of irrigation infrastructure and sprinklers as considered necessary for the efficient supply of water;
- arrange for harvesting of the fruit; and
- use its best endeavours to negotiate the sale of the fruit for the highest price practicable.

31. A Grower may elect on or before 30 June 2004 to harvest and sell the fruit from the Grower's Grove(s) (cl 8.1). However, where Growers do not elect, the Manager will harvest and sell the fruit for the highest price practicable on the Grower's behalf (cl 7). The Manager will arrange public risk insurance in respect of the orchard

and will arrange additional insurance on behalf of the Grower if requested at the Grower's expense.

32. The Responsible Entity may only be removed from its appointment in accordance with section 601FL and 601FM of the Corporations Law.

### **Fees**

33. The fee payable on application for the initial period is \$11,000 per Grove consisting of a management fee of \$9,610.70, rent of \$528 and a planting fee of \$861.30.

34. For 2002 Growers, a management fee of \$1,725.60 per Grove is payable on or before 1 October 2002 for services to be performed during the period 1 July 2002 to 30 June 2003. For 2003 Growers this amount is payable on or before 1 October 2003 for services to be performed during the period 1 July 2003 to 30 June 2004.

35. For 2002 Growers, a management fee of \$1,718 per Grove is payable on or before 1 October 2003 for services to be performed during the period 1 July 2003 to 30 June 2004. For each year thereafter, an amount of \$1,718 (indexed at 3%) is payable on or before 1 October of the relevant year.

36. For 2003 Growers \$1,718 is payable on or before 1 October 2004 for services to be performed during the period 1 July 2004 to 30 June 2005. For each year thereafter, an amount of \$1,718 (indexed at 3%) is payable on or before 1 October of the relevant year.

37. Rent of \$528 per Grove is payable on application for the initial period. For each year thereafter rent of \$528 is payable on 1 October of the relevant year. This amount will be indexed at 3% commencing the year ended 30 June 2004, for 2002 Growers, or the year ended 30 June 2005 for 2003 Growers.

38. A planting fee of \$861.30 per Grove is payable on application for services to be performed in the initial period. A further amount of \$159.50 is payable on or before 1 October 2002 for 2002 Growers for services to be provided during the period 1 July 2002 to 30 June 2003. For 2003 Growers, this amount is payable on or before 1 October 2003 for services to be performed during the period 1 July 2003 to 30 June 2004.

39. Each Grower must pay a marketing fee equal to 12.1% of the Grower's share of the sale proceeds of each harvest after deducting the harvest costs. The Manager will also be entitled to a performance fee equal to 38.5% of the amount (if any) by which the Grower's share of the sale proceeds received from the sale of annual fruit produce from each harvest, less harvest costs, exceeds the projected sale proceeds set out in the financial forecasts contained in the Prospectus.

40. The Application Monies will be banked in the Subscription Fund bank account formed under the Project's Constitution (cl 3.8).

## **Payment of Fees**

41. Under the Prospectus, the Manager is offering Terms Payment Options in respect of the initial amount payable (refer to paragraph 32 above) and all amounts payable in the second year of the project. The following options are available:

### **Cash Option**

- \$11,000 per Grove payable on application for the initial period, consisting of a management fee of \$9,610.70, rent of \$528 and a planting fee of \$861.30;
- \$2,413.10 per Grove payable on 1 October 2002 for 2002 Growers or 1 October 2003 for 2003 Growers consisting of a management fee of \$1,725.60, rent of \$528 and a planting fee of \$159.50.

### **1 Year Term Payment Option**

- deposit of \$550 payable on application;
- \$11,913.12 per grove payable in 12 equal monthly instalments (interest free) of \$992.76; and
- \$1,000 per Grove payable on 1 October 2002 for 2002 Growers or 1 October 2003 for 2003 Growers.

### **2 Year Term Payment Option**

- deposit of \$550 per Grove payable on application;
- \$13,035.60 per Grove payable in 24 equal monthly instalments of \$543.15 (including fixed interest calculated at 9% per annum); and
- \$1,000 per Grove payable on 1 October 2002 for 2002 Growers or 1 October 2003 for 2003 Growers.

### **5 Year Payment Option**

- deposit of \$1,100 per Grove payable on application;
- \$14,122.80 per Grove payable in 60 equal monthly instalments of \$235.38 (including fixed interest calculated at 9% per annum); and
- \$1,000 per Grove payable on 1 October 2002 for 2002 Growers or 1 October 2003 for 2003 Growers.

42. The total amount payable under each of the Terms Payment Options includes an Application Fee of \$50 per Grove.

43. The Manager will monitor the level of applications received under each of the Terms Payment Options and is not obliged to accept applications for terms. A limit will be imposed on the number of applications than can be accepted under each instalment option.

### **Terms Agreement**

44. If a Grower chooses to pay under one of the Terms Payment Options, they must complete a Terms Application and Direct Debit Request. A Terms Agreement will be executed by the Manager.

45. If a Grower does not pay the required instalments under the Terms Payment Option, then provided that Forest Rewards Management Pty Ltd has given the Grower 14 days written notice to remedy the situation and payment has still not been made, the balance owing under the Terms Payment Option will become immediately due and payable. In addition Forest Rewards Management Ltd may take legal proceedings to recover the amount, resume all rights and interest which the Grower has in their Grove(s), or do anything which an owner of the Grove(s) is entitled to do (cl 5.2 of the Terms Agreement).

### **Planting**

46. Under the Management Agreement, the Manager will prepare the land for planting and supply the necessary seedlings. The Manager will be responsible for planting the seedlings on the Groves by 30 September 2002 for 2002 Growers and by 30 September 2003 for 2003 Growers. Each Grove will be planted with grapefruit seedlings at a rate of 1585 trees per hectare. The Manager will replace any seedlings that fail to establish within twelve months of planting. The Manager will then maintain the trees in accordance with good horticultural practice. The services to be provided by the Manager over the term of the Project are outlined in the Management Agreement (Annexure A to the Management Agreement).

### **Harvesting and Sale**

47. Growers may elect, by notice in writing to the Manager and Responsible Entity, to harvest and sell their own fruit on or before 30 June 2004 (cl 8.1 of the Management Agreement). This Product Ruling does not apply to Growers who make such an election.

48. If no such election is made, the Grower and the Responsible Entity irrevocably appoint the Manager to negotiate the sale of the harvested fruit (cl 7.1 of the Management Agreement). The Manager will use its best endeavours to negotiate the sale of fruit for the highest

price practicable having regard to the circumstances at the relevant time.

49. The Gross Proceeds of the sale of the fruit by the Manager will be paid into the Proceeds Fund Bank Account. Separate Proceeds Funds will be created for Growers of 2002 Groves and Year 2003 Groves. Proceeds received by the Responsible Entity are to be distributed in the following order of priority:

- to pay the Grower's share of the costs of the harvest and sale as advised by the Manager (unless the Grower has made an election to sell their fruit under the Management Agreement);
- any amounts due to the Responsible Entity by the Grower under the Constitution;
- any amounts due to the Manager by the Grower under the Management Agreement;
- any amounts due to the Lessor by the Grower under the Sub-Lease Agreement; and
- the Net Proceeds to the Growers provided that if the aggregate sum to be distributed to all of the Growers is less than \$1,000 then, at the discretion of the Responsible Entity, distribution to Growers may be postponed.

## **Finance**

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

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers, for the purposes of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- terms or conditions are non-arm's length;

- repayments of the principal and payments of interest are linked to the derivation of income from the Projects;
- 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**

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### **Application of this Ruling**

52. This Ruling applies only to Growers who are accepted to participate in the Project:

- on or before 15 June 2002 and who have executed a Management Agreement and a Sub-Lease Agreement before that date(2002 Growers); and/or
- on or after 1 July 2002 and before the expiry date of the Prospectus, but in any case, before 30 June 2003 and where the Grower has executed a Sub-Lease Agreement and a Management Agreement on or between those dates (2003 Growers).

53. The Grower's participation in the Project must constitute the carrying on of a business of primary production. 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. This Ruling does not apply to those Growers who make an election under the Management Agreement to harvest and sell the fruit produced from their Grove(s).

## **The Simplified Tax System ('STS')**

### **Division 328**

54. 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**

55. 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**

56. 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.

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

### **Trading Stock**

#### **Section 70-35**

58. A Grower who is not an 'STS taxpayer' may, in some years, hold fruit 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.

59. 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, Rent, and Interest (Terms Payment Options only)**

#### **Section 8-1**

60. A Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

#### **2002 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year 1 deduction Year Ended 30 June 2002</b>	<b>Year 2 deduction Year Ended 30 June 2003</b>	<b>Year 3 deduction Year Ended 30 June 2004</b>	<b>Year 4 deduction Year Ended 30 June 2005</b>
<b>Management fees</b>	8-1	\$9,610.70 – See Note (i) (below)	\$1,725.60 – See Notes (i) & (ii) (below)	\$1,718 – See Notes (i) & (ii) (below)	\$1,718 (indexed) – See Notes (i) & (ii) (below)
<b>Rent</b>	8-1	\$528 – See Note (i) (below)	\$528 – See Notes (i) & (ii) (below)	\$528 (indexed) – See Notes (i) & (ii) (below)	\$528 (indexed) – See Notes (i) & (ii) (below)
<b>Interest (Terms Payment Options only)</b>	8-1	As incurred – See Note (iii) (below)	As incurred – See Note (iii) (below)	As incurred – See Note (iii) (below)	As incurred – See Note (iii) (below)

#### **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 at paragraph 124;
- (ii) The Management fees and the Rent shown in the Management Agreement and the Sub-Lease 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

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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 100 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;

- (iii) Interest payable under either the 2 Year Terms Payment Option or 5 Year Terms Payment Option will be deductible when incurred.

**2003 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year 1 deduction Year Ended 30 June 2003</b>	<b>Year 2 deduction Year Ended 30 June 2004</b>	<b>Year 3 deduction Year Ended 30 June 2005</b>
<b>Management Fees</b>	8-1	\$9,610.70 – See Note (i) (above)	\$1,725.60 – See Notes (i) & (ii) (above)	\$1,718 – See Notes (i) & (ii) (above)
<b>Rent</b>	8-1	\$528 – See Note (i) (above)	\$528 – See Notes (i) & (ii) (above)	\$528 (indexed) – See Notes (i) & (ii) (above)
<b>Interest (Terms Payment Options only)</b>	8-1	As incurred – See Note (iii) (above)	As incurred – See Note (iii) (above)	As incurred – See Note (iii) (above)

**Tax outcomes for Growers who are 'STS taxpayers'****Assessable Income****Section 6-5**

61. 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.

62. 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**

63. A Grower who is an 'STS taxpayer' may, in some years, hold fruit 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)).

64. 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, Rent, and Interest (Terms Payment Options only)**

#### **Section 8-1 and section 328-105**

65. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

#### **2002 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year 1 deduction Year Ended 30 June 2002</b>	<b>Year 2 deduction Year Ended 30 June 2003</b>	<b>Year 3 deduction Year Ended 30 June 2004</b>	<b>Year 4 deduction Year Ended 30 June 2005</b>
<b>Management Fees</b>	8-1	See Notes (iv), (v) & (vi) (below)	See Notes (iv), (v), (vi) & (vii) (below)	\$1,718 – See Notes (iv),(v), (vi) & (vii) (below)	\$1,718 (indexed) – See Notes (iv), (v), (vi) & (vii) (below)
<b>Rent</b>	8-1	See Notes (iv), (v) & (vi) (below)	See Notes (iv), (v), (vi) & (vii) (below)	\$528 (indexed) – See Notes (iv), (v), (vi) & (vii) (below)	\$528 (indexed) – See Notes (iv), (v), (vi) & (vii) (below)
<b>Interest (Terms Payment Options only)</b>	8-1	When Paid – See Note (viii) (below)	When Paid – See Note (viii) (below)	When Paid – See Note (viii) (below)	When Paid – See Note (viii) (below)

**PR 2002/28****Notes:**

- (iv) 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 at paragraph 124;
- (v) If a Grower who is an 'STS taxpayer' chooses to pay the Year 1 and Year 2 Management fees and Year 1 and Year 2 rent by the cash option, then these amounts will be fully paid in the year in which they are incurred. Therefore, the Management fee of \$9,610.70 and rent of \$528 will be deductible in Year 1 as it is fully paid in the year in which it is incurred. Similarly the amounts of \$1,725.60 for Management fees and \$528 (indexed) paid in Year 2 will be deductible in Year 2 as they are fully paid in the year in which they are incurred.

If a Grower who is an 'STS taxpayer' chooses to pay the Year 1 and Year 2 Management fees and rent by the terms option, then the amounts described above will not be fully paid in the year in which they are incurred. The Management fee and rent for both years 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 which is not paid in the year in which it is incurred, will be deductible in the year in which it is actually paid;

- (vi) If, for any reason, an amount shown in the Table above 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 above which is not paid in the year in which it is incurred will be deductible in the year it is actually paid;
- (vii) 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 Sub-Lease Agreement, 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 100, 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;

- (viii) Interest payable under either the 2 Year Terms Payment Option or 5 Year Terms Payment Option will be deductible when paid.

### 2003 Growers

Fee Type	ITAA 1997 Section	Year 1 deduction Year Ended 30 June 2003	Year 2 deduction Year Ended 30 June 2004	Year 3 deduction Year Ended 30 June 2005
<b>Management Fees</b>	8-1	See Notes (iv), (v) & (vi) (above)	See Notes (iv), (v), (vi) & (vii) (above)	\$1,718 - See Notes (iv), (v), (vi) & (vii) (above)
<b>Rent</b>	8-1	See Notes (iv), (v) & (vi) (above)	See Notes (iv), (v), (vi) & (vii) (above)	\$528 (indexed) - See Notes (iv), (v), (vi) & (vii) (above)
<b>Interest (Terms Payment Options only)</b>	8-1	When Paid – See Note (viii) (above)	When Paid – See Note (viii) (above)	When Paid – See Note (viii) (above)

## Tax outcomes that apply to all Growers

### Deductions for capital expenditure

#### Division 40

66. Growers will also be entitled to tax deductions relating to establishment of horticultural plants. All deductions shown in the following Table are determined under Division 40.

### 2002 Growers

Fee type	ITAA 1997 section	Year 1 Year ended 30 June 2002	Year 2 Year ended 30 June 2003	Year3 Year ended 30 June 2004	Year 4 Year Ended 30 June 2005
Establishment of horticultural plants	40-515	Nil – See Notes (ix) & (x) (below)	Nil - See Notes (ix) & (x) (below)	Nil - See Notes (ix) & (x) (below)	Amount must be calculated – see Notes (ix) & (x) (below)

**PR 2002/28****Notes:**

- (ix) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 124;
- (x) Citrus trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under sub-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 citrus 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 citrus trees have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the citrus trees enter their first commercial season (section 40-530, item 2). The Project Manager will inform Growers of when the citrus trees enter their first commercial season which is anticipated as being the year ended 30 June 2005 for 2002 Growers or 30 June 2003 for 2003 Growers.

**2003 Growers**

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year ended 30 June 2003</b>	<b>Year ended 30 June 2004</b>	<b>Year ended 30 June 2005</b>
Establishment of horticultural plants	40-515	Nil – see Notes (ix) & (x) (above)	Nil – see Notes (ix) & (x) (above)	Nil - see Notes (ix) & (x) (above)

**Interest**

67. 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, other than the Terms Payment Options offered by Forest Rewards Management Pty Ltd, 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 95 to 108 (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 Growers choice.

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

#### **Section 35-55 – Commissioner’s discretion**

68. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 or 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 2002 to 30 June 2006 for 2002 Growers and 30 June 2003 to 30 June 2007 for 2003 Growers 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.

69. 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;
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45;
- the Grower’s business activity produces assessable income for an 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).

70. Where the ‘exception’ in subsection 35-10(4) applies, or 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 the 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.

71. 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**

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

- expenditure by a Grower does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 95 to 108);
- 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.

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**Explanations**

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**Is the Grower carrying on a business?**

73. For the amounts set out in the Tables above to constitute allowable deductions the Grower's horticulture activities as a participant in the Forest Rewards Tropical Citrus Project 2002 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.

74. For schemes such as that of the Forest Rewards Tropical Citrus Project 2002, 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.

75. 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 citrus trees are established;
- the Grower has a right to harvest and sell the fruit each year from those citrus 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.

76. In this Project, each Grower enters into a Management Agreement and a Sub-Lease Agreement.

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

78. Under the Management Agreement the Project 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 Project Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Grove on the Grower's behalf.

79. In establishing the Grove, the Grower engages the Project Manager to cultivate and care for the citrus trees consistent with good horticultural practice. The Project Manager is also engaged to harvest sell, on the Grower's behalf, the fruit grown on the Grower's Grove.

80. 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.

81. 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 fruit 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.

82. The pooling of fruit grown on the Grower's Grove with the fruit of other Growers is consistent with general horticulture practices. Each Grower's proportionate share of the sale proceeds of the pooled fruit will reflect the proportion of the fruit contributed from their Grove.

83. The Project Manager's services are also consistent with general horticulture practices. The assets installed by the Lessor 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).

84. The Grower's degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Act, 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 Project Manager in certain instances, such as cases of default or neglect.

85. The horticulture 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 Forest Rewards Tropical Citrus Project 2002 will constitute the carrying on of a business.

## **The Simplified Tax System**

### **Division 328**

86. 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.

87. 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**

88. 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.

89. The management fees and rent associated with the horticulture 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 fruit) 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*

90. Under the Management Agreement and the Sub-Lease 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.

91. 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 95 to 108) 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*

92. In the absence of any application of the prepayment provisions, the timing of deductions for the management fees or the lease fees will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

93. If the Grower is not an 'STS taxpayer', the management fees and the lease fees are deductible in the year in which they are incurred.

94. 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**

95. 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.

96. 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*

97. 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)).

98. 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;

- 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.

99. 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.

100. 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.

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

101. 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*

102. In this Project, an initial management fee of \$9,610.70 and rent of \$528 per Grove will be incurred by 2002 Growers and 2003 Growers, except for those who are STS taxpayers who have participated in one of the Terms Payment Options, on execution of the Management Agreement and the Sub-Lease Agreement. The management fee and the rent are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreements, 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.

103. 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.

104. 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 Project Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Sub-Lease Agreement, rent is payable annually partially in advance for the lease of the land during the expenditure year.

105. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 33 to 39, 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*

106. Although not required under either the Management Agreement or the Sub-Lease 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 105 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

107. 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.

108. However, as noted above, prepaid rent of less than \$1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

## **Deferral of losses from non-commercial business activities**

### **Division 35**

109. 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.

110. 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.

111. 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.

112. 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.

113. 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).

114. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum 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 for 2002 Growers or 2010 for 2003 Growers. 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.

115. 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.

116. 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.

117. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Grove in the Project and does not elect to harvest their own fruit, 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 2007. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2006 for 2002 Growers and 2007 for 2003 Growers. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

118. 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 68), in the manner described in the Arrangement (see paragraphs 14 to 51). 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 9). Growers may need to apply for private

rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

119. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent horticulturist provided with the application by the Responsible Entity;
- independent, objective, and generally available information relating to the horticulture industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

#### **Section 82KL - recouped expenditure**

120. 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**

121. 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).

122. The Forest Rewards Tropical Citrus Project 2002 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 60 and 65, that would have not been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

123. 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 fruit. 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.

## **Example**

### **Entitlement to GST input tax credits**

124. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture 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:

$$1/11 \times \$4,400 = \$400.$$

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:

$$1/11 \times \$2,200 = \$200.$$

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 \$4400).

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**

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20 March 2002

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	- ITAA 1997 35-30
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