



PR 2002/44 - Income tax: Clearstream Olive Project No. 5

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 This document has changed over time. This is a consolidated version of the ruling which was published on *8 May 2002*



Product Ruling

Income tax: Clearstream Olive Project No 5

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Preamble

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

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

No guarantee of commercial success

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.

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 Clearstream Olive Project No 5, 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 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 those persons who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreement until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, each of these persons, referred to as 'Growers', will be wholesale clients 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.

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

11. This Ruling applies prospectively from 24 April 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

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the 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

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

- Revised application for a Product Ruling, dated 1 November 2001;
- Draft copy of the Information Memorandum issued for the Clearstream Olive Project No 5, undated, received on 18 March 2002;
- **Draft copy of the Management Agreement between Clearstream Olive Project No 5 Pty Ltd (the**

Manager) and the Grower, undated, received 18 March 2002;

- **Draft copy of the Lease Agreement between Clearstream No 5 Property Pty Ltd (the Landowner) and the Grower, undated, received on 18 March 2002;**
- **Draft copy of the Joint Venture Agreement between Clearstream No 5 Property Pty Ltd , the Grower and Clearstream Olive Project No 5 Pty Ltd, undated, received on 18 March 2002;**
- **Draft copy of the Option Deed between Clearstream Olive Farms Pty Ltd (the Grantor) , the Grower and Clearstream No 5 Property Pty Ltd, undated, received on 18 March 2002;**
- Draft copy of Contract of Sale of Real Estate between Clearstream Olive Farms Pty Ltd and Clearstream No 5 Property Pty Ltd , undated, received on 18 March 2002;
- Constitution of Clearstream Olive Farms Pty Ltd, dated 23 February 2000;
- Certificate of Registration of a Company for Clearstream Olive Farms Pty Ltd, dated 23 February 2000;
- Constitution of Clearstream No 5 Property Pty Ltd, dated 8 August 2001;
- Certificate of Registration of a Company for Clearstream No 5 Property Pty Ltd, dated 8 August 2001;
- Constitution for Clearstream Olive Project No 3 Pty Ltd, dated 20 December 2000;
- Certificate of Registration of a Company for Clearstream Olive Project No 3 Pty Ltd, dated 20 December 2000;
- Certificate of Registration on Change of Name, to certify that Clearstream Olive Project No 3 Pty Ltd changed its name to Clearstream Olive Project No 5 Pty Ltd, dated 5 July 2001;
- Facsimiles and attachments to ATO from the applicant's representative, dated 17 December 2001 and 4 April 2002;
- Letter and attachments to ATO from the applicant's representative, dated 18 March 2002;

- E-mails and attachments to ATO from the applicant's representative dated 20 December 2001, 23 January 2002, 25 January 2002, 28 February 2002, 8 March 2002, 13 March 2002, 18 March 2002, 19 March 2002 and 27 March 2002.

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

15. In accordance with the above documents, a Grower who participates in the arrangement must 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
- not being a retail client, the Grower has accepted a 'personal offer' of a small scale offering for the purpose of the *Corporations Act 2001*.

16. Each of these categories is explained in paragraphs 93 to 99 in the Explanations area of this Product Ruling. The documents highlighted are those Growers enter into or become a party to. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, to which the Grower, or an associate of the Grower, will be a party. The effect of these agreements may be summarised as follows.

Overview

17. The arrangement is called the Clearstream Olive Project No 5.

Location	The property is situated in the Acheron Valley- near Taggerty, Victoria.
Type of business each participant is carrying on	Commercial growing and cultivation of olive trees for both oil and table fruit.
Number of hectares under cultivation	30 hectares.
Number of Grower's Lots offered	15
Size of each Grower's Lot	2 hectares.
Number of olive trees per Grower's Lot	800 trees.
The Term of the Project	24 years from the Commencement Date.

Initial fees per Grower's Lot	\$70,400
Ongoing annual fees per Grower's Lot	Refer to paragraphs 56 to 65 for details of the fees payable.
Other Features	A Grower may also enter into an Option Deed to acquire an Option to purchase three and one-third percent (3 1/3%) of the total issued capital of the Land Owner.

The Project

18. Under the Information Memorandum, a Grower is invited to enter into a Joint Venture with the owner of an established olive grove.

19. The objective is the commercial growing and cultivation of olive trees for sale as oil and table fruit.

20. The land upon which the Project will be established is located at Lot 1 on Plan of Subdivision No 447628H, Certificate of Title Volume 10284, Folio 609. The land will be owned by Clearstream No 5 Property Pty Ltd.

21. The offer is for a minimum of one Grower's Lot interest that is obtained by entering into a Lease Agreement, Management Agreement and Joint Venture Agreement. Approximately 800 trees have been planted on each Grower's Lot before 1 July 2001.

22. A Grower on application to the Project will pay \$70,400 for each Grower's Lot, which is allocated as follows:

Management Fees for years 1 and 2	\$60,800
Initial Rent fee for year 1	<u>\$9,600</u>
Total	\$70,400

23. In addition, a Grower on application to the Project may at their discretion pay \$1,000 to secure an Option to purchase an interest in the issued capital of the Land Owner.

24. The Project seeks to raise \$1,056,000 by offering up to 15 Grower's Lot interests.

25. There is no minimum subscription for this Project.

26. Applications by Growers for an Interest in the Project will be accepted up to 31 December 2002.

27. A Grower accepted into the Project will enter into three agreements for the term of the Project:

- A Lease Agreement with the Land Owner for a Lease to use an identifiable area of land called a 'Grower's Lot';
- A Management Agreement with the Manager to manage the Grower's Lot for the term of the Project; and
- A Joint Venture Agreement for the purpose of carrying on a business of olive production and sales.

28. A Grower may also enter into an Option Deed to acquire an Option to purchase three and one-third percent (3 1/3%) of the total issued capital of the Land Owner. This opportunity to acquire an equity interest in the Land Owner is entirely at the discretion of the Grower and is not a condition of the Grower entering this arrangement.

Lease Agreement

29. Each Grower shall enter into a Lease Agreement with the Land Owner, Clearstream No 5 Property Pty Ltd.

30. Under the Lease Agreement, the Land Owner will grant to the Grower a lease to use the Grower's Lot (cl. 2). The Grower's Lot is an area of Land being approximately 2 hectares and includes 800 olive trees planted thereon and the irrigation system installed and connected thereon.

31. The Lease provides that the Grower will use the Grower's Lot for the purposes of growing and tending of olive trees and the harvesting of olives from it for the production of olives and any ancillary activities (cl. 3.2).

32. The Term of the Lease will be 24 years from the Commencement Date of the Lease Agreement.

33. The Initial Rent payable per Grower's Lot in Year 1 of the Project is \$9,600 (cl. 3.1(a)). In subsequent years, a Grower is liable to pay Annual Rent on the anniversary of the Grower's Commencement Date (cl. 3.1(b)).

Management Agreement

34. Each Grower shall enter into a Management Agreement with the Manager, Clearstream Olive Project No 5 Pty Ltd.

35. Under the Management Agreement, the Grower appoints the Manager to provide Primary Production services, harvesting related services and Management Services in accordance with the terms of this Agreement and the Manager accepts the appointment (cl. 2.1).

36. The Manager's Term will be 24 years from the Commencement Date of the Management Agreement. The Commencement Date being the date of execution of this Agreement.

37. The Management Services provided by the Manager are defined as the rearing and tending of the olive trees to maturity, and providing the management and maintenance of the olive grove established on the Grower's Lot and the undertaking of the Grower's obligations referred to in the Lease (other than those involving the payment of money) and, without limitation, includes:

- (a) the replanting of any olive trees which die during the first two (2) years after planting where such death is caused by the planting technique or vermin destruction;
- (b) the general maintenance of the Grower's Lot including control of weeds, suckers, vermin or other pests which may impede the growth of the olive trees;
- (c) the maintenance and repair of all fences, irrigation systems and staking on and around the Grower's Lot;
- (d) maintenance and repair of all access roads in or about the Grower's Lot;
- (e) the application of water and fertiliser to the Grower's Lot in such form and in such quantities necessary to maintain satisfactory olive tree growth and olive yields;
- (f) arrangement and execution of harvesting of olives from the Lot;
- (g) marketing and sale of the olives produced from the Lot; and
- (h) the provision of advice and assistance to the Grower generally in relation to all aspects of general management of and good viticultural practice on the Grower's Lot and of the olive trees thereon.

38. The Management Fees payable per Grower's Lot in Year 1 of the Project is \$60,800, and is for Management Services provided during the first 2 year period from the Grower's Commencement Date (cls. 7.1(a) and 7.3(a)(ii)(1)). In year 3 and subsequent years, a Grower is liable to pay Management Fees annually as calculated according to cls. 7.1(b), 7.1(c), 7.1(d), 7.3(a)(ii)(2) and 7.3(a)(ii)(3).

39. The Manager will harvest the olives as and when appropriate as determined at its absolute discretion (cl. 4.1(a)).

40. The Manager is appointed as the sole and exclusive selling agent of the Grower for the Olives during the term of this Agreement and will use its best endeavours to sell the olives on behalf of the

Grower on terms that the Manager reasonably considers are the best terms obtainable (cl. 4.2).

41. The Manager will take out on behalf of all of the Growers, public liability insurance and fire insurance as the Manager in its absolute discretion thinks fit (cl. 3.7).

Joint Venture Agreement

42. Each Grower shall enter into a Joint Venture Agreement with Clearstream No 5 Property Pty Ltd and the Manager, Clearstream Olive Project No 5 Pty Ltd.

43. Under the Joint Venture Agreement, the Grower and Clearstream No 5 Property Pty Ltd (the "Participants") form and agree to engage in an unincorporated Joint Venture for the purpose of conducting of a primary production business engaged in the growing of olives for sale both as table fruit and for oil pressing (cl. 2.1).

44. The respective Interests of the Participants are as follows:

- (a) Grower 95%; and
- (b) Clearstream 5% (cl. 2.2).

45. As a consequence their respective Interests under the Joint Venture, a Grower will have an undivided right, title and interest to 95% of the olive crop produced and Clearstream No 5 Property Pty Ltd will have an undivided right, title and interest to 5% of the olive crop produced from the Grower's Lot.

46. The Participants agree that their respective contributions in respect of their respective interests will be as follows:

- (a) Clearstream No 5 Property Pty Ltd shall lease to the Grower the Grower's Lot on the terms of the Lease and maintain and provide the ancillary infrastructure; and
- (b) the Grower shall pay all of the Project Expenses and arrange for the olive grove to be professionally managed (in a separate Management Agreement) (cl. 2.3).

47. As a consequence their respective contributions under the Joint Venture, a Grower will be liable for all expenditure of the Project including but not limited to the Management Fees payable under the Management Agreement and the Rent fee payable under the Lease Agreement.

48. Under the Joint Venture Agreement, the Participants appoint the Manager to conduct the Project for and on behalf of the Participants and the Manager accepts such appointment (cl. 5.1).

Option Deed

49. A Grower at their discretion may enter into an Option Deed with the Grantor, Clearstream Olive Farms Pty Ltd and the Company, Clearstream No 5 Property Pty Ltd.

50. Under the Option Deed, Clearstream Olive Farms Pty Ltd grants the Grower (or the Grower's nominee) an Option that gives the right but not the obligation to purchase three and one-third percent (3 1/3%) of the total issued capital of Clearstream No 5 Property Pty Ltd (cl.2.1).

51. The Option is exercisable within 30 days after 30 June 2011 (the 'Exercise Date') (cl. 3.1). The amount payable on the exercise of the Option will be \$60,000 (the "Exercise Price") (cl.2.1) and the exercise of the Option is subject to the Grower being in compliance as at 30 June 2011 with all obligations under the arrangement Deeds and/or Agreements (cl.3.2).

52. On application, the Option Fee payable is \$1,000 (cl. 2.2).

Gross Revenue and Distributions

53. All Gross Revenue from the Project received by the Manager will be distributed as follows:

- The Manager will deduct and pay to the Manager or the Land Owner any unpaid but due and payable Management Fees, Lease Rental or any other amounts payable under the Management Agreement or the Lease Agreement before any distribution is made to the Grower (cl. 4.4(b) of the Management Agreement); and
- The Growers' share of the Grower Gross Revenue from the Project will be paid to the Growers within twenty-one (21) days after receipt (cl. 4.4(c) of the Management Agreement).

Fees

54. In consideration of the services performed and rights granted under the terms of the Lease Agreement and the Management Agreement, the fees payable by a Grower per Grower's Lot will be as follows.

55. For year 1 of the Project, the following fees are payable on application:

- Management Fees of \$60,800; and

- Initial Rent of \$9,600.

The Management Fee payable by a Grower on application is for Management Services provided during the first 2 year period from the Commencement Date of the Management Agreement.

56. For year 2 of the Project, the following fees are payable on the first anniversary of the Grower's Commencement Date:

- Annual Rent of \$9,600.

57. For year 3 of the Project, the following fees are payable on the second anniversary of the Grower's Commencement Date:

- Management Fees of \$15,360, plus 16% of Grower's Gross Revenue derived from the sale of the crop produced during the Financial Year in which the Anniversary Date occurs; and
- Annual Rent of \$9,600.

58. For year 4 of the Project, the following fees are payable on the third anniversary of the Grower's Commencement Date:

- Management Fees of \$15,360, plus 16% of Grower's Gross Revenue derived from the sale of the crop produced during the Financial Year in which the Anniversary Date occurs; and
- Annual Rent of \$9,600.

59. For year 5 of the Project, the following fees are payable on the fourth anniversary of the Grower's Commencement Date:

- Management Fees of \$15,360, plus 16% of Grower's Gross Revenue derived from the sale of the crop produced during the Financial Year in which the Anniversary Date occurs, and
- Annual Rent of \$9,600.

60. For year 6 of the Project, the following fees are payable on the fifth anniversary of the Grower's Commencement Date:

- Management Fees of an amount equal to 26% of the Grower's Gross Revenue derived from the sale of the crop produced during the Financial Year in which the Anniversary Date occurs; and
- Annual Rent of \$9,600.

61. For year 7 of the Project, the following fees are payable on the sixth anniversary of the Grower's Commencement Date:

- Management Fees of an amount equal to 26% of the Grower's Gross Revenue derived from the sale of the

crop produced during the Financial Year in which the Anniversary Date occurs; and

- Annual Rent of \$9,600.

62. For year 8 of the Project, the following fees are payable on the seventh anniversary of the Grower's Commencement Date:

- Management Fees of an amount equal to 21% of the Grower's Gross Revenue derived from the sale of the crop produced during the Financial Year in which the Anniversary Date occurs; and
- Annual Rent of \$9,600.

63. For all subsequent years of the project till the end of the Project Term, the following fees are payable on the anniversary of the Grower's Commencement Date:

- Management Fees of an amount equal to 21% of the Grower's Gross Revenue derived from the sale of the crop produced during the Financial Year in which the Anniversary Date occurs; and
- Annual Rent of \$9,600.

64. All Management Fees which are calculated as a percentage of Grower's Gross Revenue will be deducted by the Manager from the Grower's Gross Revenue before any distribution is paid to the Grower (cl. 7.3(a)(ii)(3)).

65. In addition, if a Grower enters into an Option Deed to acquire an Option to purchase three and one-third percent (3 1/3%) of the total issued capital of the Land Owner, the fees payable by a Grower will be as follows:

- On application, the Option Fee payable is \$1,000; and
- Within 30 days after 30 June 2011, the Option is exercisable for an Exercise Price of \$60,000.

Finance

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

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;

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

Ruling

Application of this Ruling

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

- in the year ended 30 June 2002 and who have executed a Lease Agreement, Management Agreement and Joint Venture Agreement in that period; and/or
- in the year ended 30 June 2003 and who have executed a Lease Agreement, Management Agreement and Joint Venture Agreement in that period.

69. 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.

The Simplified Tax System ('STS')**Division 328**

70. For a Grower participating in the Project, the recognition of income and the timing of tax deductions 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

71. 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.

Prepaid fees

72. Management Fees, Initial Rent fee and Annual Rent fees incurred by Growers who are accepted into this Project will be subject to the prepayment rules in sections 82KZME and 82KZMF. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it 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.

73. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

74. In this Project, the tax deductions allowable for Management Fees, Initial Rent fee and Annual Rent fees will require calculation by applying the above formula to the amount incurred each year by the Grower.

Tax outcomes for Growers who are not ‘STS taxpayers’

Assessable Income

Section 6-5

75. 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.

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

Trading stock

Section 70-35

77. A Grower who is not an ‘STS taxpayer’ may, in some years, hold Olives 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.

78. 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 the Management Fees, Initial Rent fee and Annual Rent fees for non-STS taxpayers who are accepted into the Project on or before 30 June 2002

Section 8-1

79. A Grower who is not an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fees	8-1	Amount must be calculated – See Notes (i), (ii) & (iii) (below)	Amount must be calculated – See Notes (i), (ii) & (iii) (below)	Amount must be calculated – See Notes (i), (ii) (iii) & (iv) (below)
Initial Rent	8-1	Amount must be calculated – See Notes (i), (ii) & (iii) (below)	Amount must be calculated – See Notes (i), (ii) & (iii) (below)	
Annual Rent	8-1		Amount must be calculated – See Notes (i), (ii) & (iii) (below)	Amount must be calculated – See Notes (i), (ii) & (iii) (below)

Notes:

- (i) If a Grower is accepted into the Project between 1 July 2002 and 31 December 2002, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table.
- (ii) 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 141.
- (iii) The Management Fees, Initial Rent fee and Annual Rent fees shown in paragraphs 55, 56 and 57 above may **NOT** be deductible in full in the year incurred. The deduction for each year's fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 73 and Example 2 at paragraph 142).
- (iv) The deduction for the Management Fees shown in paragraph 57 above is calculated in part as a percentage of the Grower's Gross Revenue derived from the sale of the crop produced during the Financial Year in which the deduction is incurred and will be determined

and deducted by the Manager from the Grower's Gross Revenue before any distribution is paid to the Grower.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5 and section 328-105

80. 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.

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

Trading stock

Section 328-285

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

83. 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 the Management Fees, Initial Rent fee and Annual Rent fees for STS taxpayers who are accepted into the Project on or before 30 June 2002

Section 8-1 and section 328-105

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

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fees	8-1	Amount must be calculated – See Notes (v), (vi) & (vii) (below)	Amount must be calculated – See Notes (v), (vi) & (vii) (below)	Amount must be calculated – See Notes (v), (vi), (vii) & (viii) (below)
Initial Rent	8-1	Amount must be calculated – See Notes (v), (vi) & (vii) (below)	Amount must be calculated – See Notes (v), (vi) & (vii) (below)	
Annual Rent	8-1		Amount must be calculated – See Notes (v), (vi) & (vii) (below)	Amount must be calculated – See Notes (v), (vi) & (vii) (below)

Notes:

- (v) If a Grower is accepted into the Project between 1 July 2002 and 31 December 2002, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table;
- (vi) 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 141.
- (vii) The Management Fees, Initial Rent fee and Annual Rent fees shown in paragraphs 55, 56 and 57 above may **NOT** be deductible in full in the year in which they are paid by, or on behalf of the STS taxpayer. The deduction for each year's fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 73 and Example 2 at paragraph 142).
- (viii) The deduction for the Management fees shown in paragraph 57 above is calculated in part as a percentage of the Grower's Gross Revenue derived from the sale of the crop produced during the Financial Year in which the deduction is incurred and will be determined

and deducted by the Manager from the Grower's Gross Revenue before any distribution is paid to the Grower.

Tax outcomes that apply to all Growers

Interest deductibility

85. 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. Product Rulings only rule on the deductibility of expenditure where all details and related documentation have been provided to, and examined by the Tax Office. However all Growers who borrow funds in order to participate in the Clearstream Olive Project No 5, should read the discussion of the prepayment rules in paragraphs 116 to 125 (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.

Option

86. The Option Fee and Exercise Price paid to Clearstream Olive Farms Pty Ltd are 'CGT assets' (section 108-5) and the amount of \$1,000 Option Fee and the \$60,000 Exercise Price paid by a Grower is an outgoing of capital and is not allowable as a deduction. These amounts paid will represent the first element of the cost base of the shares acquired (subsection 110-25(2)).

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

Section 35-55 – Commissioner's discretion

87. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 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 2005 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.

88. For a 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 2005 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.

89. 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 129 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; or
- 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

90. 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.

91. 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.

Section 82KL and Part IVA

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

- 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

93. 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*.

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

94. 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 persons satisfies one of the following tests:

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

95. 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.

96. 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.

97. 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 'professional 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.

98. 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)).

99. 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?

100. For the amounts set out in the Tables above to constitute allowable deductions the Grower's horticultural activities as a participant in the Clearstream Olive Project No 5 must amount to the carrying on of a business of primary production. These horticultural activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

101. For schemes such as that of the Clearstream Olive Project No 5, 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.

102. 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.

103. In this Project, each Grower enters into a Lease Agreement, Management Agreement and Joint Venture Agreement.

104. Under the Lease Agreement each individual Grower will have rights over a specific and identifiable area of land. The Lease 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 Agreement allows the Manager to come onto the land to carry out its obligations under the Management Agreement.

105. Under the Management Agreement the Manager is engaged by the Grower to maintain an Olive grove on the Grower's identifiable area of land during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to maintain the Olive grove on the Grower's behalf. The Manager is also engaged to harvest and sell, on the Grower's behalf, the Olives grown on the Grower's Olive grove.

106. 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.

107. 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 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.

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

109. The Manager's services are also consistent with general horticulture practices. While the size of a Grower's Olive grove is relatively small, it is of a size and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

110. The Grower's degree of control over the Manager as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Olive 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.

111. 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 Grower’s horticulture activities in the Clearstream Olive Project No 5 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

112. 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.

113. 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 the Management Fees, Initial Rent fee and Annual Rent fees

Section 8-1

114. Consideration of whether the Management Fees, Initial Rent fee and Annual Rent fees 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.

115. The Management Fees, Initial Rent fee and Annual Rent fees 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 Fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZL to 82KZMF

116. 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.

117. For this Project, only section 82KZL (an interpretive 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 them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

118. 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)).

119. 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:
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (ii) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

120. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier other than Clearstream Olive Project No 5 Pty Ltd. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

121. 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.

122. 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.

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

123. 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

Management Fees, Initial Rent fee and Annual Rent fees for Growers accepted into the Project on or before 30 June 2002 or alternatively, between 1 July 2002 and 31 December 2002

124. Under the Lease Agreement and Management Agreement, where a Grower is accepted into the Project on or before 30 June 2002 or alternatively, between 1 July 2002 and 31 December 2002, the expenditures incurred for Management Fees, Initial Rent fee and Annual Rent fees meet the requirements of subsections 82KZME(1) and (2) and are incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for each of the above fees are determined under section 82KZMF.

125. The prepaid Management Fees, Initial Rent fee and Annual Rent fees incurred by such Growers does not fall within any of the 5 exceptions to section 82KZME. Therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF will apportion the deduction for each of the above prepaid fees over the period that the services for which the prepayment is made, are provided.

Deferral of losses from non-commercial business activities

Division 35

126. 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.

127. 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.

128. 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.

129. 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.

130. 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).

131. 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 accepted into the Project in either the year ended 30 June 2002 or the year ended 30 June 2003 who acquires the minimum allocation of one Grower's Lot in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2006. 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.

132. 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.

133. 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.

134. Information provided with the application for this Product Ruling indicates that a Grower accepted into the Project in either the year ended 30 June 2002 or the year ended 30 June 2003 who acquires the minimum allocation of one Grower's Lot in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2006. The Commissioner 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 2005.

135. 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 87 and 88), in the manner described in the Arrangement (see paragraphs 14 to 67). 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.

136. 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 Agricultural Expert provided with the Product Ruling; 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.

Section 82KL - Recouped expenditure

137. 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

138. 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).

139. The Clearstream Olive Project No 5 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 79 to 84 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

140. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the Olives. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing 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

141. 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:

$$1/11 \times \$4400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4400 *less* \$400, or \$4000.

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

$$1/11 \times \$2200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2200 *less* \$200, or \$2000.

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 \$4000 (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 \$2000 only, not one tenth of \$2200).

Example 2 – Apportionment of Fees

142. Murray decides to participate in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2002 the Project Manager informs Murray that the minimum subscription has been

reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray is an 'STS taxpayer' who is not registered, nor required to be registered for GST. He calculates his tax deduction for management fees for the **2002 income year** as follows:

Management fee x Number of days of eligible service period in the year of income
 Total number of days of eligible service period

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Murray's total tax deduction in 2002 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2002 income year).

In the **2003 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,644** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2003 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2003 income year).

\$4,644 + \$85 = \$4,729 (The sum of these two amounts is Murray's total tax deduction for management fees in 2003).

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

Detailed contents list

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

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Related Rulings/Determinations:

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

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- producing assessable income
- product rulings
- public rulings
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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