PR 2002/7 - Income tax: Northern Rivers Coffee Project 2 (revised arrangement)

Product Ruling
Income tax: Northern Rivers Coffee Project 2 (revised arrangement)

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

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. Further, we give no assurance that the 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 participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for 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 arrangements are 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 arrangements will be carried out as described in this Product Ruling.

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

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Northern Rivers Coffee Project 2, or simply as 'the Project', or the 'product'.

Tax laws

2. The tax laws dealt with in this Ruling are:

- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Division 328 (ITAA 1997);
- Section 44 of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KL (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 potential 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' or 'Members'.

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

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is

Date of effect

11. This Ruling applies prospectively from 23 January 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 the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. 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 material difference in the arrangement or in the persons' involvement in the arrangement.

Previous Ruling

14. This Ruling applies to the Project that was ruled on in Product Ruling PR 2001/63 which is withdrawn on and from the date this Ruling is made.

Arrangement

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

- Application for Product Ruling dated 15 January 2001;
- Prospectus for Coffee Management Australia Limited ('CMA' or 'the Manager') dated 2 May 2001;
- Supplementary Prospectus for CMA dated 10 May 2001;
- Second Supplementary Prospectus for CMA dated 5 September 2001;
- Third Supplementary Prospectus for CMA dated 19 December 2001;
- The Northern Rivers Coffee Project 2 Constitution received 5 March 2001;
- The Northern Rivers Coffee Project 2 Compliance Plan received 5 March 2001;
- **Management Agreement between CMA and each Grower** received 5 March 2001;
- Deed of Option to purchase land dated 20 March 2001 between Australian Rural Group Limited ('ARG') and CMA;
- Agency Agreement between CMA and ARG Custodians Limited as custodian of the Project; and
- Correspondence received from the applicant dated 12 March 2001, 29 March 2001, 5 April 2001, 10 April 2001, 23 April, 15 November 2001, 18 December 2001 and 24 December 2001.

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

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

17. 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

18. The salient features and effect of these arrangements are summarised below:

Location	Hogarth Range, near Casino, NSW
Type of business each participant is carrying on	Commercial growing, processing and marketing of coffee beans
Number of plantations on offer	334
Size of each plantation	0.144 hectares
Number of bushes per hectare	3472
The term of the investment	Until 30 June 2021
Minimum subscription	20 plantations
Initial cost	$9,412 per plantation
Initial cost per hectare	$65,354

19. The Northern Rivers Coffee Project 2 is a stapled investment. Interests will be divided into both Grower Interests, which will rent and operate the plantation, and shares in the Landholding Company which will own the Project Land. Grower Interests and shares in the landholding company cannot be sold separately although the shares can be owned by an associated entity of the Grower. The Prospectus offers 334 interests for subscription. However, CMA reserves the right to accept oversubscriptions subject to availability of suitable land and obtaining a positive Independents Agricultural Experts opinion. The Third Supplementary Prospectus dated 19 December 2001 reduces the minimum subscription for the Project to 20 stapled interests. If minimum subscription is not reached by 19 April 2002, the Project will not proceed and all application monies will be returned together with any interest earned.

20. The Project has been established to enable Growers to become proprietors of their own primary production business involving the planting and cultivation of coffee bushes on land under a lease held by ARG on property at Hogarth Range near Casino, NSW, and the harvesting and processing of coffee to dried green

bean (DGB) stage for sale and for Growers or a related entity to purchase an interest in Northern Rivers Coffee Landholder No 2 (the Landowner). Growers or their legally related associates will acquire parcels of 2,250 'A' class shares by making a payment of $2,250 in the year ended 30 June 2002.

21. The total land area to be used for the Project is 236.8 hectares. Each plantation will be 0.144 hectares and will be planted with 500 coffee bushes. CMA has entered into an 'option' agreement on an 'or nominee' basis with vendors of both Project properties to secure the initial properties required for the Project. The land will be purchased utilising the capital subscribed to the landholding company by shareholders under this Prospectus.

22. Each Grower enters into a Management Agreement with CMA under which CMA will manage the Grower's business of producing and selling DGB.

Constitution

23. The Constitution establishes the Project and operates as a deed binding all Growers of the Project and the Responsible Entity. The Constitution sets out the terms and conditions under which CMA agrees to act as Responsible Entity and thereby manage the Project. Participants, by entering into the Management Agreement, agree to the terms of the Project Constitution.

Compliance plan

24. CMA has prepared a Compliance Plan in accordance with the Corporations Law. The Compliance Plan's purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Right to occupy

25. The issuance of 'A' class shares in the Landowner as discussed in paragraph 20 above grants to individual Growers an exclusive right to a plantation which will be initially planted with approximately 500 coffee bushes for a period ceasing on 30 June 2021. The full rights and liabilities attaching to the 'A' class shares are set out in Schedule 10A of the Constitution.

26. Growers will be advised of the exact location of their plantation. The right to occupy includes the entitlement to use access roads and the agricultural infrastructure on the land.

27. Growers will pay occupancy fees to the Landowner as follows:

- a fee of $171 for the period 1 July 2002 to 30 June 2003;
- a fee of $110 for the period 1 July 2003 to 30 June 2004; and
- from 1 July 2004, for each subsequent 12 month period until the end of the Project, a fee calculated by reference to the previous year fee uplifted by movements in the All Groups Consumer Price Index.

Management Agreement

28. Growers will enter into a Management Agreement appointing CMA to manage the Growers' interests in the Project. The Management Agreement terminates on 30 June 2021, or earlier if the Grower ceases to have a right to occupy a plantation or if termination occurs otherwise in accordance with the Project Constitution (cl 3).

29. The plantation management services to be provided by CMA are detailed at clause 4. These include, amongst other things:

- preplanting and planting services (cl 4.1);
- post planting services (cl 4.4);
- harvesting the coffee cherry produced (cl 4.4(i));
- process the coffee cherry produced (cl 4.4(j)); and
- marketing and selling the coffee beans processed (cl 4.4(k)).

30. CMA is entitled to delegate all or any of the functions to be performed by it pursuant to the Management Agreement, subject to the Constitution (cl 10.1).

31. CMA may, at its discretion, pool for sale all produce of each Grower's allotment and will market and sell all such produce. The proceeds of the pooled sales will be paid into the Proceeds Fund for crediting to the account of each Grower on a proportional basis without reference to quality, volume, prices or any other factor in relation to the Grower's product or those of any other Grower.

32. Growers may take the coffee attributable to their plantations by making an election under clause 7.2 of the Management Agreement.

Fees payable by a Grower

33. A participant who enters into the Northern Rivers Coffee Project 2 will be bound by the Project Constitution and the Management Agreement. These documents detail, amongst other things, the fees and charges for which an investor is liable. In addition to the fees set out in paragraphs 34 to 40 a Grower may be liable, in certain circumstances, for a number of other fees and charges, which are not able to be currently quantified. These include the possibility, should the need arise, of the Manager charging for any administrative or other costs relating to the Member's election under cl 7.2 of the Management Agreement to take the coffee relevant to the allotment(s).

Application fee

34. A fee of $9,241 comprised of $803 for trees, $275 for planting and preplanting, $1,060 for the provision of water, $40 for other roads and infrastructure and $7,063 for management services is payable on application.

Ongoing management fees

35. Management fees will be incurred after 30 June 2002 as follows:

- a management fee of $2,860 for the 12 month period beginning 1 July 2002;
- a management fee of $2,750 for the 12 month period beginning 1 July 2003;
- a management fee of $1,300 for the 12 month period beginning 1 July 2004;
- subsequent management fees calculated by reference to the previous year fee uplifted by movements in the All Groups Consumer Price Index.

36. It is possible for participants to obtain discounts on the management fees of $7,063 per interest where bulk interests in the Project are acquired. The discounts are as follows:

- 10-25 interests 3% discount
- 26-50 interests 4% discount
- 51 or more interests 5% discount.

Direct debit fees

37. The Grower may elect to pay by direct debit the fees set out in paragraph 35 above. Where this election is made by the Grower, CMA is entitled to charge the Grower an additional fee of $11 per direct debit payment transaction.

Harvesting fees

38. Harvesting fees are to be deducted from the income from the sale of produce for the first harvest (expected in the year ended 30 June 2005) based on a CPI adjusted cost as at 1 July 2001 of $127.60 per pass, and subsequent charges based on the previous year fee uplifted by movements in the All Groups Consumer Price Index.

Processing fees

39. Processing fees will also be deducted from the income for the first year of harvest calculated on the basis of 56 cents per kilogram of processed beans and then further charges in subsequent years based on the previous year per kilogram rate uplifted by movements in the All Groups Consumer Price Index. If a Grower has made an election to take coffee from the harvest under clause 7.2 of the Management Agreement, then these processing fees are not payable by the Grower. The Grower would, however, incur a fee which compensates CMA for its costs in complying with the request under clause 7.2.

Performance fees

40. Performance fees will be charged of 25% of the net proceeds of sale of coffee attributable to the Grower's plantation. If a Grower has made an election under clause 7.2 of the Management Agreement, then this performance fee is not payable by the Grower. However, where such an election has been made, CMA is entitled to take for its own use and benefit 25% of the coffee attributable to the Grower's plantation.

Finance

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

42. 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

43. This Ruling applies only to Growers who are accepted to participate in the Project on or before 30 June 2002 and who have executed a Management Agreement before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

44. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the Prospectus and the Supplementary Prospectuses, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 20 interests is achieved. If minimum subscription is not obtained by 19 April 2002, the Project will not proceed.

The Simplified Tax System ('STS')

Division 328

45. 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

46. 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

47. 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.

48. The Grower recognises ordinary income from carrying on the business of growing coffee at the time that income is derived.

Trading stock

Section 70-35

49. A Grower who is not an 'STS taxpayer' may, in some years, hold coffee beans 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.

50. 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, Occupancy fees and Direct debit fees

Section 8-1

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

Tax Deductions available per interest				
		Year ended 30/6/2002	**Year ended 30/6/2003**	**Year ended 30/6/2004**
Management Fees Section 8-1 (ITAA 1997)	A Grower with less than 10 interests	$7,063 – See Note (i) (below)	$2,860 – See Notes (i) and (ii) (below)	$2,750 – See Notes (i) and (ii) (below)
	A Grower with 10 - 25 interests	$6,851 – See Note (i) (below)	$2,860 – See Notes (i) and (ii) (below)	$2,750 – See Notes (i) and (ii) (below)
	A Grower with 25 - 50 interests	$6,780 – See Note (i) (below)	$2,860 – See Notes (i) and (ii) (below)	$2,750 – See Notes (i) and (ii) (below)
	A Grower with 51 or more interests	$6,710 – See Note (i) (below)	$2,860 – See Notes (i) and (ii) (below)	$2,750 – See Notes (i) and (ii) (below)
Occupancy Fees Section 8-1 (ITAA 1997)		$171 – See Note (i) (below)	$110 – See Notes (i) and (ii) (below)	$110 – See Notes (i) and (ii) (below)
Direct Debit Fees Section 8-1 (ITAA 1997)		See Notes (i) and (iii) (below)	See Notes (i) and (iii) (below)	See Notes (i) and (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 122;

(ii) The Management fees and the Occupancy fees shown in the Management Agreement and the Constitution 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 occupancy of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 95 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) Where a Grower incurs direct debit fees as set out in the Management Agreement, those fees are deductible in full in the year incurred.

Deductions for capital expenses

Division 40

52. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to irrigation and establishment of horticultural plants. All deductions shown in the following Table are determined under Division 40.

Fee type	ITAA 1997 section	Year ended 30/6/2002	Year ended 30/6/2003	Year ended 30/6/2004
Irrigation costs	40-515	$353 - see notes (iv) and (v) below	$353 - see notes (iv) and (v) below	$353 – see notes (iv) and (v) below
Establishment of horticultural plants	40-515	Nil - see notes (iv) and (vi) below	Nil - see notes (iv) and (vi) below	Nil – see notes (iv) and (vi) below

Notes:

(iv) 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 122;

(v) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540);

(vi) As coffee bushes are affixed to land which the Grower does not own, they are not owned by the Grower, the conditions in subsection 40-525(3) cannot be met, and the coffee bushes are not eligible for the 4 year write-off under section 40-550. However, coffee bushes are 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land , 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 coffee bushes 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 coffee bushes 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 coffee bushes enter their first commercial season (section 40-530, item 2). The Project Manager will inform Growers of when the coffee bushes enter their first commercial season.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5

53. 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.

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

Treatment of trading stock

Section 328-285

55. A Grower who is an 'STS taxpayer' may, in some years, hold coffee beans that will constitute trading stock on hand. Where, for such a Grower ,for an income year, the difference between the value of all his/her 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)).

56. 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, Occupancy fees, Interest and Direct debit fees

Section 8-1 and section 328-105

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

Tax Deductions available per interest				
		Year ended 30/6/2002	**Year ended 30/6/2003**	**Year ended 30/6/2004**
Management Fees Section 8-1 (ITAA 1997)	A Grower with less than 10 interests	$7,063 – See Note (vii) (below)	$2,860 – See Notes (vii) and (viii) (below)	$2,750 – See Notes (vii) and (viii) (below)
	A Grower with 10 - 25 interests	$6,851– See Note (vii) (below)	$2,860 – See Notes (vii), (viii) and (ix) (below)	$2,750 – See Notes (vii), (viii) and (ix) (below)
	A Grower with 25 - 50 interests	$6,780 – See Note (vii) (below)	$2,860 – See Notes (vii), (viii) and (ix) (below)	$2,750 – See Notes (vii), (viii) and (ix) (below)
	A Grower with 51 or more interests	$6,710 – See Note (vii) (below)	$2,860 – See Notes (vii), (viii) and (ix) (below)	$2,750 – See Notes (vii), (viii) and (ix) (below)
Occupancy Fees Section 8-1 (ITAA 1997)		$171 – See Note (vii) (below)	$110 – See Notes (vii), (viii) and (ix) (below)	$110 – See Notes (vii), (viii)and (ix) (below)

Direct Debit Fees Section 8-1 (ITAA 1997)		See Notes (vii) and (x) (below)	See Notes (vii) and (x) (below)	See Notes (vii) and (x) (below)

Notes:

(vii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 122;

(viii) 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 in which it is actually paid;

(ix) Where a Member who is an 'STS taxpayer', pays the Management fees and the Occupancy fees in the relevant income years shown in the Management Agreement and the Constitution, 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 occupancy 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 (see paragraphs 89 to 100) . In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 95, 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;

(x) Where a Grower incurs direct debit fees as set out in the Management Agreement, those fees are deductible in full in the year paid.

Deductions for capital expenditure

Subdivision 328-D and Subdivision 40-F

58. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to irrigation and establishment of horticultural plants. An 'STS taxpayer' may claim deductions in relation to irrigation under Subdivision 40-F. If the irrigation expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328. Deductions for the coffee bushes must be determined under Subdivision 40-F.

59. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on irrigation under Subdivision 40-F and not under Division 328.

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

Fee type	ITAA 1997 section	Year ended 30/6/2002	Year ended 30/6/2003	Year ended 30/6/2004
Irrigation costs	40-515	$353 - see notes (xi) and (xii) below	$353 - see notes (xi) and (xii) below	$353 - see notes (xi) and (xii) below
Establishment of horticultural plants	40-515	Nil - see notes (xi) and (xiii) below	Nil - see notes (xi) and (xiii) below	Nil - see notes (xi) and (xiii) below

Notes:

(xi) 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 122;

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

Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than $1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2002 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540);

(xiii) As coffee bushes are affixed to land which the Grower does not own, they are not owned by the Grower, the conditions in subsection 40-525(3) cannot be met, and the coffee bushes are not eligible for the 4 year write-off under section 40-550. However, coffee bushes are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land, 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 coffee bushes 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 coffee bushes 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 coffee bushes enter their first commercial season (section 40-530(2)). The Project Manager will inform Growers of when the coffee bushes enter their first commercial season.

Tax outcomes that apply to all Growers

Interest

61. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 89 to 100 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

Section 35-55 – Commissioner's discretion

62. 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.

63. 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 110 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
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

64. 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.

65. 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

66. For a Grower who participates in the Project and incurs expenditure as required by the Management 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 89 to 100);
- 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

Is the Grower carrying on a business?

67. For the amounts set out in the Tables above to constitute allowable deductions the Grower's coffee growing activities as a participant in the Northern Rivers Coffee Project 2 must amount to the carrying on of a business of primary production. These coffee growing activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

68. For schemes such as that of the Northern Rivers Coffee Project 2, 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.

69. Generally, a Grower will be carrying on a business of coffee growing, and hence primary production, if:

- the Grower has an identifiable interest in the land on which the Grower's coffee bushes are established;
- the Grower has a right to harvest and sell the coffee each year from those coffee bushes;
- the coffee growing activities are carried out on the Grower's behalf;
- the coffee growing activities of the Grower are typical of those associated with a coffee growing business; and
- the weight and influence of general indicators point to the carrying on of a business.

70. In this Project, each Grower enters into a Management Agreement.

71. Under the Management Agreement and the Constitution each individual Grower will have rights over a specific and identifiable area of land. The Grower has an ongoing interest in the specific coffee bushes for the term of the Project. The Grower must use the land in question for the purpose of carrying out coffee growing activities and for no other purpose. The Project Manager may come onto the land to carry out its obligations under the Management Agreement.

72. Under the Management Agreement the Project Manager is engaged by the Grower to establish and maintain a plantation 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 plantation on the Grower's behalf.

73. In establishing the plantation, the Grower engages the Project Manager to purchase and install irrigation, and to acquire and plant coffee bushes on the Grower's plantation. During the term of the Project, these assets will be used wholly to carry out the Grower's coffee growing activities. The Project Manager is also engaged to harvest and sell, on the Grower's behalf, the coffee grown on the Grower's plantation.

74. 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.

75. 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 coffee 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.

76. The pooling of coffee grown on the Grower's plantation with the coffee of other Growers is consistent with general coffee growing practices. Each Grower's proportionate share of the sale proceeds of the pooled coffee will reflect the proportion of the coffee contributed from his/her plantation.

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

78. 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 plantation 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.

79. The coffee growing 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' coffee growing activities in the Northern Rivers Coffee Project 2 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

80. 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.

81. 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 occupancy fees

Section 8-1

82. Consideration of whether the initial management fees and occupancy 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.

83. The management fees and occupancy fees associated with the coffee growing activities will relate to the gaining of income from the Grower's business of coffee growing (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of coffee) 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

84. Under the Management Agreement and the Constitution neither the management fees nor the occupancy fees 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.

85. 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 89 to 100) 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

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

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

88. If the Grower is an 'STS taxpayer' the management fees and the occupancy fees 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

89. 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 occupancy 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.

90. 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

91. 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)).

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

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

93. 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. 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.

94. 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.

95. 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.

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

96. 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

97. In this Project, an initial management fee of $7,063 and an initial Occupancy Fee of $171 per plantation will be incurred on execution of the Management Agreement. The Management Fee and the Occupancy Fee are charged for providing management services or occupancy of land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreement, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

98. 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.

99. 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. Occupancy fees are payable annually in advance for the occupancy of the land during the expenditure year.

100. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 34 to 40 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*

101. Although not required under either the Management Agreement or the Constitution, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 100 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

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

Expenditure of a capital nature

Division 40 and Division 328

104. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to irrigation and the establishment of the coffee bushes is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

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

106. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 52 and 60 (above) in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

107. 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.

108. 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.

109. 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.

110. 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.

111. 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).

112. 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 interest in the Project is unlikely to have his/her activity pass one of the tests until the income year ended 30 June 2008. A Grower who acquires more than one interest in the Project may however, find that his/her activity meets one of the tests in an earlier income year.

113. 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.

114. 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; and

(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.

115. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2006. The Commissioner 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. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

116. 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 62), in the manner described in the Arrangement (see paragraphs 15 to 42). 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.

117. 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 consultant;
- information in the Prospectus showing the sale price of coffee beans at wholesale markets over recent years;
- independent, objective, and generally available information relating to the horticultural industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity; and
- the Prospectus for the Project which sets out projected coffee yields at the properties, and coffee prices of the projected market.

Section 82KL - recouped expenditure

118. 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

119. 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).

120. The Northern Rivers Coffee Project 2 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 51 to 60 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.

121. 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 coffee. 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

122. 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	$2 200*
Total due and payable by 1 January 2002 (includes GST of $600)	$6 600

*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 x $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 x $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).

Detailed contents list

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

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Commissioner of Taxation
23 January 2002

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Related Rulings/Determinations:
PR 1999/95; PR 2001/63, TR 92/1; TR 97/11; TR 97/16; TR 92/20; TR 98/22; TD 93/34; TR 2000/8; IT 360

Subject references:
- carrying on a business
- commencement of a business
- interest expenses
- harvesting expenses
- management fees
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- tax benefits
- horticultural expenses

Legislative references:
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