



PR 2003/2 - Income tax: 2003 Timbercorp Almond Project (revised arrangement)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *29 January 2003*



Product Ruling

Income tax: 2003 Timbercorp Almond Project (revised arrangement)

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Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the 2003 Timbercorp Almond Project or simply as 'the Project'.

Tax law(s)

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);
 - Section 25-25 (ITAA 1997);
 - Section 70-35 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Division 40 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Section 82KZME (ITAA 1936);
 - Section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the Ralph *Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

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

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling these persons are referred to as 'Growers'.

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

Qualifications

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

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Date of effect

11. This Ruling applies prospectively from 29 January 2003, 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 2006. 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.

Previous Ruling

14. This Ruling replaces Product Ruling PR 2002/143 which is withdrawn on and from the date this Ruling is made 29 January 2003.

Product Ruling PR 2002/143 will continue to apply to participants who entered into the Project before 29 January 2003.

Arrangement

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

- Application for a Product Ruling dated 27 August 2002;
- Draft Management Agreement between Timbercorp Securities Limited ('TSL') and Almond Management Pty Ltd ('AMPL'), dated 23 August 2002;
- Draft **Constitution** for the 2003 Timbercorp Almond Project, dated 27 August 2002;
- Draft Compliance Plan for the 2003 Timbercorp Almond Project, dated 27 August 2002;
- Draft Custody Agreement for the 2003 Timbercorp Almond Project, dated 27 August 2002;
- **Draft Almondlot Management Agreement** between TSL and each Grower, dated 28 October 2002;
- Draft Prospectus for the 2003 Timbercorp Almond Project, dated 28 November 2002 ('the Prospectus');
- Draft Lease Agreement for the 2003 Timbercorp Almond Project (Yungera Site) between ALPL as Lessor and TSL as Lessee, provided on 5 December 2002;
- Draft Sub-lease Agreement for the 2003 Timbercorp Almond Project (Yungera Site) between TSL as Sub-lessor and ALPL as Sub-lessee, provided on 5 December 2002;
- **Draft Licence and Joint Venture Agreement** between ALPL, TSL and each Grower, dated 9 December 2002;
- Draft Almond Orchard Management Agreement for the 2003 Timbercorp Almond Project between AMPL, Select Harvests Limited ('Select'), TSL, Timbercorp Limited, Almond Investments Australia Pty Ltd and ALPL, undated;
- Draft Tree Supply and Capital Works Agreement for the 2003 Timbercorp Almond Project between ALPL,

Select, Timbercorp Limited and Almond Investments Australia Pty Ltd, undated;

- Draft 2003 Timbercorp Almond Project Finance Package, undated; and
- Correspondence and attachments from the Applicant dated 28 October 2002, 22 November 2002, 25 November 2002, 26 November 2002, 28 November 2002, 5 December 2002, 9 December 2002 and 20 January 2003.

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

16. The documents highlighted are those Growers enter into or become a party to. The Loan Agreement referred to in the Finance Package will be executed where a Grower successfully applies for finance from Timbercorp Finance Pty Ltd. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are part of the arrangements to which this Ruling applies. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

Overview

17. This arrangement is called the 2003 Timbercorp Almond Project.

Location	Yungera site, near Boundary Bend in north west Victoria
Type of business each participant is carrying on	Cultivating almond trees on their designated 0.25 hectare Almondlots and harvesting the almonds for processing and sale
Area under cultivation	Up to 500 hectares will be divided into 2000 Almondlots of 0.25 hectares each. There is an option to accept oversubscriptions and cultivate additional land.
Minimum subscription	No minimum subscription
Minimum number of Almondlots than can be subscribed for	Two (2), although TSL reserves the right in its absolute discretion to accept applications for less than

	two Almondlots.
Number of almond trees	An average of 247 trees per hectare or 62 trees per Almondlot
Term of the Project	Approximately 20 years commencing on acceptance of a Grower's application and ending on 30 June 2023
Initial cost to Growers	\$6,065 per Almondlot, comprising initial Management Fee of \$5,200 and Licence Fee of \$865
Initial cost per hectare	\$24,260
Other costs to Growers	On going costs will be payable (refer to paragraph 28).
Joint Venture	Each Grower will enter into a joint venture with ALPL. The Grower will be entitled to 90% of the joint venture assets and will be entitled to 90% of the almonds and of the proceeds of sale. The Grower will also be responsible for 90% of the management fees.

18. The Land Owner, ALPL, will establish an almond orchard on land known as the Yungera site which is situated within close proximity to Boundary Bend, in north west Victoria. The Land Owner will also establish all infrastructure and other capital works necessary to operate a commercial almond growing operation.

19. The offer to participate in the Project is open until the expiry of the prospectus. Application moneys payable by applicants who are accepted into the Project on or before 15 June 2003 will be in respect of services to be wholly provided by 30 June 2003. TSL will only accept applicants during the period 16 June 2003 to 30 June 2003 if the services in consideration of the application moneys payable by these applicants can be wholly provided by 30 June 2003. Applicants who are accepted on or before 30 June 2003 are described as 'Early Growers'. Applicants who are accepted into the Project on or after 1 July 2003 and before the offer period closes are referred to as 'Post 30 June Growers'. The application moneys payable by 'Post 30 June Growers' on application are payable in respect of services to be wholly provided by 30 June 2004. It should be noted that TSL will only provide services following the execution of the Licence and Joint Venture Agreement and the Almondlot Management Agreement.

20. Growers (in joint venture with ALPL) will enter into the Almondlot Management Agreement with TSL, to perform services in relation to the cultivation and management of their Almondlots. Under the Management Agreement, TSL will engage AMPL to carry out the Orchard Services required under the Almondlot Management Agreement and to sell the almonds. Under the Almond Orchard Management Agreement, AMPL has engaged Select to undertake the day to day management of the Almondlots, harvest, process and sell the almonds.

21. Under the Almond Orchard Management Agreement, Select guarantees to AMPL that the entire annual crop of almonds available for harvest in a particular season will be sold by 30 June in the financial year after the year in which the harvest for that season commences. This Agreement also provides that until the almonds from the Project are sold, they will be kept separate from all other almonds that have been processed or stored by Select. Select will pool the Growers' almonds with all other almonds sold by it. As contemplated by Schedule 1 of this Agreement, sub-pools will be established by Select. These sub-pools will be based on grades that will be marketed separately and for which substantial price differentials will exist. Prices will be calculated separately for each sub-pool. Based on this calculation, each Grower will receive the same price as Select receives for each sub-pool. Accordingly, each Grower will receive a pro-rata share of the net sale proceeds less his or her annual costs.

22. TSL will endeavour to arrange insurance on the Growers' behalf. Where this is available, Growers are required to insure their Almondlots against damage or destruction by fire and other insurable risks. TSL will arrange payment of insurance premiums to the appropriate insurers.

Licence and Joint Venture Agreement

23. Under the Licence and Joint Venture Agreement, ALPL warrants that it will use best endeavours to establish the Orchard by 30 June 2003. Under this agreement each Grower will be given a right to use and occupy a minimum of two 0.25 hectare Almondlots for a period of approximately 20 years ending on 30 June 2023, for the purpose of cultivating the Almondlots for the production of almonds for processing and sale. TSL has the discretion to accept an application for less than two Almondlots.

24. Under the agreement, each Grower will enter into a joint venture arrangement with ALPL (on a 90%:10% basis) in respect of the cultivation and management of their Almondlots. As a result, each Grower will be responsible for 90% of all management costs associated with the cultivation and management of their Almondlots

and will be entitled to 90% of all produce. In return for paying an annual licence fee, each applicant Grower obtains a non-exclusive licence to use and occupy Almondlots (in joint venture with ALPL). Under the terms of the agreement, a Grower may only use the land for the purpose of cultivating and harvesting almonds for processing and sale.

25. At the expiration of the Project, each Grower must return the Almondlots to ALPL in good condition but is not required to remove the almond trees or restore the Almondlots to their original condition.

Almondlot Management Agreement

26. Under the Almondlot Management Agreement, each Grower (in joint venture with ALPL) engages TSL to manage the orchard on behalf of the Grower. TSL is required to perform the services listed in a proper and efficient manner in accordance with good horticultural and environmental practices. Included in the listed services are pruning of the almond trees, vermin control, obtaining water licences and irrigating the orchard, soil testing, fertilising the trees, destruction of diseased trees, keeping improvements in good repair, maintaining fire breaks, soil management, weed control, keeping records of chemicals applied, inspection of stakes, fences and equipment, retying trees to stakes or trellising where required and replacement of trees where required.

27. TSL will also prepare, or arrange for the preparation of, annual Management Plan for the Project, including a horticultural plan for the Orchard, horticultural program, operational plan and annual financial and operational budgets in relation to these horticultural matters, review the Management Plan and, if necessary, make amendments to it. The initial Management Plan for the Financial Year ended 30 June 2003 will be prepared on or about the Commencement Date or before 30 June 2003, whichever date is earlier and attached to the Agreement as the Second Schedule. TSL will also be responsible for harvesting, processing and sale of almonds as well as the provision of administrative services.

Fees

28. Under the terms of the Licence and Joint Venture Agreement and the Almondlot Management Agreement, Growers will make the following payments per Almondlot:

Early Growers

- \$5,200 management fee in respect of services to be provided in the period commencing on the Commencement Date and ending on 30 June 2003

payable in advance on or before the Commencement Date ('initial management fee');

- \$1,870 management fee in respect of services to be provided in the period 1 July 2003 to 30 June 2004 payable on 31 October 2003;
- \$1,870 management fee in respect of services to be provided in the period 1 July 2004 to 30 June 2005 payable on 31 October 2004;
- \$865 licence fee for the period from the Commencement Date until 30 June 2003 payable on or before the Commencement Date;
- \$865 licence fee for each of the Financial Years ending 30 June 2004 and 30 June 2005 payable on 31 October 2003 and 31 October 2004, respectively.

Post 30 June Growers

- \$5,200 management fee in respect of services to be provided in the period commencing on the Commencement Date and ending on 30 June 2004 payable in advance on or before the Commencement Date ('initial management fee');
- \$1,870 management fee in respect of services to be provided in the period 1 July 2004 to 30 June 2005 payable on 31 October 2004;
- \$865 licence fee for the period from the Commencement Date until 30 June 2004 payable on or before the Commencement Date;
- \$865 licence fee for the Financial Year ending 30 June 2005 payable on 31 October 2004.

All Growers

From and including the Financial Year ending 30 June 2006 all Growers will pay the following fees in each Financial Year:

- management fee in respect of services to be provided in each Financial Year to be estimated in the first instance by TSL and adjusted once the actual costs of managing the Grower's Almondlots are determined, payable on 31 October each year;
- an additional management fee of 3% of the proceeds of sale;
- an incentive fee, of 25% of so much of the proceeds of sale (after deducting the fee referred to in the previous

dot point) payable to a Grower in a financial year as exceeds the proceeds estimated in the prospectus, less any allowance for inflation arriving at such estimate, but indexed from the date of the Almondlot Management Agreement. This fee will be calculated on a 2 year rolling basis to allow for variations in yields from year to year;

- licence fee the amount being the licence fee payable on the immediately preceding 31 October, indexed, payable on 31 October each year.

29. If a Grower fails to pay an amount payable by the due date, the Constitution sets-out the manner in dealing with such default.

Finance

30. Growers can either fund their participation in the Project themselves, borrow from an independent lender, or may elect to use the financing packages offered by Timbercorp Finance Pty Ltd (a lender associated with the Responsible Entity).

31. Under the financing package offered by Timbercorp Finance Pty Ltd ('the Lender'), Growers may enter into the following finance arrangement.

32. A loan application fee of \$250 is payable. The minimum loan is \$5,000. The Lender will lend, generally, up to 80% of the fixed fees payable by Growers during the first three years of the Project at commercial interest rates. In the event of default, a higher interest rate will apply. In all instances, the loan is repayable by equal monthly installments of principal and interest deducted from the borrower's bank account under a direct debit authority. All or part of a loan may be repaid at any time without penalty. Corporate borrowers are required to provide guarantees and indemnities. The provision of finance involves full recourse loans and the Lender will pursue legal action against defaulting borrowers.

33. This Ruling does not apply if the finance arrangement entered into by the Grower includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the

funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;

- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than Timbercorp Finance Pty Ltd, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

34. This Product Ruling applies to Growers who are accepted to participate in the Project:

- on or before 30 June 2003, where the Grower has executed the Licence and Joint Venture Agreement and the Almondlot Management Agreement on or before that date ('Early Growers'). Application to participate in the Project that is received during the period 16 June 2003 to 30 June 2003 will only be accepted (and Agreements executed) if TSL can wholly provide the services in consideration of the moneys payable on application by 30 June 2003; and/or
- on or after 1 July 2003 and before the expiry date of the Prospectus where the Grower has executed the Licence and Joint Venture Agreement and the Almondlot Management Agreement on or between those dates ('Post 30 June Grower').

35. 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**

36. 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

37. 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**

38. That part of the gross sales proceeds from the Project attributable to the Grower's share of the gross proceeds from the sale of the product of the joint venture, less any GST payable on the Grower's share of those proceeds (section 17-5), will be assessable income of the Grower under section 6-5. Note that the term 'joint venture' is used in this Product Ruling in a general accounting and legal sense, and **not** as a reference to entities that are entitled to apply to the Commissioner to be treated as an approved GST joint venture within the meaning of Division 51 of *A New Tax System (Goods and Services Tax) Act 1999*.

39. The Grower recognises ordinary income from carrying on the business of growing almonds for processing and sale at the time that income is derived.

Trading stock**Section 70-35**

40. During the term of the Project a Grower who is not an 'STS taxpayer' may hold almonds 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.

41. 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.

42. During each year of the Project TSL will provide the Grower with sufficient information to enable the Grower to determine the value of trading stock on hand at the end of the relevant income year.

Deductions for management fees, licence fees and interest**Section 8-1**

43. An Early Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses.

Fee Type	ITAA 1997 Section	30/6/2003	30/6/2004	30/6/2005
Management fee	8-1	\$5,200 – See Notes (i) & (ii) below	\$1,870 – See Notes (i) & (ii) below	\$1,870 – See Notes (i) & (ii) below
Licence fee	8-1	\$865 – See Notes (i) & (ii) below	\$865 – See Notes (i) & (ii) below	\$865 – See Notes (i) & (ii) below
Interest on borrowed funds	8-1	As incurred – See Note (iii) below	As incurred – See Note (iii) below	As incurred – See note (iii) below

44. A Post 30 June Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses.

Fee Type	ITAA 1997 Section	30/6/2004	30/6/2005	30/6/2006
Management fee	8-1	\$5,200 – See Notes (i) & (ii) below	\$1,870 – See Notes (i) & (ii) below	As incurred – See Notes (i) & (ii) below
Licence fee	8-1	\$865 – See Notes (i) & (ii) below	\$865 – See Notes (i) & (ii) below	\$865, indexed – See Notes (i) & (ii) below
Interest on borrowed funds	8-1	As incurred – See Note (iii) below	As incurred – See Note (iii) below	As incurred – See note (iii) below

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 123;
- (ii) The management fees and the licence fees shown in the Almondlot Management Agreement and the Licence and Joint Venture Agreement are deductible in full in the year that they are incurred. However, if a Grower chooses to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 96 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) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than

Timbercorp Finance Pty Ltd, the internal financier, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with Timbercorp Finance Pty Ltd, should read the discussion of the prepayment rules in paragraphs 90 to 104 (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.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5 and section 328-105

45. That part of the gross sales proceeds from the Project attributable to the Grower's share of the gross proceeds from the sale of the product of the joint venture, less any GST payable on the Grower's share of those proceeds (section 17-5), will be assessable income of the Grower under section 6-5. Note that the term 'joint venture' is used in this Product Ruling in a general accounting and legal sense, and **not** as a reference to entities that are entitled to apply to the Commissioner to be treated as an approved GST joint venture within the meaning of Division 51 of *A New Tax System (Goods and Services Tax) Act 1999*.

46. The Grower recognises ordinary income from carrying on the business of growing almonds for processing and sale at the time the income is received (paragraph 328-105(1)(a)).

Trading stock

Section 328-285

47. During the term of the Project, a Grower who is an 'STS taxpayer' may hold almonds that will constitute trading stock on hand. Where the difference between the value of all of a Grower's trading stock at the start of an income year and a reasonable estimate of it at the end of an income year is less than \$5,000, the Grower does not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

48. 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)).

49. During each year of the Project, TSL will provide the Grower with sufficient information to enable the Grower to determine the value of trading stock on hand at the end of the relevant income year.

Deductions for management fees, licence fees and interest

Section 8-1 and section 328-105

50. An Early Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses.

Fee Type	ITAA 1997 Section	30/6/2003	30/6/2004	30/6/2005
Management fee	8-1 & 328-105	\$5,200 – See Notes (iv), (v) & (vi) below	\$1,870 – See Notes (iv), (v) & (vi) below	\$1,870 – See Notes (iv), (v) & (vi) below
Licence fee	8-1 & 328-105	\$865 – See Notes (iv), (v) & (vi) below	\$865 – See Notes (iv), (v) & (vi) below	\$865 – See Notes (iv), (v) & (vi) below
Interest on borrowed funds	8-1 & 328-105	As incurred – See Note (vii) below	As incurred – See Note (vii) below	As incurred – See note (vii) below

51. A Post 30 June Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses.

Fee Type	ITAA 1997 Section	30/6/2004	30/6/2005	30/6/2006
Management fee	8-1 & 328-105	\$5,200 – See Notes (iv), (v) & (vi) below	\$1,870 – See Notes (iv), (v) & (vi) below	As incurred – See Notes (iv), (v) & (vi) below
Licence fee	8-1 & 328-105	\$865 – See Notes (iv), (v) & (vi) below	\$865 – See Notes (iv), (v) & (vi) below	\$865 – indexed See Notes (iv), (v) & (vi) below

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Interest on borrowed funds	8-1 & 328-105	As incurred – See Note (vii) below	As incurred – See Note (vii) below	As incurred – See Note (vii) below
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Notes:

- (iv) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 123;
- (v) 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;
- (vi) Where a Grower who is an 'STS taxpayer', pays the management fees and the licence fees in the relevant income years shown in the Almondlot Management Agreement and the Licence and Joint Venture Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as 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 96, 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;
- (vii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd, the internal financier is outside the scope of this Ruling. However, all Growers, including those who finance their participation in the Project other than with Timbercorp Finance Pty Ltd, should read the discussion of the prepayment rules in

paragraph 90 to 104 (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.

Tax outcomes that apply to all Growers

Deduction for the loan application fee

Section 25-25

52. The Loan Application fee of \$250 is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The expense is deductible over the period of the loan specified in the loan agreement, or five years, whichever is the shorter period, beginning with the year in which they were incurred (subsections 25-25(4) and (5)).

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

Section 35-55 – Commissioner's discretion

53. 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 2008 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

54. For a Grower who is an individual and who enters the Project during the year ended 30 June 2004 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 2004 to 30 June 2008 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

55. 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 109 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

- a 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)).

56. 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.

57. 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.

Deductions for horticultural plant

Division 40

58. A Grower will also be entitled to tax deductions relating to the almond trees on the Almondlot. The deductions shown in the table below are determined under Division 40.

ITAA 1997 Section	30/6/2003	30/6/2004	30/6/2005	30/6/2006
Section 40-515	nil - See Note (ix) (below)	nil - See Note (ix) (below)	nil - See Note (ix) (below)	\$102.38 – See Notes (viii) & (ix) below

Notes:

- (viii) 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 123;
- (ix) An almond tree is considered to be a 'horticultural plant' as defined in subsection 40-520(2). A Grower holds a licence to cultivate almond trees on a designated land called an Almondlot for the growing of almonds for commercial gain in Joint Venture with

ALPL. This licence is limited to that Grower's Prescribed Proportion of the Joint Venture Assets of 90%. As a Grower holds the land under a licence, 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 is determined using the formula in section 40-545. The establishment expenditure that can be written-off by a Grower is limited to 90% of the capital expenditure incurred that is attributable to the establishment of the almond trees. As the almond trees have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the almond trees enter their first commercial season (section 40-530, item 2).

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

59. For a Grower who participates in the Project and incurs expenditure as required by the Almondlot Management Agreement and the Licence and Joint Venture 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 90 to 104);
- 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?

60. For the amounts set out in the tables above to constitute allowable deductions the Grower's activities of cultivating almond trees and harvesting the almonds for eventual sale as a participant in the 2003 Timbercorp Almond Project must amount to the carrying on of a business of primary production.

61. Where there is a business, or a future business, the gross proceeds from the sale of the almonds will constitute gross assessable income in their own right. The generation of 'business income' from

such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

62. For schemes such as that of the 2003 Timbercorp Almond Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929; (1984) 16 ATR 55.

63. Generally, a Grower will be carrying on a business of cultivating almond trees and harvesting the almonds for eventual sale, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the almonds produce from those trees;
- the cultivating almond trees and harvesting the almonds are carried out on the Grower's behalf;
- the activities of the Grower are typical of those associated with a business of cultivating almond trees and harvesting the almonds for commercial gain; and
- the weight and influence of general indicators point to the carrying on of a business.

64. In this Project, each Grower enters into a Licence and Joint Venture Agreement and an Almondlot Management Agreement.

65. Under the Licence and Joint Venture Agreement, each individual Grower will have rights over a specific and identifiable area of 0.25 hectares or more of land. The Licence and Joint Venture Agreement provides the Grower with an ongoing interest in the specific trees on the licenced area for the term of the Project. Under the Licence, the Grower must use the land in question for the purpose of carrying out activities of cultivating almond trees and harvesting the almonds for eventual sale and for no other purpose. The Licence allows TSL, as the Manager, to come onto the land to carry out its obligations under the Almondlot Management Agreement.

66. Under the Almondlot Management Agreement the Manager is engaged by the Grower to maintain an Almondlot 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 Almondlot on the Grower's behalf.

67. The Manager is also engaged to harvest the almonds grown on the Grower's Almondlot for processing and eventual sale on the Grower's behalf.

68. 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.

69. 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 almonds 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.

70. There will be a pooling of almonds from trees grown on the Grower's Almondlot with almonds from other sources. Each Grower's proportionate share of the sale proceeds of the pooled almonds will reflect the proportion of the trees contributed from their Almondlot (see paragraph 21 for more details).

71. The Manager's services are also consistent with general horticultural practices. They are of the type ordinarily found in horticultural ventures that would commonly be said to be businesses. While the size of an Almondlot is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

72. The Grower's degree of control over the Manager as evidenced by the Almondlot 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 Almondlot 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.

73. The activities of cultivating almond trees and harvesting the almonds for eventual sale, 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 activities of cultivating almond trees and harvesting the almonds for eventual sale in the 2003 Timbercorp Almond Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

74. 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.

75. 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 licence fees

Section 8-1

76. Consideration of whether the initial management fee and licence fee 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.

77. The management fees and licence fees associated with the activities of cultivating almond trees and harvesting the almonds for eventual sale will relate to the gaining of income from the Grower's business of cultivating almond trees and harvesting the almonds for eventual sale (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of almonds) 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

78. Under the Almondlot Management Agreement and the Licence and Joint Venture Agreement neither the management fees nor the licence 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.

79. 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 90 to 104) 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

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

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

82. If the Grower is an 'STS taxpayer' the management fees and the licence 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.

Interest deductibility

Section 8-1

(i) Growers who use Timbercorp Finance Pty Ltd as the finance provider

83. Some Growers may finance their participation in the Project through a loan facility with Timbercorp Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of management and licence fees.

84. The interest incurred for the year ended 30 June 2003 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations - the cultivation and growing of almond trees and the licence of the land on which the trees will have been planted - that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

85. As with the management fees and the licence fees, in the absence of any application of the prepayment provisions (see paragraphs 90 to 104), the timing of deductions for interest will again depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

86. If the Grower is not an 'STS taxpayer', interest is deductible in the year in which it is incurred.

87. If the Grower is an 'STS taxpayer' interest is not deductible until it has been both incurred and paid, or is paid for the Grower. If interest 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.

(ii) Growers who DO NOT use Timbercorp Finance Pty Ltd as the finance provider

88. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier other than Timbercorp Finance Pty Ltd is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

89. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Grower may choose to prepay such interest.

Unless such prepaid interest is ‘excluded expenditure’ any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 90 to 104).

Prepayment provisions

Sections 82KZL to 82KZMF

90. 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.

91. 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 ‘STS taxpayers’ from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

92. 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)).

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

- the taxpayer’s allowable deductions under the agreement for the ‘expenditure year’ exceed any assessable income attributable to the agreement for that year;
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the

significant aspects of the arrangement are managed by someone other than the taxpayer; and

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

94. 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 Timbercorp Finance 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.

95. 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.

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

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

97. 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

98. In this Project, an initial management fee of \$5,200 and an initial licence fee of \$865 per Almondlot will be incurred on execution of the Almondlot Management Agreement and the Licence and Joint Venture Agreement. The management fee and the licence fee are charged for providing management services or licencing land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

99. 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.

100. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee and the fees for subsequent years, is for the Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Licence and Joint Venture Agreement, licence fees are payable annually on 31 October for the licence to use and occupy the land from 1 July to 30 June during the expenditure year. Similarly, under the loan agreements to be executed between Growers and Timbercorp Finance Pty Ltd interest is payable monthly in arrears.

101. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 28, 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

102. Although not required under either the Almondlot Management Agreement, the Licence and Joint Venture Agreement, or the Loan Agreement with Timbercorp Finance Pty Ltd, a Grower participating in the Project may **choose** to prepay fees/interest for a period beyond the 'expenditure year'. Similarly, Growers who use financiers other than Timbercorp Finance Pty Ltd may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 101 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

103. For these Growers, the amount and timing of deductions for any relevant prepaid management fees, prepaid licence 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.

104. 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.

Deductibility of the loan application fee

Section 25-25

105. Borrowing expenses are deductible under section 25-25 where the borrowed moneys are used or are to be used during that income year for income producing purposes. The expenses are deductible over the period of the loan specified in the loan agreement, or five years, whichever is the shorter period, beginning with the year in which they were incurred (subsections 25-25(4) and (5)). Borrowing expenses of \$100 or less are deductible in the year in which they are incurred (subsection 25-25(6)).

Deferral of losses from non-commercial business activities

Division 35

106. 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 incurred by an individual from certain business activities will not be allowable in an income year unless:

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

107. 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.

108. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity,

or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

109. For the purposes of applying the objective tests, 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.

110. In broad terms, the objective tests require:

- at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

111. 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 participation of two Almondlots (although TSL reserves the right to accept applications for one Almondlot) in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2011. Growers who acquire more than the minimum participation in the Project may however, find that their activity meets one of the tests in an earlier income year.

112. 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.

113. 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 satisfied one of the objective tests; and
- (iii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

114. For a Grower who is an individual and who enters the Project during the years ended 30 June 2003 and/or 30 June 2004, information provided with this Product Ruling indicates that a Grower in the Project is expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2009. 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 2008.

115. 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 paragraphs 53 & 54), in the manner described in the Arrangement (see paragraphs 15 to 33). 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.

116. 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 draft report of the independent Almond Orchard Expert; and
- independent, objective, and generally available information relating to the almond growing industry.

Section 82KL – recouped expenditure

117. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

118. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

119. Section 82KL's operation depends, among other things, on the identification of 'additional benefit(s)'. Here, there may be a loan provided to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA – general anti-avoidance provisions

120. 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).

121. The 2003 Timbercorp Almond Project 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 43, 44, 50, 51 and 58, 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.

122. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of almonds. 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

Example – Entitlement to GST input tax credits

123. 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 \$2,200 *less* \$200, or \$2,000.

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

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

Detailed contents list

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Commissioner of Taxation

29 January 2003

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/1; TR 92/20; TD 93/34;
TR 97/11; TR 97/16; TR 98/22;
TR 2000/8; PR 1999/95;
PR 2002/143; IT 360

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fee expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance

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- ITAA 1936 82KH(1)
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- ITAA 1936 82KZME
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Case references:

- FCT v. Lau 84 ATC 4929; (1984) 16 ATR 55

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