

PR 2003/22 - Income tax: Western Tiers Truffiere Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *14 May 2003*



Product Ruling

Income tax: Western Tiers Truffiere Project

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

Goods and services tax

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

Changes in the law

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 Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

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

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e. being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling, each of these persons, referred to as 'Growers', will be wholesale clients for the purpose of the *Corporations Act 2001* or will have accepted an offer which qualifies as a small scale offer for the purpose of the *Corporations Act 2001*.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion or who otherwise do not intend to derive assessable income from it. Growers who elect to harvest and market their own produce (see paragraphs 40 and 56) are excluded from the class of persons to whom this Ruling applies. Also, the class of persons will not include any Growers that do not pay the full amount of subscription monies payable under the Management Agreement and the Lease Agreement on or before 30 June 2003 for 2003 Growers and 30 June 2004 for 2004 Growers.

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 14 May 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.

Arrangement

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

- Application for Product Ruling as constituted by documents provided on 31 January 2003, 12 February 2003, 26 March 2003, 5 April 2003, 11 April 2003 and 17 April 2003 and additional correspondence dated 11 February 2003, 12 February 2003, 21 February 2003, 26 February 2003, 3 March 2003, 5 March 2003, 1 April 2003, 5 April 2003, 8 April 2003, 14 April 2003, 15 April 2003 and 28 April 2003;
- Draft Information Memorandum for Western Tiers Truffiere Project prepared and issued by Agri Truffle Pty Ltd, undated;
- **Draft Management Agreement between Agri Truffle Pty Ltd and the Grower, undated;**
- Draft Lease Agreement ('Head-Lease') between Random Nominees Pty Ltd ('the Lessor'), Mark Simon Edward Ranicar ('the Land Owner') and Agri Truffle Pty Ltd ('the Lessee'), received 11 February 2003;
- Letter of Variation to Head-Lease Agreement, undated;
- **Draft Lease Agreement ('Sub-Lease') between Agri Truffle Pty Ltd ('the Lessor') and each Grower ('the Lessee'), undated;**
- **Share Option between Agri Truffle Land Company Pty Ltd ('the Company') and Agri Truffle Pty Ltd and the Grower, received 11 February 2003;**
- Call Option Deed between Mark Simon Edward Ranicar ('the Owner') and Agri Truffle Land Company Pty Ltd ('ATLC'), received 11 February 2003;
- Agreement to Sell and Buy between Mark Simon Edward Ranicar ('the Vendor') and Agri Truffle Land Company Pty Ltd ('the Purchaser'), received 11 February 2003; and

- Technology Supply Agreement between Agri Truffle Pty Ltd and the Truffle Expert, dated 30 December 2000.

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

15. The documents highlighted are those that Growers may 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.

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

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

- the Grower is a wholesale client as defined in section 761G of the *Corporations Act 2001*; or
- not being a retail client, the Grower has accepted a 'personal offer' of a small scale offering for the purpose of the *Corporations Act 2001*.

18. Each of these categories is explained in paragraphs 81 to 87 in the Explanations area of this Product Ruling.

Overview

19. The arrangement is called the Western Tiers Truffiere Project.

Location	Property situated at Mole Creek Head Road, Deloraine in Tasmania.
Type of business each participant is carrying on	Long term commercial cultivation of Truffle inoculated oak trees for the purpose of harvesting Truffles for sale.
Number of hectares to be under cultivation	This Information Memorandum provides for up to 40 hectares to be planted.
Size of each Trufflelot	0.25 hectares

Number of trees per hectare	300
The term of the Project	20 years
Initial Cost	\$10,728
Initial costs per hectare	\$42,912
Ongoing costs	<p>Management Fees payable to the Manager for performing the Trufflelot services during the relevant years.</p> <p>Land Rental Fee.</p> <p>Irrigation Fee Instalments to be paid in the second and third year of the Project.</p> <p>Bonus.</p> <p>Sales and Marketing Costs.</p> <p>Rates and taxes attributable to the improvements made on the Land.</p>
Other costs	Option to purchase shares in Land Company at a cost of \$250.

20. Growers applying under this Information Memorandum join as either 2003 Growers or 2004 Growers depending on the date of acceptance of their application. The Commencement Date for their participation in the Project is the date of acceptance of their application. The Commencement Date also determines the period for the provision of the Establishment Services to which the Subscription Moneys apply. The relevant periods are summarised as follows:

Application lodged	Grower	Commencement date (Date of Acceptance)	Total subscription moneys	Period of provision of establishment services
on or before 27/6/2003	2003	on or before 27/6/2003	\$10,728	from Commencement Date to 30/6/2003.
on or after 28/6/2003	2004	at any time between 1/7/2003 and 15/6/2004 (inclusive)	\$10,728	from Commencement Date to

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				30/6/2004.
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21. The Project land is located on Mole Creek Head Road, Deloraine in Tasmania being part of the land comprised in Folio 4 of the Register volume 36989. The Project is to cultivate a large scale intensive Truffiere on land that is held by the Manager and will run for a period of twenty years.
22. Growers participating in the Project will enter into a Sub-Lease Agreement between Agri Truffle Pty Ltd ('the Lessor') and the Grower and a Management Agreement between Agri Truffle Pty Ltd ('the Manager') and the Grower.
23. The Sub-Lease gives a Grower a Lease over an identifiable area of land called a Trufflelot until the Project is terminated on approximately 30 June 2023 for a 2003 Grower and 30 June 2024 for a 2004 Grower.
24. The Project will not be a registered managed investment scheme under the Corporations Law.
25. Under the Information Memorandum, the Manager proposes to offer up to 160 Trufflelots of 0.25 hectares, following the execution of the Sub-Lease Agreement and the Management Agreement. The Trufflelots will be planted with a variety of oak trees, specially inoculated to produce black truffles. A minimum of 75 inoculated trees will be planted on each Trufflelot. Subject to suitable land being available, further Trufflelots will be issued if more than 160 Trufflelots are subscribed for. There is no minimum subscription for this Project. Each Grower may subscribe for a minimum of one Trufflelot.
26. Under the Management Agreement, the Grower appoints the Manager to manage the Grower's Trufflelot(s) by establishing, managing and maintaining the Trufflelot(s) and collecting and selling the Truffle Produce in return for the Annual Management Fee. The Grower must pay fees to the Manager for the provision and planting of seedlings and for the irrigation system that will be installed on the Trufflelot(s).
27. Trufflelots will be allocated by Agri Truffle Pty Ltd which will maintain a map of the Project identifying each Trufflelot.
28. Growers will execute a Power of Attorney enabling the Manager to act on their behalf as required when they make an application for a Trufflelot.

29. When Growers enter into the Project, they will pay an option fee of \$250 per Trufflelot. The Option fee grants the Grower an option to purchase shares in the Land Company which holds an option from the Land Owner to acquire the Land on which the Truffiere is located (comprising the Project Land, inoculated trees and other infrastructure and capital works). The option must be exercised within a six month period ending 31 May 2008. The options have an exercise price of \$2,850 indexed by the higher of 3% or CPI per option. The Land Company will only exercise its option to purchase the land where enough options are taken up by Growers sufficient to hold at least 50% of the Land company. The Land company will only proceed with the land purchase where the 50% threshold is met.

Head-Lease Agreement

30. The Head-Lease Agreement is entered into between The Lessor, the Land Owner and Agri Truffle Pty Ltd. The term of the Lease is 23 years. Under the provisions of the Lease the Lessee may use the Land only as a Truffiere. The Lease allows the Lessee to enter into an Agreement with Growers for the purposes of establishing a Truffiere. The Lessor is to provide the lessee with access to 120 mega litres of water or 2 mega litres of water per hectare under management in each Lease Year.

Sub-Lease Agreement

31. The Sub-Lease Agreement sets out the roles and obligations of the parties to the Agreement which is entered into between Agri Truffle Pty Ltd as the Lessor and the Grower. Under the terms of the Agreement the Grower may only use the Land for the purpose of cultivating Truffles.

32. Growers participating in the Project are granted an interest in the land by the Lessor in the form of a lease to use their Trufflelot for the purpose of conducting a long-term business of cultivating Truffle inoculated Trees for the growing and harvesting of Truffles for sale.

33. The Agreement commences on the date the Sub-Lease Agreement is executed by the Manager. The Project is terminated pursuant to the provisions of the Agreement or on the date of completion of the lease of the Land (clauses 2 and 5). Growers are granted an option to renew the Sub-Lease pursuant to the provisions of the Agreement (clause 3.4). The new lease will commence at the end of the Sub-Lease Agreement and continue for a period of one year. The new lease may not be renewed more than five times.

34. Each Grower must pay Rent to the Lessor being an amount set out in clause 6 of the Sub-Lease Agreement.

35. Under the terms of the Sub-Lease Agreement, the Grower, among other things:

- must not commit or allow any illegal or unlawful act on the land;
- must cultivate, manage and maintain the land in accordance with the best practices of Truffle cultivation; and
- must allow reasonable access to the Lessor and/or any of its agents at any time for any reasonable purpose.

Management Agreement

36. The Management Agreement sets out the roles and obligations of the parties to the Agreement. The Agreement is entered into between the Manager and the Grower for each Trufflelot. Under the Agreement, the Grower appoints the Manager to establish, cultivate, maintain, harvest and sell the Produce from the Trufflelots (Recital C).

37. The Agreement commences on the date the Management Agreement is executed by the Manager. The Project is terminated pursuant to the provisions of the Agreement or on the date of completion of the lease of the Land (clauses 6, 32.1 and 33.2).

38. The Management Agreement provides that each Grower appoints the Manager to perform services under the Agreement. The services to be performed are specified in the definition of 'Establishment Services' and 'Management Services'. The Manager will supervise and manage all activities to be carried out on the Trufflelot on behalf of the Grower including, but not limited to, the provision of the following services:

- (i) Establishment Services:
 - complete all preparatory work necessary for the planting of seedlings on the land including all ploughing and vermin control by 30 June 2003 for 2003 Growers and 30 June 2004 for 2004 Growers; and
 - supply and plant healthy oak seedlings inoculated with *Tubor melanosporum* by 30 November 2003 for 2003 Growers and 30 November 2004 for 2004 Growers.
- (ii) Management Services:

- replant any seedlings that the Grower requires to be replaced, that fail to establish or that die due to planting techniques or vermin destruction;
- control vermin, weeds, suckers and other pests;
- maintain in good condition and repair all fire breaks, access roads, tracks and fences;
- apply fertiliser in such form and in such quantities so as to maintain satisfactory performance of the Trees;
- maintain the irrigation system to ensure the Trees are properly watered and that the irrigation system is working satisfactorily at all times; and
- develop a marketing plan and market the Produce on behalf of the Grower.

Harvesting and Sale

39. The Grower has full right, title and interest in the Truffles that are produced by the Grower on the Trufflelot (clause 11). The Truffle inoculated Oak Trees will remain the property of the Lessor. The Manager must arrange for the harvest of the Produce from the Truffle inoculated Oak Trees and the marketing and sale of the truffles.

40. Growers may elect, on or before 30 June 2004 for 2003 Growers and on or before 30 June 2005 for 2004 Growers, to be an Electing Grower and to collect their Grower's Produce by giving notice in writing to the Manager (clause 8.1). This Product Ruling does not apply to Growers who make such an election.

41. The Manager will harvest, process and sell the Produce on behalf of Non-Electing Growers for the maximum practicable price (clause 9.1).

42. The Manager will ensure that Truffles harvested from all Trufflelots subscribed for in different Financial Years are stored and pooled separately. In addition, the Manager will keep separate records in respect of Produce from Trufflelots subscribed for in different Financial Years. The Gross Proceeds from the sale of Truffles from the above mentioned Trufflelots will be recorded separately and the Manager will apply the Gross Proceeds of Sale in the following order:

- any unpaid Rent;
- unpaid Annual Management Fees;
- unpaid Irrigation Fees;

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- all sales and marketing costs (clause 10); and
- the bonus (clause 11).

The balance of the proceeds will be distributed to the Non-Electing Growers on a proportionate basis (clause 12).

43. If a Grower is an Electing Grower (clause 8.2), the Grower must pay any unpaid Rent, Annual Management Fees and any other unpaid monies owed under the Management Agreement at the time the Grower collects their Grower's Produce.

Fees

44. Under the terms of the Management and Sub-Lease Agreements, a Grower will make payments per Trufflelot as described below.

45. **The Subscription Moneys** are payable by each Grower when the Application is accepted for the period up to and including 27 June 2003 for 2003 Growers and 1 July 2003 to 15 June 2004 for 2004 Growers. However, the Manager may accept Applications and allot Trufflelot(s) to Growers where Trufflelot Applications have been received by 27 June 2003 for 2003 Growers and 15 June 2004 for 2004 Growers from Growers who are unable to pay Subscription Moneys in full on Application as they are waiting on finance to be finalised. Applicants accepted on this basis must provide evidence by 27 June 2003 for 2003 Growers and 15 June 2004 for 2004 Growers that a loan application has been approved and all subscription monies due must be paid in full within 60 days of the due date. This Ruling will not apply to Growers accepted into the Project on this basis and where payment is outstanding as at 30 June 2003 for 2003 Growers and 30 June 2004 for 2004 Growers, see paragraph 57.

46. The Subscription Moneys for both 2003 Growers and 2004 Growers is made up of the Management Fee, Rent, Seedling and Planting Fee, first instalment of the Irrigation Fee and Option Fee as follows:

Management Fee	\$7,887
Rent	\$479
Seedling and Planting Fee	\$1,565
Irrigation Fee	\$797
Option Fee	\$250

47. Ongoing **Annual Management Fees** are payable to the Manager for performing the management services during the relevant year. The fees are:

Year	2003 Grower	2004 Grower
2004	\$4,637	
2005	\$2,063	\$4,637
2006	Indexed	\$2,063

From the Financial Year ending 30 June 2006 for 2003 Growers and the Financial Year ending 30 June 2007 for 2004 Growers, the Annual Management Fee shall be the amount due and payable in the preceding year increased by the greater of 3% or the Consumer Price Index for the 12 months of the preceding Financial Year.

48. Following the first year, **Land Rental Fees** are payable as follows:

Year	2003 Grower	2004 Grower
2004	\$495	
2005	\$509	\$495
2006	Indexed	\$509

From the Financial Year ending 30 June 2006 for 2003 Growers and the Financial Year ending 30 June 2007 for 2004 Growers, the Land Rental Fee will be the amount due and payable in the preceding year increased by the greater of 3% or the Consumer Price Index for the 12 months of the preceding Financial Year.

49. **Irrigation Fee** instalments of \$797 each are to be paid to the Manager in the second and third years of the Project.

50. A **Bonus** equal to 25% of the surplus operating cashflow over and above forecast cashflows is payable to the Manager. The Manager must appoint an independent auditor to calculate the bonus.

51. The Manager is entitled to **Sales and Marketing Costs** at cost plus 20% unless the total costs exceed 10% of the sale value of the produce, at which point services are provided at cost.

52. The Grower must pay **Rates and taxes** in respect of the Land that are attributable to the improvements made on the land by the Grower.

Finance

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

54. The Project documents allow for Applications to be accepted and Allotment of Trufflelot(s) to occur where Growers are not able to pay Subscription Moneys in full on Application as they are waiting for finance to be finalised. Growers accepted in these circumstances will be excluded from this Ruling where full subscription monies are not paid by 30 June 2003 for 2003 Growers and 30 June 2004 for 2004 Growers.

55. 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

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

- on or before 15 June 2003;
- during the period 16 June 2003 to 27 June 2003 (provided the Manager can wholly provide the services in consideration of the moneys payable on application by 30 June 2003); or
- during the period 1 July 2003 to 15 June 2004.

and the Grower has executed a Lease Agreement and a Management Agreement. A Grower's participation in the Project must constitute the carrying on of a business of primary production.

57. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. This Ruling does not apply to:

- Growers who make an election to collect the Grower's Produce from the Grower's Trufflelot(s); or
- 2003 Growers who have not paid full subscription monies by 30 June 2003 and 2004 Growers who have not paid full subscription monies by 30 June 2004.

The Simplified Tax System ('STS')

Division 328

58. 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

59. 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

60. 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.

61. The Grower recognises ordinary income from carrying on the business of Truffle cultivation at the time that income is derived.

Trading stock

Section 70-35

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

63. 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.

64. The Manager will advise the Grower of the value of trading stock on hand at the end of each year.

Deductions for Annual Management Fees and Rent

Section 8-1

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

For Growers accepted into the Project in the year ended 30 June 2003:

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Annual Management Fee	8-1	\$7,887 – See Notes (i) & (ii) (below)	\$4,637 – See Notes (i) & (ii) (below)	\$2,603 – See Notes (i) & (ii) (below)
Rent	8-1	\$479 – See Notes (i) & (ii) (below)	\$495 – See Notes (i) & (ii) (below)	\$509 – See Notes (i) & (ii) (below)

For Growers accepted into the Project in the year ended 30 June 2004:

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Annual Management Fee	8-1	\$7,887 – See Notes (i) & (ii) (below)	\$4,637 – See Notes (i) & (ii) (below)	\$2,603 – See Notes (i) & (ii) (below)
Rent	8-1	\$479 – See Notes (i) & (ii) (below)	\$495 – See Notes (i) & (ii) (below)	\$509 – See Notes (i) & (ii) (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 148.
- (ii) The Annual Management Fees and the Rent shown in the Lease and Management Agreements 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 118 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in

which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Deductions for capital expenditure

Division 40

66. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g. irrigation) and Truffle inoculated Oak Trees. All deductions shown in the following Table are determined under Division 40.

For Growers accepted into the Project in the year ended 30 June 2003:

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Irrigation Costs	40-515	\$797 – see Notes (iii) & (iv) below	\$797 – see Notes (iii) & (iv) below	\$797 – see Notes (iii) & (iv) below
Establishment of horticultural plants (Seedling and Planting Fees)	40-515	Nil – see Notes (iii) & (v) below	Nil – see Notes (iii) & (v) below	Nil – see Notes (iii) & (v) below

For Growers accepted into the Project in the year ended 30 June 2004:

Fee type	ITAA 1997 section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Irrigation Costs	40-515	\$797 – see Notes (iii) & (iv) below	\$797 – see Notes (iii) & (iv) below	\$797 – see Notes (iii) & (iv) below
Establishment of horticultural plants (Seedling and Planting Fees)	40-515	Nil – see Notes (iii) & (v) below	Nil – see Notes (iii) & (v) below	Nil – see Notes (iii) & (v) below

Notes:

- (iii) 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 148.
- (iv) 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).
- (v) Truffle inoculated oak trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under Lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the Truffle inoculated oak trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the Truffle inoculated oak trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, then the result is a straight-line write-off at a rate of 7%. The deduction is allowable when the Truffle inoculated oak trees enter their first commercial season (section 40-530, item 2). The Manager will inform Growers of when the Truffle inoculated oak trees enter their first commercial season.

Tax outcomes for Growers who are 'STS taxpayers'**Assessable income*****Section 6-5 and section 328-105***

67. 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.

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

Treatment of trading stock

Section 328-285

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

70. 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)).

71. The Responsible Entity will advise the Grower of the value of trading stock on hand at the end of each year.

Deductions for Annual Management Fees and Rent

Section 8-1 and section 328-105

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

For Growers accepted into the Project in the year ended 30 June 2003:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Annual Management Fee	8-1 & 328-105	\$7,887 – See Notes (vi), (vii) & (viii) (below)	\$4,637 – See Notes (vi), (vii) & (viii) (below)	\$2,603 – See Notes (vi), (vii) & (viii) (below)
Rent	8-1 & 328-105	\$479 – See Notes (vi), (vii) & (viii) (below)	\$495 – See Notes (vi), (vii) & (viii) (below)	\$509 – See Notes (vi), (vii) & (viii)(below)

For Growers accepted into the Project in the year ended 30 June 2004:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Annual Management Fee	8-1 & 328-105	\$7,887 – See Notes (vi), (vii) & (viii) (below)	\$4,637 – See Notes (vi), (vii) & (viii) (below)	\$2,603 – See Notes (vi), (vii) & (viii) (below)
Rent	8-1 & 328-105	\$479 – See Notes (vi), (vii) & (viii) (below)	\$495 – See Notes (vi), (vii) & (viii) (below)	\$509 – See Notes (vi), (vii) & (viii)(below)

Notes:

- (vi) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example at paragraph 148.
- (vii) 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.
- (viii) Where a Grower who is an 'STS taxpayer' pays the Annual Management fees and the Rent in the relevant income years shown in the Lease and Management Agreements, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 112 to 126). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 118, unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the

prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Deductions for capital expenditure

Subdivision 328-D and Subdivisions 40-F

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

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

For Growers accepted into the Project in the year ended 30 June 2003:

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Irrigation Costs	40-515	\$797 – see Notes (ix) & (x) below	\$797 – see Notes (ix) & (x) below	\$797 – see Notes (ix) & (x) below
Establishment of horticultural plants (Seedling and Planting Fees)	40-515	Nil – see Notes (ix) & (xi) below	Nil – see Notes (ix) & (xi) below	Nil – see Notes (ix) & (xi) below

For Growers accepted into the Project in the year ended 30 June 2004:

Fee type	ITAA 1997 section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Irrigation Costs	40-515	\$797 – see Notes (ix) & (x) below	\$797 – see Notes (ix) & (x) below	\$797 – see Notes (ix) & (x) below
Establishment of horticultural plants (Seedling and Planting Fees)	40-515	Nil – see Notes (ix) & (xi) below	Nil – see Notes (ix) & (xi) below	Nil – see Notes (ix) & (xi) below

Notes:

- (ix) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example at paragraph 148.
- (x) 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' which can be allocated to a 'general STS pool'. The 'cost' of the asset is the amount paid by each Grower. The tax deduction allowable in the years ended 30 June 2003 or 30 June 2004 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. A deduction is available in the income year in which the water facility is 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. The Manager will advise when that has occurred. 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).

- (xi) Truffle inoculated oak trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under Lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the Truffle inoculated oak trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the Truffle inoculated oak trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, then the result is a straight-line write-off at a rate of 7%. The deduction is allowable when the Truffle inoculated oak trees enter their first commercial season (section 40-530(2)). The Project Manager will inform Growers of when the Truffle inoculated oak trees enter their first commercial season.

Tax outcomes that apply to all Growers

Interest

75. 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 112 to 126 (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.

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

76. For a Grower who is an individual and who enters the Project during the year ended 30 June 2003 or 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 2003 to 30 June 2009 for 2003 Growers and 30 June 2004 to 30 June 2010 for 2004 Growers that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling.

77. 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 133 in the Explanations part of this ruling below);
- 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)).

78. 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.

79. 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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 112 to 126);
- 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.

Explanation

Corporations Act 2001

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

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

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

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

- the ‘product value test’ (paragraph 761G(7)(a)); or
- the ‘individual wealth test’ (paragraph 761G(7)(c)).

84. A participant in a managed investment scheme, referred to below as ‘the person’ or ‘the person to whom the offer is made’, will satisfy the ‘product value test’ where:

- the minimum amount payable for the interests in the Project on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or

- the amount payable for the interests in the Project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the Project of the same class that are held by the person add up to at least \$500,000.

85. A participant in a managed investment scheme, referred to below as ‘the person’ or ‘the person to whom the offer is made’, will satisfy the ‘individual wealth test’ where, it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made, that the person to whom the offer is made:

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

86. Alternatively, under section 1012E, a Grower may participate in the Project by accepting a ‘personal offer’ for an interest in the Project. Offers made under section 1012E cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than \$2 million dollars (subsection 1012E(2)).

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

Is the Grower carrying on a business?

88. For the amounts set out in the Tables above to constitute allowable deductions, the Grower’s Truffle cultivation activities, as a participant in the Western Tiers Truffiere Project, must amount to the carrying on of a business of primary production. These Truffle cultivation activities will fall within the definitions of ‘horticulture’ and ‘commercial horticulture’ in section 40-535 of the ITAA 1997.

89. For schemes such as the Western Tiers Truffiere 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.

90. Generally, a Grower will be carrying on a business of a Truffiere where:

- the Grower has an identifiable interest in the Trufflelot (by lease) in the land on which the Grower's Truffle inoculated oak trees are established;
- the Grower has a right to harvest and sell the Truffles each year from those trees;
- the Truffle cultivation activities are carried out on the Grower's behalf;
- the Truffle cultivation activities of the Grower are typical of those associated with a Truffiere business; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

91. In this Project, each Grower enters into a Management Agreement and a Lease Agreement.

92. Under the Lease Agreement, each individual Grower will have rights over a specific and identifiable area of land. The Lease Agreement provides the Grower with an ongoing interest in the specific Truffles on the leased area for the term of the Project. Under the Lease, the Grower must use the land in question for the purpose of carrying out Truffle cultivation activities and for no other purpose. The Lease allows the Manager to come onto the land to carry out its obligations under the Management Agreement.

93. Under the Management Agreement, the Manager is engaged by the Grower to establish and maintain a Truffiere 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 Trufflelot on the Grower's behalf.

94. In establishing the Truffiere, the Grower engages the Manager to purchase and install water facilities (e.g. irrigation) and to acquire and plant Truffle inoculated oak trees on the Grower's Trufflelot. During the term of the Project, these assets will be used wholly to carry out the Grower's Truffle cultivation activities. The Manager is also engaged to harvest and sell, on the Grower's behalf, the Truffles grown on the Grower's Trufflelot.

95. 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.

96. 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 their Truffles 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).

97. The pooling of Truffles grown on the Grower's Trufflelot with the Truffles of other Growers is consistent with general Truffle cultivation practices. Each Grower's proportionate share of the sale proceeds of the pooled Truffles will reflect the proportion of the Truffles contributed from their Trufflelot.

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

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

100. The Truffle cultivation 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' Truffle cultivation activities in the Western Tiers Truffiere Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

101. 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.

102. 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 Annual Management Fees and Rent***Section 8-1***

103. Consideration of whether the Annual Management Fees and Rent are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer is contractually committed to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

104. The Annual Management Fees and Rent associated with the Truffle cultivation activities will relate to the gaining of income from the Grower's business of Truffle cultivation (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of Truffles) 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 Annual 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

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

106. 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 112 to 126) 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

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

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

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

Interest deductibility

Section 8-1

110. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier 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.

111. 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 112 to 126).

Prepayment provisions***Sections 82KZL to 82KZMF***

112. 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.

113. 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

114. 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)).

115. 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.

116. 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 deductions 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.

117. 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.

118. 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.

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

119. 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

120. In this Project, an initial Annual Management Fee of \$7,887 and Rent of \$479 per Trufflelot will be incurred on execution of the Management Agreement and the Lease Agreement. The Annual Management Fee and the Rent are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

121. In particular, the Annual 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 Annual Management Fee has been inflated to result in reduced fees being payable for Annual Management Fees in subsequent years.

122. 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 Annual Management Fee, and the fees for subsequent years, is for the Project Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Lease Agreement, Rent is payable on the date of acceptance of the application for the lease of the land during the expenditure year to 30 June 2003 for 2003 Growers and to 30 June 2004 for 2004 Growers. For each succeeding Financial Year, Rent is payable in the relevant Financial Year.

123. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 45, 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*

124. Although not required under either the Management Agreement or the Lease Agreement, 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 123 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

126. 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

127. 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 water facilities and the establishment of the Truffle inoculated oak trees is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

128. 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'.

129. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 66 and 74 (above) in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

130. 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.

131. 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.

132. 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.

133. 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.

134. 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).

135. 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 Trufflelot in the Project during the years ended 30 June 2003 or 30 June 2004 is unlikely to have their activity pass one of the tests until the income year ended 30 June 2012 or 30 June 2013. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

136. 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.

137. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where the business activity has started to be carried on and for that, or those income years;

- because of its nature, the business activity has not satisfied, or will not satisfy one of the tests set out in Division 35; and
- there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

138. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Trufflelot in the Project is expected to be carrying on a business activity that will pass one of the tests in the income year ended 30 June 2012 or 30 June 2013, or will produce a taxation profit, for the income years ended 30 June 2010 or 30 June 2011 to 30 June of the year in which the Project terminates.

139. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion for all income years up to, and including the income year ended 30 June 2009 for 2003 Growers and 30 June 2010 for 2004 Growers.

140. 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 76), in the manner described in the Arrangement (see paragraphs 14 to 55). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b) that it would be unreasonable for the loss deferral rule in subsection 35-10(2) not to 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.

141. 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 expert and additional evidence provided with the application by the Manager; and
- independent, objective, and generally available information relating to the truffle growing industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Manager.

Losses and Outgoings incurred under Certain Tax Avoidance Schemes

Section 82KL – recouped expenditure

142. 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’.

143. ‘Additional benefit’ (see the definition of ‘additional benefit’ at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit 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.

144. Section 82KL’s operation depends, among other things, on the identification of a certain quantum of ‘additional benefits’. 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 tax avoidance provisions

145. 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).

146. The Western Tiers Truffiere 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 65 to 74 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.

147. 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 Truffles. 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

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

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

*Taxable supply

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

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

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

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

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

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

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

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14 May 2003

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