



PR 2003/23 - Income tax: Guilderton Olives Stage 2

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 This document has changed over time. This is a consolidated version of the ruling which was published on *28 June 2006*



Product Ruling

Income tax: Guilderton Olives Stage 2

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Preamble

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

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

Potential participants may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. 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 investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

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

Terms of Use of this Product Ruling

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 law(s)' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as Guilderton Olives Stage 2, or just 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 70 (ITAA 1997);
- Division 328 (ITAA 1997);
- Division 328 of the *Income Tax (Transitional Provisions) Act 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 to 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 laws 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 investing 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 investors 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 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 agreement until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, each of these persons, referred to as 'Growers', will be wholesale clients for the purpose of the *Corporations Act 2001* 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. The class of persons to whom this Ruling applies does not include Growers who elect to collect and market their own olives from their Leased Area(s).

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

Note: The Addendum to this Ruling that issued on 28 June 2006 applies on and from 1 July 2005.

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 specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to

withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling for Guilderton Olives Stage 2 dated 13 January 2003 as constituted by documents provided on 25 February 2003 and 14 March 2003; and additional correspondence dated 13 March 2003, 17 April 2003, 28 April 2003 and 30 April 2003;
- **Draft Lease and Management Agreement for Guilderton Olives Stage 2 between Guilderton Olives Pty Ltd (the 'Manager') and Croot LandCo Pty Ltd (the 'Lessor') and the Grower;**
- Information Memorandum for Guilderton Olives Stage 2 prepared and issued by Guilderton Olives Pty Ltd;
- Constitution of Guilderton Olives Pty Ltd dated 12 February 2001;
- Constitution of Croot LandCo Pty Ltd dated 16 February 1999;
- Land suitability report by an independent soil expert;
- Hydro geological Report by an independent expert;
- Olive Oil Supply Agreement between Guilderton Olives Pty Ltd (the 'Manager') and Premium Olive Marketing Limited ('Marketing Company'), dated 7 September 2001; and
- Olive Oil Processing Agreement between Guilderton Olives Pty Ltd (the 'Manager') and Premium Olive Marketing Limited ('Marketing Company'), dated 7 September 2001.

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 above in **bold** are those that Growers may enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a

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Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

16. 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*.

17. Each of these categories is explained in paragraphs 80 to 86 in the Explanations area of this Product Ruling.

18. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised below.

Overview

19. The arrangement is called Guilderton Olives Stage 2 and is summarised as follows:

Location	Land located in the Guilderton region of Western Australia.
Type of business each participant is carrying on	Commercial cultivation of Olive Trees for the purpose of Olive Oil production.
Number of hectares under cultivation	39
Size of each Leased Area	0.78 hectare
Number of trees per hectare	666 trees per hectare which may be progressively thinned.
Number of trees per Leased Area	518
Term of the investment	Approximately 18 years
Initial cost	Grower Category 1 - \$16,118 Grower Category 2 - \$16,118 Plus \$10,452 for the acquisition of shares in the Lessor.
Initial cost per hectare	Grower Category 1 - \$20,664 Grower Category 2 - \$20,664

Ongoing costs	Management Fees Irrigation Fee instalments for the second and third year of the Project. Processing Costs Manager's Bonus Additional insurance cover if requested by the Grower.
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20. Growers applying under this information memorandum join as either Grower Category 1 or Grower Category 2 depending on their date of application. The date of application also determines the date of execution of the Lease and Management Agreement and the period of provision of First Period services, as follows:

Application lodged	Grower	Date of Execution	Total Subscription Sum	Period of provision of First Period services
On or before 27/06/2003	Grower Category 1	On or before 27/6/2003.	\$26,570	From date of execution of Lease and Management Agreement to 30/6/2003.
After 27/06/2003 and on or before 1/6/2004	Grower Category 2	As soon as practical after acceptance of the application but not before 1/07/2003 or after 1/6/2004	\$26,570	From date of execution of Lease and Management Agreement to 30/6/2004.

21. The Project involves the cultivation of a large scale, intensive olive grove ('the Grove') upon land which is held by the Lessor. The Project land is located in the Guilderton region of Western Australia. The Project is for a period of approximately eighteen years.

22. Under the Information Memorandum, the Manager proposes to offer 50 Leased Areas of 0.78 hectares, which have been planted with Olive Trees by the Lessor. Each Leased Area will contain approximately 518 Olive Trees. The Information Memorandum states there is no minimum subscription. Each investor may subscribe for a minimum of one Leased Area. The Leased Areas held by Growers will be identified and delineated on the Grove Plan.

23. Growers participating in the arrangement will enter into a Lease and Management Agreement between the Manager, the Lessor, and the Grower.

24. The Agreement gives a Grower a lease from Croot LandCo Pty Ltd of an identifiable area of land called a 'Leased Area' until the Project is terminated on 30 June 2020.
25. Growers will execute a Power of Attorney enabling the Manager to act on their behalf, as required, when they make an application for a Leased Area.
26. The Grower engages the Manager to cultivate and maintain the Leased Area, and to harvest or arrange to harvest the Olives. The Growers pay for the irrigation system that has been installed on the Leased Area. Unless the Grower has elected to collect the produce from their Leased Area personally, the Manager will arrange to process the Olives and market the Olive Oil on behalf of the Grower (clauses 23 and 25).
27. The Manager has entered into an Olive Oil Supply Agreement with a marketing company. The marketing company has agreed, subject to the valid exercise of the Put Option in the Olive Oil Supply Agreement, to purchase all of the Olive Oil produced from the Olives grown in the Grove, for the term of the Olive Oil Supply Agreement.

Lease and Management Agreement

28. The Lease and Management Agreement sets out the roles and obligations of the parties to the Agreement. It is entered into between the Manager, the Lessor and the Grower for each Leased Area. The Agreement establishes the Project and operates as a contract binding on all of the Growers in the Project, the Manager and the Lessor. Under the Agreement the Lessor grants a lease to the Grower and the Grower appoints the Manager to cultivate, maintain, harvest and process the Olives and to sell the Olive Oil from the Grower's Leased Area.
29. The Lease and Management Agreement sets out the terms and conditions under which Guilderton Olives Pty Ltd agrees to act as Manager and thereby manage the Project. The Lease and Management Agreement will be executed on behalf of a Grower following the signing of the Application Form in the Information Memorandum, which includes a Power of Attorney. Growers are bound by the Lease and Management Agreement by virtue of their participation in the Project. Growers may assign their interest only in certain circumstances as set out in clause 31 of the Lease and Management Agreement.
30. The Agreement commences on the date the Lease and Management Agreement is executed by the Manager. The Project is terminated pursuant to the provisions of the Agreement, upon payment of the final distribution of net income to Growers or 30 June 2020, whichever is the earliest (item 10 of the Schedule).

31. Growers participating in the Project are granted an interest in land by the Lessor in the form of a lease to use the Leased Area for the purpose of conducting a long-term business of cultivating Olive Trees for the purpose of Olive Oil production.

32. Each Grower must pay a Licence Fee to the Lessor being an amount as specified in the Schedule to the Lease and Management Agreement (item 5).

33. Under clause 7 of the Lease and Management Agreement, among other things, the Grower:

- must not use or permit any other person to use the Leased Area for a noxious or illegal purpose;
- must comply with all relevant laws, regulations, notices, or orders relating to the use and occupancy of the Leased Area, the Fixtures or the use of machinery;
- shall not remove any earth, gravel, stones, sand, minerals, Olive Trees or any fixtures from the Leased Area or install any fixtures on the Leased Area without the consent of the Lessor;
- must not do or permit to be done on the Leased Area anything that will cause a nuisance, disturbance, obstruction or damage; and
- shall not erect any sign of any kind on the Leased Area.

34. The Lease and 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 'Grove Services' (item 9 of the Schedule). The Manager will supervise and manage all activities to be carried out on the Leased Area on behalf of the Grower.

35. The Manager will provide the following services during the initial period:

- maintain an irrigation system for the Olive Trees on the Leased Area;
- cultivate, tend, train, prune, fertilise, replant, spray and otherwise care for the Olive Trees as and when required;
- keep access laneways within the Leased Area;
- use all reasonable measures to keep the Leased Area free from vermin, noxious weeds, pests and diseases;
- establish and maintain in good repair and condition adequate firebreaks in and about the Leased Areas; and

- replace any Olive Trees that fail to establish or that die during the initial period.

36. The Manager will provide the following ongoing services under this agreement:

- maintain an irrigation system for the Olive Trees on the Leased Area;
- cultivate, tend, train, prune, fertilise, replant, spray and otherwise care for the Olive Trees as and when required;
- keep access laneways within the Leased Area;
- use all reasonable measures to keep the Leased Area free from vermin, noxious weeds, pests and diseases;
- establish and maintain in good repair and condition adequate firebreaks in and about the Leased Areas;
- replace any Olive Trees that fail to establish or that die during the first year of the Scheme;
- arrange for the harvesting of the Olives; and
- use reasonable endeavours to arrange the processing of the Olives and the sale of the Olive Oil.

37. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

Fees

38. The Subscription Sum is payable by each Grower on Application for the period from the date of the Lease and Management Agreement ('Commencement Date') to 30 June in the financial year in which execution of the Agreement takes place (the 'First Period'). The Subscription Sum is made up of the Management Fee, Licence Fee and the first instalment of the Irrigation Fee, as follows:

	Grower Category 1	Grower Category 2
Management Fee	\$11,115.50	\$11,115.50
Licence Fee	\$1,888.70	\$1,888.70
Irrigation Fee	\$3,114.10	\$3,114.10

39. The fees in subsequent years are as follows:

- **Management Fees** are payable to the Manager for performing the Grove Services during the relevant year. After the First Period, the Management Fee is payable for each Financial Year up until and including 30 June 2020. The fees for Grower Category 1 are \$8,660.30 and \$5,407.60 for the years ended 30 June 2004 and 2005 respectively. The fee for Grower Category 2 is \$8,660.30 for the year ended 30 June 2005;
- After the Financial Year ending 30 June 2005 the Management Fee shall be the Grower's Proportional Interest of the estimated costs of performing the Grove Services and managing the Leased Area and 5% of the estimated Gross Proceeds per Leased Area for that Financial Year;
- After the First Period, the Grower shall pay the **Licence Fees** in the annual amounts specified in Item 5 of the Schedule for the life of the Project;
- **Irrigation Fee** instalments of \$3,114.10 each are to be paid to the Manager in the second and third year of the Project;
- If in any 2 consecutive Financial Years the average of the actual total net returns per Leased Area exceeds the average projected total net returns per Leased Area, the **Manager's Bonus**, equal to 15% of the excess, is payable;
- Premiums for insurance cover against destruction or damage by fire arranged by the Manager if requested by the Grower; and
- All expenses associated with the scheme including any indemnities to which the Manager is entitled, with respect to all liabilities and expenses incurred by it in relation to the proper performance of its duties as Manager.

40. Under the terms of the Lease and Management Agreement all moneys received from applications shall be paid to the Manager. The Manager will be entitled to the balance of the Subscription Sum, including any accrued interest, remaining after payment of Licence Fees, Irrigation Fee, insurance and any other amount to be paid from the Subscription Sum for performing the Grove Services during the First Period (clause 28 of the Lease and Management Agreement).

Harvesting

41. The Manager will harvest or arrange for some other person to harvest the Olives in each year that there is a commercially harvestable crop (clause 23). The Grower has full right, title and interest in the Olives that are produced by the Grower in the Leased Area (clause 15). The Olive Trees will remain the property of the Lessor.

42. The Manager will undertake to harvest Olives from Leased Areas subscribed for in a Financial Year separately from Olives subscribed for in other Financial Years.

Processing and sale of Olive Oil

43. The Grower appoints the Manager as the Grower's agent to ensure the processing of the Olives and marketing and sale of the Olive Oil, unless the Grower elects to take possession of the harvested Olives. The gross amount received by the Manager from the sale of the Olive Oil is called the 'Gross Proceeds'.

44. Pursuant to clause 26.1 of the Lease and Management Agreement the Gross Proceeds from sale of the Olive Oil from the Leased Areas of Communal Growers will be paid to the Manager who will deposit the proceeds into one or more Proceeds Funds. The term 'Communal Growers' refers to those Growers who do not elect to collect the harvested Olives.

45. Within 21 days of the receipt of the Gross Proceeds the Manager will provide to each Communal Grower a certificate setting out in relation to those Growers:

- the Gross Proceeds;
- the total quantity of Olive Oil sold; and
- the number of Leased Areas producing the olive oil included in the sale (clause 26.2).

46. On receipt of the Gross Proceeds from the sale the Manager will firstly deduct the portion of the Manager's Bonus payable where the conditions in clause 28(c) are satisfied (see paragraph 39) Secondly, the Grower's Proportional Interest of the Gross Proceeds is reduced by any Annual Payments and interest payable by the Grower that are in default and any fees payable with respect to the Grower under the terms of the Lease and Management Agreement. The remaining Gross Proceeds will be distributed to the Communal Growers on a proportionate basis, including their Proportional Interest in the net income of the Proceeds Fund from the previous accounting

period. The terms 'Proceeds Fund' and 'Proportional Interest' are defined in clause 1.1 of the Lease and Management Agreement.

47. The Manager will keep separate records of the Olives harvested and the application of the Gross Proceeds received from the Olive Oil produced from each Leased Area in a particular financial year.

48. When the Manager receives a certificate from an independent horticultural expert that no less than 90% of the Leased Areas subscribed for in a Financial Year are in full production, the Manager shall merge each of the Proceeds Funds relating to the Leased Areas with the Proceeds Funds of other Leased Areas deemed to be in full production.

49. If a Grower elects to collect the harvested Olives in accordance with clause 24, the Manager will advise the Grower of the time and place at which the Olives will be available for collection by the Grower, the amount of Annual Payment for the next Financial Year and the estimated amount of the Manager's Bonus payable pursuant to clause 24.5. The amounts due must be paid at least 1 week prior to collection of the Olives. After the sale of the Olive Oil the Manager will ascertain the actual amount of Manager's Bonus and notify the Grower of any amount payable or refundable.

Shares

50. Each Grower or Nominee must subscribe for 87,100 shares in the landowning company, Croot LandCo Pty Ltd at an exercise price of 12 cents per share.

Finance

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

52. 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

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

- on or before 15 June 2003 (Grower Category 1);
- during the period 16 June to 27 June 2003, provided the Manager can wholly provide the services in consideration of the moneys payable on application by 30 June 2003 (Grower Category 1); or
- during the period after 27 June 2003 to 1 June 2004 (Grower Category 2); and

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

54. 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 harvested Olives and take sole responsibility for the processing and marketing of any resultant Olive Oil.

The Simplified Tax System ('STS')

Division 328

55. 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'.

55A. Changes to the STS rules apply from 1 July 2005. From that date, 'STS taxpayers' may use the accruals accounting method. For a Member participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Member who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

Qualification

56. 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' or who are 'STS taxpayers' using the accruals accounting method for the 2005-06 and later income years' after 'STS taxpayers

Assessable Income

Section 6-5

57. 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.

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

Trading stock

Section 70-35

59. A Grower who is not an 'STS taxpayer' may, in some years, hold olives and/or olive products 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.

60. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Grower may claim the amount of that excess as an allowable deduction.

Deductions for management fees and rent

Section 8-1

61. A Grower who is not an 'STS taxpayer' or who is an 'STS taxpayer' using the accruals accounting method for the 2005-06 and later income years may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the following Tables.

Grower Category 1

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Management Fee	8-1	\$11,115.50 See Notes (i) &(ii)below	\$8,660.30 See Notes (i) &(ii)below	\$5,407.60 See Notes (i) &(ii)below
Licence Fee (Rent)	8-1	\$1888.70 See Notes (i) & (ii) below	\$1945.90 See Notes (i) & (ii) below	\$2004.20 See Notes (i) & (ii) below

Grower Category 2

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Management Fee	8-1	\$11,115.50 See Notes (i) & (ii) below	\$8,660.30 See Notes (i) & (ii) below	See paragraph 39.
Licence Fee (Rent)	8-1	\$1,888.70 See Notes (i) & (ii) below	\$1,945.90 See Notes (i) & (ii) below	\$2,004.20 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 1 at paragraph 143.

- (ii) The Management Fees and the Licence Fees shown in the Management Agreement and the Lease Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the 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 115 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

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

Grower Category 1

Fee type	ITAA 1997 section	Year 1 30/6/2003	Year 2 30/6/2004	Year 3 30/6/2005
Irrigation Fee	40-515	\$3,114.10 See Notes (iii) and (iv) below	\$3,114.10 See Notes (iii) and (iv) below	\$3,114.10 See Notes (iii) and (iv) below

Grower Category 2

Fee type	ITAA 1997 section	Year 1 30/6/2004	Year 2 30/6/2005	Year 3 30/6/2006
Irrigation Fee	40-515	\$3,114.10 See Notes (iii) and (iv) below	\$3,114.10 See Notes (iii) and (iv) below	\$3,114.10 See Notes (iii) and (iv) 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 1 at paragraph 143.
- (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).

Tax outcomes for Growers who are 'STS taxpayers' or 'STS taxpayers' using the cash accounting method for the 2005-06 and later income years

Assessable Income

Section 6-5 and section 328-105

63. 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.

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

Trading stock

Section 328-285

65. A Grower who is an 'STS taxpayer' may, in some years, hold olives and/or olive produce that will constitute trading stock on hand. For an income year, where the difference between the value of the trading stock at the start of the income year and a reasonable estimate of it at the end of the 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)).

66. Alternatively, a Grower who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

Deductions for management fees and rent**Section 8-1 and section 328-105**

67. A Grower who is an 'STS taxpayer' or an 'STS taxpayer' using the cash accounting method for the 2005-06 and later income years may claim tax deductions for the following revenue expenses:

Grower Category 1

Fee Type	ITAA 1997 Sections	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Management Fee	8-1 & 328-105	\$11,115.50 See Notes (v) & (vi) below	\$8,660.30 See Notes (v), (vi) & (vii) below	\$5,407.60 See Notes (v), (vi) & (vii) below
Licence Fee (Rent)	8-1 & 328-105	\$1,888.70 See Notes (v) & (vi) below	\$1,945.90 See Notes (v), (vi) & (vii) below	\$2,004.20 See Notes (v), (vi) & (vii) below

Grower Category 2

Fee Type	ITAA 1997 Sections	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Management Fee	8-1 & 328-105	\$11,115.50 See Notes (v) & (vi) below	\$8,660.30 See Notes (v), (vi) & (vii) below	See paragraph 39.
Licence Fee (Rent)	8-1 & 328-105	\$1,888.70 See Notes (v) & (vi) below	\$1,945.90 See Notes (v), (vi) & (vii) below	\$2,004.20 See Notes (v), (vi) & (vii) below

Notes:

- (v) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example 1 at paragraph 143.
- (vi) If for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' or an 'STS taxpayer' using the cash accounting method for the 2005-06 and later income years then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year

in which it is incurred will be deductible in the year it is actually paid.

- (vii) Where a Grower who is an 'STS taxpayer' or an 'STS taxpayer' using the cash accounting method for the 2005-06 and later income years, pays the Management Fees and the Licence Fees in the relevant income years shown in the Lease and Management Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 109 to 115). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 115, 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 and 40-G

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

69. The deductions shown in the following table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities 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 (viii) below.

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

Grower Category 1

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Irrigation costs	40-515	\$3,114.10 See Notes (viii) & (ix) below	\$3,114.10 See Notes (viii) & (ix) below	\$3,114.10 See Notes (viii) & (ix) below

Grower Category 2

Fee type	ITAA 1997 section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Irrigation costs	40-515	\$3,114.10 See Notes (viii) & (ix) below	\$3,114.10 See Notes (viii) & (ix) below	\$3,114.10 See Notes (viii) & (ix) below

Notes:

- (viii) 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 1 at paragraph 143.
- (ix) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1,000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2003 (Grower Category 1) or 2004 (Grower Category 2) is determined by multiplying its 'cost' by half the relevant STS pool

rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one-third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one-third in each of the next 2 years of income (section 40-540).

Tax outcomes that apply to all Growers

Interest

71. 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 109 to 116 (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.

Shares

72. The shares in Croot LandCo Pty Ltd are CGT assets (section 108-5 of the ITAA 1997) and the amounts paid by a Grower to acquire those assets is an outgoing of capital and not allowable as a deduction.

73. The amounts paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)). Any disposal of the shares by a Grower will be a CGT event and may give rise to a capital gain or loss.

Dividends relating to the shares

74. Dividends paid out of profits by Croot LandCo Pty Ltd are included in the assessable income of shareholders under section 44(1) of the ITAA 1936.

Division 35 - deferral of losses from non-commercial business activities***Section 35-55 - Commissioner's discretion***

75. For a Grower who is an individual and who enters the Project during the years ending 30 June 2003 or 30 June 2004 the rule in section 35-10 may apply to the business activity comprised by their involvement in the Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2003 to 30 June 2005 that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling.

76. 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 130 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)).

77. Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of the deductions attributable to their business activity in excess of any assessable income from that activity, i.e. any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

78. 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 subsection 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from this perspective has not been made.

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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 109 to 116);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Corporations Act 2001

80. For this Ruling to apply, an offer for an interest in the project must:

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

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

81. 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));
- the 'individual wealth test' (paragraph 761G(7)(c)); and
- the 'professional investor test' (paragraph 761G(7)(d)).

82. 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.

83. 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.

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 'professional investor test' where:

- the person is a financial services licensee or; and
- the person controls at least \$10 million for the purposes of investment in securities.

85. 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)).

86. 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?

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

88. For schemes such as that of the Guilderton Olives Stage 2 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.

89. Generally, a Grower will be carrying on a business of cultivating Olive Trees for the production of Olive Oil, and hence primary production, where:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's Olive Trees are established;
- the Grower has a right to harvest and sell the Olives each year from those Olive trees;
- the activities of cultivating Olive Trees for the production of Olive Oil are carried out on the Grower's behalf;
- the horticulture activities of the Grower are typical of those associated with a business of cultivating Olive Trees for the production of Olive Oil; and
- the weight and influence of general indicators point to the carrying on of a business.

90. In this Project, each Grower enters into a Lease and Management Agreement with the Lessor and the Manager.

91. Under the Lease and Management Agreement each individual Grower will have rights over a specific and identifiable area of 0.78 hectares of land. The Lease and Management Agreement provides the Grower with an ongoing interest in the specific trees on the Leased Area for the term of the Project. The Grower must use the land in question for the purpose of carrying out the cultivation of Olive Trees for the purpose of Olive Oil production, and for no other purpose. The Lease and Management Agreement allows the Manager to come onto the land to carry out its obligations under this Agreement.

92. Under the Lease and Management Agreement the Manager is engaged by the Grower to carry out the Grove Services 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 manage and maintain the Leased Area on the Grower's behalf.

93. The Grower engages the Manager to maintain the Olive Trees on the Leased Area according to the principles of sound horticulture practice which includes irrigation, fertilisation, weed control and pruning. The Manager is engaged to harvest or arrange for the harvest of the Olives grown on the Grower's Leased Area. The Manager is also engaged to arrange the processing of the Olives and to sell the Olive Oil produced, on the Grower's behalf. Growers can elect to exercise the right to personally market and sell the Olives attributed to their Leased Area

94. 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.

95. 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 the processed Olive Oil 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.

96. The pooling of olives grown on the Grower's Leased Area with the Olives of other Growers is consistent with general horticulture practices. Each Grower's proportionate share of the sale proceeds of the olive oil produced from the pooled olives will reflect the proportion of the olives contributed from their Leased Area.

97. The Manager's services are consistent with general horticulture practices. The assets installed by the Lessor are of a type ordinarily used in carrying on a business of horticulture. While the size of each Leased Area is relatively small, it is of a size and scale to allow it to be commercially viable. (see *Taxation Ruling* IT 360).

98. The Grower's degree of control over the Manager as evidenced by the Lease and 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 Leased Area 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.

99. The horticulture activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' horticulture activities in the Guilderton Olives Stage 2 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

100. 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.

101. 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 lease fees***Section 8-1***

102. Consideration of whether the initial management fees and lease fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

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

103. The management fees and lease fees associated with the horticulture activities will relate to the gaining of income from the Grower's business of olive growing (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of olive oil produced from processing the olives) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management 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

104. Under the Lease and Management Agreement neither the management fees nor the lease 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.

105. 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 109 to 116) 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

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

107. If the Grower is not an 'STS taxpayer' or is an 'STS taxpayer' using the accruals accounting method for the 2005-06 and later income years, the management fees and the lease fees are deductible in the year in which they are incurred.

108. If the Grower is an 'STS taxpayer' or an 'STS taxpayer' using the cash accounting method for the 2005-06 and later income years the management fees and the lease fees are deductible in the income year in which they are paid, or are paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Prepayment provisions

Sections 82KZL to 82KZMF

109. 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.

110. 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

111. 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)).

112. 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.

113. 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 Guilderton Olives 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.

114. 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.

115. 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.

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

116. 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

117. In this Project, an initial management fee of \$11,115.50 and an initial Lease Fee of \$1,888.70 per Leased Area will be incurred on execution of the Lease and Management Agreement. The Management Fee and the Licence Fee are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreement. Under the Agreement, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

118. 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.

119. There is also no evidence that 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 Lease and

Management Agreement, Licence Fees are payable annually in advance for the lease of the land during the expenditure year.

120. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 38 and 39, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

Growers who choose to pay fees for a period in excess of that required by the Project's agreements

121. Although not required under the Lease and Management Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers other than Guilderton Olives Pty Ltd may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 120 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

122. 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.

123. 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

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

125. 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'.

126. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 62 in the Tables and the accompanying Notes.

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

127. 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.

128. 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.

129. 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.

130. 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.

131. 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).

132. 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 Leased Area in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2008. 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.

133. 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.

134. 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.

135. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Leased Area 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 2008, or will produce a taxation profit, for the income years ended 30 June 2006, 30 June 2007 and 30 June 2008.

136. 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 2005.

137. 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 75), in the manner described in the Arrangement (see paragraphs 14 to 52). If so, this

Ruling, and specifically the decision in relation to paragraph 35-55(1), 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) will apply in such changed circumstances.

138. 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 a Director of the Guilderton Olives Pty Ltd (the Manager) provided with the application;
- the binding contract with Premium Olive Marketing Limited for the sale of the Olive Oil setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the Olives are grown; and
- independent, objective and generally available information relating to the Olive Oil industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Manager.

Section 82KL - recouped expenditure

139. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA - general tax avoidance provisions

140. 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).

141. The Guilderton Olives Stage 2 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 61 to 70 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.

142. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the olives. There are no facts that would suggest

that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Examples

Example 1 - Entitlement to GST input tax credits

143. 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 2002, 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 1/1/2003 to 30/6/2003	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2003 (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:

$$\frac{1}{11} \times \$4,400 = \$400.$$

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:

$$\frac{1}{11} \times \$2,200 = \$200.$$

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 2003, 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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Related Rulings/Determinations:

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

Subject references:

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

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