


PR 2003/26 - Income tax: Australian Olives Project No. 5

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



Product Ruling

Income tax: Australian Olives Project No. 5

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

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax 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 Australian Olives Project No. 5 or simply as 'the Project'.

Tax laws

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

- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Division 70 (ITAA 1997)
- Division 328 (ITAA 1997);
- Section 44 of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KL (ITAA 1936);
- Section 82KZL (ITAA 1936);
- Section 82KZME (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

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 Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

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

Class of persons

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

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion or who otherwise do not intend to derive assessable income from it. Members who either elect to maintain or harvest their Grove or who enter into other subcontracting arrangements (see paragraph 30) are excluded from the class of persons to whom this Ruling applies.

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 specified below. This arrangement incorporates the following documents:

- Application for a Product Ruling from Australian Olives Limited (AOL) dated 20 March 2003 in respect of the Australian Olives Project No. 5 as constituted by documents provided on 14 March 2003 and 20 March 2003 and additional correspondence dated 2 April 2003, 8 April 2003, 9 April 2003, 10 April 2003, 11 April 2003, 7 May 2003 and 8 May 2003;
- Draft Australian Olives Project No. 5 Prospectus (Australian Registered Scheme Number 103 920 190, a managed investment scheme under the *Corporations Act 2001*);
- Constitution for Australian Olives Project No. 5 ('the Constitution');
- Draft Supplementary Constitution for Australian Olives Project No. 5 received on 10 April 2003;
- Draft Second Supplementary Constitution for Australian Olives Project No. 5 received on 8 May 2003;
- **Grove Licence Agreement** between Collective Olive Groves Limited (COGL) ('the Landowner'), Australian Olives Limited (AOL) ('the Responsible Entity') and the Member;
- **Grove Agreement** between AOL and the Member;
- **Finance Agreement** between AOL ('the Lender') and the Borrower (the Member);

- **Finance Agreement** between Collinsville Finance Pty Ltd ('the Lender') and the Borrower (the Member);
- Compliance Plan for the Project;
- Water Supply Agreement;
- Variation Water Supply Agreement;
- Lease and Sublease for Lots 12, 79 and 310 on CP ML2152, Merivale, Tummaville between COGL and AOL.

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

15. The documents highlighted are those that the Members enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Member, or an associate of the Member 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.

Overview

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

Location	'Yallamundi', 86 kms south west of Toowoomba
Type of business participant is carrying on	Commercial growing of varieties of olive trees to produce olives for oil production
No. of Groves on offer	3,520
Size of each Grove	0.15 hectares
No. of trees per hectare	353
No. of trees per Grove	53
Term of the investment	Until 30 June 2023
Initial cost	\$4,433 per Grove
Initial cost per hectare	\$29,553
Ongoing costs	<ul style="list-style-type: none"> • Management Fees, Licence Fees and Harvesting Costs • Insurance in relation to fires and other natural disasters

18. The Prospectus invites applicants to participate in two specific interests. The first is a right to participate in a project called 'Australian Olives Project No. 5' ('the Project'), which is a managed investment scheme under *Corporations Act 2001*. Once the application is accepted the applicant becomes a Member. The second is an option for the Member or an associate of the Member to acquire shares in COGL, the Project's landowning company. AOL will only transfer the ordinary shares in the landholding company to Members or their associates in minimum parcels of 73 ordinary shares at \$80 per parcel.

19. During the term of the Project each Member will have the right to use and occupy a separate and independently identifiable area of project land, known as a Grove, upon which the olive trees (53 per Grove) will be grown. There is no variation between individual Members' Groves within the Project or between rights attached thereto, except that the Manager may plant different varieties of Olive trees on individual Groves based on overall Project objectives.

20. Olive growing projects will be conducted on a series of properties collectively called 'Yallamundi', which is 86 km south west of Toowoomba. This particular Project will involve Lots 12, 79 and 310 on CP ML2152, Parish of Tummaville, and County of Merivale, which is owned by COGL. The offer contained under this prospectus is for three thousand five hundred and twenty (3,520) Groves. There is no minimum subscription.

21. Once an application is accepted the Member is bound by the terms of the Constitution. At the same time the Member enters into a Grove Agreement and a Grove Licence Agreement by virtue of a Limited Power of Attorney granted to the Responsible Entity who will sign those agreements on behalf of Members. The Grove Agreement provides that the Member may make a number of elections including an election under clause 5.4(a) to manage and maintain his/her own Grove and personally carry out all of the duties of the Responsible Entity other than the initial duties set out in clause 4.1. In this event, the Responsible Entity may still be required to supply water to the Members Grove for a fee. The elections a Member can make under the Grove Agreement are further discussed in paragraph 30 of this Ruling.

22. Members' applications received on or before 15 June 2003 will, pending AOL's discretion, be accepted by 15 June 2003. Members' applications received from 16 June 2003 to 30 June 2003 (dates inclusive) will be accepted by AOL, at its discretion, on or after 1 July 2003.

23. A Member entering into the Grove Licence Agreement and the Grove Agreement will be liable to pay the following amounts

24. On application:

- \$4,400 in respect of the following fees – \$343 for Landcare Operations, \$1,500 for Irrigation, \$535 for Olive Tree acquisition and establishment and \$2,022 for Grove Management fee payable for the services of the Manager from the date of acceptance to the next 30 June following the date of acceptance;
- \$33 in respect of a Grove Licence fee payable to the Landowner for the period from the date of acceptance to the next 30 June following the date of acceptance.

Thereafter \$33 is payable in respect of an annual Grove Licence Agreement fee commencing from the 1 July in the year following acceptance. In each year, the Land Owner will issue an invoice to the Member for one half of that year's fee by 1 December, payable by 31 December, and will issue an invoice for the balance of that year's fee by 1 June, payable by 30 June.

This amount will be indexed in subsequent years in accordance with increases in the All Groups Consumer Price Index for Brisbane ('the CPI').

Subsequent Payments:

- \$935 is payable in respect of an annual Grove Agreement fee commencing from the 1 July in the year following acceptance where the Member does not elect to undertake his/her own maintenance of the Grove. In each year, the Manager will issue an invoice to the Member for one half of that year's fee by 1 December, payable by 31 December, and will issue an invoice for the balance of that year's fee by 1 June, payable by 30 June.

This amount will be indexed in subsequent years in accordance with increases in the All Groups Consumer Price Index for Brisbane ('the CPI').

- An amount will also be payable as a harvesting fee (unless the Member elects to harvest his/her olives). This fee will be adjusted to reflect the actual cost of the harvest, and will be due upon presentation of an invoice to the Member, though the Responsible Entity will be able to accept payment from sale proceeds. Fees may be higher where the Member elects to have the trees on his/her Grove harvested separately.

25. There is no assurance or guarantee in respect of the future success of, or financial returns associated with, the Project by the promoter apart from a guarantee that the Manager will replace any trees that fail (for whatever reason) until the first harvest, predicted to be Year 4 of the Project.

Grove Licence Agreement

26. The Grove Licence Agreement is executed between Collective Olive Groves Limited (the land owner), the Responsible Entity and each Member. By the commencement of the Grove Licence Agreement the land owner will have totally cleared the Grove of trees, undergrowth, weeds, sticks and stones to a state which enables the Grove to be cultivated for the purposes of the Project (clause 8(a)). Members entering the Grove Licence Agreement will pay occupancy fees outlined in paragraph 24 above (clause 6.1) for a licence to use and occupy the Grove for the limited purposes of planting, growing, harvesting and marketing olives for a period ending on the 30 June 2023. A licence will relate to an identifiable area of land. The Member may appoint an agent under a Grove Agreement to perform the licensed activities (clause 7.2).

Grove Agreement

27. Members will enter into a Grove Agreement appointing AOL, as Responsible Entity, to manage the Member's interest in the Project on the terms and conditions set out in the Grove Agreement. Members enter into the Agreement until the year ended 30 June 2023 unless the Agreement is terminated earlier (clause 3).

28. Clause 4.2 of the Grove Agreement provides that the Responsible Entity must perform the following duties by the 30 June after the applications have been accepted:

- acquire for the Member at least 53 olive seedlings;
- carry out necessary irrigation works;
- undertake drainage and soil loss prevention works;
- pre-planting and preparation;
- if necessary, tend the olive seedlings and the Member's Grove;
- plant the olive seedlings at the proper time having regard to sound agricultural practices;
- supply adequate water;

- eradicate weeds and repair any damage caused by AOL; and
- undertake certain preventive measures concerning land degradation.

29. After these initial duties have been performed, AOL must provide continuing maintenance of the Groves under clause 4.3 of the Grove Agreement unless the Member has elected to undertake the ongoing maintenance of the Grove.

30. A Member has a right to elect to undertake the ongoing maintenance of the Grove and only pay for the services (including water) supplied by the Manager (clause 5.4). Members can also elect to have their olives harvested separately and/or to receive any olives harvested from their Grove to sell, market or deal with as they determine (clause 5.3). Members electing to conduct their own harvest and/or maintenance must ensure the work is of a similar standard to that of the work conducted by the Manager of the other Groves (clause 5.1). **Members who either elect to maintain or harvest their Grove or who enter into other subcontracting arrangements will be outside the arrangements to which this Ruling relates and will be unable to rely on this Ruling.**

31. The Responsible Entity may employ agents, contractors, professional advisers and other consultants to perform its obligations under the Agreement (clause 10.1).

Constitution

32. The Project is governed by the Project's Constitution. The Constitution includes provisions about the legal obligations, rights and limits to the liability of the Members and details the powers of the parties to the Constitution. This document details a number of procedures, including:

- the payment of application fees;
- the disbursement of proceeds from the Project;
- complaints handling;
- the payment of fees and expenses;
- transmission of Members' interests;
- meetings; and
- register of Members.

33. For those Members who elect AOL to manage their Groves, AOL will pool the olives attributable to the Members' Groves and then store, market and sell the produce without having regard to the

quality of the particular produce from the particular Groves (clause 25.1(b)). AOL will then pay to the 'Proceeds Fund' the proceeds of the olive sales. Amounts for the Grove Agreement, Grove Licence Agreement and other limited outgoings will then be deducted (including taxes) and the result will be distributed proportionately between Members (clause 25.3(a)).

34. A Member's share of the net proceeds from the sale of olives will be reduced, accordingly, where there is total or partial destruction of that Member's Grove or the level of production is otherwise reduced or inadequate compared to other Groves for any reason (clause 25.3(h)).

35. Members will not be entitled to any part of the Proceeds Fund in respect of a Production Period where they have elected to sell their own olives or if the Member's Grove failed to produce any olives for sale (clause 25.3(g)).

36. AOL will bear all costs of carrying out its duties under the Grove Agreement (clause 6.6).

Compliance Plan

37. The Compliance Plan describes how the Responsible Entity will ensure its compliance with the *Corporations Act 2001* and the Project's Constitution. A Compliance Plan is designed to ensure that the interests of the Members are protected. The Compliance Plan in this arrangement sets out both details of the compliance procedures and the position within the Responsible Entity, who will be held responsible for the compliance procedures in areas including:

- naming the Compliance Officer within the Responsible Entity;
- the appointment and monitoring of the Custodian;
- holding Project property;
- marketing the Project;
- conduct of the business, such as the use of qualified contractors;
- application money and commissions payment details;
- compliance committee appointment and function;
- audit functions;
- keeping of records and accounts;
- related party issues;
- fees and expenses;

- complaints handling procedures;
- training and supervision of personnel; and
- review of the compliance level.

Harvesting and Marketing

38. The Responsible Entity has negotiated an agreement with Inglewood Olive Processors Limited ('the Processor'). The Processor has agreed to purchase all the available Products in accordance with a Pricing Schedule that has an inbuilt minimum price mechanism. The Responsible Entity has the right to seek a better price than the Processor's nominated price if a better alternative price is available.

Finance

39. Members can fund their investment in the Project themselves, borrow from AOL, Collinsville Finance Pty Ltd (a related entity of AOL) or borrow from an independent lender.

40. AOL will offer finance to Members, per Grove, on the following terms:

- payment of \$1,000 deposit on application and pay 24 monthly instalments of principal and interest of \$165.12, commencing one month from the loan settlement date;
- payment of \$1,000 deposit on application and pay 48 monthly instalments of principal and interest of \$92.25, commencing one month from the loan settlement date; or
- payment of \$1,000 deposit on application and pay 60 monthly instalments of principal and interest of \$77.88, commencing one month from the loan settlement date.

A loan application fee of \$275 is payable before the loan settlement date. In the event of default, AOL may, in addition to other actions to remedy such default, sell and/or transfer all of the rights and interests which the Member has in the Olive Grove/s and/or any Grove Agreement and Grove Licence Agreement for the Olive Grove/s.

41. Collinsville Finance Pty Ltd will offer finance to Members, per Grove, on the following terms :

- minimum loan of \$9,026 (two Groves and two parcels of shares in COGL);

- first instalment of principal and interest is due and payable on 15 July 2003 with 83 monthly instalments, each of \$79.31 per Grove, payable from 15 August 2003; and
- the loan expiry date is 15 June 2010.

A loan application fee, being the higher of \$275 or 1% of the principal, is payable before the loan settlement date. In the event of default, Collinsville Finance Pty Ltd may, in addition to other actions to remedy such default, sell and/or transfer all of the rights and interests which the Member has in the Olive Grove/s and/or any Grove Agreement and Grove Licence Agreement for the Olive Grove/s.

42. AOL and Collinsville Finance Pty Ltd will deposit the borrowed funds directly into the Australian Olives Project No. 5 Application Funds Account in respect of Members' Applications for Interests in the Project.

43. This Ruling does not apply if a Member 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 other than AOL or Collinsville Finance Pty Ltd, are involved or become involved, in the provision of finance to Members for the Project.

Ruling

Application of this Ruling

44. This Ruling applies only to Members who are accepted to participate in the Project on or before 30 June 2004 and who have executed a Grove Agreement and a Grove Licence Agreement before that date. The Member's participation in the Project must constitute the carrying on of a business of primary production.

45. A Member is not eligible to claim any tax deductions until the Member's application to enter the Project is accepted and the Project has commenced.

46. Members who either elect to maintain or harvest their Grove or who enter into other subcontracting arrangements will be outside the arrangements to which this Ruling relates and will be unable to rely on this Ruling.

The Simplified Tax System ('STS')

Division 328

47. For a Member 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 Member is an 'STS taxpayer'. To be an 'STS taxpayer' a Member must:

- be eligible to be an 'STS taxpayer'; and
- have elected to be an 'STS taxpayer'.

Qualification

48. This Product Ruling assumes that a Member who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Member may become an 'STS taxpayer' at a later point in time. Also, a Member 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 Members that cannot be accommodated in this Ruling. Such Members can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Members who are not ‘STS taxpayers’**Assessable income*****Section 6-5***

49. That part of the gross sales proceeds from the Project attributable to the Member’s produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Member under section 6-5.

50. The Member recognises ordinary income from carrying on the business of olive growing at the time that income is derived.

Trading stock***Section 70-35***

51. A Member who is not an ‘STS taxpayer’ may, in some years, hold olives that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Member must include the amount of that excess in assessable income.

52. 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 Member may claim the amount of that excess as an allowable deduction.

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

Deductions for Grove fees, Grove Licence fees and Interest for Members accepted into the Project on or before 15 June 2003

Section 8-1

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

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Grove Fee	8-1	\$2,022 – See Notes (i) & (ii) (below)	\$935 – See Notes (i) & (ii) (below)	\$935 (indexed) – See Note (i) & (ii) (below)
Grove Licence Fee	8-1	\$33 – See Notes (i) & (ii) (below)	\$33 – See Notes (i) & (ii) (below)	\$33 (indexed) – See Notes (i) & (ii) (below)
Interest	8-1	As incurred See Note (iii) (below)	As incurred See Note (iii) (below)	As incurred See Note (iii) (below)

Notes:

- i. If the Member 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 144.
- ii. The Grove fees and the Grove Licence fees shown in the Grove Agreement and the Grove Licence Agreement are deductible in full in the year that they are incurred. However, if a Member **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the licensing 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 114 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.
- iii. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than AOL or Collinsville Finance Pty Ltd, is outside the scope of this Ruling. However all Members, including those who finance their participation in the Project other than with AOL or

Collinsville Finance Pty Ltd, should read the discussion of the prepayment rules in paragraphs 108 to 119 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 Member's choice.

Deductions for capital expenditure for Members accepted into the Project on or before 15 June 2003

Division 40

55. A Member who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g. irrigation), a 'landcare operation' and olive trees. All deductions shown in the following table are determined under Division 40.

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Irrigation facility	40-515	\$500 – see Notes (iv) & (v) below	\$500 – see Notes (iv) & (v) below	\$500 – see Notes (iv) & (v) below
Landcare operations	40-630	\$343 – see Notes (iv) & (vi) below		
Establishment of horticultural plants (olive trees)	40-515	Nil – see Notes (iv) & (vii) below	Nil – see Notes (iv) & (vii) below	Nil – see Notes (iv) & (vii) below

Notes:

- iv. If the Member 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 144.
- v. Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Member on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).
- vi. Any capital expenditure incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630.

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

Deductions for Grove fees, Grove Licence fees and Interest for Members accepted into the Project after 30 June 2003

Section 8-1

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

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Grove Fee	8-1	\$2,022 – See Notes (i) & (ii) (above)	\$935 – See Notes (i) & (ii) (above)	\$935 (indexed) – See Note (i) & (ii) (above)
Grove Licence Fee	8-1	\$33 – See Notes (i) & (ii) (above)	\$33 – See Notes (i) & (ii) (above)	\$33 (indexed) – See Notes (i) & (ii) (above)
Interest	8-1	As incurred See Note (iii) (above)	As incurred See Note (iii) (above)	As incurred See Note (iii) (above)

Deductions for capital expenditure for Members accepted into the Project after 30 June 2003

Division 40

57. A Member who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g. irrigation), a 'landcare operation' and olive trees. All deductions shown in the following Table are determined under Division 40.

Fee type	ITAA 1997 section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Water facility	40-515	\$500 – see Notes (iv) & (v) (above)	\$500 – see Notes (iv) & (v) (above)	\$500 – see Notes (iv) & (v) (above)
Landcare operations	40-630	\$343 – see Notes (iv) & (vi) (above)		
Establishment of horticultural plants (olive trees)	40-515	Nil – see Notes (iv) & (vii) (above)	Nil – see Notes (iv) & (vii) (above)	Nil – see Notes (iv) & (vii) (above)

Tax outcomes for Members who are 'STS taxpayers'

Assessable income

Sections 6-5 and 328-105

58. That part of the gross sales proceeds from the Project attributable to the Member's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Member under section 6-5.

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

Treatment of trading stock

Section 328-285

60. A Member who is an 'STS taxpayer' may, in some years, hold olives that will constitute trading stock on hand. Where, for such a Member, 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)).

61. Alternatively, a Member 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)).

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

Deductions for Grove fees, Grove Licence fees and Interest for Members accepted into the Project on or before 15 June 2003

Sections 8-1 and 328-105

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

Fee Type	ITAA 1997 Sections	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Grove Fee	8-1 & 328-105	\$2,022 – See Notes (viii), (ix) & (x) (below)	\$935 – See Notes (viii), (ix) & (x) (below)	\$935 (indexed) – See Notes (viii), (ix) & (x) (below)
Grove Licence Fee	8-1 & 328-105	\$33 – See Notes (viii), (ix) & (x) (below)	\$33 – See Notes (viii), (ix) & (x) (below)	\$33 (indexed) – See Notes (viii), (ix) & (x) (below)
Interest	8-1 & 328-105	When paid – See Note (xi) (below)	When paid – See Note (xi) (below)	When paid – See Note (xi) (below)

Notes:

- viii. If the Member 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 144.

- ix. 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 Member 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 Member. 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.
- x. Where a Member who is an 'STS taxpayer', pays the Grove fees and the Grove Licence fees in the relevant income years shown in the Grove Agreement and Grove Licence Agreement, those fees are deductible in full in the year that they are paid. However, if a Member **chooses** to prepay fees for the doing of a thing (e.g. the provision of management services or the licensing 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 108 to 119). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 114, 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.
- xi. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than AOL or Collinsville Finance Pty Ltd, is outside the scope of this Ruling. However all Members, including those who finance their participation in the Project other than with AOL or Collinsville Finance Pty Ltd, should read the discussion of the prepayment rules in paragraph 108 to 119 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 Member's choice.

Deductions for capital expenditure for Members accepted into the Project on or before 15 June 2003

Subdivisions 328-D, 40-F and 40-G

64. A Member who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g. irrigation), a 'landcare operation' and olive trees. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F and in relation to a 'landcare operation' under Subdivision 40-G. If the 'water facility' or 'landcare operation' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under

Division 328. Deductions for the olive trees must be determined under Subdivision 40-F.

65. The deductions shown in the following Table assume, for representative purposes only, that a Member has either chosen to or can only claim deductions for expenditure on water facilities or a 'landcare operation' under Subdivisions 40-F or 40-G 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 Notes (xiii) and (xiv) below.

66. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1,000 (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 Member is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Water facility	40-515	\$500 – see Notes (xii) & (xiii) below	\$500 – see Notes (xii) & (xiii) below	\$500 – see Notes (xii) & (xiii) below
Landcare operations	40-630	\$343 – see Notes (xii) & (xiv) below		
Establishment of horticultural plants (olives)	40-515	Nil – see Notes (xii) & (xv) below	Nil – see Notes (xii) & (xv) below	Nil – see Notes (xii) & (xv) below

Notes:

- xii. If the Member 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 144.
- xiii. 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 Member may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Member's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed

'depreciating asset' is less than \$1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Member 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, for Members accepted into the Project on or before 15 June 2003, or in the year ended 30 June 2004, for Members accepted into the Project during the year ended 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. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Members 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 Member 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).

- xiv. Any capital expenditure incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630. If the expenditure is on a 'depreciating asset' (the underlying asset), the Member may choose to claim a deduction under either Division 328 or Subdivision 40-G (although expenditure on some items of plant can only be deducted under Division 328). For the purposes of Division 328, each Member'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 Member 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 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', the expenditure is fully deductible under Subdivision 40-G.
- xv. Olive trees are a 'horticultural plant' as defined in subsection 40-525(2). As Members hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under

paragraph 40-515(1)(b) for their decline in value. The deduction for the olive trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Member that is attributable to their establishment. If the olive trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the olive trees enter their first commercial season (section 40-530(2)). The Project Manager will inform Members of when the olive trees enter their first commercial season.

Deductions for Grove fees, Grove Licence fees and Interest for Members accepted into the Project after 30 June 2003

Sections 8-1 and 328-105

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

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	\$2,022 – See Notes (viii), (ix) & (x) (above)	\$935 – See Notes (viii), (ix) & (x) (above)	\$935 (indexed) – See Notes (viii), (ix) & (x) (above)
Grove Licence Fee	8-1 & 328-105	\$33 – See Notes (viii), (ix) & (x) (above)	\$33 – See Notes (viii), (ix) & (x) (above)	\$33 (indexed) – See Notes (viii), (ix) & (x) (above)
Interest	8-1 & 328-105	When paid – See Note (xi) (above)	When paid – See Note (xi) (above)	When paid – See Note (xi) (above)

Subdivisions 328-D, 40-F and 40-G

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

69. The deductions shown in the following Table assume, for representative purposes only, that a Member has either chosen to or can only claim deductions for expenditure on water facilities or a 'landcare operation' under Subdivisions 40-F or 40-G 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 Notes (xiii) and (xiv) above.

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 Member is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

Fee type	ITAA 1997 section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Water facility	40-515	\$500 - see Notes (xii) & (xiii) above	\$500 - see Notes (xii) & (xiii) above	\$500 - see Notes (xii) & (xiii) above
Landcare operations	40-630	\$343 - see Notes (xii) & (xiv) above		
Establishment of horticultural plants (olives)	40-515	Nil - see Notes (xii) & (xv) above	Nil - see Notes (xii) & (xv) above	Nil - see Notes (xii) & (xv) above

Tax outcomes that apply to all Members

Shares

71. The shares in Collective Olive Groves Ltd are CGT assets (section 108-5 of the ITAA 1997) and the amount paid by a Member to acquire those assets is an outgoing of capital and not allowable as a deduction.

72. The amount 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 Member will be a CGT event and may give rise to a capital gain or loss.

Dividends relating to the shares

73. Dividends paid out of profits by Collective Olive Groves Ltd are included in the assessable income of shareholders under subsection 44(1) of the ITAA 1936

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

74. For a Member who is an individual and who enters the Project during the year ended 30 June 2003 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2003 to 30 June 2007 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.

Similarly, for a Member who is an individual and who enters the Project during the year ended 30 June 2004 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2004 to 30 June 2008 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

75. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 129 in the Explanations part of this ruling, below); or
- a Member’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Member’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)).

76. Where, the ‘exception’ in subsection 35-10(4) applies, the Member’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 Member 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.

77. Members are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Members should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1) 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 and 82KZMF, 82KL and Part IVA

78. For a Member who participates in the Project and incurs expenditure as required by the Grove Agreement and the Grove Licence Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Member does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 108 to 119);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Is the Member carrying on a business?

79. For the amounts set out in the Tables above to constitute allowable deductions the Member's olive growing activities as a participant in the Australian Olives Project No. 5 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.

80. For schemes such as that of the Australian Olives Project No. 5, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Member'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.

81. Generally, a Member will be carrying on a business of olive growing, and hence primary production, if:

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

82. In this Project, each Member enters into a Grove Agreement and a Grove Licence Agreement.

83. Under the Grove Licence Agreement each individual Member will have rights over a specific and identifiable area of land. The Grove Licence Agreement provides the Member with an ongoing interest in the specific olive trees on the licensed area for the term of the Project. Under the licence the Member must use the land in question for the purpose of carrying out olive growing activities and for no other purpose. The licence allows the Project Manager to come onto the land to carry out its obligations under the Grove Agreement.

84. Under the Grove Agreement the Project Manager is engaged by the Member to establish and maintain a Grove on the Member'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 Grove on the Member's behalf.

85. In establishing the Grove, the Member engages the Project Manager to purchase and install water facilities (e.g. irrigation), to carry out 'landcare operation' and to acquire and plant olive trees on the Member's Grove. During the term of the Project, these assets will be used wholly to carry out the Member's olive growing activities. The Project Manager is also engaged to harvest and sell, on the Member's behalf, the olives grown on the Member's Grove.

86. 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.

87. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Member in the Project will derive assessable income from the sale of its olives that will return a before-tax profit,

i.e. a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

88. The pooling of olives grown on the Member's Grove with the olives of other Members is consistent with general olive growing practices. Each Member's proportionate share of the sale proceeds of the pooled olives will reflect the proportion of the olives contributed from their Grove.

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

90. The Member's degree of control over the Project Manager as evidenced by the Grove Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Member with regular progress reports on the Member's Grove and the activities carried out on the Member's behalf. Members are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

91. The olive growing activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Member's olive growing activities in the Australian Olives Project No. 5 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

92. Subdivision 328-F sets out the eligibility requirements that a Member must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

93. The question of whether a Member is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Member 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 Grove fees and Grove Licence fees***Section 8-1***

94. Consideration of whether the initial Grove fees and Grove Licence 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.

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

96. Under the Grove Agreement and under the Grove Licence Agreement neither the Grove fees nor the Grove Licence fees are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

97. However, where a Member chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 108 to 119) will apply to determine the amount and timing of the deductions regardless of

whether the Member 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

98. In the absence of any application of the prepayment provisions, the timing of deductions for the Grove fees or the Grove Licence fees will depend upon whether a Member is an 'STS taxpayer' or is not an 'STS taxpayer'.

99. If the Member is not an 'STS taxpayer', the Grove fees and the Grove Licence fees are deductible in the year in which they are incurred.

100. If the Member is an 'STS taxpayer' the Grove fees and the Grove Licence fees are deductible in the income year in which they are paid, or are paid for the Member (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 Member.

Interest deductibility

Section 8-1

(i) Members who use AOL or Collinsville Finance Pty Ltd as the finance provider

101. Some Members may finance their participation in the Project through a loan facility with AOL or Collinsville Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of Grove Licence and Grove fees.

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

103. As with the Grove fees and the Grove Licence fees, in the absence of any application of the prepayment provisions (see paragraphs 108 to 119), the timing of deductions for interest will again depend upon whether a Member is an 'STS taxpayer' or is not an 'STS taxpayer'.

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

105. If the Member is an 'STS taxpayer' interest is not deductible until it has been both incurred and paid, or is paid for the Member. If interest that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid, or is paid for the Member.

(ii) Members who DO NOT use AOL or Collinsville Finance Pty Ltd as the finance provider

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

107. While the terms of any finance agreement entered into between relevant Members and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Member 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 108 to 119).

Prepayment provisions

Sections 82KZL to 82KZMF

108. 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.

109. 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

110. 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)).

111. 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.

112. 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 Member in this Project who, in order to participate in the Project may borrow funds from a financier other than AOL or Collinsville Finance Pty Ltd. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are

directly related to the activities under the arrangement. If a Member prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

113. There are a number of exceptions to these rules, but for Members 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 Members in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

114. 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.

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

115. 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

116. In this Project, an initial Grove fee of \$4,400 and an initial Grove Licence fee of \$33 per Grove will be incurred on execution of the Grove Agreement and the Grove Licence Agreement. The Grove fee and the Grove Licence fee are charged for providing management services or licensing land to a Member 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.

117. In particular, the Grove 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 Grove fee has been inflated to result in reduced fees being payable for Grove fees in subsequent years.

118. 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 Grove 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 Grove Licence Agreement, Grove Licence fees are payable for the licence of the land during the expenditure year. Similarly, under the loan agreements to be executed between Members and AOL or Collinsville Finance Pty Ltd interest is payable monthly in arrears.

119. On this basis, provided a Member incurs expenditure as required under the Project agreements, as set out in paragraph 24, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

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

120. Although not required under the Grove Agreement, the Grove Licence Agreement or the Loan Agreement with AOL or Collinsville Finance Pty Ltd, a Member participating in the Project may **choose** to prepay fees/interest for a period beyond the 'expenditure year'. Similarly, Members who use financiers other than AOL or Collinsville Finance Pty Ltd may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 119 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

121. For these Members, the amount and timing of deductions for any relevant prepaid Grove fees, prepaid Grove 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.

122. 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

Divisions 40 and 328

123. Any part of the expenditure of a Member 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, a 'landcare operation' and the establishment of the olive trees is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

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

125. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 55, 57, 66 and 70 in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

126. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2) a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

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

127. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

128. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

129. For the purposes of applying Division 35, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Members who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

130. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);

- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);
- (c) at least \$500,000 of real property, or an interest in real property, (excluding any private dwelling) is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

131. A Member 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 Member who acquires the minimum allocation of one Grove in the Project in the year ended 30 June 2003 is unlikely to have their activity pass one of the tests until the income year ended 30 June 2010. Similarly, that a Member who acquires the minimum allocation of one Grove in the Project in the year ended 30 June 2004 is unlikely to have their activity pass one of the tests until the income year ended 30 June 2011. Members who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

132. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Member's participation in the Project.

133. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where 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.

134. Information provided with this Product Ruling indicates that a Member who acquires the minimum investment of one Grove in the Project during the year ended 30 June 2003 is expected to be carrying

on a business activity that will pass one of the tests in the income year ended 30 June 2010, or will produce a taxation profit, for the income years ended 30 June 2008, 30 June 2009 and 30 June 2010.

135. The Commissioner will decide for such a Member 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 2007.

136. Similarly, a Member who acquires the minimum investment of one Grove in the Project during the year ended 30 June 2004 is expected to be carrying on a business activity that will pass one of the tests in the income year ended 30 June 2011, or will produce a taxation profit, for the income years ended 30 June 2009, 30 June 2010 and 30 June 2011.

137. The Commissioner will decide for such a Member 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 2008.

138. This Product Ruling is issued on a prospective basis (i.e. before an individual Member'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 74), in the manner described in the Arrangement (see paragraphs 14 to 43). 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). Members may need to apply for private rulings on how paragraph 35-55(1) will apply in such changed circumstances.

139. 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 horticulturalist and additional expert or scientific evidence provided with the application by the Responsible Entity;
- the binding olive sale contract(s) with the olive processor for the sale of the olives setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the olive trees are grown;

- independent, objective, and generally available information relating to the olive industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Losses and Outgoings incurred under Certain Tax Avoidance Schemes

Section 82KL – recouped expenditure

140. 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.

Schemes to Reduce Income Tax

Part IVA – general tax avoidance provisions

141. 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).

142. The Australian Olives Project No. 5 will be a ‘scheme’. A Member will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 44 to 78 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.

143. Members 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 olives. There are no facts that would suggest that Members 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

144. 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).

Detailed contents list

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Previous draft:

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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;
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IT 360

Subject references:

- NCL provisions
- non commercial losses
- Commissioner's discretion
- product rulings
- schemes and shams
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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