PR 2004/102 - Income tax: Barkworth Olive Estates - Riverina

Product Ruling

Income tax: Barkworth Olive Estates – Riverina

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Potential participants may wish to refer to the Tax Office website at **www.ato.gov.au** or contact the Tax Office directly to confirm the currency of this Product Ruling or any other Product Ruling that the Tax Office has issued.

Preamble

*The number, subject heading, **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.]*

No guarantee of commercial success

The Tax Office **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 and how the product fits an existing portfolio. 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 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, 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 Tax Office 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.

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 of the ITAA 1997;
- section 17-5 of the ITAA 1997;
- Division 27 of the ITAA 1997;
- Division 35 of the ITAA 1997;
- Division 70 of the ITAA 1997;
- Division 328 of the ITAA 1997;
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZL of the ITAA 1936;
- section 82KZME of the ITAA 1936;
- section 82KZMF of the ITAA 1936; and
- Part IVA of the ITAA 1936.

Goods and Services Tax

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

Changes in the Law

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 Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

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

Class of persons

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

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

- enter into a Management Agreement with Barkworth Estates Pty Ltd and elect to harvest and market their olives from their Farm(s);
- enter into other subcontracting arrangements; or
- do not enter into a Management Agreement with Barkworth Estates Pty Ltd,

are excluded from the class of persons to whom this Ruling applies (see paragraph 29).

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 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 2007. 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 Product Ruling, dated August 10, 2004, as constituted by documents provided on 17 August 2004, 17 September 2004 and 15 October 2004 in respect of the Barkworth Olive Estates – Riverina and additional correspondence received on 17 September 2004 and 15 October 2004;
- Draft Information Memorandum issued by Barkworth Estates Pty. Ltd (BEPL), dated 10 September 2004, received in the ATO on 17 September 2004;
- Draft **Contract for Sale of Land** between Barkworth Olive Groves Limited (BOGL) and each Grower, undated, received on 15 October 2004;
- Barkworth Olive Estates – Riverina Neighbourhood Management Statement, registered 20 May 2004, received in the ATO on 17 August 2004;
- Barkworth Olive Estates – Riverina Neighbourhood Development Contract, registered 20 May 2004, received in the ATO on 17 August 2004;
- Draft **Management Agreement** between BEPL and each Grower, undated, received in the ATO on 17 September 2004;
- Olive Oil Purchase Agreement between Inglewood Olive Processors Limited and BEPL, undated, received in the ATO on 17 August 2004; and
- Water Supply Agreement between BOGL and BEPL undated, received in the ATO on 17 September 2004.

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

15. The documents highlighted are those Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are part of the arrangements to which this Ruling applies. The effect of these agreements is summarised below.

16. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client. **This Ruling does not apply unless** the Grower is a wholesale client as defined in section 761G of the *Corporations Act 2001* or will have accepted an offer which qualifies as a small scale offer under section 1012E of the *Corporations Act 2001* (refer to paragraphs 54 to 59 in the Explanation area of this Ruling).

Overview

17. This arrangement is called the Barkworth Olive Estates – Riverina (the Project).

Location	Bassano/Kingston Park Property near Griffith
Type of business each participant is carrying on	Cultivating olive trees on 2.12 hectare approx olive Farm owned by the Grower and harvesting the olives for production and sale of olive oil.
Number of hectares under cultivation	Approximately 150 hectares
Number of olive trees per hectare	An average of 326 trees
Size of each Farm	2.12 hectares approx
Number of olive trees per Farm	693
Minimum number of Farms per Grower	1
The term of the project in years	The Grower has title to the land. The Management Agreement between the Grower and BEPL is for approximately 20 years commencing on acceptance of a Grower's application and ending on 30 June 2025.
Subscription amount per Farm	$22,000 in year ended 30 June 2005 for purchase of land. $28,600 for Management Fees for the year ended 30 June 2005.
Minimum subscription for Project	None
Ongoing Management Fees	$27,500 in each of the years ended 30 June 2006 and 30 June 2007 respectively.

18. Applications to participate in the Project are open until 31 May 2005. In consideration of the moneys payable on application, BOGL and BEPL will wholly provide the services under the Contract for Sale of Land and the Management Agreement, respectively, prior to 30 June 2005.

19. Growers will purchase a 2.12 hectare lot from BOGL. BOGL will establish an olive grove and all associated infrastructure on this land.

20. Growers may enter into a Management Agreement with BEPL, to perform services in relation to the maintenance and growing of their Farms. Under this agreement, the Manager may also harvest the olives, effect the processing of olives into olive oil and sell the oil on behalf of the Growers (at market prices) who will be entitled to the proceeds in their respective proportions. The Manager has entered into an olive oil supply and purchase agreement with Inglewood Olive Oil Processors Limited.

Contract for the Sale of Land

21. Growers enter into a contract to purchase 2.12 hectare lots from BOGL. Under clause 41 of the Contract for the Sale of Land (the contract), BOGL is required to complete at its own cost and expense, on or before 15 June 2005, the irrigation lines, preparation of land for planting and supply and plant 693 Olive Cultivars. In accordance with clause 15 of the contract, the Grower pays a deposit of $2,000 on application and must pay the balance, completing the contract, within 14 days. The legal title to the property does not pass before completion (clause 16.4).

Neighbourhood Plan

22. The Project land is located on Lot 11 in Section Plan DP 756043, Neighbourhood Plan Lot 285854 on the Kingston Park Property near Griffith. There are 74 lots, with freehold titles, for sale. Associated with the titles is common property, totalling 88.5 hectares, which is collectively owned by the purchasers of the 74 separate titles. This common property is to be dedicated for use as a nature reserve and for infrastructure for the benefit of the owners of the 74 separate titles. Included in the infrastructure will be a lake of approximately 20 hectares surface area which will serve as a reservoir for distribution of irrigation water to the 74 lots. Also included will be buildings for storage of farm equipment and a possible processing plant.

23. The Neighbourhood Plan, covered by Subdivision Certificate No. 2002/018 dated 19 March 2004, is governed by the Community Land Development Act, 1989. Under this Act the owner of a community lot owns all of the improvements on that lot and the common property is vested in the owners of the community lots as tenants in common.

24. The Neighbourhood Management Statement, registered on 20 May 2004, sets out the rules and restrictions for all lot owners, including such items as; restrictions on the inappropriate use of the property, maintenance of private access within the Neighbourhood Association, no internal fencing, the requirement for Public Liability Insurance for $10,000,000 and the establishment of an Executive Committee.

25. A Neighbourhood Development Contract was approved and registered on 20 May 2004.

Management Agreement

26. Under the Management Agreement, each Grower may engage the Manager to maintain and cultivate the grove on behalf of the Grower, harvest the olives, and effect the processing of the olives into olive oil and market the oil for sale for the duration of the term. The olives from the Grower's Farm(s) will be not be pooled with olives from other Grower's Farms (clause 5.6(a) of the Management Agreement).

27. Under clauses 4.1 and 4.2, the Manager is required to perform the following services:

(a) tend the Trees and Grower's Farm in a proper and skilful manner including irrigating;

(b) comply with the Neighbourhood Management Statement in respect of the Project;

(c) promptly pay when due all local and other authorities rates, charges, taxes and levies and all Neighbourhood Association levies imposed upon the Grower in respect of the Grower's ownership of the Farm;

(d) eradicate as far as reasonably possible any pests and competitive weeds which may affect the growth or yield of the Trees;

(e) prune and shape Trees;

(f) maintain and repair damage to roads, tracks or fences on Neighbourhood property or on adjoining land resulting from the actions of the Manager or its contractors or in order to comply with any local authority condition of approval in respect of the Project;

(g) embark on such operations as may be required to prevent or combat land degradation on the Grower's Farm or land surrounding the Grower's Farm; and

(h) carry out repair and maintenance work (if required) to the irrigation work for the benefit of the Grower's Farm.

28. Additionally, under clause 4.2, the Manager is required, unless the Grower elects in writing, to:

(i) harvest the Trees on the Grower's Farm at or around the time estimated by the Manager to maximise the produce from all of the Farms established at or around the same time as the Grower's Farm, but keeping the olives from each farm separate;

(j) process or cause to be processed olives from the Grower's Farm into olive oil; and

(k) sell the Olive Oil Attributable to the Grower's Farm to Inglewood Olive Processors Limited in accordance with the terms of the Olive Oil Purchase Agreement.

29. **This Ruling does not apply to Growers who do not enter into a Management Agreement with BEPL or to Growers who enter into a Management Agreement with BEPL and elect to harvest and process olives from their own Farms.**

30. The Manager will arrange insurance on the Growers' behalf.

Fees

31. Under the terms of the Contract for Sale of Land and the Management Agreement, a Grower will make the following payments per Farm:

- the initial subscription costs outlined in the Contract for Sale of Land and the Management Agreement, totalling $22,000 and $28,600 per Farm respectively payable on application and before June 30, 2005;
- Management Fees of $27,500 per Farm payable on 1 July 2005 and 1 July 2006; and
- ongoing costs outlined in the Management Agreement payable in year 4 through to year 20 as summarised below.

32. The Manager will only provide services following the execution of the Contract for Sale of Land and the Management Agreement.

33. The subscription moneys payable on application (in advance) are payable in respect of services to be wholly provided by 30 June 2005. The fees payable on 1 July 2005 and on or 1 July 2006 are payable in respect of services to be wholly provided by 30 June 2006 and 30 June 2007 respectively.

34. After the third year, that is, from the financial year ending 30 June 2007, the Management Fees payable by each Grower to the Manager are calculated as the higher of a set amount or percentages of gross income from the sale of olive oil as set out in the Management Agreement. Income for a given year which exceeds that year's income threshold as set out in the Management Agreement is subject to a reduced management fee of 20% of the excess income (in addition to the standard fee charged on income up to that threshold).

Finance

35. Growers are required to fund their involvement in the Project themselves or by borrowing from an independent lender.

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

37. This Ruling applies only to Growers who are accepted to participate in the Project on or before 31 May 2005 and who have executed a Contract for the Sale of Land and a Management Agreement before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

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

The Simplified Tax System (STS)

Division 328

39. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

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

Qualification

40. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'

Assessable income

Section 6-5

41. 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.

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

Trading stock

Section 70-35

43. A Grower 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 Grower must include the amount of that excess in assessable income.

44. 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

Section 8-1

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

Fee Type	ITAA 1997 Section	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Management Fee	8-1	$28,600 – See Notes (i) & (ii)	$27,500 – See Notes (i) & (ii)	$27,500 – See Notes (i) & (ii)

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 (for example input tax credits): Division 27. See example at paragraph 100.

(ii) The Management Fees shown in the Management 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 (for example the provision of management services) 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 86 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.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable income

Section 6-5 and section 328-105

46. 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.

47. The Grower 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

48. A Grower who is an 'STS taxpayer' may, in some years, hold olives that will constitute trading stock on hand. Where, for such a Grower, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than $5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1) of the ITAA 1997).

49. 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) of the ITAA 1997).

Deductions for Management Fees

Section 8-1 and section 328-105

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

Fee Type	ITAA 1997 Sections	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Management Fee	8-1 & 328-105	$28,600 – See Notes (iii), (iv) & (v)	$27,500 – See Notes (iii), (iv) & (v)	$27,500 – See Notes (iii), (iv) & (v)

Notes:

(iii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example input tax credits): Division 27. See example at paragraph 100.

(iv) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

(v) Where a Member who is an 'STS taxpayer', pays the Management Fees in the relevant income years shown in the 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 (for example 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 (see paragraphs 80 to 91) . In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 86, 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.

Tax outcomes that apply to all Growers

51. 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 80 to 91 as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

Section 35-55 – exercise of Commissioner's discretion

52. A Grower who is an individual accepted into the Project by 31 May 2005 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending **30 June 2005 to 30 June 2008**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME to 82KZMF (but see paragraphs 80 to 91;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanation

Corporations Act 2001

54. 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*.

54A. 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)).

54B. 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)).

55. Offers to wholesale clients do not require a prospectus or product disclosure statement.

56. 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 persons satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c)); or
- the 'professional investor test' (paragraph 761G(7)(d)).

57. 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.

58. 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.

59. 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:
- the person controls at least $10 million for the purposes of investment in securities.

Is the Grower carrying on a business?

60. For the amounts set out in the Tables above to constitute allowable deductions the Grower's olive growing activities as a participant in the Barkworth Olive Estates – Riverina 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.

61. For schemes such as that of the Barkworth Olive Estates – Riverina, 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 *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

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

- the Grower has an identifiable interest 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 olive growing activities are carried out on the Grower's behalf;
- the olive growing activities of the Grower are typical of those associated with an olive growing business; and
- the weight and influence of general indicators point to the carrying on of a business.

63. In this Project, each Grower enters into a Management Agreement and a contract to purchase the land upon which the olive growing business will be conducted.

64. Under the terms of the Contract for the Sale of Land, the vendor will establish the Farm. The vendor will purchase and install the water facilities (irrigation works) and acquire and plant Olive Cultivars on the Grower's Farm. During the term of the Project, these assets will be used wholly to carry out the Grower's olive growing activities.

65. Under the Management Agreement the Project Manager is engaged by the Grower to maintain the Farm on the Grower's identifiable area of land during the term of the Project. The Project Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to maintain the Farm on the Grower's behalf. The Project Manager is engaged to harvest and sell, on the Grower's behalf, the olives grown on the Grower's Farm.

66. 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.

67. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of its olives that will return a before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

68. The Project Manager's services on the Grower'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 Farm is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

70. 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 Grower's olive growing activities in the Barkworth Olive Estates – Riverina will constitute the carrying on of a business.

The Simplified Tax System

Division 328

71. 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.

72. 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

Section 8-1

73. Consideration of whether the initial Management 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.

74. The Management Fees associated with the olive growing 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 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' purposes 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

75. Under the Management Agreement the Management Fees are not 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.

76. 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 80 to 91) 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

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

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

79. If the Grower is an 'STS taxpayer' the Management 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

80. 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 (that is, the performance of management services) 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.

81. 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

82. 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)).

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

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

84. 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 an independent financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

85. 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.

86. 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.

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

87. 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

88. In this Project, an initial management fee of $28,600 per Farm will be incurred on execution of the Management Agreement. The management fee is charged for providing management services to a Grower by 30 June 2005. Under the Management Agreement, further annual expenditure is required each year during the term of the Project for the provision of management services until 30 June in those years.

89. 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.

90. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee, and the fees for subsequent years, is for the Project Manager doing 'things' that are not to be wholly done within the expenditure year.

91. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 31 to 34, 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*

92. Although not required under the Management Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 90, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

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

Section 35-55 – exercise of Commissioner's discretion

94. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2005 to 30 June 2008** the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14, *Income tax: Division 35 – non-commercial business losses*. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2005 up to and including 30 June 2008:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35;
- there is an objective expectation that within a period that is commercially viable for the olive industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

95. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) is conditional on the Project being carried on in the manner described in this Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Ruling a Grower will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL – recouped expenditure

96. 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

97. 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).

98. Barkworth Olive Estates – Riverina 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 45 and 50 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.

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

Example

Entitlement to GST input tax credits

100. 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 2003 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 1/1/2004 to 30/6/2004	$4,400*
Carrying out of upgrade of power for your vineyard as quoted	$2,200*

Total due and payable by 1 January 2004 (includes GST of $600)	$6,600

*Taxable supply

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

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

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 2004, 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

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

Commissioner of Taxation
3 November 2004

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 360; PR 1999/95; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TR 98/22; TR 2000/8; TR 2001/14; TD 93/34

Subject references:

- advance deductions and expenses for certain forestry expenditure
- carrying on a business
- commencement of business
- fee expenses
- management fees
- non-commercial losses
- producing assessable income
- product rulings
- public rulings
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- taxation administration

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)

- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 40-535
- ITAA 1997 Div 70
- ITAA 1997 70-35
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- ITAA 1997 328-105(1)(b)
- ITAA 1997 328-285
- ITAA 1997 328-285(1)
- ITAA 1997 328-285(2)
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- Copyright Act 1968
- Corporations Act 2001
- Corporations Act 2001 761G
- Corporations Act 2001 761G(7)(a)
- Corporations Act 2001 761G(7)(c)
- Corporations Act 2001 761G(7)(d)

Case references:

- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

ATO references
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