

PR 2004/17 - Income tax: Heydon Park Ginseng Project No. 2

 This cover sheet is provided for information only. It does not form part of *PR 2004/17 - Income tax: Heydon Park Ginseng Project No. 2*

 This document has changed over time. This is a consolidated version of the ruling which was published on *25 February 2004*



Product Ruling

Income tax: Heydon Park Ginseng Project No. 2

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	47
Explanation	75
Examples	122
Detailed contents list	124

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 'Heydon Park Ginseng Project No. 2', or simply as 'the Project'.

Tax law(s)

2. The tax law(s) 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 328 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KZME (ITAA 1936);
 - section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation

legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

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

Note to promoters and advisers

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

Class of persons

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

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

Qualifications

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

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration
Intellectual Property Branch
Department of Communications, Information Technology and
the Arts
GPO Box 2154
Canberra ACT 2601
or by e-mail: commonwealth.copyright@dcita.gov.au

Date of effect

11. This Ruling applies prospectively from 25 February 2004, 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 for the Heydon Park Ginseng Project No 2 dated 29 December 2003 as constituted by documents received on 6 January 2004, 23 January 2004, 30 January 2004, 2 February 2004,

3 February 2004 and 5 February 2004 and additional correspondence received from the Applicant dated 25 November 2003 (which was received by the ATO on 14 January 2004), 23 January 2004, 27 January 2004, 30 January 2004, 3 February 2004 and 5 February 2004;

- Draft Product Disclosure Statement of the Heydon Park Ginseng Project No. 2 received by the ATO under covering email dated 11 February 2004;
- **Draft Constitution of the Heydon Park Ginseng Project No. 2 between Heydon Park Ltd ('the Responsible Entity') and the Growers received by the ATO** under covering email dated 5 February 2004;
- Draft Compliance Plan of the Heydon Park Ginseng Project No. 2 received with the Application for a Product Ruling dated 29 December 2003;
- **Draft Management Agreement of the Heydon Park Ginseng Project No. 2 between Heydon Park Ltd ('the Manager') and the Grower received by the ATO** under covering email dated 3 February 2004;
- Ginseng Supply and Purchase Agreement of the Heydon Park Ginseng Project No. 2 between Heydon Park Ltd ('the Manager') and Panax Ginseng Wholesalers Pty Ltd ('the Processor') dated 1 June 2002;
- Option Agreement between Frank & Gabriel Gregory Casimaty ('the Grantor') and Tasmanian Panax Ginseng Pty Ltd ('the Grantee') dated 27 January 2004;
- Agreement to Lease between Tasmanian Panax Ginseng Pty Ltd ('the Lessor') and Heydon Park Ltd ('the Manager') dated 30 January 2004;
- Draft Lease document between Tasmanian Panax Ginseng Pty Ltd ('the Lessor') and Heydon Park Ltd ('the Lessee') received with the Application for a Product Ruling dated 29 December 2003; and
- Deed of Variation between Heydon Park Ltd ('the Manager') and Tasmanian Panax Ginseng Pty Limited ('TPG') dated 4 December 2003.

Note: certain information received from the applicant has been provided 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 Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

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

Overview

17. The arrangement is called Heydon Park Ginseng Project No. 2 and is summarised as follows:

Location	414 Back Tea Tree Road Richmond in Southern Tasmania.
Type of business	Commercial cultivation of ginseng plants.
Number of hectares under cultivation	33.3 hectares
Name of development	Heydon Park Ginseng Project No. 2
Size of participation (module)	3.33 square metres
Minimum individual participation	10 modules for Australian investors 50 modules for overseas investors
Number of plants per module	60 plants
The term of the Project	Up to 5 years
Nature of the Project	The establishment and maintenance of a ginseng plantation.
Initial Costs per participation	Per 10 modules, if grower pays costs on the Settlement Date: Ginseng plants \$22; Occupation Fee \$33; Management Fee \$1,320. Per 10 modules, if grower pays by instalments: Ginseng plants \$22; Occupation Fee \$33;

	Management Fee \$1,320; Interest \$192.
Initial costs per hectare	\$412,500 for Growers who pay in full on application. \$470,100 for Growers who pay by instalments.
Ongoing costs	Continuing Management Fees, Occupation Fee and Harvesting and Processing Fee.
Expected Production	7.5 tonnes per hectare.
Minimum Subscription	1,000 modules, totalling \$137,500.

The Project

18. The Project involves establishing, planting, cultivating and harvesting ginseng plants and the sale of ginseng roots. The maximum number of modules on offer is 100,000 and the minimum number of modules required to be sold before the Project can commence is 1,000. Applications must be for a minimum of 10 modules (for overseas applicants the minimum application is 50 modules). Unless otherwise stated, all references to fees in this Product Ruling refer to the level of fees associated with 10 ginseng modules.

19. Growers are invited to enter the Project by applying under a Product Disclosure Statement registered with the Australian Securities and Investment Commission. Each Grower shall complete an Application Form and Power of Attorney attached to a current Product Disclosure Statement. Applications will not be accepted after 31 October 2004. The Power of Attorney appoints the Manager, Heydon Park Ltd, to do everything necessary to execute the Management Agreement on behalf of the Growers.

20. An Option to Purchase the Project land has been executed and an Agreement to Lease has been granted to the Manager, Heydon Park Ltd by the Lessor, Tasmanian Panax Ginseng Pty Ltd. The Manager will, via the Management Agreement, grant a licence to each Grower to occupy an identifiable area of land, being approximately 3.33 square metres, called a 'module' for the purpose of growing ginseng for the duration of the Project. The Project is to terminate on 30 November 2008.

21. The fees payable on acceptance are in respect of the purchase of ginseng plants, the Occupation Fee and the Management Fee for the Initial Period, shadecloth expenses (including shadecloth structure), landcare expenses and irrigation expenses.

PR 2004/17

22. In the Accrual Periods (as defined in paragraph 23) following the Initial Period the Growers are required to pay Continuing Management Fees, Occupation Fees and Harvesting and Processing Fees. The Manager may sue for and recover any monies required to be paid under the Constitution which have not been so paid by a Grower, together with interest at the rate of 17 per centum per annum. Notwithstanding this, the Manager may deduct from any amounts owing to the Grower from the Project any outstanding Occupation Fees, Management Fees and/or Harvest and Processing Fees.

23. The 'Initial Period' means the period beginning on the date of issue of each Participant's interest and ending 12 months from the date thereof. An Accrual Period means either:

- the period from the expiration of the Initial Period up to and including the next following last day of November;
- each twelve monthly period ending on the last day of the month of November in each year during the term of the Project; or
- the period from and including the first day of December immediately prior to the date of termination of the Project until that date of termination.

24. For the minimum subscription of 10 modules the Grower has the option of paying the full amount of \$1,375 (consisting of initial management fee of \$1,320, plant purchase expense of \$22 and occupation fee of \$33) on the Settlement Date or accepting the instalment plan. If the Grower accepts the instalment plan, a further \$192 is payable which represents interest at 12.2% (instalment interest expense). Under the instalment plan the amount payable is \$1,567. This amount is payable as a deposit of \$440 on application and 23 consecutive instalments of \$49 payable monthly in arrears with the first payment due and payable one month after the Settlement Date.

25. The deposit of \$440 is comprised of plant purchase expense of \$22, occupation fee of \$33 and grove establishment and management fee of \$385. This grove establishment and management fee of \$385 is in turn comprised of initial management expenses of \$278, plant establishment expenses of \$49 and capital expenses of \$58.

26. The monthly instalment amounts of \$49 are comprised of management costs of \$34.70 (being \$29.50 for management expenses and \$5.20 for plant establishment expenses), capital expenses of \$6 and instalment interest expense of \$8.30.

27. The distribution of sale proceeds from the sale of the ginseng roots to Growers is determined in accordance with clauses 7.1, 7.2 and 7.3 of the Management Agreement (refer to paragraphs 41 to 43 below).

28. The Manager has entered into a presale agreement with the Processor under which the Processor agrees to purchase all the ginseng roots produced, provided the roots conform to a specified quality, at a fixed price of \$186.75 per kilogram.

Constitution

29. The primary object of the Project is for Growers to conduct the business of planting, growing and cultivating ginseng plants for the production of ginseng roots, and the harvesting, marketing and sale of the ginseng products produced therefrom.

30. The project will not commence until minimum subscription is reached and applications will not be accepted until this time. After acceptance of his or her Application Form by the Responsible Entity each Grower must enter into the Management Agreement.

31. The Responsible Entity must pay the application monies accompanying the signed Application Forms into the Applications Bank Account as soon as practicable after their receipt, but not later than the close of business on the next working day after the day of receipt.

32. Upon acceptance of an Application Form, the Responsible Entity shall transfer relevant application monies from the Applications Bank Account to the Scheme Bank Account.

33. A Member's Business Income received with respect to the Scheme must be paid by the Responsible Entity into the Scheme Bank Account.

34. The Responsible Entity shall be entitled to pay all monies required to be paid on behalf of the Members pursuant to this Constitution or the Management Agreement in accordance with the relevant provisions out of the Scheme Bank Account including without limitation, the Initial and Continuing Management Fees, the Occupation Fees, the Harvest and Processing Fee, GST and any other monies payable by a Member pursuant to the Constitution or the Management Agreement.

35. The Constitution lists all fees payable by Growers, namely, Plant Fees (clause 4.2), Initial Management Fees (clause 4.3), Continuing Management Fees (clause 4.4), Occupation Fees (clause 4.5) and the Harvest and Processing Fee (clause 4.6).

Management Agreement

36. Under this Agreement the Grower appoints the Manager to manage the Grower's business and the Manager hereby agrees to so act.

37. The Manager will provide management services to the Growers as detailed at clause 1.1 of the Agreement.
38. The Initial Management Fee is comprised of the following:
- shadecloth expenses of \$90.90;
 - irrigation expenses of \$40.90;
 - landcare expenses of \$63.80;
 - ginseng beds and establishment expenses \$168.50; and
 - other agronomic services of \$955.90
39. The Manager grants to the Grower the exclusive right to carry out the Grower's Business upon the Ginseng Module and to do all other things upon the Ginseng Module that may be necessary to be carried out upon the Ginseng Module pursuant to this Agreement. The term of this licence shall be for the same term as the Grower's business.
40. The Grower, his servants, agents and contractors shall have the right of ingress and egress to and from the Ginseng Module and the use of any common parts of the Land at all reasonable times as are necessary for the Grower to conduct the Grower's Business. The Manager shall have the right of entry upon the Ginseng Module to carry out the management services on behalf of the Grower as provided herein.
41. The Manager is authorised by the Grower to pool the ginseng roots harvested from the Ginseng Module with ginseng roots from Ginseng Modules of other Growers in the Project.
42. Where the ginseng roots are pooled, the sale proceeds therefrom (after deduction of all amounts to be deducted by the Manager as provided in the Scheme Constitution or the Management Agreement) shall form part of the Total Project Sales.
43. Each Grower's proportionate share of the Total Project Sales will be calculated so as to reflect the size and number of Ginseng Modules held by the Grower that contributed to the pool.

Fees Payable by the Grower

44. **For Growers who pay in full on application:**

Initial Management Fee

- \$1,320 payable on Settlement Date.

Plant Fees

- \$22 payable on Settlement Date.

Continuing Management Fees

- For the first Accrual Period, \$9.20 per 10 modules per month or part thereof;
- For each succeeding Accrual Period, the amount which is the greater of either, \$110 adjusted for the CPI or the amount of the Continuing Management Fee of the prior Accrual Period increased by 3%.

Occupation Fees

- For the Initial Period, \$33 payable on the Settlement Date;
- For the first Accrual Period, \$2.80 for each month payable in advance;
- For each succeeding Accrual Period, the amount which is the greater of, either \$33 adjusted for CPI or the amount of the Occupation Fee for the prior Accrual Period increased by 3%.

Harvesting and Processing Fee

- An amount equal to 11% of the Members Business Income.

For Growers who pay by instalments:***Initial Management Fee***

- \$385 payable on the Settlement Date (Refer to paragraph 25 for a dissection of this payment); and
- The balance by 23 equal monthly instalments of \$49 commencing one month after the initial payment. (Refer to paragraph 26 for a dissection of the monthly payments of \$49).

Plant Fees

- \$22 payable on Settlement Date.

Continuing Management Fees

- For the first Accrual Period, \$9.20 per 10 modules per month or part thereof;
- For each succeeding Accrual Period, the amount which is the greater of either, \$110 adjusted for the CPI or the amount of the Continuing Management Fee of the prior Accrual Period increased by 3%.

Occupation Fees

- For the Initial Period, \$33 payable on the Settlement Date;
- For the first Accrual Period, \$2.80 for each month payable in advance;
- For each succeeding Accrual Period, the amount which is the greater of, either \$33 adjusted for CPI or the amount of the Occupation Fee for the prior Accrual Period increased by 3%.

Harvesting and Processing Fee

- An amount equal to 11% of the Members Business Income.

Finance

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

46. 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

47. This Ruling applies only to Growers who are accepted to participate in the Project and who have executed a Management Agreement during the year ended 30 June 2004 or up to and including 31 October 2004 for the year ended 30 June 2005. The Grower's participation in the Project must constitute the carrying on of a business of primary production. Each Grower must have acquired the minimum of ten modules in the Project.

Minimum subscription

48. 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. A Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 1,000 modules, which represents the point at which the Project is financially viable, is achieved.

The Simplified Tax System ('STS')

Division 328

49. 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

50. 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.

Prepaid fees

51. The Initial Management Fee and Occupation Fee incurred by Growers who are accepted into this Project are subject to the prepayment rules in sections 82KZME and 82KZMF. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Note (ii) below).

52. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

53. In this Project, the tax deductions allowable for the Initial Management Fee and Occupation Fee must be calculated by applying the above formula to the amount incurred each year by the Grower.

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

54. 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.

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

Deductions for Initial Management Fee, Continuing Management Fees, Occupation Fees and Instalment Interest Expense***Section 8-1***

56. A Grower who acquires 10 modules and is accepted into the Project on or before 30 June 2004 and is not an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses. For Growers who acquire additional modules, the deduction allowable is increased by 1/10th for each additional module acquired.

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Initial Management Fee	8-1	Must be calculated - See Notes (i) & (ii) below	Must be calculated - See Notes (i) & (ii) below	Nil
Occupation Fees	8-1	\$33 – See Notes (i) & (iii) below	Manager to advise – See Notes (i) & (iv) below	Manager to advise – See Notes (i) & (v) below
Continuing Management Fees	8-1	Nil	Manager to advise – See Notes (i) & (iv) below	Manager to advise – See Notes (i) & (v) below
Instalment Interest Expense	8-1	Where applicable \$192 – See Note (vi) below	Nil	Nil

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example 1 at paragraph 122.
- (ii) The revenue components of the Initial Management Fee of \$1320 shown in paragraph 38, viz, Ginseng Beds and Establishment Expense (\$168.50) and Other Agronomic Services (\$955.90) are **NOT** deductible in full in the year incurred. The deduction for each year's fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 52). The Manager will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred (See Example 2 at paragraph 123).
- (iii) Although the Management Agreement requires the Occupation Fee to be prepaid, for a Grower who acquires the minimum allocation of 10 modules, the amount of the prepaid Occupation Fee is less than \$1,000. For the purposes of this Project, an amount of less than \$1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and, for a Grower who is not an 'STS taxpayer', is deductible in full in the year in which it is incurred. However, where a Grower acquires more than the minimum allocation of 10 modules in the Project, the amount of the Grower's prepaid Occupation Fee may be \$1,000 or more. Such Growers **MUST** determine the deduction for the prepaid Occupation Fee on the same basis as the prepaid Management fees, i.e. using the formula shown above in paragraph 52.
- (iv) The deductions for the Continuing Management Fee and the Occupation Fee for the Year Ended 30 June 2005 depend upon the date of entry of Growers into the Project. The Manager will inform Growers of the number of days in that income year that the Manager performed ongoing management services. This figure is necessary to calculate the deduction allowable for the fees incurred.
- (v) The deduction for the Continuing Management Fee and the Occupation Fee for the Year Ended 30 June 2006 will be determined by the Manager and the Manager will inform Growers of the amount of the deduction.

- (vi) If a Grower elects to pay the Initial Management Fee by instalments, the interest expense is deductible in full. However, where a Grower acquires more than the minimum allocation in the Project, reference should be made to Note (iii) above.

57. Where Growers enter the Project on or after 1 July 2004 and on or before 31 October 2004 the deductions available for the Years Ended 30 June 2005, 30 June 2006 and 30 June 2007 are those shown above for the Years Ended 30 June 2004, 30 June 2005 and 30 June 2006 respectively.

Deductions for capital expenditure

Division 40

58. A Grower who acquires 10 modules and who is accepted into the Project on or before 30 June 2004 and is not an 'STS taxpayer' will also be entitled to tax deductions relating to, water facilities (e.g. irrigation), a 'landcare operation', and shadecloth. All deductions shown in the following Table are determined under Division 40. For Growers who acquire additional modules, the deduction allowable is increased by 1/10th for each additional module acquired.

Fee type	ITAA 1997 section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Shadecloth	40-25	Must be calculated - See Notes (vii) & (viii) below	Must be calculated - See Notes (vii) & (viii) below	Must be calculated - See Notes (vii) & (viii) below
Water facility (e.g. irrigation, dam, bore, etc.)	40-515	\$13.64 - see Notes (vii) & (ix) below	\$13.63 - see Notes (vii) & (ix) below	\$13.63 - see Notes (vii) & (ix) below
Landcare operations	40-630	\$63.80 - see Notes (vii) & (x) below	Nil	Nil

Notes:

- (vii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example 1 at paragraph 122.

- (viii) Shadecloth is a 'depreciating asset' to which Division 40 applies. Each Grower holds an interest in the shadecloth which is a 'low-cost asset' and can be allocated to a 'low-value pool'. Once any 'low-cost asset' of a Grower is allocated to a 'low-value pool', all other 'low-cost assets' the Grower start to 'hold' in that year or a later year must be allocated to that pool. If the Grower has already allocated an asset to a 'low-value pool', the shadecloth would also have to be allocated to that pool. Otherwise, the Grower must decide whether to create a 'low-value pool'. If the shadecloth is allocated to a 'low-value pool', the capital expenditure on the shadecloth will be deducted under the diminishing value methodology of the pool based on a rate of 18.75% in the year the shadecloth is first used and a rate of 37.5% in subsequent years (section 40-440). If the shadecloth is not allocated to a 'low-value pool', they can be written off based on the 'effective life' of the shadecloth. As there has been no determination of the 'effective life' of shadecloth by the Commissioner, Growers must self-assess an 'effective life'. Shadecloth is not installed until after the plants are planted and no deduction for the decline in value is available until this installation occurs. The Manager will advise Growers of that date to enable them to calculate the deduction.
- (ix) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).
- (x) 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.

59. Where Growers enter the Project on or after 1 July 2004 and on or before 31 October 2004 the deductions available for the Years Ended 30 June 2005, 30 June 2006 and 30 June 2007 are those shown above for the Years Ended 30 June 2004, 30 June 2005 and 30 June 2006 respectively.

Tax outcomes for Growers who are 'STS taxpayers'**Assessable Income*****Section 6-5***

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

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

Deductions for Initial Management Fee, Continuing Management Fees, Occupation Fees and Instalment Interest Expense***Section 8-1 and section 328-105***

62. A Grower who is an 'STS taxpayer' is only able to claim a deduction for an expense, otherwise deductible under section 8-1, to the extent that the expense is paid or has been paid for the Grower. Therefore, in particular, where a Grower who is accepted into the Project on or before 30 June 2004 and is an 'STS taxpayer' acquires the minimum allocation of 10 modules and pays by instalments, tax deductions for the following revenue expenses may only be claimed in each income year as shown below. For Growers who acquire additional modules, the deduction allowable is increased by 1/10th for each additional module acquired.

Fee Type	ITAA 1997 Sections	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Initial Management Fee (Non Instalment Payers)	8-1 & 328-105	Must be calculated See Notes (xi) & (xii) below	Must be calculated See Notes (xi) & (xii) below	Nil
Initial Management Fee (Instalment Payers)	8-1 & 328-105	Amounts must be calculated – See Notes (xi), (xii) & (xiii) below	Amounts must be calculated – See Notes (xi), (xii) & (xiii) below	Amounts must be calculated – See Notes (xi), (xii) & (xiii) below

PR 2004/17

Occupation Fees	8-1 & 328-105	\$33 - see Notes (xi) & (xiv) below	Manager to advise – see Notes (xi) & (xv) below	Manager to advise - see Notes (xi) & (xvi) below
Continuing Management Fees	8-1 & 328-105	Nil	Manager to advise – See Notes (xi) & (xv) below	Manager to advise – See Notes (xi) & (xvi) below
Instalment Interest Expense	8-1 & 328-105	Amounts must be calculated – see Note (xvii) below	Amounts must be calculated – see Note (xvii) below	Amounts must be calculated – see Note (xvii) below

Notes:

- (xi) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See Example 1 at paragraph 122.
- (xii) The revenue components of the Initial Management Fee of \$1,320 shown in paragraph 38, viz, Ginseng Beds and Establishment Expense (\$168.50) and Other Agronomic Services (\$955.90) are NOT deductible in full in the year in which they are paid by, or on behalf of, the STS taxpayer. The deduction for each year's fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 52). The Manager will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred. (See Example 2 at paragraph 123).
- (xiii) Growers who choose to use the instalment plan will be entitled to a deduction firstly for that portion of the Initial Management Fee comprising the Ginseng Beds and Establishment Expense and the Other Agronomic Services, paid on the Settlement Date. This amount totals \$349 (Other Agronomic Services of \$278, Plant Purchase Expense of \$22 and Plant Establishment Expense of \$49). In addition, such Growers will be entitled to a further deduction of \$34.70 in relation to the Initial Management Fee comprising the Plant Establishment Expense of \$5.20 and the Other Agronomic Services of \$29.50, for each monthly instalment of \$49 paid in the Initial Period. For the

Accrual Periods following the Initial Period, such Growers will be entitled to a deduction of \$34.70 in relation to the Initial Management Fee for each monthly instalment of \$49 paid in those Accrual Periods.

- (xiv) Although the Management Agreement requires the Occupation Fee to be prepaid, for a Grower who acquires the minimum allocation of 10 modules, the amount of the prepaid Occupation Fee is less than \$1,000. For the purposes of this Project, an amount of less than \$1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and, for a Grower who is an 'STS taxpayer', is deductible in full in the year in which it is incurred and paid. However, where a Grower acquires more than the minimum allocation of 10 modules in the Project, the amount of the Grower's prepaid Occupation Fee may be \$1,000 or more. Such Growers **MUST** determine the deduction for the prepaid Occupation Fee on the same basis as the prepaid Initial Management Fee, i.e. using the formula shown above in paragraph 52.
- (xv) The deductions for the Continuing Management Fee and the Occupation Fee for the Year Ended 30 June 2005 depend upon the date of entry of Growers into the Project. The Manager will inform Growers of the number of days in that income year that the Manager performed ongoing management services. This figure is necessary to calculate the deduction allowable for the fees incurred (see Example 2 at paragraph 123).
- (xvi) The deduction for the Continuing Management Fee and the Occupation Fee for the Year Ended 30 June 2006 will be determined by the Manager and the Manager will inform Growers of the amount of the deduction (see Example 2 at paragraph 123).
- (xvii) Each of the monthly instalments includes an equal amount of interest instalment expense of \$8.30. The deduction available for this interest instalment expense in the Initial Period will be \$8.30 for each monthly instalment of \$49 paid in the Initial Period. The deduction available in the Accrual Periods following the Initial Period will be \$8.30 for each monthly instalment of \$49 paid in those Accrual Periods.

63. Where Growers enter the Project on or after 1 July 2004 and on or before 31 October 2004 the deductions available for the Years Ended 30 June 2005, 30 June 2006 and 30 June 2007 are those shown above for the Years Ended 30 June 2004, 30 June 2005 and 30 June 2006 respectively.

Deductions for capital expenditure

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

64. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g. irrigation), a 'landcare operation', and shadecloth. Deductions relating to the 'cost' of shadecloth must be determined under Division 328. 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.

65. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities 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 Note (xx) 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 Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

67. A Grower who is accepted into the Project on or before 30 June 2004 and acquires 10 modules and is an 'STS taxpayer' will also be entitled to the following tax deductions. For Growers who acquire additional modules, the deduction allowable is increased by 1/10th for each additional module acquired.

Fee type	ITAA 1997 section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Shadecloth	328-180	Amounts must be calculated – See Notes (xviii) & (xix) below	Nil	Nil
Water facility (e.g. irrigation, dam, bore, etc)	40-515	Amounts must be calculated – see Notes (xviii) & (xx) below	Amounts must be calculated – see Notes (xviii) & (xx) below	Amounts must be calculated - see Notes (xviii) & (xx) below
Landcare operations	40-630	\$6.38 - see Notes (xviii) & (xxi) below	Nil	Nil

Notes:

- (xviii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27: See example 1 at paragraph 122.
- (xix) Shadecloth is a ‘depreciating asset’ to which Division 40 applies. Each Grower holds an interest in the shadecloth which is a ‘low-cost asset’ as defined in subsection 40-425(2). It cannot be allocated to the ‘general STS pool’ (section 328-180). A deduction equal to the amount of the Grower’s expenditure for the shadecloth is available in the income year in which they are used or ‘installed ready for use’. This is so provided the Grower is an ‘STS taxpayer’ for the income year in which it starts to ‘hold’ the asset and the income year in which it first uses the asset or has it ‘installed ready for use’ to produce assessable income. Shadecloth is not installed until after the ginseng plants are planted. The Manager will advise when that has occurred.
- (xx) Any irrigation system, dam or bore is a ‘water facility’ as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a ‘depreciating asset’ (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower’s interest in the underlying asset is itself deemed to be a ‘depreciating asset’. If the

'cost' apportionable to that deemed 'depreciating asset' is less than \$1,000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 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, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

- (xxi) 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 Grower 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 Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1,000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable 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.

68. Where Growers enter the Project on or after 1 July 2004 and on or before 31 October 2004 the deductions available for the Years Ended 30 June 2005, 30 June 2006 and 30 June 2007 are those shown above for the Years Ended 30 June 2004, 30 June 2005 and 30 June 2006 respectively.

Tax outcomes that apply to all Growers

Interest

69. Whilst the interest expense incurred in relation to the instalment option is deductible in terms of paragraphs 56 and 62 above, 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 92 to 102 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

Section 35-55 – Commissioner's discretion

70. For a Grower who is an individual and who enters the Project during the years ended 30 June 2004 and 30 June 2005 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), for the Growers who enter the Project during the year ended 30 June 2004, the Commissioner will decide that for the income years ended 30 June 2004 to 30 June 2008 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. For the Growers who enter the Project during the year ended 30 June 2005 the Commissioner will decide that for the income years ending 30 June 2005 to 30 June 2008 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.

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

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 109 in the Explanations part of this ruling, below);
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)).

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

73. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner’s decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be commercially viable. An assessment of the Project or the product from this perspective has not been made.

Section 82KL and Part IVA

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

- 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

Is the Grower carrying on a business?

75. For the amounts set out in the Tables above to constitute allowable deductions the Grower's ginseng cultivation activities as a participant in the Heydon Park Ginseng Project No. 2 must amount to the carrying on of a business of primary production. These ginseng cultivation activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

76. For schemes such as that of the Heydon Park Ginseng Project No. 2, 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.

77. Generally, a Grower will be carrying on a business of ginseng cultivation, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's plants are established;
- the Grower has a right to harvest and sell the ginseng roots each year from those plants;
- the ginseng cultivation activities are carried out on the Grower's behalf;
- the ginseng cultivation activities of the Grower are typical of those associated with a ginseng cultivation business; and
- the weight and influence of general indicators point to the carrying on of a business.

78. In this Project, each Grower enters into a Management Agreement.

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

80. Under the Management Agreement the Manager is engaged by the Grower to establish and maintain a module on the Grower's identifiable area of land during the term of the Project.

81. In establishing the module, the Grower engages the Manager to purchase and install shadecloth and water facilities (e.g. irrigation), to carry out 'landcare operation' and to acquire and plant ginseng plants on the Grower's module. During the term of the Project, these assets will be used wholly to carry out the Grower's ginseng cultivation activities. The Manager is also engaged to harvest and sell, on the Grower's behalf, the ginseng roots grown on the Grower's module.

82. 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.

83. 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 ginseng roots 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.

84. The pooling of ginseng roots grown on the Grower's module with the ginseng roots of other Growers is consistent with general ginseng cultivation practices. Each Grower's proportionate share of the sale proceeds of the pooled ginseng roots will reflect the proportion of the ginseng roots contributed from their module.

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

86. The Grower's degree of control over the 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 module and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

87. The ginseng cultivation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' ginseng cultivation activities in the Heydon Park Ginseng Project No. 2 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

88. 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.

89. 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 Initial Management Fee, Continuing Management Fees, Occupation Fees and Instalment Interest Expense

Section 8-1

90. Consideration of whether the Initial Management Fee, Continuing Management Fees, Occupation Fees and Instalment Interest Expense 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.

91. The Initial Management Fee, Continuing Management Fees, Occupation Fees and Instalment Interest Expense associated with the ginseng cultivation activities will relate to the gaining of income from the Grower's business of ginseng cultivation (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of ginseng roots) is to be gained from this business. They will thus be deductible under the first limb of section 8-1 as per paragraphs 56 and 62 above. Further, no 'non-income producing'

purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. The deductibility of the capital components of the Initial Management Fee, being shadecloth expenses, irrigation expenses and landcare expenses, is discussed in paragraphs 103 to 105 of this Ruling.

Prepayment provisions

Sections 82KZL to 82KZMF

92. 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.

93. For this Project, only section 82KZL (an interpretive provision) and sections 82KZME and 82KZMF are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

94. 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)).

95. 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.

96. 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.

97. 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.

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

98. 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

99. The expenditure incurred by a Grower in the Project for the Initial Management Fee and Occupation Fees meet the requirements of subsections 82KZME(1) and (2) and is incurred under an ‘agreement’ as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

100. The prepaid Occupation Fees being an amount of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for the Occupation Fees in the income year in which it is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for Occupation Fees in the income year in which it is incurred.

101. However, where a Grower acquires more than the minimum allocation of 10 interests in the Project and the quantum of the Occupation Fees is \$1,000 or more, the deduction allowable for those amounts will also be subject to apportionment according to the formula in subsection 82KZMF(1).

102. Although not required under the Management Agreement, a Grower participating in the Project may **choose** to prepay fees in relation to the Accrual Periods. Where this occurs, and unless one of the exceptions to section 82KZME applies, section 82KZMF will apply to apportion the expenditure according to the formula in subsection 82KZMF(1), shown at paragraph 97 above.

Expenditure of a capital nature

Division 40 and Division 328

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

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

105. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 58 and 67 (above) in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

106. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2) a deduction for a loss 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.

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

108. 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.

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

110. 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).

111. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of 10 modules in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2009. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

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

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

114. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of 10 modules in the Project is expected to be carrying on a business activity that will produce a taxation profit, for the year ended 30 June 2009.

115. The Commissioner will decide for Growers who enter the Project during the year ended 30 June 2004 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. As the lease of the land for the project will expire on 30 November 2008, the Commissioner will decide for Growers who enter the Project during the year ended 30 June 2005 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.

116. This Product Ruling is issued on a prospective basis (i.e. before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 70), in the manner described in the Arrangement (see paragraphs 14 to 46). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it

would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

117. 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 agricultural consultant and additional expert or scientific evidence provided with the application by the Responsible Entity;
- the binding supply and purchase agreement with the Processor for the sale of the ginseng roots setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the ginseng roots are grown; and
- independent, objective, and generally available information relating to the ginseng industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Section 82KL – recouped expenditure

118. 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

119. 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).

120. The Heydon Park Ginseng Project No. 2 will be a ‘scheme’. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 56 to 67 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.

121. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the ginseng roots. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Examples

Example 1 – Entitlement to GST input tax credits

122. 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).

Example 2 – Deductions for Initial Management Fee and Continuing Management Fees

123. Augustus, an 'STS taxpayer' who is not registered, nor required to be registered for GST, applies for and is allotted 10 modules in the project on 1 May 2004. Augustus pays the full amount of \$1,375 on the Settlement Date.

For Augustus:

- The Initial Period runs from 1 May 2004 to 30 April 2005;
- The Accrual Period from the expiration of the Initial Period runs from 1 May 2005 to 30 November 2005; and
- The first twelve monthly Accrual Period runs from 1 December 2005 to 30 November 2006.

Augustus would be entitled to a deduction for the Initial Management Fee and Continuing Management Fees as shown below. It should be noted that in relation to the Initial Management Fee of \$1,320, the deduction below refers only to the revenue component of the Initial Management Fee (\$1,124.40), comprising Ginseng Beds and Establishment Expense (\$168.50) and Other Agronomic Services (\$955.90). The remaining components of the Initial Management Fee, being Shadecloth expenses (\$90.90), Irrigation expenses (\$40.90) and Landcare expenses (\$63.80), are deductible as shown in paragraphs 58 and 67 above.

Year Ended 30 June 2004

Augustus would calculate his deduction for the Initial Management Fee as:

Initial Management Fee x $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

\$1,124.40 X $\frac{61}{365}$

= **\$188** (this is the total tax deduction available to Augustus for the Year Ended 30 June 2004 for the prepaid Initial Management Fee of \$1,124.40. It represents the 61 days for which management services were provided in the Year Ended 30 June 2004).

Year Ended 30 June 2005

Augustus will be able to claim a tax deduction for both the Initial Management Fee and Continuing Management Fee.

Management Fee

$$\$1,124.40 \times \frac{304}{365}$$

= **\$936** (this represents the balance of the prepaid Initial Management Fee for services provided to Augustus in the Year Ended 30 June 2005).

Continuing Management Fee

2 months (viz, 1 May 2005 to 30 June 2005) @ \$9.20 per month

= **\$18** (this represents the management services that were provided in the first 2 months of the Accrual Period following the Initial Period).

Year Ended 30 June 2006

Augustus will be able to claim a tax deduction for Continuing Management Fees calculated as the sum of two separate amounts:

- (i) 5 months (viz, 1 July 2005 to 30 November 2005) @ \$9.20 per month

= **\$46** (this represents the management services that were provided in the remaining 5 months of the Accrual Period following the Initial Period).

- (ii) $\$110^* \times \frac{7}{12}$

= **\$64** (this represents the management services that were provided in the first 7 months of the first twelve monthly Accrual Period)

\$46 + \$64 = \$110 (The sum of these two amounts is the total tax deduction available to Augustus for Continuing Management Fees for the Year Ended 30 June 2006).

* The \$110 Continuing Management Fee is adjusted for either the CPI or the amount of the Continuing Management Fee of the prior Accrual Period increased by 3%.

Detailed contents list

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

	Paragraph
What this Product Ruling is about	1
Tax law(s)	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	17
The Project	18
Constitution	29
Management Agreement	36
Fees payable by the Grower	44
Finance	45
Ruling	47
Application of this Ruling	47
Minimum subscription	48
The Simplified Tax System ('STS')	49
<i>Division 328</i>	49
Qualification	50
Prepaid fees	51
Tax outcomes for Growers who are not 'STS' taxpayers	54
Assessable Income	54
<i>Section 6-5</i>	54

Deductions for Initial Management Fee, Continuing Management Fees, Occupation Fees and Instalment Interest Expense	56
<i>Section 8-1</i>	56
Deductions for capital expenditure	58
<i>Division 40</i>	58
Tax Outcomes for Growers who are ‘STS taxpayers’	60
Assessable Income	60
<i>Section 6-5</i>	60
Deductions for Initial Management Fee, Continuing Management Fees, Occupation Fees and Instalment Interest Expense	62
<i>Section 8-1 and section 328-105</i>	62
Deductions for capital expenditure	64
<i>Subdivision 328-D and Subdivisions 40-F and 40-G</i>	64
Tax outcomes that apply to all Growers	69
<i>Interest</i>	69
Division 35 - Deferral of losses from non-commercial business activities	70
<i>Section 35-55 – Commissioner’s discretion</i>	70
<i>Section 82KL and Part IVA</i>	74
Explanation	75
Is the Grower carrying on a business?	75
The Simplified Tax System	88
<i>Division 328</i>	88
Deductibility of Initial Management Fee, Continuing Management Fees, Occupation Fees and Instalment Interest Expense	90
<i>Section 8-1</i>	90
Prepayment provisions	92
<i>Sections 82KZL to 82KZMF</i>	92
<i>Sections 82KZME and 82KZMF</i>	94
<i>Application of the prepayments provisions to this Project</i>	99
Expenditure of a capital nature	103
<i>Division 40 and Division 328</i>	103
Deferral of losses from non-commercial business activities	106
<i>Division 35</i>	106

Section 82KL - recouped expenditure	118
Part IVA - general tax avoidance provisions	119
Examples	122
Example 1 – Entitlement to GST input tax credits	122
Example 2 – Deductions for Initial Management Fee and Continuing Management Fees	123
Detailed contents list	124

Commissioner of Taxation

25 February 2004

<i>Previous draft:</i>	- ITAA 1936 82KZL
Not previously issued in draft form	- ITAA 1936 82KZL(1)
	- ITAA 1936 82KZME
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZME(1)
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1936 82KZME(2)
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1936 82KZME(3)
TR 2000/8; PR 1999/95; IT 360	- ITAA 1936 82KZME(7)
	- ITAA 1936 82KZMF
<i>Other Rulings/Determinations</i>	- ITAA 1936 82KZMF(1)
TR 2001/14	- ITAA 1936 Pt IVA
	- ITAA 1936 177A
<i>Subject references:</i>	- ITAA 1936 177C
- carrying on a business	- ITAA 1936 177D
- commencement of business	- ITAA 1936 177D(b)
- crops as trading stock	- ITAA 1997 6-5
- fee expenses	- ITAA 1997 8-1
- horticulture	- ITAA 1997 17-5
- irrigation expenses	- ITAA 1997 Div 27
- Management Fees expenses	- ITAA 1997 Div 35
- plantation forestry	- ITAA 1997 35-10
- primary production	- ITAA 1997 35-10(2)
- primary production expenses	- ITAA 1997 35-10(3)
- primary production income	- ITAA 1997 35-10(4)
- producing assessable income	- ITAA 1997 35-30
- product rulings	- ITAA 1997 35-35
- public rulings	- ITAA 1997 35-40
- schemes and shams	- ITAA 1997 35-45
- tax administration	- ITAA 1997 35-55
- tax avoidance	- ITAA 1997 35-55(1)
- tax benefits under tax avoidance schemes	- ITAA 1997 35-55(1)(a)
	- ITAA 1997 35-55(1)(b)
- tax shelters	- ITAA 1997 Div 40
- tax shelters project	- ITAA 1997 Subdiv 40-F
- trading stock	- ITAA 1997 Subdiv 40-G
	- ITAA 1997 40-25
<i>Legislative references:</i>	- ITAA 1997 40-425(2)
- Copyright Act 1968	- ITAA 1997 40-440
- ITAA 1936 Div 3 Subdiv H of Part	- ITAA 1997 40-515
- ITAA 1936 82KL	- ITAA 1997 40-515(1)(a)

PR 2004/17

- ITAA 1997 40-520(1)
- ITAA 1997 40-535
- ITAA 1997 40-540
- ITAA 1997 40-630
- ITAA 1997 40-635
- ITAA 1997 Div 328
- ITAA 1997 Subdiv 328-D
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1997 328-105

- ITAA 1997 328-105(1)(a)
- ITAA 1997 328-180
- TAA 1953 Part IVAAA

Case references:

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

ATO references:

NO: 2002/000884
ISSN: 1441-1172