



PR 2004/18 - Income tax: 2004 Timbercorp Almond Project

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 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: 2004 Timbercorp Almond Project

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

Preamble

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

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential 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 law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the '2004 Timbercorp Almond Project' or simply as 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Section 25-25 (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 82KZL (ITAA 1936);
 - Sections 82KZME - 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and services tax

3. In this Ruling all fees and expenditure referred to include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a 'Participant 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 laws enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering 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 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 as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Participant 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;
- persons who are accepted to participate in the Project on or after 16 June 2004 and on or before 30 June in 2004;
- persons who are accepted to participate in the Project on or after 16 June 2005 and on or before 30 June in 2005;

- persons who participate in the Project through offers made other than through the Product Disclosure Statement; and
- Timbercorp Securities Limited and its associates.

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 Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

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

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for a Product Ruling dated 3 February 2004 as constituted by documents received on 30 July 2003, 8 September 2003, 30 October 2003, 27 January 2004, 2 February 2004, 3 February 2004 and 10 February 2004;
- Draft Product Disclosure Statement for the 2004 Timbercorp Almond Project ('PDS'), as amended, provided on 16 February 2004, undated, prepared for Timbercorp Securities Limited A.C.N. 092 311 469 ('TSL'), ('the Responsible Entity');
- The **Constitution** of the 2004 Timbercorp Almond Project, undated, as amended, received on 27 January 2004;
- Draft Compliance Plan of the 2004 Timbercorp Almond Project, undated, received on 8 September 2003;
- Draft **Almondlot Management Agreement** between each 'Participant Grower' and TSL undated, as amended, received on 2 February 2004;
- Draft Almond Orchard Management Plan, undated, received on 8 September 2003;
- Draft Management Agreement between TSL and Almond Management Pty Ltd ('Almond Management'), undated, received on 8 September 2003;

- Draft Almond Orchard Management Agreement for the 2004 Timbercorp Almond Project between Almond Management, Select Harvests Limited ('Select'), TSL, Timbercorp Limited, Almond Investments Australia Pty Ltd and Almond Land Pty Ltd, undated, received on 8 September 2003;
- Draft Tree Supply and Capital Works Agreement for the 2004 Timbercorp Almond Project between Almond Land Pty Ltd, Select, Timbercorp Limited and Almond Investments Australia Pty Ltd, undated, received 8 September 2003;
- Draft **Sub-lease Agreement** between each Participant Grower, Almond Land Pty Ltd and TSL, undated, as amended, received on 18 February 2004;
- Draft Lease Agreement between Almond Land Pty Ltd and TSL for the 2004 Timbercorp Almond Project (Wandown Site), undated, received on 10 February 2004;
- Draft Custody Agreement between TSL and the Custodian, received on 8 September 2003; and
- Draft Finance Package, which includes the **Loan Application Form** and Loan Explanation and Loan Terms, undated, received on 8 September 2003.

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

15. The documents highlighted are those that 'Participant Growers' may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Participant Grower, or any associate of a Participant Grower, will be a party to, which are a part of the arrangement. In this Ruling the term 'associate' has the meaning given by section 318 of the ITAA 1936. The effect of these agreements is summarised as follows.

16. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

Overview

17. The salient features of the 2004 Timbercorp Almond Project are as follows:

Location	North West Victoria.
Type of business to be carried on by each Participant Grower	Commercial growing and cultivation of almond trees for the purpose of harvesting almonds for sale.
Number of hectares offered for cultivation	Up to 500 with capacity for oversubscription.
Size of each Almondlot	0.25 hectares.
Minimum allocation	2 'Almondlots' (TSL may allocate less at its absolute discretion.)
Minimum subscription	None.
Number of trees per hectare	Approximately 247.
Term of the Project	20 years.
Initial cost per 'Almondlot'	\$4,075 for 'Early Growers'. \$5,700 for 'Post 30 June Growers'.
Initial cost per hectare	\$16,300 for 'Early Growers'. \$22,800 for 'Post 30 June Growers'.
Ongoing costs	Annual 'Rent'. Annual management 'fees and charges'.
Other fees and costs	Deferred management fees. Incentive fees. Insurance.

18. The Project will be registered as a managed investment scheme under the *Corporations Act 2001*. Applications to participate in the Project must be made on the Application Form shown in the PDS. There is no minimum amount that must be raised under the PDS. A Custodian will be appointed under the Custody Agreement to protect the interests of the 'Participant Growers' in their dealings with TSL.

19. Under a Power of Attorney contained on the Application Form, 'Applicants' who are accepted to participate in the Project will enter into agreements with TSL and its associates to establish and manage 'Almond Trees' for the purpose of harvesting the 'Almonds' for sale.

20. 'Participant Growers' whose applications are accepted on or before 15 June 2004 will become 'Early Growers'. 'Participant Growers' whose applications are accepted on or after 1 July 2004 and on or before 15 June 2005 will become 'Post 30 June Growers'.

21. The Project land is on a property known as Wandown, which is situated within close proximity to Boundary Bend, in North West

Victoria. TSL will enter into a Lease with Almond Land Pty Ltd ('Land Owner') of the Land and the Water Licences. Participant Growers entering into the Project will sub-lease land from TSL. The Land Owner will establish the infrastructure and other capital works necessary to operate a commercial almond growing operation.

22. The minimum area of land that will be sub-leased by each 'Participant Grower' is 2 'Almondlots' of 0.25 hectares, although TSL reserves the right to accept applications for less than 2 'Almondlots'.

23. A 'Participant Grower' will also enter into an Almondlot Management Agreement with TSL to cultivate and maintain the 'Almond Trees' and be responsible for harvesting, procuring the processing of and selling the Participant Grower's 'Almonds', 'Crop' or 'Product'.

24. As an alternative to participation by a 'Participant Grower' as a single entity, the terms of the Constitution, the Almondlot Management Agreement, and the Sub-lease provide that two 'Participant Growers' may enter into a Joint Venture.

Constitution

25. The Constitution establishes the Project and operates as a deed binding all of the 'Participant Growers' (clause 8.6) and TSL. The Constitution sets out the terms and conditions under which TSL agrees to act as Responsible Entity and thereby manage the Project.

26. Under clause 4, TSL holds the Application Money on bare trust. TSL accounts for the Application Money in a special trust account and deposits the money into a bank account solely for 'Application Money' for this Project. Once TSL is satisfied that all documents have been executed and any finance has been approved for an applicant, the 'Application Money' is released and applied against the fees due to TSL (clause 9.3).

27. Where two Growers enter a Joint Venture the Constitution provides that:

- one Joint Venture Grower is liable for the fees and other amounts payable under the Almondlot Management Agreement and the 'Initial Rent' (defined in the Constitution to mean the rent payable on application, clause 1.1) payable under the Sub-lease ('First Joint Venture Grower') (clause 29.5(a)); and
- the other Joint Venture Grower is liable for the ongoing 'Rent' and other amounts payable under the Sub-lease ('Second Joint Venture Grower') (clause 29.5(b)).

28. The 'First Joint Venture Grower' is liable for 68% and the 'Second Joint Venture Grower' for 32% of any incentive fees (clause 29.5(c)) and each will be entitled to these proportions of the Joint Venture's 'Almonds', 'Crop' and the 'Product', and the 'Joint Venture Proceeds' (clause 29.6).

29. In summary, the Constitution also sets out provisions relating to:

- invitations and offers under the PDS (clause 2);
- the irrevocable appointment of TSL as the 'Participant Grower's' agent, representative and attorney (clause 3);
- procedures relating to 'Applications' (clause 6);
- the absolute discretion of TSL to refuse an 'Application' (clause 7);
- the effect of an Applicant's 'Application' being accepted by TSL (clause 8);
- preparation and execution of the Sub-lease, and Almondlot Management Agreement by TSL and release of the 'Application Money' (clause 9);
- preparation and issuing of 'Almondlot Statements' to 'Participant Growers' and the setting up and maintenance of a Register of 'Participant Growers' (clause 10);
- TSL's powers (clause 11);
- the keeping of a separate Agency Account for the holding of 'Proceeds and any other money', apart from 'Application Money' and interest thereon, that TSL may hold for the 'Participant Grower' (clause 12);
- distributions from the 'Agency Account' of 'Proceeds' to 'Participant Growers' and to insured 'Participant Growers' and pooling of amounts (clause 13);
- the right of TSL to be paid fees and other expenses (clauses 14 and 17);
- the status, the retention by TSL, and termination by TSL or the 'Participant Growers', of the Almondlot Management Agreement and Sub-lease (clause 18). This includes the right of 'Participant Growers' to obtain a copy of the above agreements by written request to TSL (clause 18.2) and the consequences of termination of these agreements (clause 18.4);

- the right of ‘Participant Growers’ to inspect certain documents related to their participation in the Project and to offer and give opinions to TSL (clause 19.1);
- the assignment and transmission of ‘Almondlots’ (clause 20) and restrictions on such assignments and transmissions (clause 21);
- resolution of complaints made by the ‘Participant Grower’ in relation to the Project or TSL (clause 25); and
- termination of the Project (clause 26).

30. Although Clause 6.4 of the Constitution provides that ‘Participant Growers’ may pay the Application Money by instalments, **this Product Ruling does not apply to any ‘Participant Grower’ who enters into an arrangement to pay their Application Money by instalments.**

Compliance Plan

31. As required by the *Corporations Act 2001*, TSL has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that TSL manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of ‘Participant Growers’ are protected.

Head Lease

32. The ‘Land’ and ‘Water Licences’ for the Project are owned by Almond Land Pty Limited (the Lessor) and will be leased to TSL under the Head Lease. The Head Lease sets out the terms and conditions under which the Lessor will lease the ‘Land’ and ‘Water Licences’ to TSL to use and exploit during the ‘Term’ of the Project.

Sub-lease

33. Participant Growers will enter into a Sub-lease with TSL and Almond Land Pty Ltd (in the Sub-lease called the ‘Land Owner’). Under clause 3.1, TSL grants a Sub-lease of the ‘Almondlot(s)’ to the ‘Participant Grower’ for the purpose of growing and cultivating of ‘Almond Trees’ for the production of ‘Almonds’, ‘Crop’ or ‘Product’ for commercial gain. ‘Almondlot’ is defined to include the ‘Participant Grower’s’ separate and identifiable interest in the ‘Land’ and includes the ‘Almond Trees’, the ‘Capital Works’ and the ‘Water Licences’.

34. The Landowner must establish the orchard, including the necessary infrastructure and capital works on the 'Land' by 31 May 2004 and plant the almond trees by no later than June 2004 (clause 2.1). Under clause 3.2 the 'Land Owner' must fully exploit its 'Water Licences' to enable water to be supplied to the 'Almondlots' by TSL for the benefit of all the 'Participant Growers' during the 'Term' of the Project in accordance with the provisions of the Almondlot Management Agreement.

35. The Sub-lease is conditional upon the 'Participant Grower' entering into the Almondlot Management Agreement (clause 6.1).

36. The Sub-lease also sets out:

- its 'Term' (clause 4.1);
- the 'Rent' payable by 'Participant Growers' (clause 7);
- provisions dealing with damage to or reduction in the viability of the Participant Grower's 'Almondlots' (clauses 10.3 and 10.4);
- the obligations and rights of the 'Participant Grower' (clauses 6 and 8), TSL (clauses 5 and 6) and the 'Land Owner' (clauses 6 and 9); and
- provisions relating to early termination of the Sub-lease by the 'Participant Grower' or TSL (clause 10) and the rights and obligations of the parties following such termination (clause 12).

Almondlot Management Agreement

37. Under clause 4.2 of the Almondlot Management Agreement a 'Participant Grower' engages TSL as an independent contractor to carry out the 'Orchard services' during the 'Term' of the Project.

38. The 'Orchard Services' include:

- pruning the 'Almond Trees';
- operating the irrigation system;
- fertilising the 'Almondlots';
- keeping the improvements on the relevant 'Almondlots' in good and substantial repair;
- weeding the 'Almondlots';
- replanting any of the 'Almond Trees' in need of replacement;
- complying with the 'Participant Grower's' obligations under the Sub-lease (except for those relating to payment of fees);

- procuring additional water if required from time to time to irrigate the Orchard by way of temporary water rights; and
- preparing the Management Plan for the Project, including a horticultural plan for the Orchard, a horticultural program, operational plan and annual financial and operational budgets in relation to these horticultural matters.

39. During each year of the Project TSL will test the 'Almonds' and, where they are ready for harvesting, harvest the mature 'Almond Trees' and deliver the harvested 'Almonds' to delivery point(s) for processing and sale (clause 6). Under clause 7, as agent for the 'Participant Grower', TSL will process, market and sell their share of the 'Almonds', the 'Crop' and the 'Product' for as high a price as it can reasonably achieve. 'Participant Growers' are entitled to receive a proportion of the proceeds of sale of all of the 'Product' or 'Crop' according to their interest in the Project (clause 7.3(a)).

40. The Almondlot Management Agreement also sets out:

- certain administrative services to be provided to the 'Participant Growers' during the 'Term' of the Project;
- the requirement for TSL to provide an annual report to 'Participant Growers' no later than 4 months after the end of each financial year of the Project (clause 13);
- the ability of the Participant Grower to terminate the Almondlot Management Agreement in cases such as default (clause 15); and
- dispute resolution procedures (clause 18).

Pooling of amounts and distribution of 'Proceeds'

41. Both the Constitution (clause 13) and the Almondlot Management Agreement (clause 7.3) set out provisions relating to the pooling of amounts from the sale of the Participant Growers' 'Almonds', 'Crop' or 'Product' and the distribution of 'Proceeds' from that sale or from insurance proceeds. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only 'Participant Growers' who have contributed 'Almonds', 'Crop' or 'Product' or insurance proceeds to the pool making up the 'Proceeds' are entitled to benefit from distributions from those 'Proceeds'; and
- any pools of 'Almonds', 'Crop' or 'Product' or other 'Proceeds' must consist only of 'Almonds', 'Crop' or

‘Product’ or other ‘Proceeds’ contributed by ‘Early Growers’ or ‘Post 30 June Growers’ in the 2004 Timbercorp Almond Project.

Management Agreement

42. Under the Management Agreement, TSL engages Almond Management Pty Ltd as Project Manager, to manage and administer the Project, to manage, direct and conduct the ‘Project Operations’ on behalf of the Participant Growers and to perform the ‘Orchard Services’.

Almond Orchard Management Agreement

43. Under the Almond Orchard Management Agreement, Almond Management Pty Ltd engages Select Harvests Ltd as an independent contractor to provide management and cultivation services, including the ‘Orchard Services’ (clause 4), ‘Processing Services’ (clause 5) and ‘Marketing Services’ (clause 6). Select must carry out the provision of these services in accordance with an ‘Almond Orchard Management Plan’. A draft ‘Almond Orchard Management Plan’ prepared by Select for the ‘Financial Year’ ending 30 June 2005 forms part of the application for this Product Ruling.

Tree Supply and Capital Works Agreement

44. Under the Tree Supply and Capital Works Agreement, Almond Land Pty Ltd (the Land Owner) engages Select Harvests Ltd as an independent contractor to provide services (the ‘Capital Works’) to establish the almond orchard. The ‘Capital Works’ include the preparation of the ‘Land’, the installation of irrigation facilities, and the planting and staking of the ‘Almond Trees’ at a density of approximately 247 trees per hectare on the Participant Growers’ ‘Almondlots’.

45. Under clause 5.2(c) Select will replace and replant, at its cost, any ‘Almond Tree’ that fails within 6 months where the failure is caused by Select.

Fees

46. The annual fees and charges **per Almondlot**, set out in clause 11 of the Almondlot Management Agreement and the 'Rent', set out in clause 7 of the Sub-lease, are as follows:

'Early Growers' will pay:

- For the 'Orchard Services' and all other services to be provided in the period from the Commencement Date to 30 June 2004, **\$3,950** payable upon application;
- For the 'Orchard Services' and all other services in the period 1 July 2004 to 30 June 2005, **\$1,500** payable on 31 October 2004, **plus a deferred amount of 1.65%** of the 'Gross Proceeds' of the sale of 'Crop' and 'Product' payable in each 'Financial Year' of the Project that the 'Proceeds' are paid (see paragraph 47);
- For the 'Orchard Services' and all other services in the period 1 July 2005 to 30 June 2006, **\$1,500** payable on 31 October 2005, **plus a deferred amount of 1.65%** of the 'Gross Proceeds' of the sale of 'Crop' and 'Product' payable in each 'Financial Year' of the Project that the 'Proceeds' are paid (see paragraph 47);
- For the 'Orchard Services' and all other services in each subsequent 'Financial Year' after 30 June 2006, the **estimated costs** of operating the 'Almondlot', **plus 0.55%** of the 'Gross Proceeds', payable on 31 October 2006 and each 31 October thereafter (see paragraph 48);
- An **incentive fee of 27.5%** of 'Net Proceeds' in excess of the 'Incentive Fee Threshold' in each financial year;
- **\$125** for 'Rent' payable upon application for the period commencing on the 'Commencement Date' and ending on 30 June 2004; and
- **\$1,500** for 'Rent' for the 'Financial Years' ending 30 June 2005, 2006, 2007, 2008 and 2009, then that amount (indexed for CPI) in each subsequent year, payable on the 31 October of the relevant 'Financial Year'.

'Post 30 June Growers' will pay:

- For the 'Orchard Services' and all other services to be provided in the period from the Commencement Date to 30 June 2005, **\$4,950** payable upon application;

- For the 'Orchard Services' and all other services in the period 1 July 2005 to 30 June 2006, **\$1,500** payable on 31 October 2005, **plus a deferred amount of 3.3%** of the 'Gross Proceeds' of the sale of 'Crop' and 'Product' payable in each 'Financial Year' of the Project that the 'Proceeds' are paid (see paragraph 47);
- For the 'Orchard Services' and all other services in each subsequent 'Financial Year', the **estimated costs** of operating the 'Almondlot', **plus 0.55%** of the 'Gross Proceeds', payable on 31 October 2006 and each 31 October thereafter (see paragraph 48);
- An **incentive fee of 27.5%** of 'Net Proceeds' in excess of the 'Incentive Fee Threshold' in each financial year;
- **\$750** for 'Rent' payable upon application for the period commencing on the Commencement Date and ending on 30 June 2005; and
- **\$1,500** for 'Rent' for the 'Financial Years' ending 30 June 2006, 2007, 2008 and 2009, then that amount (indexed for CPI) in each subsequent year, payable on the 31 October of the relevant 'Financial Year'.

47. As noted above, the annual fee in the 2005 and 2006 'Financial Years' (as relevant) consists of a set dollar amount and a deferred amount paid out of any 'Proceeds' payable to the 'Participant Grower'. The deferred amount is calculated as a percentage of the 'Participant Grower's' 'Gross Proceeds' and becomes payable at any time 'Proceeds' are paid over the term of the Project.

48. As noted above, from the 2007 'Financial Year', the annual fee will consist of an amount for the estimated costs of operating the 'Almondlot' plus a management fee equal to 0.55% of the 'Participant Grower's' 'Gross Proceeds'. The estimated costs of operating the 'Almondlot' for a 'Financial Year' will include an adjustment for the difference between the actual costs and the estimated costs of managing the 'Almondlot' during the preceding 'Financial Year'.

Finance

49. Participant Growers can fund their involvement in the Project by borrowing from independent sources or from Timbercorp Finance Pty Ltd ('the Financier'), a lender associated with the Responsible Entity.

50. The Financier will provide 'Participant Growers' with loans on a full recourse basis and will pursue legal action against any defaulting borrowers. Details of the loans that will be offered to

‘Participant Growers’ by the Financier are set out in the ‘Loan Application Form’ and ‘Loan Explanation and Loan Terms’. These documents are summarised as follows:

- the Financier will lend up to 90% of the Participant Grower’s application amount but, at its discretion, may lend up to 100% of the Participant Grower’s application amount;
- the Financier will provide ‘Participant Growers’ who subscribe to the minimum subscription amount of two ‘Almondlots’ with a minimum ‘Loan Amount’ of \$5,000;
- the ‘Participant Grower’ will pay a loan application fee of \$250 to accompany the ‘Application Form’;
- the ‘Participant Grower’ may choose from a 3, 4, 5 or 7 year ‘Loan Term’ at an interest rate which is fixed for the ‘Loan Term’;
- the fixed rate of interest will depend on whether the ‘Participant Grower’ chooses a 3, 4, 5 or 7 year loan;
- the loan is repayable over the ‘Loan Term’ by equal monthly instalments of principal and interest;
- in the event that any amount is overdue, the Financier may charge interest at the ‘Default Rate’;
- the ‘Participant Grower’ is entitled to repay the whole or any part of the ‘Total Amount Owing’ without penalty for early repayment;
- during the ‘Loan Term’ the ‘Participant Grower’ will assign and transfer over to the Financier by way of fixed charge all its rights, title and interest at any time in the Project including ‘Almondlots’ and the Project Agreements; and
- during the ‘Loan Term’ the ‘Participant Grower’ must maintain fire, wind and storm insurance over the ‘Almondlots’ on a full replacement basis.

51. Participant Growers cannot rely on this Product Ruling if they enter into a finance agreement with the Financier that materially differs from that set out in the ‘Loan Application Form’ and ‘Loan Explanation and Loan Terms’ provided to the Tax Office by TSL with the application for this Product Ruling.

52. Participant Growers also cannot rely on this Product Ruling if Application Money otherwise remains unpaid by 30 June 2004. Where an application is accepted subject to finance approval by any

lending institution, 'Participant Growers' cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by 30 June 2004.

53. This Ruling also does not apply if the finance arrangement entered into by the 'Participant Grower' with the Financier or any other lender includes or has any of the following features:

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

Ruling

Application of this Ruling

54. This Ruling applies only to 'Participant Growers' who are accepted to participate in the Project and who have executed an Almondlot Management Agreement and a Sub-lease Agreement:

- on or before 15 June 2004 ('Early Growers'); and/or
- on or after 1 July 2004 and on or before 15 June 2005 ('Post 30 June Growers').

55. The Participant Grower's participation in the Project must constitute the carrying on of a business of primary production. A 'Participant Grower' is not eligible to claim any tax deductions until the 'Participant Grower's' application to enter the Project is accepted and the Project has commenced.

The Simplified Tax System ('STS')

Division 328

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

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

Qualification

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

Assessable Income

Section 6-5

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

59. A 'Participant Grower' who is not an 'STS taxpayer' recognises ordinary income from carrying on the business of growing almonds for processing and sale at the time that income is derived.

60. A 'Participant Grower' who is an 'STS taxpayer' recognises ordinary income from carrying on the business of growing almonds for processing and sale at the time that income is received (paragraph 328-105(1)(a)).

Deductions for ‘Management Fees’, ‘Rent’, interest, and borrowing costs***Section 8-1, section 328-105, and section 25-25***

61. An ‘**Early Grower**’ who enters into the Project on or before 15 June 2004 may claim tax deductions, on a per Almondlot basis, for the following expenditure.

Fee Type	30 June 2004	30 June 2005	30 June 2006
‘Management Fee’	\$3,950 - See Notes (i), (ii) & (iii)	\$1,500 - See Notes (i), (ii) & (iii)	\$1,500 - See Notes (i), (ii) & (iii)
‘Rent’	\$125 – See Notes (i), (ii) & (iii)	\$1,500 – See Notes (i), (ii) & (iii)	\$1,500 – See Notes (i), (ii) & (iii)
Interest on loans with Timbercorp Finance Pty Ltd	As incurred (Non-STs taxpayers) Or as paid (STs taxpayers) See Note (iii) & (iv)	As incurred (Non-STs taxpayers) Or as paid (STs taxpayers) See Note (iii) & (iv)	As incurred (Non-STs taxpayers) Or as paid (STs taxpayers) See note (iii) & (iv)
Borrowing costs for loans with Timbercorp Finance Pty Ltd	Must be calculated - See Note (v)	Must be calculated - See Note (v)	Must be calculated - See Note (v)

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 116;
- (ii) The ‘Management Fees’ and the ‘Rent’ shown in the Almondlot Management Agreement and the Sub-lease are deductible under section 8-1 in full in the year that they are incurred (where the Grower is not an ‘STs taxpayer’) or, under paragraph 328-105(1)(b) in the

year in which they are paid (where the Grower is an 'STS taxpayer');

- (iii) This Ruling does not apply to Growers who choose to prepay fees for 'Management Services' or 'Rent', or who choose or who are required to prepay interest under a loan agreement (see paragraph 97). Amounts that are prepaid for a period that extends beyond the income year in which the expenditure is incurred may be subject to the prepayment provisions in sections 82KZME to 82KZMF of the ITAA 1936. Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project;
- (iv) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd is outside the scope of this Ruling. Growers who borrow from lenders other than Timbercorp Finance Pty Ltd may request a private ruling on the deductibility of the interest incurred; and
- (v) The Loan Application fee payable to Timbercorp Finance Pty Ltd is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd is outside the scope of this Ruling.

62. A **'Post 30 June Grower'** whose application is accepted on or after 1 July 2004 and on or before 15 June 2005 may claim tax deductions, on a per Almondlot basis, for the following expenditure.

Fee Type	30 June 2005	30 June 2006
'Management Fee'	\$4,950 – See Notes (i), (ii) & (iii)	\$1,500 – See Notes (i), (ii) & (iii)
'Rent'	\$750 – See Notes (i), (ii) & (iii) & (vi)	\$1,500 – See Notes (i), (ii) & (iii) & (vi)
Interest on loans with Timbercorp Finance Pty Ltd	As incurred – See Notes (iii) & (iv)	As incurred – See Notes (iii) & (iv)

Borrowing costs for loans with Timbercorp Finance Pty Ltd	Must be calculated - see Note (v)	Must be calculated - see Note (v)
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Note:

- (vi) For a 'Post 30 June Grower' accepted on or after 1 February 2005 and on or before 15 June 2005, the deduction for Rent is \$125 per month for each month or part month that the Grower leases the land. This will mean that for 'Post 30 June Growers' accepted on or after 1 February 2005, the full \$750 payable for the year ended 30 June 2005, will not be deductible. See paragraphs 92 and 93.

Joint Venture 'Participant Growers'

63. A 'Participant Grower' who is a Joint Venture 'Participant Grower' (as explained in paragraphs 27 to 28 above) and is **not** an 'STS taxpayer' may claim deductions for the following amounts set out in the relevant Tables and Notes above:

- the **'First Joint Venture Grower'** referred to in paragraph 27 may claim deductions under section 8-1 for amounts incurred for the management services and 'Rent' for the first year of their participation in the project, any interest on funds borrowed from Timbercorp Finance Pty Ltd, and under section 25-25 for any borrowing costs payable to Timbercorp Finance Pty Ltd;
- the **'Second Joint Venture Grower'** referred to in paragraph 27 may claim deductions under section 8-1 for amounts incurred for ongoing 'Rent', any interest on funds borrowed from Timbercorp Finance Pty Ltd, and under section 25-25 for any borrowing costs payable to Timbercorp Finance Pty Ltd.

64. Where either or both the 'First Joint Venture Grower' or the 'Second Joint Venture Grower' **is** an 'STS taxpayer' the deductions referred to in paragraphs 61 and 62, other than the borrowing expenses, are deductible in the income year in which they are paid by, or paid on behalf of the Joint Venture Grower (paragraph 328-105(1)(b)). Borrowing costs for Joint Venture Growers who are 'STS taxpayers' remain deductible under section 25-25 in the years shown in the Table above. Each Joint Venture Grower may also claim

deductions for its proportional share of the incentive fees and the horticultural plant write-off explained below.

Deductions for horticultural plants

Division 40

65. Each 'Participant Grower' will also be entitled to tax deductions relating to the almond trees planted on the Almondlot. If the 'Participant Grower' is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. See example at paragraph 116.

66. An almond tree is considered to be a 'horticultural plant' as defined in subsection 40-520(2). A 'Participant Grower' holds a sub-lease to cultivate almond trees on a designated area of land called an 'Almondlot' for the growing of 'Almonds' for commercial gain. As a 'Participant Grower' holds the 'Almondlot' under a sub-lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value.

67. The deduction is determined using the formula in section 40-545. Almond trees have an 'effective life' of greater than 13 but fewer than 30 years and, for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the 'Almond Trees' enter their first commercial season (section 40-530, item 2). TSL will notify 'Participant Growers' when their 'Almond Trees' enter their first commercial season and the amount that may be claimed.

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

Section 35-55 – Commissioner's discretion

68. For a 'Participant Grower' who is an individual and who enters the Project by 15 June 2004 in the year ended 30 June 2004 (an 'Early Grower') or by 15 June 2005 in the year ended 30 June 2005 (a 'Post 30 June Grower') the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project.

69. Under paragraph 35-55(1)(b) the Commissioner will decide for these 'Participant Growers' that the rule in section 35-10 does not apply to this activity for the income years ending **30 June 2004 to 30 June 2009** provided that the Project is carried out in the manner described in this Ruling.

70. 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 104 in the Explanations part of this ruling, below); or
- a Participant Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- a Participant 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)).

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

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

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

73. For a ‘Participant Grower’ who participates in the Arrangement described above and incurs expenditure as required by the Almondlot Management Agreement, the Sub-lease and any loan agreement with the Financier, the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a ‘Participant Grower’ who participates in the Project does not fall within the scope of sections 82KZME to 82KZMF;
- 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 'Participant Grower' carrying on a business?

74. For the amounts set out in the Table above to constitute allowable deductions the 'Participant Grower's' activities of cultivating almond trees and harvesting the 'Almonds', 'Crop' or 'Product' for eventual sale as a participant in the 2004 Timbercorp Almond Project must amount to the carrying on of a business of primary production.

75. Where there is a business, or a future business, the gross proceeds from the sale of the 'Almonds', 'Crop' or 'Product' will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

76. For schemes such as the 2004 Timbercorp Almond Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Participant Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

77. Generally, a 'Participant Grower' will be carrying on a business of growing almonds, and hence primary production, if:

- the 'Participant Grower' has an identifiable interest in the land (by lease) or rights over the land (by licence) on which the Participant Grower's 'Almond Trees' are established;
- the 'Participant Grower' has a right to harvest and sell the 'Product';
- the cultivation of the 'Almond Trees' and harvesting of the 'Almonds' are carried out on the 'Participant Grower's' behalf;
- the activities of the 'Participant Grower' are typical of those associated with a business of cultivating almond trees and harvesting the almonds for commercial gain; and
- the weight and influence of general indicators point to the carrying on of a business.

78. In this Project, each 'Participant Grower' enters into an Almondlot Management Agreement and a Sub-Lease.

79. Under the Sub-Lease each individual 'Participant Grower' will have rights over one or more specific and identifiable areas of land, each known as an Almondlot. The Sub-Lease provides the 'Participant Grower' with an ongoing interest in the specific 'Almond Trees' on the sub-leased area for the term of the Project from the commencement of the Sub-lease. Under the Sub-lease the 'Participant Grower' must use the land in question for the purpose of cultivating almond trees and harvesting the almonds, and for no other purpose. The Sub-lease allows TSL to come onto the land to carry out its obligations under the Almondlot Management Agreement.

80. Under the Almondlot Management Agreement, TSL is engaged by the 'Participant Grower' to provide management services, including 'Orchard Services' on the Participant Grower's identifiable area of land during the term of the Project. Under the Management Agreement and Almond Orchard Management Agreement the management services are sub-contracted to Select Harvests Ltd. Select Harvests Ltd has provided evidence that it holds the appropriate professional skills and credentials to provide the services to establish and maintain the 'Almondlot' on the Participant Grower's behalf during the 'Term' of the Project.

81. TSL is also engaged to harvest and sell, on the Participant Grower's behalf, the 'Almonds' grown on the Participant Grower's 'Almondlot'(s).

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 'Participant Grower' in the Project will derive assessable income from the sale of the 'Almonds', 'Crop' or 'Product' 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 the 'Almonds', 'Crop' or 'Product' grown on the Participant Grower's 'Almondlot' with the 'Almonds', 'Crop' or 'Product' of other 'Participant Growers' in the 2004 Timbercorp Almond Project is consistent with general horticultural practices. Each Participant Grower's proportionate share of the sale proceeds of the pooled 'Almonds', 'Crop' or 'Product' will reflect the proportion of the 'Almonds', 'Crop' or 'Product' contributed from their 'Almondlot'.

85. The Manager's services are also consistent with general horticultural practices. They are of the type ordinarily found in almond growing ventures that would commonly be said to be

businesses. While the size of an individual ‘Almondlot’ is relatively small, it is of a size and scale to allow it to be commercially viable.

86. The Participant Grower’s degree of control over TSL as evidenced by the Constitution and Almondlot Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, TSL is required to provide the ‘Participant Grower’ with regular progress reports on the Participant Grower’s ‘Almondlot’ and the activities carried out on the Participant Grower’s behalf. ‘Participant Growers’ are able to terminate arrangements with TSL in certain instances, such as cases of default or neglect.

87. The activities of the ‘Participant Grower’ are typical of those associated with a business of cultivating almond trees and harvesting the almonds for commercial gain, 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 Participant Grower’s activities of cultivating almond trees and harvesting the almonds for eventual sale in the 2004 Timbercorp Almond Project 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 ‘Participant 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 ‘Participant Grower’ is eligible to be an ‘STS taxpayer’ is outside the scope of this Product Ruling. Therefore, any ‘Participant Grower’ who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an ‘STS taxpayer’.

Deductibility of ‘Management Fees’ and ‘Rent’

Section 8-1

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

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer’s assessable income;

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

91. The 'Management Fees' and, subject to paragraphs 92 and 93, the 'Rent' will relate to the gaining of income from the Participant Grower's business of growing almonds (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of 'Almonds', 'Crop' or 'Product') is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. Subject to paragraphs 92 and 93, there is no capital component of this fee. The tests of deductibility under the first limb of section 8-1 are met. Subject to paragraphs 92 and 93, the exclusions do not apply.

92. One of the exclusions under section 8-1 relates to expenditure that is capital, or is capital in nature. Any part of the expenditure of a Grower entering into a horticulture business which is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and hence will not be deductible under section 8-1. The Commissioner is of the view that depending upon when they are accepted to participate in the Project, a portion of the initial 'Rent' payable by a 'Post 30 June Grower' will be capital expenditure. Therefore, the amount allowed as a deduction for 'Rent' under section 8-1 will be allowed as follows.

93. If a 'Post 30 June Grower' enters the project on or before 31 January 2005 the 'Rent' of \$750 payable on application for the period from the 'Commencement Date' to 30 June 2005 will be deductible in full. However, 'Post 30 June Growers' accepted to participate in the Project on or after 1 February 2005 and on or before 15 June 2005, will not be entitled to the full deduction. The deduction will be calculated on a pro-rata monthly basis of \$125 for each month or part month that the 'Post 30 June Grower' sub-leases the land from TSL.

Interest deductibility

Section 8-1

(i) 'Participant Growers' who use Timbercorp Finance Pty Ltd as the finance provider

94. Some 'Participant Growers' may finance their participation in the Project through a loan facility with Timbercorp Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the 'Management Fees' under the Almondlot Management Agreement.

95. The interest incurred will be in respect of a loan to finance the Participant Grower's business operations - the cultivation and growing of almonds and the sub-lease of the land on which the 'Almond Trees' will have been planted - that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

(ii) 'Participant Growers' who DO NOT use Timbercorp Finance Pty Ltd as the finance provider

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

Prepayment provisions

Sections 82KZL to 82KZMF

97. 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.

Application of the prepayment provisions to this Project

98. Under the Arrangement to which this Product Ruling applies 'Management Fees' and 'Rent' are incurred annually and interest payable to Timbercorp Finance is incurred monthly. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this Arrangement. A 'Participant Grower' who is an 'STS taxpayer' can, therefore, claim a deduction for each of the relevant amounts in the income year in which the amount is paid. A 'Participant Grower' who is not an 'STS taxpayer' can claim a deduction for each of the relevant amounts in the income year in which the fee is incurred.

99. However, sections 82KZME and 82KZMF may have relevance if a 'Participant Grower' in this Project prepays all or some of the expenditure payable under the Almondlot Management Agreement or prepays interest under a loan agreement (including loan agreements with lenders other than Timbercorp Finance Pty Ltd). Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

100. As noted in the Ruling section above, 'Participant Growers' who prepay fees or interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

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

101. 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 satisfied; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

102. 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.

103. 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 satisfied, the discretion is exercised, or the exception applies.

104. 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 'Participant Growers' who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

105. 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).

106. A 'Participant 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 'Participant Grower' who acquires the minimum participation of two 'Almondlots' (although TSL reserves the right to accept applications for one Almondlot) in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2012. 'Participant Growers' who acquire more than the minimum allocation of one 'Almondlot' in the Project may however, find that their activity meets one of the tests in an earlier income year.

107. 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 Participant Grower's participation in the Project.

108. 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:

- (i) the business activity has started to be carried on;
- (ii) because of its nature, it has not satisfied one of the objective tests; and
- (iii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

109. For a ‘Participant Grower’ who is an individual and who enters the Project during the years ended 30 June 2004 and/or 30 June 2005, information provided with the application for this Product Ruling indicates that they are expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2010. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2009.

110. This Product Ruling is issued on a prospective basis (i.e. before an individual Participant 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 paragraphs 68 and 69), in the manner described in the Arrangement (see paragraphs 14 to 53). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). ‘Participant Growers’ may need to apply for private rulings on how paragraph 35-55(1) will apply in such changed circumstances.

111. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent expert and additional expert and scientific evidence provided by the Responsible Entity with the application; and
- independent, objective, and generally available information relating to the almond 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

112. 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

113. 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).

114. The 2004 Timbercorp Almond Project will be a ‘scheme’. A ‘Participant Grower’ will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 61, 62 and 65-67 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.

115. Participant 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 ‘Almonds’, ‘Crop’ or ‘Product’. There are no facts that would suggest that Participant 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

116. 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	<u>\$2,200*</u>
Total due and payable by 1 January 2004 (includes GST of \$600)	<u>\$6,600</u>

*Taxable supply

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

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

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

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

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

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

In preparing her income tax return for the year ended 30 June 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

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Commissioner of Taxation

25 February 2004

Previous draft:

Not previously released in draft form

Related Rulings/Determinations:

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

Other Rulings/Determinations:

TR 2001/14

Subject references:

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

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- ITAA 1997 25-25
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
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