

PR 2004/88 - Income tax: Tasmanian Truffle Project No. 2 (Second Supplementary Product Disclosure Statement) - post 31 January 2005 Growers

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 This document has changed over time. This is a consolidated version of the ruling which was published on *31 May 2006*



Product Ruling

Income tax: Tasmanian Truffle Project No. 2 (Second Supplementary Product Disclosure Statement) – post 31 January 2005 Growers

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Preamble

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

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

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

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax 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 'Tasmanian Truffle Project No. 2' 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 of the ITAA 1997;
 - section 17-5 of the ITAA 1997;
 - Division 27 of the ITAA 1997;
 - Division 35 of the ITAA 1997;
 - Division 40 of the ITAA 1997;
 - Division 328 of the ITAA 1997;
 - Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KZME of the ITAA 1936;
 - section 82KZMF of the 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. 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 who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (that is, being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling, 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;
- who elect to maintain their own Trufferie;
- whose 'Trees' are planted on or after 31 December 2005;
- who are accepted to participate in the project on or before 31 January 2005; or
- who are accepted to participate in the project on or after 16 June 2005.

Qualifications

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

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Date of effect

11. This Ruling applies prospectively from 8 September 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).

Note: The Addendum to this Ruling that issued on 31 May 2006, applies on and from 1 July 2005.

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 persons' involvement in the arrangement.

Arrangement

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

- Application for a Product Ruling dated 24 June 2004, as constituted by documents provided on 8 July 2004 and additional correspondence (including e-mails) dated 14, 20, 21, 24, and 26 March 2003, 3, 4, 14, 15, 16, 17, 22, 23, 24, 27, 28, and 29 April 2003, 2, 5, 6, 9, 10, 13, 14, 15, 18, 19, 20, and 22 May 2003, 15 July 2003, 5, 6, 14, 18, 25, 28, and 29 August 2003, 13 and 17 August 2004;
- **Product Disclosure Statement** (PDS) for the Tasmanian Truffle Project No. 2 issued by Managed Projects Australia Limited A.C.N. 101 887 638 ('Managed Projects', the 'Responsible Entity' and the 'Custodian') on 7 July 2003, received by the Tax Office on 6 August 2003;
- **Draft Supplementary Product Disclosure Statement** ('SPDS') for the issue of interests in: Tasmanian Truffle Project No. 2 ARSN 103 852 473, received by the Tax Office on 15 August 2003;
- **Draft Second Supplementary Product Disclosure Statement** ('2nd SPDS') for the issue of interests in: Tasmanian Truffle Project No. 2 ARSN 103 852 473, received by the Tax Office on 8 July 2004;
- **Constitution** establishing the Tasmanian Truffle Project No. 2 ('the Constitution'), dated 5 May 2003;
- **Trufferie Management Agreement** ('the Management Agreement') attached as Schedule 2 of the Constitution, to be entered into by each Grower and Managed Projects, dated 5 May 2003;
- Sub-contract Trufferie Management Agreement between Managed Projects and Tasmanian Truffle Enterprises Limited (the 'Contractor'), received by the Tax Office on 14 April 2003;
- Lease Agreement between Needlesdale Truffles Pty Ltd (the 'Landlord') and Managed Projects (the 'Tenant'), received by the Tax Office on 15 April 2003;
- Compliance Plan for Tasmanian Truffle Project No. 2 issued by Managed Projects A.C.N. 101 887 638 received by the Tax Office on 15 April 2003;
- Australian Financial Services Licence of Managed Projects Australia Limited dated 10 March 2003;

- **Licence Agreement** attached as Schedule 1 of the Constitution, to be entered into by each Grower and Managed Projects, dated 5 May 2003;
- Extension and Variation of Lease executed by Tasmanian Truffle Enterprises Limited dated 7 May 2003, received by the Tax Office on 14 May 2003;
- Transfer of Lease between Tasmanian Truffle Enterprises Limited A.C.N. 082 081 712 and Managed Projects Australia Limited dated 7 May 2003, received by the Tax Office on 14 May 2003; and
- Draft Deed of Assignment attached as Schedule 3 to the Constitution, received by the Tax Office on 15 April 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 Growers may 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. For the purposes of this Product Ruling, 'associate' has the meaning given by section 318 of the ITAA 1936.

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

Overview

17. The arrangement is called the Tasmanian Truffle Project No. 2 and is summarised as follows:

Location	Property situated at Tricketts Road, Deloraine, in northern Tasmania
Type of business to be carried on by each participant	Long term commercial cultivation of <i>Melanosporum sporum</i> ('Black Truffle' or 'Truffle') inoculated Oak and Hazelnut Trees for the purpose of harvesting Truffles for sale
Number of hectares under cultivation	Up to 38 hectares divided into 380 'Trufferies', with an option to accept oversubscriptions
Size of each 'Trufferie'	0.1 hectare (one 'Trufferie')
Minimum allocation per Grower	One 'Trufferie'

Number of 'Trees' per hectare	400 'Trees' per hectare
The term of the Project	Approximately 22 years, commencing on acceptance of the participant's application and ending 30 June 2027
Initial Cost per 'Trufferie'	\$2,783 'Initial Management Fee' and \$55 'Licence Fee' on application totalling \$2,838
Ongoing costs	Annual 'On-going Management Fees' of \$1,045 and 'Licence Fees' of \$55
Other costs	Harvesting and marketing fee

18. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The objective of the Project is to establish and manage long term commercial cultivation of 'Truffle' 'Inoculated' Oak and Hazelnut trees for the purpose of harvesting Truffles for sale. The Responsible Entity for the Project is Managed Projects Australia Limited ('Managed Projects').

19. The Project is located on Trickets Road, Deloraine in northern Tasmania being part of the land comprised in Folio 1 of the Register Volume 219540. The land is 79.3 hectares in size, 38 hectares of which has been allocated for the Project.

20. Participation in the Project is made by applying for one or more Trufferie(s), each of 0.1 hectares in size. Invitation to participate is made in the Product Disclosure Statement ('PDS') dated 9 July 2003, which is supplemented by the Supplementary Product Disclosure Statement ('SPDS') dated 2 February 2004 and the Second Supplementary Product Disclosure Statement ('SPDS2') dated 31 July 2004. The Project will be terminated on 30 June 2027, a period of approximately 22 years. A minimum of 40 inoculated 'Trees' will be grown on each 'Trufferie'. A maximum of 380 'Trufferies' are available for the project.

21. There is a right to accept over subscriptions, this may increase subject to demand and availability of suitable land.

22. Under the Project, an Applicant whose application is accepted will enter into a Licence Agreement and a Management Agreement with Managed Projects.

23. Under the Management Agreement, in return for the 'Initial Management Fee' and the 'On-going Management Fee' the Grower appoints the 'Manager' as an independent contractor to manage the Grower's 'Trufferie' by establishing and maintaining the 'Trufferies' and harvesting the Truffles.

24. Under the Licence Agreement, in return for the annual licence fee the Licensor grants the Grower a licence over their respective 'Trufferies' to use and occupy an identifiable 0.1 hectare of land

suitable for planting 'Truffle' 'Inoculated' Oak and Hazelnut trees for the purposes of cultivating, maintaining and harvesting Truffles.

25. When an Applicant becomes a Grower Managed Projects must enter in the Register of Growers all relevant details of the Grower and the land allocated to the Grower in the Grower's Licence.

26. Managed Projects has the right to accept or reject applications in whole or in part. For the purposes of this Product Ruling the relevant application period is on or after 1 February 2005 and on or before 15 June 2005.

Constitution

27. The Constitution sets out the terms and conditions under which Managed Projects agrees to act as Responsible Entity and 'Manager' of the Project. The Licence Agreement, Trufferie Management Agreement and Deed of Assignment are Schedules to the Constitution. These Agreements, other than the Deed of Assignment, will be executed on behalf of each Grower who has signed the Application and Power of Attorney Form in the PDS and who is accepted into the Project on or before 15 June 2005. After acceptance and execution of the Agreements, Growers are bound by the Constitution by virtue of their participation in the Project. A Grower may assign their interest in the Project by executing the Deed of Assignment.

28. Under clause 11.3, Managed Projects in its absolute discretion, may accept or refuse any application for an interest in the Project. Upon refusal Managed Projects must refund the application moneys to the applicant within 30 days. Under clause 12 all application moneys received shall be forwarded to the Custodian. Managed Projects must ensure that the Custodian deposits the Application Money into an account designated as the Applications Fund Account for Tasmanian Truffle Project No. 2.

29. Upon acceptance of an application, Managed Projects becomes contractually bound by the Trufferie Management Agreement and Licence Agreement to issue the interest to the applicant in accordance with clause 11.4.

30. Before invoicing the Project for the application moneys, Managed Projects must be satisfied, among other things, that the Licence Agreements and the Trufferie Management Agreements have become binding upon all parties to them.

31. Under clause 11.2 Managed Projects may accept applications by signing those parts of the application and its ancillary documents requiring its signature. Once 'Trufferies' are issued to applicants, the application will be endorsed, or a plan stapled to the original application form, and then kept in safe custody by the Custodian until the winding up of the scheme. Growers may receive a copy of the Constitution on payment of \$50.00 (clause 24.1).

32. Managed Projects is entitled to be paid for its services in managing the 'Trufferie' (clause 6). Among other things, the Constitution sets out in detail the following:

- if there is any inconsistency in the Agreements, the Constitution prevails (clause 13);
- a process for dealing with complaints (clause 4);
- the winding up of the Project (clause 5);
- the assignment of Grower's interest (clause 16);
- powers and duties of Managed Projects and the appointment of agents (clause 15);
- meetings of Growers (clause 17);
- default by Growers (clause 22); and
- retirement and removal of Managed Projects (clause 23).

Compliance Plan

33. As required by the *Corporations Act 2001*, Managed Projects has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that Managed Projects, as the Responsible Entity, complies with obligations and responsibilities under the *Corporations Act 2001* and the Constitution. The Compliance Plan is designed to protect the interests of the Growers.

Trufferie Management Agreement

34. The Trufferie Management Agreement ('Management Agreement') between Managed Projects (as the 'Manager') and each Grower commences to apply from the date of signing and continues until the termination of the Grower's interest or the termination or expiration of the Project on 30 June 2027. The Grower engages Managed Projects as an independent contractor to manage the licensed 'Trufferie'.

35. Growers that elect to maintain their own 'Trufferie' (clause 19) are outside the scope of this Product Ruling and the taxation consequences of their participation in the Project are not dealt with in this Ruling. Such a Grower may request a private ruling on the taxation consequences of their participation in the Project.

36. The 'Manager' will provide the initial management services. These services, set out in clause 4, involve the selection and overseeing the preparation of the Land for planting, and the management of the environment in which the inoculated 'Trees' have been planted. These include, among other things:

- selection and purchase of Oak and Hazelnut trees;

- inoculation of the 'Trees' using the certified inoculation process;
- testing of all 'Trees' for infection;
- certifying the 'Trees' as having been inoculated and infected with Black Truffle;
- the design and layout for the 'Trees' to be planted in the licensed land;
- management and care of the 'Trees' in the nursery prior to planting;
- overseeing the preparation of the licensed land;
- ensuring the landowner has applied initial quantities of herbicide, lime and fertiliser;
- once certified, hand planting the certified 'Trees';
- holding and nurturing the 'Trees' in a suitable nursery;
- maintaining drainage;
- eradicating or controlling pests and weeds;
- ensure installation of suitable irrigation system;
- maintaining the irrigation system;
- irrigating the 'Trees' in the licensed land or in the nursery;
- maintaining infrastructure; and
- general management.

37. Growers who are accepted into the Project on or after 1 February 2005 and on or before 15 June 2005 will have their initial management services completed by 30 June 2005 (clause 5) and their 'Trees' planted by 31 December 2005, (clause 8).

38. The 'Manager' will provide on-going management services which involve the ongoing tending and rearing of the seedlings (clause 6). The services also include, among other things:

- irrigating the 'Trees';
- maintaining the 'Trees';
- general maintenance (including weed and vermin control);
- maintenance of firebreaks, access roads and tracks;
- monitoring of soil and leaves of the 'Trees';
- application of herbicide, fungicide and fertiliser;
- provision of annual Grower 'Trufferie' progress reports;
- land degradation prevention;

- harvesting of Truffles;
- grading and processing of Truffles;
- marketing and sale of Truffles; and
- accounting to the Grower for the proceeds of the Truffles.

39. The Grower authorises the 'Manager' to decide when it is appropriate to ascertain, by use of its dogs or other animals, whether Truffles are growing on the tree roots, and if so to harvest those Truffles, and to make all the arrangements for harvesting, freighting and making the Truffles available for sale. The 'Manager' will pay for all costs of harvesting and marketing and will be reimbursed out of the proceeds for its disbursements.

40. In this Agreement, the Grower irrevocably and unconditionally appoints the 'Manager' as its sole agent to market and sell the Truffles cultivated on the Land in a proper and competent manner.

41. In consideration of the 'Manager' carrying out its duties under the Management Agreement, the Grower must pay the 'Manager' the fees set out in paragraph 57.

Sub-contract Trufferie Management Agreement

42. Under the Sub-contract Trufferie Management Agreement Managed Projects sub-contracts its duties under the Management Agreement to Tasmanian Truffle Enterprises Limited (as 'the Contractor').

Lease Agreement

43. A Lease Agreement is entered into between Needlesdale Truffles Pty Ltd ('the Landlord') and Managed Projects ('the Tenant') for the leased premises Trickets Road Deloraine, Tasmania. The term of the Lease is 24 years. Under the provisions of the Lease the Tenant may use the Land only as a 'Trufferie'. The Lease Agreement allows for the provision of management services for the purposes of maintaining each 'Trufferie'.

Licence Agreement

44. The Licence is granted (clause 2) by Managed Projects to Growers named and described in Schedule 1 of the Licence Agreement. Under the terms of the Licence, each Grower is granted a right to use and occupy an identifiable interest in an area of land (as identified under Schedule 2) consisting of a minimum of one Trufferie, of 0.1 hectare, for the purpose of planting, cultivating and nurturing the production of Black Truffles.

45. Under clause 3 Managed Projects agrees with the Grower that it:

- has leased the land;
- must ensure that the capital works for the establishment of the 'Trufferie' have been completed; and
- has identified the individual plots.

46. The Licence Agreement sets out the purpose for which the Grower may use the land (clause 2), the term of the Agreement being from the commencement date until 30 June 2027 or the termination of the Grower's interest in the Project (clause 5). This Agreement is subject to and conditional upon the Grower entering into the Management Agreement (clause 7).

47. The Grower may terminate the Licence Agreement if Managed Projects commits a breach of the Agreement, or by giving 4 months notice in the event of the whole or substantial part of the 'Trufferie' is destroyed (clause 5). Managed Projects may terminate the Agreement if the Grower fails or neglects to pay the licence fee (clause 5 and clause 8). If Managed Projects terminates the Licence Agreement it may also terminate the Management Agreement and the Grower will lose all rights and interests in the Project (clause 5). Further, the Licence Agreement terminates immediately if the Management Agreement is terminated for any reason (clause 5).

48. Each Grower must pay the licence fee set out in clause 8 of the Licence Agreement. Under the terms of the Licence Agreement (clause 10), among other things, the Grower must:

- use the 'Trufferie' only for the purpose of the project operations;
- comply with good horticultural and environmental practices;
- maintain the Trufferie;
- permit the landowner, employees, agents or contractors to enter the Trufferie;
- comply or procure compliance with the Management Agreement; and
- give occupiers of other 'Trufferies' the relevant rights as are necessary for access and enjoyment of their land.

49. Clause 11 sets out the circumstances under which Managed Projects and the Grower may assign their rights in the Project.

Power of attorney

50. To be accepted to participate in the Project, Growers must grant Managed Projects an irrevocable power of attorney for the term of the project. This allows Managed Projects to enter into any

agreement for the purposes of Truffle processing and sale. Managed Projects as attorney may, where required, stamp and register this instrument at the cost of the Applicant.

Harvesting and sale

51. Harvesting fees will be deducted from the sale of 'Truffles'. The first commercial 'Truffle' harvest is expected in the year ended 30 June 2012.

52. The 'Manager' must arrange for the harvest of the 'Truffles' from the 'Truffle' 'Inoculated' Oak and Hazelnut trees and make all arrangements for the harvesting, processing, grading, freighting and sale of the Truffles (clause 9 (a) of the Management Agreement).

53. Under clause 9 (b) of the Management Agreement the Grower authorises the 'Manager' to pool Truffles harvested from the 'Trufferie' with Truffles harvested from all other 'Trufferies' in the Project that were planted at the same time and which have contributed Truffles to the relevant pool. The net proceeds from the sale of Truffles will be divided equally among those Growers in accordance with number of 'Trufferies' that were planted at the same time and the provisions of the Licence Agreement. Where the produce from a Grower's 'Trufferie' is of sufficiently reduced quality or quantity, that Grower's share of the pooled sale proceeds may be reduced.

54. The Grower must reimburse to the 'Manager' the reasonable costs incurred by the 'Manager' in the use of its dogs or other animals in the 'Trufferie' for harvesting purposes (clause 16 of the Management Agreement). Such costs include, but are not limited to, food, board and transport.

55. Under clause 17 the remuneration of Managed Projects will include the entitlement to a portion of the 'Truffles' where minimum levels of production are reached from each stage of planting.

56. The net proceeds from the sale of Truffles will be recorded separately and the 'Manager' will apply the net proceeds from the sale to on-going management fees and licence fees.

Fees

57. Pursuant to clause 8 of the Licence Agreement and clauses 15 and 16 of the Management Agreement, a Grower will make the following payments per Trufferie:

- the 'Initial Management Fee' of \$2,783;
- an initial licence fee of \$55, payable on application;
- an 'On-going Management Fee' of \$1,045, payable on 1 July 2005;

- an 'On-going Management Fee' of \$1,045, payable on 1 July in all subsequent years, indexed according to CPI; and
- a licence fee of \$55, payable on 31 October in all subsequent years, indexed according to CPI.

Timing of management services

58. The initial management services shown in the Management Agreement will be commenced by the 'Manager' after the Grower is accepted into the Project and will continue until 30 June 2005.

59. The on-going management services shown in the Management Agreement commence 1 July 2005. The planting of 'Trees' is to be completed by 31 December 2005. The first on-going management service period will continue until 30 June 2006. The on-going management services fee will be for services provided from 1 July to 30 June (one financial year) for each subsequent period.

Finance

60. Growers can fund their investment in the Project themselves or borrow from an independent lender. Managed Projects and its associates will not offer finance to Growers or introduce Growers to a 'preferred financier'.

61. Regardless of the source of loan funds, this Ruling will not apply to Growers if the 'Manager' accepts their Application subject to finance approval by a lending institution and the full amount payable at the time of Application, including any loan funds, is not paid to the 'Manager' by 30 June 2005.

62. 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

63. This Ruling applies only to Growers who are accepted to participate in the Project and who have executed a Trufferie Management Agreement and Licence Agreement on or after 1 February 2005 and on or before 15 June 2005.

64. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

65. This Ruling does **not** apply to Growers who:

- are accepted to participate in the Project on or before 31 January 2005 or on or after 16 June 2005;
- have their 'Trees' planted on or after 31 December 2005; or
- make an election under clause 19 of the Management Agreement.

The Simplified Tax System ('STS')

Division 328

66. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. Changes to the STS rules apply from 1 July 2005. From that date, STS taxpayers may use the accruals accounting method. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different under the STS where the Grower uses the cash accounting method.

Qualification

67. 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.

Assessable income

Section 6-5 and section 328-105

68. 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.

69. Other than Growers referred to in paragraph 70, a Grower recognises ordinary income from carrying on the business of growing Truffles at the time that income is derived.

70. A Grower who is an 'STS taxpayer' (for the 2004-05 income year) or an 'STS taxpayer' continuing to use the cash accounting method (for 2005-06 and later income years) will be assessable on ordinary income from the carrying on the business of growing Truffles at the time that income is received.

Deductions for the Initial Management fee, On-going Management Fee and Licence Fee

Section 8-1

71. A Grower who is accepted into the Project on or after 1 February 2005 and on or before 15 June 2005 may claim, on a per 'Trufferie' basis, tax deductions for the following revenue expenses:

Fee Type	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Initial Management Fee	\$2,124 – See Notes (i), (ii) & (iii)		
On-going Management Fee		\$1,045 – See Notes (i), (iv) & (v)	\$1,045 indexed – See Notes (i), (iv) & (v)
Licence Fee	\$55 – See Notes (i), (iv) & (v)	\$55 – indexed See Notes (i), (iv) & (v)	\$55 indexed – See Notes (i), (iv) & (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 (for example input tax credits): Division 27. See example at paragraph 111.
- (ii) For the 2004-05 income year, only the 'Licence Fee' and that part of the 'Initial Management Fee' shown in the Table above is deductible in full in the year that it is incurred (where the Grower is not an 'STS taxpayer') or the year in which it is paid (where the Grower is an 'STS taxpayer').
 - (iii) Part of the 'Initial Management Fee' is of a capital nature. An amount totalling \$52 cannot be claimed as a deduction (see paragraph 72) and a further amount totalling \$607 is capital expenditure for the establishment of horticultural plants (paragraph 73 sets out the timing of deductions for this amount).
 - (iv) For the 2005-06 income year and later years, where a Grower pays the 'Ongoing Management Fee' and the 'Licence Fee' in the relevant income years show in the 'Management Agreement' and the 'Licence Agreement' those fees are deductible in full in the year that they are incurred where the Grower is not an 'STS taxpayer' or, is an 'STS taxpayer' using the accruals accounting method.

For the 2005-06 income year and later years, where a Grower pays the 'Ongoing Management Fee' and the 'Licence Fee' in the relevant income years show in the 'Management Agreement' and the 'Licence Agreement' those fees are deductible in full in the year that they are paid where the Grower is an 'STS taxpayer' using the cash accounting method.
 - (v) This Ruling does not apply to Growers who choose to prepay the 'Licence Fees' or 'Ongoing Management Fees'. 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 section 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.

Non-deductible capital expenditure

72. Certain amounts that form part of the 'Initial Management Fee' payable by Growers is paid for services performed by the 'Manager' before the Grower is accepted into the Project. These amounts, totalling \$52 per Trufferie, do not constitute allowable deductions under section 8-1 or Division 40.

Deductions for horticultural plant***Subdivision 40-F***

73. Subject to paragraph 75, Growers will be entitled to tax deductions for that part of the 'Initial Management Fee' which relates to the establishment of the 'Inoculated' Oak and Hazelnut trees. The amount and timing of these deductions is determined under Subdivision 40-F.

74. 'Truffle' 'Inoculated' Oak and Hazelnut Trees are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a Licence Agreement, one of the conditions of subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the 'Truffle' 'Inoculated' Oak and Hazelnut Trees is determined using the formula in section 40-545 and is based on the capital expenditure of \$607 incurred by the Grower that is attributable to their establishment. If the 'Truffle' 'Inoculated' Oak and Hazelnut Trees have an 'effective life' of greater than 30 years for the purposes of section 40-545, then the result is a straight-line write off at a rate of 7%. This results in an allowable deduction of \$42.50 per annum from the time when the 'Truffle' 'Inoculated' Oak and Hazelnut Trees enter their first commercial season (subsection 40-530(2)). The 'Manager' will inform Growers of when the 'Truffle' 'Inoculated' Oak and Hazelnut Trees enter their first commercial season but this is not expected to occur before 2012.

75. 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 (for example input tax credits): Division 27. See example at paragraph 111.

Interest deductibility

76. 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.

77. Growers who borrow funds should note that if they prepay interest for a period that extends beyond the income year in which the interest is incurred the amount of interest allowable as a deduction may be determined under the prepayment rules (see paragraph 98). Subject to the 'excluded expenditure' exception, the prepayment rules apply whether a 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***

78. An individual Grower who has not made an election under clause 19 of the Management Agreement and who is accepted into the

Project on or after 1 February 2005 and on or before 15 June 2005 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending **30 June 2005 to 30 June 2012**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

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

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

- expenditure by a 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 Grower carrying on a business?

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

81. Where there is a business, or a future business, the gross proceeds from the sale of the truffles 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.

82. For schemes such as that of the Tasmanian Truffle 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

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

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

- the Grower has an identifiable rights over the land (by licence) on which the Grower's 'Truffle' 'Inoculated' Oak and Hazelnut trees are established;
- the Grower has a right to harvest and sell the Truffles each year from those 'Trees';
- the Truffle cultivation activities are carried out on the Grower's behalf;
- the Truffle cultivation activities of the Grower are typical of those associated with a Truffle cultivation business; and
- the weight and influence of general indicators point to the carrying on of a business.

84. In this Project, each Grower enters into a Management Agreement and a Licence Agreement.

85. Under the Licence Agreement each individual Grower will have rights over a specific and identifiable area of land. The Licence Agreement provides the Grower with an ongoing interest in the specific 'Inoculated' Oak and Hazelnut trees on the licensed area for the term of the Project. Under the Licence Agreement the Grower must use the land in question for the purpose of carrying out Truffle cultivation and for no other purpose. The Licence Agreement allows the 'Manager' to come onto the land to carry out its obligations under the Management Agreement.

86. Under the Management Agreement the 'Manager' is engaged by the Grower to establish and maintain a 'Trufferie' on the Grower's identifiable area of land during the term of the Project. The 'Manager' has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the 'Trufferie' on the Grower's behalf.

87. In establishing the Trufferie, the Grower engages the 'Manager' to acquire and plant 'Truffle' 'Inoculated' Oak and Hazelnut trees on the Grower's 'Trufferie'. During the term of the Project, these assets will be used wholly to carry out the Grower's Truffle growing activities. The 'Manager' is also engaged to harvest and sell, on the Grower's behalf, the Truffles grown on the Grower's 'Trufferie'.

88. 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.

89. 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 Truffles that will return a

before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

90. The pooling of Truffles grown on the Grower's 'Trufferie' with the Truffles of other Growers is consistent with general Truffle cultivation practices. Each Grower's proportionate share of the sale proceeds of the pooled Truffles will reflect the proportion of the Truffles contributed from their 'Trufferie'.

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

92. The Grower's degree of control over the 'Manager' as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the 'Manager' will provide the Grower with regular progress reports on the Grower's 'Trufferie' 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.

93. The Truffle 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 Grower's Truffle growing activities in the Tasmanian Truffle Project No. 2 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

94. 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.

95. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of management fees and licence fees

Section 8-1

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

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

97. The management fees and licence fees associated with the Truffle growing activities will relate to the gaining of income from the Grower's business of Truffle growing (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of Truffles) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purposes in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. That part of the 'Initial Management Fee' that is of a capital nature has been apportioned and separately dealt with. The remaining part of the 'Initial Management Fee', the 'On-going Management Fee' and the 'Licence Fee' is of a revenue nature. In respect of these amounts the tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply to these amounts.

Prepayment provisions

Sections 82KZL to 82KZMF

98. 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 (for example 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

99. For Growers who enter the Project on or after 1 February 2005 and on or before 15 June 2005, an 'Initial Management Fee' of \$2,783, deductible to the extent of \$2,124, and initial licence fee of \$55 per

'Trufferie' will be incurred on execution of the 'Trufferie' Management Agreement and the Licence Agreement. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of on-going management services and a licence over the land until 30 June in those years.

100. In particular, the management fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the 'Initial Management Fee' has been inflated to result in reduced fees being payable for on-going management fees in subsequent years.

101. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the 'Initial Management Fee', and the fees for subsequent years, is for the 'Manager' doing 'things' that are not to be wholly done within the expenditure year. Under the Licence Agreement, licence fees are payable annually in advance for the licence of the land during the expenditure year.

102. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 57, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

Expenditure of a capital nature

Division 40

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.

104. In this Project, some expenditure incurred by Growers for the 'Initial Management Fee' is for services provided before the Grower is accepted to participate in the Project. This capital expenditure is non-deductible (see paragraph 72). Other expenditure included as part of the 'Initial Management Fee' is attributable to establishment of the inoculated Oak and Hazelnut trees is also of a capital nature. This expenditure falls for consideration under Subdivision 40-F of the ITAA 1997 (see paragraph 73).

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

105. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2005 to 30 June 2012** the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 *Income tax: Division 35 – non-commercial business losses*. Accordingly, based on the evidence supplied, the

Commissioner has determined that for those income years ended 30 June 2005 up to and including 30 June 2012:

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

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

Losses and outgoings incurred under certain tax avoidance schemes

Section 82KL – recouped expenditure

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

Schemes to reduce income tax

Part IVA – general tax avoidance provisions

108. 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).

109. The Tasmanian Truffle 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 paragraph 71 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.

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

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

Example

Entitlement to GST input tax credits

111. 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:

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

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 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).

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Previous draft:

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Related Rulings/Determinations:

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

Subject References:

- carrying on a business
- commencement of business
- fee expenses
- horticulture
- irrigation expenses
- management fees expenses
- primary production
- primary production expenses
- primary production income
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- tax administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative References:

- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)

- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Div 40
- ITAA 1997 Subdiv 40-F
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(2)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530(2)
- ITAA 1997 40-535
- ITAA 1997 40-545
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZMF
- ITAA 1936 Part IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
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Case References:

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

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