



PR 2005/17 - Income tax: Environinvest Beef Cattle Project 2005 - 2005 Graziers (to 15 June 2005)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *16 February 2005*



Product Ruling

Income tax: Environinvest Beef Cattle Project 2005 – 2005 Graziers (to 15 June 2005)

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

Preamble

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

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 relates. In this Ruling this arrangement is sometimes referred to as the 'Environinvest Beef Cattle Project 2005' 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;
- section 25-25 of the ITAA 1997;
- Division 27 of the ITAA 1997;
- Division 35 of the ITAA 1997;
- Division 70 of the ITAA 1997;
- Division 328 of the ITAA 1997;
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZME of the ITAA 1936;
- section 82KZMF of the ITAA 1936; and
- Part IVA of the ITAA 1936.

Goods and Services Tax

3. All fees and expenditure referred to in this Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a 'Grazier') 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 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 as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Graziers'.

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 finance their participation in the Project through loans with Environinvest Finance Pty Ltd other than those described at paragraphs 65 to 72 of this Product Ruling;
- persons who are accepted to participate in the Project during the period on or after 16 June 2005 and on or before 30 June 2005;
- persons who are accepted to participate in the Project during the period on or after 1 July 2005 and on or before 30 September 2005, being 2006 Graziers to whom Product Ruling PR 2005/18 applies;
- persons who are accepted to participate in the Project during the period on or after 1 October 2005; and
- persons who participate in the Project through offers made other than through the Product Disclosure Statement.

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 16 February 2005, 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 2007. The Ruling continues to apply, in respect of the tax law 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:

- Draft Product Disclosure Statement (PDS), for the Environinvest Beef Cattle Project 2005, prepared and issued by Environinvest Ltd A.B.N. 81 080 743 791 (Environinvest), received 20 December 2004;
- Draft 2005 Multi-invest **Application and Power of Attorney Form**, received 1 February 2005;
- Draft **Constitution** of the Environinvest Beef Cattle Project 2005 made by Environinvest (Responsible Entity), received 6 December 2004;
- Draft **Management Agreement** between Environinvest (the Manager) and the Grazier, received 2 December 2004;
- Draft **Cattle Lease Agreement** between Environinvest (the Lessor) and the Grazier, received 2 December 2004;
- Draft **Agistment Agreement** between Environinvest (the Licensor) and each Grazier, received 2 December 2004;
- Draft Environinvest Finance Pty Ltd Loan Agreement (the Loan Agreement) received 8 February 2005;
- Draft Compliance Plan for the Environinvest Beef Cattle Project 2005, undated;
- Draft Operations Management Agreement between Environinvest and the Operations Manager, undated;
- Draft Herd Lease Agreement between Cattle Owner and Environinvest, undated;
- Draft Head Lease Agreement between Land Owner and Environinvest, undated;
- Application for Product Ruling dated 8 October 2004 as constituted by documents received on 25 October 2004, 1 November 2004, 11 November 2004, 2 December 2004, 6 December 2004, 10 December 2004, 14 December 2004, 20 December 2004, 4 January 2005, 5 January 2005, 6 January 2005, 7 January 2005, 11 January 2005, 1 February 2005, 7 February 2005 and 8 February 2005.

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 Graziers enter into or become a party to. The Loan Agreement will be executed where a Grazier successfully applies for finance from Environinvest Finance Pty Ltd. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grazier, or any associate of a Grazier, will be a party to, which are part of the arrangements to which this Ruling applies. 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. It should be noted that the term Grazier as used in this Ruling means each several person who becomes a party to these documents as a result of the allotment of 'Droves' pursuant to an Application in the PDS. For the purposes of this Ruling, Graziers whose applications are accepted, whose 'Project Documents' are executed and to whom 'Droves' are allocated during the period on or before 15 June 2005 will become 2005 Graziers.

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

Overview

18. The salient features of the Project are as follows:

Location	Properties situated in northern and southern Australia such as Queensland, Northern Territory, New South Wales, Victoria and South Australia
Type of business each participant will be carrying on	Medium term commercial leasing, breeding, grazing and sale of beef cattle for profit
The term of the Project	7 years
Size of each 'Drove'	4 cows or heifer
Minimum allocation per Grazier	12 'Droves'
Minimum subscription for the Project	24 'Droves'
Initial Cost	\$1,980 per 'Drove'
Other costs to Graziers	Various ongoing fees and expenses are payable (see paragraphs 53 to 63).

19. The Project will be registered as a managed investment scheme under the *Corporations Act 2001*.

20. The offer to participate in the Project must be made through an application form. There is a minimum subscription of 24 'Droves' that must be achieved before the Project can proceed. The minimum allocation of 'Droves' to each Grazier is 12 'Droves'.

21. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints Environinvest to enter into, on behalf of the Grazier, a 'Cattle Lease Agreement', 'Agistment Agreement', 'Management Agreement' (Project Agreements) and any other documents required to hold an interest in the Project.

Constitution

22. The Constitution establishes the Project and operates as a deed binding all Graziers and Environinvest. The Constitution sets out the terms and conditions under which Environinvest agrees to act as Responsible Entity and thereby manage the Project. Upon acceptance into the Project Graziers are bound by the Constitution by virtue of their participation in the Project.

23. Under clause 7.4 of the Constitution, Environinvest holds the 'Application Money' on bare trust. Environinvest will deposit all 'Application Moneys' received from applicants in a 'Project Account'. Once Environinvest has accepted the application and all of the 'Project Documents' have been executed and remain in force (clause 5.1) the 'Application Money' may be transferred and applied against the fees due to Environinvest (clause 8).

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

- the irrevocable appointment of Environinvest as the Grazier's agent, representative and attorney (clause 3);
- the holding of interests in the Project (clause 5);
- procedures relating to 'Applications' (clause 7);
- the issue of interests in the Project and the transfer of 'Application Money' paid by an applicant from the 'Project Account' to the Responsible Entity (clause 8);
- completion and execution of 'Project Documents' prior to or upon acceptance of an application by the Responsible Entity (clause 9);
- the issue of a numbered 'Certificate' (clause 10);
- the Responsible Entity's powers in relation to investments and borrowings (clause 12);
- the Responsible Entity's powers and duties relating to the management of the Project (clause 14);

- the keeping and maintenance of a register of Graziers who hold an interest in the Project (clause 15);
- the appointment of agents to perform tasks (clause 16);
- the right of the Responsible Entity to be paid fees and other expenses and the duty to make payments in respect of the Project from its own assets in respect to certain expenses (clause 17);
- the keeping of a 'Project Account' for the holding of proceeds and any other amounts held by the Responsible Entity on behalf of the Graziers and the manner in which the proceeds are to be distributed (clause 18);
- resolution of complaints made by the Grazier in relation to the Responsible Entity's management of the Project (clause 19);
- the liabilities and indemnities of the Responsible Entity (clause 20) and the Graziers (clause 21);
- the assignment of a Grazier's interest in the Project (clause 22);
- transmission of a Grazier's interest in the Project as a consequence of the death, bankruptcy or mental incapacity of a Grazier (clause 23);
- the retirement and removal of the Responsible Entity (clause 24); and
- termination of the Project (clause 30) and the winding up of the Project (clause 31).

Acceptance of Applications

25. The Grazier's participation in the Project commences on the date the Grazier's 'Project Documents' are executed and 'Droves' are allocated to the Grazier. The 'Project Documents' may be executed upon acceptance of a Grazier's application for 'Droves'. The 'Project Documents' commence on the day that the conditions in clause 8 of the Constitution are met. Under clause 8, the Responsible Entity will accept an applicant and an applicant will be issued an interest in the Project and become a Grazier where, amongst other things, the following conditions are satisfied:

- the applicant has paid the full amount of 'Application Money' as specified in the PDS upon application for 'Droves';
- the Responsible Entity has accepted the applicant's application;

- minimum subscription of 24 'Droves' for the Project is reached;
- the Responsible Entity is ready, willing and able to commence performing its duties pursuant to the 'Project Documents'; and
- the Compliance Officer of the Project has not notified the directors of the Responsible Entity that there is an outstanding material breach of any of the provisions of the Constitution or the *Corporations Act 2001* which is detrimental to the interests of the Applicants.

26. The Responsible Entity may accept applications made under the PDS during the 'Application Period' being the period from 1 October 2004 to 30 September 2005. **However, this Ruling only applies to Graziers who are accepted to participate in the Project during the period commencing from 16 February 2005 to 15 June 2005 (2005 Graziers).**

Compliance Plan

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

Cattle Lease Agreement

28. The Cattle Lease Agreement is entered into between Environinvest, as the Lessor, and the Grazier. The Agreement sets out the roles and obligations of the parties to the Agreement. Under the terms of the Agreement the Grazier will lease the 'Stock', being a minimum of 12 'Droves'. Each 'Drove' consisting of a 4 cow or heifer ('Female') sub-unit, together with any replacements or additional cows or heifers that may be leased from time to time. Each cow or heifer contained in each 'Drove' leased by the Grazier will be identified via a 'Stock Identifier'. The details of each 'Female' contained in each 'Drove' leased to the Grazier will be set out in the Annexure to the Cattle Lease Agreement.

29. The Lessor owns or holds a leasehold interest in the 'Stock'. Graziers participating in the Project are granted an interest in 'Stock' by the Lessor in the form of a lease to use their 'Stock' for the purpose of breeding and to establish the Grazier's 'Herd' to carry on the business of leasing, breeding, grazing and the sale of beef cattle for profit.

30. On the 'Signing Date', being the date on which the Grazier's application for an interest in the Project is accepted and the Cattle Lease Agreement is executed, the Lessor agrees to Lease the 'Stock' to the Grazier on and from the 'Commencement Date'. The Agreement is terminated pursuant to the provisions of the Agreement (clause 13) or on 30 June of the fifth 'Subsequent Year'.

31. Each Grazier must pay a Cattle Lease Fee to the Lessor being an amount as specified in clause 4 and item 5 of the Schedule to the Cattle Lease Agreement. On or before the end of the fourth 'Subsequent Year', 50% of the 'Stock' will be returned to the Lessor and removed from the Lease. The Manager has the discretion to select the retiring 'Stock'. Under the Agreement, the Grazier and the Lessor may agree to lease additional 'Stock' or lease 'Stock' for additional periods under the terms and conditions of the Agreement.

32. Under the terms of the Cattle Lease Agreement, among other things, the Grazier agrees:

- to maintain the 'Stock' and, upon termination or expiry of the Lease, return the 'Stock' to the Lessor;
- that the Grazier is responsible for all costs and expenses of the delivery, maintenance and return of the 'Stock';
- to use the Grazier's best endeavours to ensure that the 'Herd' remains free from any illness, disease or parasite;
- to use the Grazier's best endeavours to ensure at all times that the 'Stock' receives all necessary pasture, feeding and supplementary feeding and water supplies to maintain 'Stock' in good condition and health in accordance with accepted animal husbandry practices for the beef cattle industry; and
- not to encumber or in any way deal with the Lessor's interest in the 'Stock' except with the prior written consent of the Lessor.

33. Under the terms of the Cattle Lease Agreement the Lessor agrees, amongst other things:

- to deliver to the Grazier such reasonable breeding information and records of the 'Stock' as requested in a 'Notice' issued by the Grazier;
- that at the 'Commencement Date' the 'Stock' will be pregnancy tested and found to be in calf; and
- prior to the commencement of the next calving season, replace any of the 'Stock' which die or are in the Manager's opinion unsuitable for breeding, with 'Stock' which have been pregnancy tested and found to be in calf.

34. Under clause 6.2 of the Cattle Lease Agreement, the Lessor acknowledges and agrees that the Grazier will lease the 'Stock' for the purpose of producing 'Progeny' that will be used in the Grazier's business of cattle breeding and production. The Grazier is the absolute owner of all the 'Progeny'. The leased 'Stock' will remain the property of the Lessor.

Agistment Agreement

35. The PDS provides that Environinvest will either own, lease or sub-lease the 'Land' on which the Project will be conducted.

36. Graziers entering into the Project will enter into an Agistment Agreement with Environinvest as the Licensor. Each Grazier will be granted a non exclusive licence to occupy the 'Land' for a period commencing on the 'Commencement Date'. The Agistment Agreement will terminate on 30 June of the seventh 'Subsequent Year, or subject to earlier termination pursuant to clause 13 of the Agistment Agreement or such later date as the Manager's obligations under the Management Agreement come to an end.

37. Items 5 and 6 of the Schedule to the Agistment Agreement provide the particulars of the 'Land' where the Project will be conducted. The 'Land' will comprise of the 'Initial Land' and 'Further Land'.

38. The Agistment Agreement sets out the roles and obligations of the parties to the Agreement. Under the terms of the Agistment Agreement the Grazier will occupy and use the 'Land' to agist and graze the cows or heifers leased by the Grazier from the Lessor and the Grazier's Progeny (the Herd) on the Land for the term of the Agreement.

39. Each Grazier must pay an Agistment Fee to the Licensor being an amount as specified in clause 3 of the Agistment Agreement and item 4 of the Schedule to the Agistment Agreement.

Management Agreement

40. The Management Agreement is entered into between Environinvest, as the Manager, and the Grazier. Under the Management Agreement the Grazier appoints the Manager as an independent contractor to oversee and manage the Grazier's 'Business' of leasing, breeding, grazing and selling beef cattle for profit.

41. The Agreement commences on the date the Grazier's application for an interest in the Project is accepted and the Management Agreement is executed. The Agreement is terminated pursuant to the provisions of the Agreement on 30 June of the seventh Subsequent Year or at such time as determined under the Project Agreements (clauses 4 and 21).

42. The Management Agreement provides that each Grazier appoints the Manager to perform 'Application Services' which include the selection of 'Land' and if necessary, some or all of the 'Breeding Management Services', 'Stock Management Services' and 'Identification Services'.

43. The Manager will also provide the 'Services' which are defined to mean 'Administration Services', 'Breeding Management Services', 'Feedlot Management Services', 'Identification Services', 'Land Management Services', 'Sales Management Services' and 'Stock Management Services'. These services will be provided as soon as reasonably practicable from the completion of the 'Application Services' and in each 'Subsequent Year' during the term of the Management Agreement.

44. Under clause 10.1 of the Management Agreement, the Manager is authorised to sub-contract any of the services it has agreed to perform under the Agreement. The Manager may, as part of providing the 'Feedlot Management Services', appoint a 'Feedlot Manager' to manage the 'Feedlot' and provide 'Feedlot Services'.

45. The Manager will not undertake any work on behalf of a Grazier prior to the Grazier being issued an interest in the Project.

Pooling of 'Progeny' and 'Grazier's Entitlement' to 'Net Sales Proceeds'

46. The Management Agreement (clause 5) sets out provisions relating to the 'Grazier's Entitlement' to 'Net Sales Proceeds'. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Graziers who have contributed 'Progeny' to the sales pool in a 'Subsequent Year' are entitled to benefit from distributions from those 'Net Sales Proceeds'; and
- any pooled 'Progeny' must consist only of 'Progeny', contributed by Graziers of the same Project 'Class'.

47. Under the Management Agreement the Grazier agrees to participate in the sales pool at the point of sale of the 'Progeny'.

48. During the term of the Project steers, cows and heifers, which, in the opinion of the Manager, are unsuitable for breeding, will be contributed to the sales pool. The Manager will provide the 'Sale Management Services' in respect to the Grazier's 'Progeny' together with all 'Progeny' of other Graziers that contribute to the sales pool in each 'Subsequent Year'. The Grazier's 'Progeny' will be contributed to the sales pool during the term of the Project.

49. The 'Grazier's Entitlement' to the 'Net Sales Proceeds' from the sale of the 'Progeny' contributed to the sales pool will be determined as follows:

Grazier's Entitlement = the amount of Net Sales Proceeds × Grazier's Interest

50. The 'Net Sales Proceeds' are the 'Sales Proceeds', being the gross proceeds from the sale of all or part of the 'Progeny' and the sale of progeny of the other Graziers of the 'Class', less the costs and expenses of sale reimbursed to the Manager. The Manager will deduct from 'Sales Proceeds' the costs incurred in transporting the 'Herd' for the purpose of sale and all other reasonable expenses incurred in the sales process which include advertising and marketing expenses and fees charged by sale agents. The Manager will deduct from 'Net Sales Proceeds' any 'Feedlot Expenses' and 'Transportation Expenses' payable, the 'Feedlot Management Fee', the 'Sales Management Fee', the 'Performance Bonus Fee' and any other amount payable by the Grazier under the 'Project Documents'.

51. The 'Grazier's Interest' is the number of 'Droves' leased by the Grazier as a proportion of the number of 'Droves' leased by Graziers of the same 'Class' as determined in accordance with the Management Agreement. Graziers who do not contribute to a sales pool in a 'Subsequent Year' will not be included in the calculation of 'Grazier's Interest'.

52. If any of the 'Progeny' are destroyed or damaged and the Grazier or another Grazier receives insurance proceeds from an insurance claim made under an insurance policy taken out under clause 13 of the Management Agreement in respect of the 'Progeny', the 'Grazier's Interest' shall be adjusted to reflect the changed composition of the Total Herd. Where a Grazier receives insurance proceeds, the calculation of 'Grazier's Interest' will be adjusted to reflect the reduction of the Total Herd.

Project Fees

53. Under the terms of the Management Agreement, the Cattle Lease Agreement and the Agistment Agreement, a Grazier will make payments per 'Drove' as described below.

54. In consideration of the 'Application Services' to be provided by the Manager, a Grazier will pay an **Initial Management Fee** of \$1,980. This amount must be paid in full on application. These services will be completed as soon as reasonably practicable after the 'Commencement Date' but no later than 30 June 2005 (Application Year).

55. On 30 June of each 'Subsequent Year' following the Application Year, ongoing **Management Fees** are payable in arrears to the Manager for performing the 'Administration Services', 'Breeding Management Services', 'Land Management Services' and 'Stock Management Services' during the continuation of the Management Agreement. The fees will be calculated under a formula set out in the Management Agreement.

56. On or before 30 June of each 'Subsequent Year' following the Application Year, a **Cattle Lease Fee** is payable in arrears during the continuation of the Cattle Lease Agreement. The Cattle Lease Fee is payable to the Manager on the Lessor's behalf. The fees will be calculated in accordance with a formula set out in the Cattle Lease Agreement.

57. On or before 30 June of each 'Subsequent Year' following the Application Year, ongoing **Agistment Fees** are payable in arrears to the Manager on the Licensor's behalf for the agistment of the Grazier's 'Herd' during the continuation of the Agistment Agreement. The fees will be calculated under a formula set out in the Agistment Agreement.

58. **Out of Pocket Expenses**, if any, are payable by the Grazier to the Manager. The Manager shall notify the Grazier of any 'Out of Pocket Expenses' incurred or to be incurred by the Manager. The 'Out of Pocket Expenses' will be due and payable to the Manager within 15 days of the date of a 'Notice' outlining the Grazier's share of any Out of Pocket Expenses.

59. **Feedlot Expenses** are payable to the Manager for the expenses charged by the 'Feedlot Manager' during the continuation of the Management Agreement. The fees will be calculated under a formula set out in the Management Agreement.

60. **Transportation Expenses** are payable to the Manager in respect to the cost incurred by the Manager in transporting all or part of the 'Herd' to the 'Feedlot'. The fees will be calculated under a formula set out in the Management Agreement.

61. **Feedlot Management Fees** are payable to the Manager for the provision of 'Feedlot Management Services' during the continuation of the Management Agreement. The fees will be calculated under a formula set out in the Management Agreement.

62. **Sales Management Fees** are payable by the Grazier to the Manager from the 'Net Sale Proceeds' for the provision of the 'Sales Management Services'. The 'Sales Management Fee' is an amount of 4.5% of the 'Grazier's Entitlement' to the 'Net Sale Proceeds'.

63. **Performance Bonus Fees** are payable by the Grazier to the Manager where the average price per animal net of sales costs and 'Feedlot Expenses' is greater than the 'Benchmark Price'. The 'Performance Bonus Fee' is an amount of 15% of the excess of the weighted average net price per animal over the weighted average 'Benchmark Price'.

Finance

64. Graziers can fund their involvement in the Project by borrowing from independent sources or from Environinvest Finance Pty Ltd (the Lender).

65. The Lender will provide Graziers with loans on a full recourse basis and will pursue legal action against any defaulting borrowers. Details of the types of loan that will be offered to Graziers by the Lender are set out in the Loan Agreement. The types of loans to which this Ruling will apply are as follows:

- (i) a **Principal Only Loan** with the following features:
 - the principal is repayable in 12 equal monthly instalments, in arrears;
 - a loan establishment fee of no more than \$100 is payable; and
 - security by fixed charge over the Grazier's interest in the Project;
- (ii) a **Principal and Interest Loan** with a term up to 7 years; and
- (iii) an 'Interest Only Loan' with a maximum term of 6 years
This Ruling does not apply if the term of the 'Interest Only Loan' is more than 6 years or the repayment of the principal under such a loan is deferred or substantially deferred until the termination of Project or repayment is linked to the timing of the derivation of income in the final year of the Project.

66. The 'Principal and Interest Loan' and the 'Interest Only Loan' (interest bearing loans) have the following features:

- the rate of interest per annum of not more than 10% above the prevailing cash rate or swap rate;
- a loan establishment fee of no more than \$100 is payable; and
- security by fixed charge over the Grazier's interest in the Project.

67. The Loan Agreement provides that if the loan type is 'Principal and Interest Loan', the principal and interest can either be paid in equal monthly instalments in arrears or, at the request of the Grazier, annually in advance (clause 4.2).

68. In respect of the 'Interest Only Loan', the Loan Agreement provides that the interest must be paid annually in advance. However, a Grazier can request that the interest be paid monthly in arrears (clause 4.1).

69. The Loan Agreement provides that if certain conditions under clause 4.4 are met a Grazier may, at anytime, be required to repay any or all of the borrowed funds.

70. Loans other than those described above are not covered by this Product Ruling.

71. Furthermore, 2005 Graziers cannot rely on any part of this Product Ruling if 'Application Money' otherwise remains unpaid as at 15 June 2005. Where an application is accepted subject to finance approval by **any** lending institution, 2005 Graziers cannot rely on any part of this Ruling if written evidence of that approval has not been given to the Responsible Entity by 15 June 2005.

72. This Ruling does not apply if the finance arrangement entered into by the Grazier with the Lender 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 Environinvest Finance Pty Ltd, are involved or become involved in the provision of finance to Graziers for the Project.

Ruling

Application of this Ruling

73. Subject to the exclusions set out in paragraph 8, this Ruling applies only to Graziers who are accepted to participate in the Project, whose Project Agreements have been executed and who have had 'Droves' allocated to them on or before 15 June 2005 (2005 Graziers).

74. The Grazier's participation in the Project must constitute the carrying on of a business of primary production. A Grazier is not eligible to claim any tax deductions until the Grazier's application to enter the Project is accepted and 'Droves' are allocated to the Grazier. Under the terms of the Product Disclosure Statement, a Grazier's application will not be accepted and the Project will not proceed until the minimum subscription of 24 'Droves' is achieved.

The Simplified Tax System (STS)

Division 328

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

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

Qualification

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

Assessable income

Sections 6-5 and 328-105

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

78. A Grazier who is not an 'STS taxpayer' recognises ordinary income from carrying on the business of leasing, breeding, grazing and sale of beef cattle for profit at the time that income is derived.

79. A Grazier who is an 'STS taxpayer' recognises ordinary income from carrying on the business of leasing, breeding, grazing and sale of beef cattle for profit at the time that income is received (paragraph 328-105(1)(a)).

Trading stock**Section 70-35**

80. A Grazier who is not an 'STS taxpayer' may, in some years, hold cattle that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Grazier must include the amount of that excess in assessable income (subsection 70-35(2)).

81. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Grazier may claim the amount of that excess as an allowable deduction (subsection 70-35(3)).

Section 328-285

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

83. Alternatively, a Grazier who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

Deductions for the Initial Management Fee and other fees and expenses payable under the Project**Sections 8-1 and 328-105**

84. For the year ending 30 June 2005 Graziers (who are not 'STS taxpayers') can claim a deduction under section 8-1 of the ITAA 1997, for the **Initial Management Fee of \$1,980** per 'Drove'.

85. For the years ending 30 June 2006 and 30 June 2007, Graziers (who are not 'STS taxpayers') can also claim deductions under section 8-1 of the ITAA 1997 for expenditure incurred for:

- Management Fees;
- Cattle Lease Fees;
- Agistment Fees;
- Out of Pocket Expenses;
- Feedlot Expenses;
- Transportation Expenses;
- Feedlot Management Fees;
- Sales Management Fee; and

- Performance Bonus Fees.

86. Graziers (who are 'STS taxpayers') can also claim the deductions set out in paragraphs 84 and 85 in the years ending 30 June 2005 and 30 June 2006 and 2007, respectively. However, if, for any reason, any of these fees and expenses are not fully paid in the year in which they are incurred then these are only deductible to the extent to which these have been paid, or have been paid for the Grazier. For a Grazier (who is an 'STS taxpayer') fees and expenses which are not paid in the year in which they are incurred will be deductible in the year in which these are actually paid (paragraph 328-105(1)(b)).

87. This Ruling does not rule on the deductibility of any portion of the Out of Pocket Expenses that relate to the cost of bringing or defending any third party legal proceedings for and on behalf of Graziers. If such expenditure is incurred Graziers may request a private ruling on the deductibility or otherwise of the expenditure.

88. This Ruling does not apply to Graziers who choose to prepay fees and expenses payable under the Project. 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 and 82KZMF of the ITAA 1936. Any Grazier who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.

Goods and Services Tax (GST)

Division 27

89. If the Grazier 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). See the Example at paragraph 142.

Deductions for interest payable under a Loan Agreement with Environinvest Pty Ltd

Sections 8-1 and 328-105

90. For the years ending 30 June 2005 to 30 June 2007, the deductions available to Graziers who enter into an interest bearing loan as described in paragraphs 66 to 69 of this Product Ruling are provided below.

91. Graziers (who are not 'STS taxpayers') can claim deductions under section 8-1 of the ITAA 1997, for interest incurred **monthly in arrears**.

92. Graziers who incur interest **annually in advance** cannot claim such interest in full in the year in which it is incurred, unless the amount of the interest is 'excluded expenditure' (see paragraph 131). Where the amount of interest is not 'excluded expenditure' the deduction for the interest paid in advance each year must be determined using the formula in subsection 82KZMF(1) (see paragraph 128).

93. Interest deductions for Graziers (who are 'STS taxpayers') are also limited to the amount paid by, or paid for the Grazier in an income year. For a Grazier (who is an 'STS taxpayer') interest that is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid (paragraph 328-105(1)(b)).

94. The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Environinvest Finance Pty Ltd is outside the scope of this Ruling. Graziers who borrow from lenders other than Environinvest Finance Pty Ltd may request a private ruling on the deductibility of the interest incurred.

Deductions for the loan establishment fee payable under the Loan Agreement

Section 25-25

95. Borrowing expenses are deductible under subsection 25-25(1) where the borrowed moneys are used or will be used during that income year for income producing purposes. In respect of borrowing expenses of \$100 or less, these are deductible in the year in which they are incurred (subsection 25-25(6)).

Deferral of losses from non-commercial business activities

Section 35-55

96. A 2005 Grazier, who is an individual with the minimum allocation of 12 'Droves', 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 Graziers for the income years ending **30 June 2005 and 30 June 2006**. This conditional exercise of the discretion will allow those losses to be offset against the Grazier's other assessable income in the income year in which the losses arise.

97. While Graziers may still incur losses after the years shown above, financial projections by the Responsible Entity indicate that in these later years of the Project the assessable income test in section 35-30 will be met. The assessable income test requires that a Grazier derives at least \$20,000 of assessable income in an income year from their business of breeding and selling beef cattle.

98. Where a Grazier satisfies the assessable income test in an income year the Grazier will not be required to defer any loss attributable to their business activity, to a later year. Instead, this loss can be offset against other assessable income of the Grazier for the year in which the loss arises.

99. However, if a Grazier either fails to pass the assessable income test in an income year after 30 June 2006, or fails to pass one of the other tests in Division 35, they should seek a private ruling on how Division 35 will apply to their business activity for that income year.

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

100. For a Grazier who participates in the arrangement described above and incurs expenditure as required by the Project Agreements, the following provisions of the ITAA 1936 have application as indicated:

- fees and expenses payable under the Management Agreement, Cattle Lease Agreement and Agistment Agreement and interest payable monthly in arrears under the Loan Agreement is not within the scope of sections 82KZME and 82KZMF;
- interest payable annually in advance is subject to sections 82KZME and 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 Grazier carrying on a business?

101. For the amounts set out in the tables above to constitute allowable deductions the Grazier's activities of leasing, breeding, grazing and sale of beef cattle as a participant in the Environinvest Beef Cattle Project 2005 must amount to the carrying on of a business of primary production.

102. Where there is a business, or a future business, the 'Sale Proceeds' from the sale of cattle 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.

103. For schemes such as the Environinvest Beef Cattle Project 2005, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grazier's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55. Taxation Rulings are available from the Tax Office or the ATO's Internet site at <http://www.ato.gov.au>.

104. Generally, a Grazier will be carrying on a business of breeding and selling beef cattle, and hence primary production, if:

- the Grazier has an identifiable interest (by lease) or rights over (by licence) cattle held for breeding purposes;
- the Grazier has a right to take and sell the progeny of the leased or licensed cattle;
- the breeding of the cattle and sale of their progeny are carried out on the Grazier's behalf;
- the activities of the Grazier are typical of those associated with a business of leasing, breeding, grazing and sale of beef cattle; and
- the weight and influence of general indicators point to the carrying on of a business.

105. In this Project, each Grazier enters into a Management Agreement, Cattle Lease Agreement, and an Agistment Agreement.

106. Under the Cattle Lease Agreement, each individual Grazier will have rights over a number of specific and identifiable cattle held for breeding purposes. During the term of the Cattle Lease Agreement the Grazier will have an ongoing interest in the individual cows and heifers that make up the Grazier's 'Droves'.

107. The Cattle Lease Agreement acknowledges that the Grazier is the absolute owner of the 'Progeny' that is the offspring of the leased stock and any offspring of the leased stock that forms the Grazier's 'Herd'. The progeny of the Grazier's 'Herd' will be identified via the use of tags to ensure correct identification of ownership and accurate recording of livestock. Under the Cattle Lease Agreement, the Grazier must use the stock in question for the purpose of breeding and establishing the Grazier's 'Herd' to carrying on the business of leasing, breeding, grazing and sale of beef cattle for profit and for no other purpose. The Cattle Lease Agreement allows Environinvest to carry out its obligations under the Management Agreement.

108. Under the Agistment Agreement, each individual Grazier will have rights over a specific and identifiable area of land. The Agistment Agreement provides the Grazier with an ongoing interest in the 'Land' in the form of a non-exclusive licence to occupy and use the 'Land' to agist and graze the 'Herd' for the term of the Project. The licence allows the Manager to come onto the Land to carry out its obligations under the Management Agreement.

109. Under the Management Agreement Environinvest is engaged by the Grazier to establish and maintain the Grazier's 'Herd' agisted on the 'Land' during the term of the Project. Environinvest has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to maintain the cattle on the Grazier's behalf.

110. In establishing the 'Herd', the Grazier engages the Manager to oversee the Grazier's business of leasing, breeding, grazing and selling beef cattle for profit and appoints the Manager as an independent contractor to provide 'Administration Services', 'Breeding Management Services', 'Feedlot Management Services', 'Identification Services', 'Land Management Services', 'Sales Management Services' and 'Stock Management Services' and various other services in respect to the Grazier's 'Herd'.

111. 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.

112. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grazier in the Project will derive assessable income from the sale of cattle 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.

113. The pooling of the Grazier's cattle with cattle of other Graziers is not inconsistent with general pastoral practices. Each Grazier's proportionate share of the sale proceeds of the pooled cattle will reflect the proportion of the cattle contributed by the Grazier. Graziers who do not contribute cattle to a pool are excluded from sharing in the proceeds of that pool.

114. Environinvest's services are also consistent with general pastoral practices. They are of the type ordinarily found in pastoral ventures that would commonly be said to be businesses. While the size of a 'Herd' is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

116. The activities of leasing, breeding, grazing and selling beef cattle, 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 Grazier's activities of breeding and selling beef cattle in the Environinvest Beef Cattle Project 2005 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

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

118. The question of whether a Grazier is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (but refer to Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11). Therefore, any Grazier 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'.

Initial Management Fee and other fees and expenses payable under the Project

Section 8-1

119. Consideration of whether the fees payable under the Management Agreement, Cattle Lease Agreement, and Agistment Agreement 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.

120. Any part of the expenditure of a Grazier entering into a pastoral business attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, a portion of the Out of Pocket Expenses may be paid in relation to the cost of the Manager bringing or defending any third party legal proceedings for and on behalf of Graziers. In some instances the bringing and defending of third party legal proceedings may be properly characterised as capital expenditure and cannot be deducted under section 8-1.

121. The fees payable under the Management Agreement, Cattle Lease Agreement and Agistment Agreement, other than any possible cost of bringing and defending a third party legal proceeding that is properly characterised as capital expenditure, are associated with the Grazier's leasing, breeding and grazing activities and the sale of the progeny and will relate to the gaining of income from the Grazier's business (see above), and hence have a sufficient connection to the operations by which income (from the sale of cattle) 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 fees is identifiable from the arrangement. The fees appear to be reasonable and the fees have no capital component. The tests of deductibility under the first limb of section 8-1 are met and the exclusions do not apply.

Interest deductibility

Section 8-1

(i) Graziers who use Environinvest Finance Pty Ltd as the finance provider

122. Some Graziers may finance their participation in the Project through a loan facility with Environinvest 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 fees payable under the Management Agreement, Cattle Lease Agreement, and Agistment Agreement.

123. The interest incurred by Graziers from the Commencement Date and in subsequent years of income will be in respect of a loan to finance the Grazier's business operations – the leasing, breeding, grazing and selling of beef cattle – 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) Graziers who DO NOT use Environinvest Finance Pty Ltd as the finance provider

124. The deductibility of interest incurred by Graziers who finance their participation in the Project through a loan facility with a bank or financier other than Environinvest 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

125. 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 income year, then it is not expenditure to which the prepayment rules apply.

Application of the prepayment provisions to this Project

126. Under the arrangement to which this Product Ruling applies fees payable under the Management Agreement, Cattle Lease Agreement and Agistment Agreement are incurred annually. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this expenditure. A Grazier 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, or paid on their behalf. A Grazier 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.

127. The prepayment provisions in sections 82KZME and 82KZMF have also no application to interest incurred monthly in arrears. However, sections 82KZME and 82KZMF may have relevance if a Grazier in this Project enters into interest bearing loans and the interest is incurred annually in advance. The interest incurred annually in advance may need to be apportioned under section 82KZMF.

128. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion the prepaid interest and allow a deduction over the period that the interest relates to.

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

129. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

130. 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.

131. There are a number of exceptions to these rules, but for Graziers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Graziers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

132. As noted in the Ruling section above, Graziers who prepay fees or interest, other than prepaid interest that may be payable under the interest bearing loans discussed above (see paragraphs 66 to 69), 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

Section 35-55

133. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2005 and 30 June 2006** 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 and 30 June 2006:

- it is because of its nature the business activity of a Grazier will not satisfy one of the four tests in Division 35; and
- there is an objective expectation that within a period that is commercially viable for the cattle industry, a Grazier's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

134. Therefore, a Grazier 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 for those income years ended 30 June 2005 and 30 June 2006.

135. 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 Grazier will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

136. Financial projections provided with the application for this Product Ruling indicate that Graziers may continue to make taxation losses beyond the commercially viable period for the cattle industry. However, in each of those loss years, the financial projections provided by the Responsible Entity show that Graziers are expected to derive assessable income of at least \$20,000. Where a Grazier derives assessable income of at least \$20,000 in an income year they will meet the assessable income test in section 35-30 of Division 35. Graziers who meet the assessable income test, or one of the other tests in Division 35, will not be required to defer losses arising from the business of breeding and selling beef cattle.

137. If a Grazier fails to meet the assessable income test in those years, or fails to meet one of the other tests set out in sections 35-35, 35-40 or 35-45, the losses may be deferred under section 35-10 of Division 35. In such circumstances Graziers may apply for a private ruling on how Division 35 will apply to their business activity for that income year.

Section 82KL – recouped expenditure

138. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits'. 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

139. 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).

140. The Environinvest Beef Cattle Project 2005 will be a 'scheme'. A Grazier will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions detailed at paragraphs 84 to 86 and 90 to 93 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.

141. Graziers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the breeding and selling beef cattle. There are no facts that would suggest that Graziers 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

142. 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).

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Commissioner of Taxation

16 February 2005

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Not previously issued as a draft

Related Rulings/Determinations:

PR 1999/95; PR 2004/59;
 PR 2004/83; PR 2005/18;
 TR 92/1; TR 92/20; TR 97/11;
 TR 97/16; TR 98/22; TR 2000/8;
 TR 2001/14; TR 2002/6;
 TR 2002/11; TD 93/34; IT 360

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- non-commercial losses
- producing assessable income
- product rulings
- public rulings
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- taxation administration

Legislative references:

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