

# ***PR 2005/62 - Income tax: 2005 Timbercorp Mango Project - Early Growers***

⚠ This cover sheet is provided for information only. It does not form part of *PR 2005/62 - Income tax: 2005 Timbercorp Mango Project - Early Growers*

⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *27 April 2005*



## Product Ruling

### Income tax: 2005 Timbercorp Mango Project – Early Growers

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Potential participants may wish to refer to the Tax Office website at [www.ato.gov.au](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.

#### **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

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is referred to as the '2005 Timbercorp Mango Project or simply as 'the Project'.

### Tax law(s)

2. The tax laws dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 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;
- Subdivision 61-J of the ITAA 1997;
- Division 328 of the ITAA 1997;
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZL of the ITAA 1936;
- section 82KZME and 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 '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 s 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 'Growers'.

8. The class of persons to whom this Ruling applies does not include:

- persons who intend to terminate their involvement in the Arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it;
- persons who participate in the Project through offers made other than through the Product Disclosure Statement;
- persons who enter into this arrangement after 15 June 2005;
- persons who elect to manage their Mangolots;
- persons who finance their participation in the Project through loans with Timbercorp Finance Pty Ltd other than those described at paragraphs 53 to 62 of this Product Ruling; and
- Timbercorp Securities Limited and its associates.

## Qualifications

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

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## Date of effect

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11. This Ruling applies prospectively from 27 April 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

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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

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

- Application for a Product Ruling dated 4 January 2005 as constituted by documents received on 4 January 2005, 17 January 2005, 21 February 2005, 23 February 2005, 24 February 2005, 2 March 2005, 8 March 2005, 5 April 2005 and additional correspondence dated 28 February 2005, 8 March 2005, 5 April 2005, 6 April 2005 and 20 April 2005;
- Draft Product Disclosure Statement for the 2005 Timbercorp Mango Project (PDS) received on 10 March 2005;
- Draft **Constitution** of the 2005 Timbercorp Mango Project, as amended, received on 10 March 2005;
- Draft Compliance Plan of the 2005 Timbercorp Mango Project, received on 4 January 2005;
- Drafts of Orchard 1, Orchard 2 and Orchard 3 Head Leases between Mango Land Pty Ltd (Mango Land) and Timbercorp Securities Ltd (TSL) for the Oolloo Property, Mataranka Property and Dimbulah Property respectively, received on 4 January 2005;
- Drafts **Orchard 1, Orchard 2, Orchard 3 Licence Agreements (Licence Agreements)** between TSL, Mango Land and Grower (Grower), Orchard 2 and Orchard 3 Licence Agreements received on 4 January 2005 and amended Orchard 1 Licence Agreement received on 10 March 2005;
- Draft **Mangolot Management Agreement** between Grower and TSL, as amended, and received on 10 March 2005;
- Draft **Grower PBR Sub-Licence & Marketing Agreement** between Grower, Mangocorp Management Pty Ltd (Mangocorp Management) and TSL, as amended, and received on 10 March 2005;
- Draft Management Agreement between TSL and Mangocorp Management as amended and received on 10 March 2005;

- Draft Mango Orchard Management Agreement for the 2005 Timbercorp Mango Project between Harvest Markets Pty Ltd (Harvest Markets), Ooloo Farm Management Pty Ltd (Ooloo Management), Mangocorp Management and Timbercorp Ltd received on 4 January 2005;
- Draft Capital Works Agreement between Mango Land, Ooloo, Harvest Markets and Timbercorp Limited, as amended and received on 10 March 2005;
- Draft Custody Agreement between TSL and Custodian received on 4 January 2005; and
- 2005 Timbercorp Projects Finance Package and Special Finance Offer (finance documents) received on 2 March 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 that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows.

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

### Overview

17. The salient features of the 2005 Timbercorp Mango Project are as follow:

Location	Ooloo and Mataranka in the Northern Territory and Dimbulah in Queensland
Type of business to be carried on by each Grower	Commercial growing and cultivation of Mango trees for the purpose of harvesting Mangoes for sale
Number of hectares offered for cultivation	362
Size of each Mangolot	0.25 hectares
Minimum allocation	2 'Mangolots'
Minimum subscription	None
Number of trees per hectare	An average of 235 trees per hectare

Term of the Project	20 years
Initial cost per 'Mangolot'	\$8,800
Ongoing costs	Annual licence Fees, management costs
Other fees and costs	Deferred management fees, Royalty fee and PBR & Marketing fee and other marketing costs

18. The Project will be registered as a managed investment scheme under the *Corporations Act 2001*. 'Applications' to participate in the Project must be made during the 'Offer Period' which is:

- for 'Applications' received on or before 15 June 2005, the period commencing from date of issue of the PDS to 15 June 2005; and
- for 'Applications' received on or after 1 July 2005, the period commencing from 1 July 2005 to 15 June 2006.

19. For the purposes of this Ruling, Growers whose 'Applications' are accepted during the period on or before 15 June 2005 will become Early Growers. **This Ruling only applies to 'Early Growers'. In this Ruling 'Early Growers' are referred to as 'Growers'. Note that a separate Product Ruling PR 2005/63 has issued for 'Post-30 June Growers' who are accepted into the Project from 1 July 2005 to 15 June 2006.**

20. The offer to participate in the Project must be made through an 'Application' in the form attached to the PDS. There is no minimum amount that must be raised under the PDS and oversubscription will not be accepted. A Custodian will be appointed under the Custody Agreement to protect the interests of Growers in their dealings with TSL.

21. Under the Power of Attorney in the form attached to the PDS, 'Applicants' irrevocably appoint TSL to enter into the Licence Agreement and Mangolot Management Agreement on their behalf. They will also be bound by the Constitution on acceptance into the Project.

### **Constitution**

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

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

24. In summary, the Constitution also sets out provisions relating to:
- invitations and offers under the PDS (clause 2);
  - appointment of TSL as the Grower's irrevocable agent, representative and attorney (clause 3);
  - how the Responsible Entity is to hold property of the Grower (clause 5);
  - procedures relating to 'Applications' (clause 6);
  - the discretion of TSL to refuse an 'Application' (clause 7);
  - the effect of an 'Application' being accepted by TSL (clause 8);
  - preparation and execution of the Licence Agreement and Mangolot Management Agreement by TSL and release of the 'Application Money' (clause 9);
  - preparation and issuing of 'Mangolot Statements' to Growers and the setting up and maintenance of a 'Register' (clause 10);
  - TSL's powers (clause 11);
  - the keeping of a separate 'Agency Account' for the holding of 'Proceeds and any other money', apart from 'Application Money' and interest thereon, that TSL may hold for the Grower (clause 12);
  - the appointment of TSL as agent and attorney to deal with the processing and sale of the 'Mangoes' and distributions from the 'Agency Account' of 'Proceeds' to Growers and insurance proceeds (clause 13);
  - the right of TSL to be paid fees and other expenses (clause 14);
  - authority to use money in the 'Agency Account' and powers of investment of the money standing in the 'Agency Account' (clauses 15 and 16);
  - the status, the retention by TSL, and termination by TSL or the Growers, of the Mangolot Management Agreement and Licence Agreement (clause 18). This includes the right of Growers to obtain a copy of the above agreements by written request to TSL (clause 18.2) and the consequences of termination of these agreements (clause 18.4);
  - the right of the Grower to inspect certain documents related to their participation in the Project and to offer and give opinions to TSL (clause 19.1);

- the assignment and transmission of 'Mangolots' (clause 20) and restrictions on such assignments and transmissions (clause 21);
- procedures for calling a meeting of Growers (clause 22);
- resolution of complaints made by the Grower in relation to the Project or TSL (clause 25); and
- termination of the Project (clause 26).

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

### **Joint Venture**

26. The Constitution allows two persons to enter into a 'Joint Venture'. Clause 29 of the Constitution deals with the rights and obligations of Growers who constitute themselves as 'Joint Venturers'. The 'Application' in the form attached to the PDS identifies the 'First Joint Venturer' and the 'Second Joint Venturer' in the 'Joint Venture'.

27. Early Growers who enter into a 'Joint Venture' will have the following 'Prescribed Proportion' of the 'Joint Venture Assets':

- the First Joint Venturer – 55%; and
- the Second Joint Venturer – 45% (clause 29.4).

### **Compliance Plan**

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

### **Head Leases**

29. The Head Leases set out the terms and conditions under which Mango Land Pty Limited (Land Owner) will lease the Land and Water Licences to TSL for the Term of the Project. The Land and Water Licences for the Project will be owned by the Land Owner and will be leased to TSL under the Orchard 1 Head Lease, the Orchard 2 Head Lease and the Orchard 3 Head Lease.

30. Orchard 1 is the mango orchard of approximately 135 hectares on the Oolloo Property in Katherine in Northern Territory established on or about 15 October 2003. Orchard 2 is an orchard of approximately 101 hectares on the McFarlane Property in Mataranka in Northern Territory. Orchard 3 is an orchard of approximately 126 hectares on the Dimbulah Property in North Queensland. Orchard 2 and Orchard 3 will be established as mango orchards on or about 30 September 2005.

### **Grower Licences (Licence Agreements)**

31. A Grower will enter into 3 (Orchard 1, Orchard 2 and Orchard 3) Licence Agreements in respect of a Mangolot. A Mangolot is a parcel of approximately 0.25 hectares of 3 stapled, separately identifiable areas of land in 3 distinct geographical locations. Each 0.25 hectare Mangolot constitutes of approximately 0.093 hectares of Orchard 1 (Orchard 1 Licenced Area), 0.07 hectares of Orchard 2 (Orchard 2 Licenced Area) and 0.087 hectares of Orchard 3 (Orchard 3 Licenced Area).

32. A 'Mangolot' is defined to include the 'Mango Trees', the 'Capital Works' and the 'Required Water Licences'. Under clause 3.2 TSL must fully exploit its Water Licences to maximise their use by all Growers during the Term of the Project in accordance with the provisions of the Mangolot Management Agreement.

33. The Licence Agreements grant the Grower licences effective from the Commencement Date to use the identifiable areas which form part of the Mangolot for the sole purpose of conducting the Mangolot Operations (clause 3.1).

34. Under clause 6 the Licence Agreements are subject to and conditional upon the:

- Grower entering into the Mangolot Management Agreement and the Grower PBR Sub-Licence & Marketing Agreement;
- TSL entering into valid and subsisting Head Leases in respect of Orchard 1, Orchard 2 and Orchard 3; and
- Grower entering into contemporaneous Licence Agreements and Concurrent Licence Agreements in respect of a Mangolot spread across 3 distinct geographical locations.

35. The Licence Agreements also set out:

- its Term (clause 4.1);
- the Licence Fees payable by Growers (clause 7);
- the obligations and rights of the Grower (clauses 8), TSL (clause 5) and the Land Owner (clause 9); and

- provisions relating to early termination of the Licence Agreements by the Grower or TSL (clause 10) and the effects of such termination (clause 10).

### **Grower PBR Sub-Licence & Marketing Agreement**

36. Under this Agreement, a Grower is granted a non-exclusive sub-licence to cultivate, maintain, harvest, ripen, pack, maintain and market and sell the Mangoes through Mangocorp Management which engages Harvest Markets as the exclusive marketer of the Mangoes. The Grower is not given the right to propagate the mango trees. In consideration for the rights granted, the Grower will pay royalty fees (3.3%), and other marketing and sale costs and a PBR and marketing fee of (1.65%) of the Proceeds of Sale of the Crop every year payable out of, and at the time Proceeds are received by TSL (clauses 3.2 and 3.3).

### **Mangolot Management Agreement**

37. Under this Agreement the Grower engages the Responsible Entity to cultivate the Grower Mangolots and to carry out the management services subject to the terms and conditions of this Agreement. This Agreement shall commence on the Commencement Date and shall continue until 30 June 2025 or until termination under clause 17 of this Agreement. These grounds include default by one party in the performance of its duties.

38. TSL will manage and cultivate the 'Mangolots' on behalf of the Grower in accordance with the Management Plan and good horticultural and environmental practices (clause 5.1).

39. In the period ending 30 June 2005, TSL will carry out and complete the following services:

- Infrastructure Management Services, commencing from the Commencement Date and carried out in respect of Orchard 1, Orchard 2 and Orchard 3 on the Growers 'Mangolots' (clause 5.2(a) to (f));
- Administrative and other Management Services, commencing from the 'Commencement Date' (clause 5.2(g) to (m)); and
- Mango Tree Management Services, in respect of the Orchard 1 (clause 5.2(n) to (z)).

40. The Agreement also stipulates the services to be provided after 30 June 2005 and each subsequent 'Financial Years' (clause 5.2A).

41. During the Project Term TSL will harvest the Mangoes (clause 7), sort, pack, and ripen them (clauses 7 and 8). Under the Agreement the Grower authorises TSL to cause Mangocorp Management to market and sell the Grower's interest in the Crop in accordance with its obligations under the Grower PBR Sub-Licence & Marketing Agreement.

42. The Mangolot Management Agreement also sets out the requirement for TSL to provide an annual report to Growers within 7 months after the end of each financial year of the Project (clause 15).

43. Under clause 1.5 of the Agreement, TSL can delegate its obligations under this Agreement. Pursuant to this right to delegate, TSL will enter into a Management Agreement with Mangocorp Management, an associate of TSL, who in turn will enter into a Mango Orchard Management Agreement with a number of parties.

### **Pooling of amounts and distribution of Proceeds**

44. Both the Constitution (clause 13) and the Mangolot Management Agreement (clause 9.1) set out provisions relating to the pooling of amounts held by TSL on behalf of Growers. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Growers who have contributed Mangoes or insurance proceeds pool in a 'Subsequent Year' are entitled to benefit from distributions of Proceeds from the pool;
- Grower's that do not contribute to a pool will not have any interest in the Proceeds from the pool; and
- any pooled Mangoes or insurance proceeds must consist only of Mangoes or other Proceeds contributed by Growers of this Project.

### **Management Agreement**

45. Under the Management Agreement, TSL engages Mangocorp Management as an independent contractor to manage and administer the Project, and to manage, direct and conduct the Project Operations on behalf of the Growers and perform the Orchard Services.

### **Mango Orchard Management Agreement**

46. Under the Mango Orchard Management Agreement, Mangocorp Management engages Ooloo Management, a subsidiary of Harvest Markets as independent contractor to provide management and cultivation services, including the 'Orchard Services' (clause 4), 'Harvesting Services' (clause 5) and 'Sorting and Processing Services' (clause 6) and 'Ripening Services' (clause 7). Ooloo Management must carry out the services in accordance with a Management Plan.

### **Capital Works Agreement**

47. Under the Capital Works Agreement, Mango Land Pty Ltd (the Land Owner) engages Ooloo Management as an independent contractor to provide services in relation to Capital Works associated with the establishment of orchards. The Capital Works include the preparation of the Land, the installation of irrigation facilities, and the planting of the Mango Trees on Orchard 2 and Orchard 3.

48. Under clause 4.2(c) Ooloo Management will replace and replant, at its cost, any Mango Trees that fail within 6 months where the failure is caused by Ooloo Management.

### **Fees**

49. Fees payable per Mangolot by a Grower who is not in Joint Venture are as follows. These fees are specified in the Mangolot Management Agreement (clause 13) and Licence Agreement (clause 7), and Grower PBR Sub-Licence & Marketing Agreement (clauses 3.2 & 3.3).

#### *Management Fees*

- (i) for the period from Commencement Date until 30 June 2005, **\$8,800**, payable on or before the Commencement Date;
- (ii) for the period 1 July 2005 to 30 June 2006, fixed management fees of **\$2,200**, payable on 31 October 2005, plus a further amount (called the deferred management fee). The deferred management fee represents part of the management fee for the 'Financial Year' ending 30 June 2006. It is payable in each 'Financial Year', and is **2.2% of Gross Proceeds** of the sale of Crop payable at the time any Proceeds are received by TSL;
- (iii) for the period 1 July 2006 to 30 June 2007, fixed management fees of **\$2,800**, payable on 31 October 2006, plus a further amount (called the deferred management fee). The deferred management fee represents part of the management fee for the Financial Year ending 30 June 2007. It is payable in each Financial Year, and is **2.2% of Gross Proceeds** of the sale of Crop payable at the time any Proceeds are received by TSL;
- (iv) from and including the Financial Year ending 30 June 2008, the management fee for services in each Financial Year is the **estimated operating costs** payable on 31 October each year;

- (v) an **incentive fee of 27.5%** of so much of the annual Net Proceeds in a Financial Year as exceeds the Incentive Fee Threshold; and
- (vi) Royalty fee, **(3.3%)**, and other marketing and sale costs, and a PBR and marketing fee of **(1.65%)** of the Proceeds of Sale of the Crop every year payable out of and at the time Proceeds are received by TSL.

### *Licence Fees*

- (vii) for the period from the Commencement date to 30 June 2005, **nil**;
- (viii) for the period 1 July 2005 to 30 June 2006, **nil**;
- (ix) for the Financial Year ending 30 June 2007, **\$400**, payable on 31 October 2006;
- (x) for the 'Financial Year' ending 30 June 2008, **\$600**, payable on 31 October 2007;
- (xi) for the 'Financial Year' ending 30 June 2009, **\$735**, payable on 31 October 2008; and
- (xii) for subsequent 'Financial Years', the annual 'Licence Fees' will be the annual 'Licence Fee' payable on the immediately preceding 31 October, 'Indexed', payable on 31 October each year.

50. The **estimated operating costs** of the Mangolot for a 'Financial Year' will include an adjustment for the difference between the actual costs and the estimated costs of managing the Mangolot during the preceding Financial Year.

51. Fees payable per Mangolot by a Grower who is in Joint Venture (Joint Venture Grower) are stipulated in clause 29.5 of the Constitution. Under this clause, the actual amount of fees to which a Joint Venture Grower will be solely responsible for are expressed as percentages of the fees outlined in paragraph 49. These percentages are as follows.

### *First Joint Venture Grower*

- 100% of the management fees set out in subparagraph 49(i);
- 55% of the deferred management fees set out in subparagraphs 49(ii) & 49(iii);
- 55% of the management fees set out in subparagraph 49(iv) from and including the 'Financial Year' ending 30 June 2009;
- 55% of the Royalty fee, Commission, other marketing costs, and PBR & marketing fee set out in subparagraph 49(vi); and

- 55% of the licence fees set out in subparagraphs 49(xi) & 49(xii) from and including the 'Financial Year' ending 30 June 2009.

*Second Joint Venture Grower*

- 100% of the fixed management fees set out in subparagraphs 49(ii) & 49(iii);
- 45% of the deferred management fees set out in subparagraphs 49(ii) & 49(iii);
- 100% of the of the management fees set out in subparagraph 49(iv) for the financial year ending 30 June 2008;
- 45% of the management fees set out in subparagraph 49(iv) from and including the Financial Year ending 30 June 2009;
- 45% of the Royalty fee, Commission, other marketing costs, and PBR & marketing fee set out in subparagraph 49(vi);
- 100% of the of the licence fees set out in subparagraphs 49(ix) and 49(x); and
- 45% of the licence fees set out in subparagraphs 49(xi) & 49(xii) from and including the Financial Year ending 30 June 2009.

52. Joint Venture Growers will be responsible for any incentive fees set out in subparagraph 49(v) in their respective 'Prescribed Proportions'.

**Finance**

53. Growers can fund their involvement in the Project by borrowing from independent sources or from Timbercorp Finance Pty Ltd (the Financier), a lender associated with the Responsible Entity. Details of the loans that will be offered to Growers by the Financier are set out in the finance documents provided to the Tax Office by TSL with their application for this Product Ruling.

54. The Financier will provide Growers with loans on a full recourse basis and will pursue legal action against any defaulting borrowers. Growers can apply to borrow up to 90% of the Application Money. If approved, the Loan Amount will be used to pay the balance of the Application Money and the \$250 Loan Application Fee. On application to participate in the Project, Growers will be required to pay a deposit, being the balance still to be paid for their Mangolots after deducting the Loan Amount.

55. The types of loans to which this Ruling applies are as follows:

- principal and interest loans; and
- loans with interest only period then becoming principal and interest loans.

56. These types of loans have the following features:

- during the Loan Term the Grower will assign and transfer over to the Financier by way of fixed charge, all its rights, title and interest at any time in the Project including Mangolots and the 'Project Agreements';
- the Grower is entitled to repay the whole or any part of the Total Amount Owing without penalty for early repayment;
- the Lower Interest Rate is fixed for the term of the loan; and
- in the event that any amount is overdue, the Financier may charge interest at the Higher Interest Rate.

57. It is also a common feature of these types of loans that the interest and the Loan Amount will be paid by monthly instalments. Principal and interest loans are repayable by equal monthly instalments of principal and interest over the Loan Term. In respect of loans with interest only period then becoming principal and interest, the monthly instalments during the interest only period will be sufficient to pay the accruals of interest only and the monthly instalments during the principal and interest period will be sufficient to repay the loan by the end of the Loan Term.

58. Each monthly instalment is due and payable on the last Business Day of each month with the first instalment due on the last Business Day of the month in which the Loan Term commences. Monthly instalments will be deducted from the borrower's bank account under a direct debit authority.

59. The Loan Terms available under the types of loans discussed above are summarised below.

*Principal and interest loans*

- 3 years at 9.0% p.a.;
- 4 years at 9.95% p.a.;
- 5 years at 10.5% p.a.; and
- 7 years at 10.95% p.a.

*Loans with interest only period then principal and interest:*

- 1 year interest only, then 3 to 5 years principal and interest at 10.50% p.a. interest applicable to all years;
- 2 years interest only, then 3 to 5 years principal and interest at 10.95% p.a. interest applicable to all years; and

- 3 years interest only, then 3 to 5 years principal and interest at 11.50% p.a. interest applicable to all years.

60. Growers cannot rely on this Product Ruling if they enter into a finance agreement with the Financier that materially differs from that set out in the finance documents provided to the Tax Office by TSL with their application for this Product Ruling.

61. Growers also cannot rely on this Product Ruling if Application Moneys otherwise remain unpaid by 15 June 2005. Where an application is accepted subject to finance approval by any lending institution, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by 15 June 2005.

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

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

## Ruling

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### Application of this Ruling

63. Subject to exclusions set out in paragraph 8, this Ruling applies only to Growers who are accepted to participate in the Project on or before 15 June 2005, and who have executed a Mangolot Management Agreement, a Grower PBR Sub-Licence & Marketing Agreement, and an Orchard 1, Orchard 2, and Orchard 3 Licence Agreement on or before that date.

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

### The Simplified Tax System ('STS')

#### *Division 328*

65. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. 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

66. 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.

### 25% Entrepreneurs tax offset

#### *Subdivision 61-J*

67. For the first income year starting on or after 1 July 2005, subdivision 61-J of the ITAA 1997 provides a 25% tax offset of income tax liability related to the business income of a business in the STS with annual group turnover of less than \$75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

**Assessable income****Section 6-5**

68. That part of the Harvest Proceeds from the Project attributable to the Grower, 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, for the 2005-06 income year and later years, a Grower will be assessable on ordinary income from carrying on their business of horticulture in the income year in which that income is derived.

70. For the 2005-06 income year and later years, a Grower who is an 'STS taxpayer' using the cash accounting method will be assessable on ordinary income from carrying on their business of horticulture in the income year in which that income is received.

**Deductions for Management Fees, Licence Fees, Interest and Loan Application Fee****Sections 8-1, 328-105 and 25-25**

71. A Grower (who is not a Joint Venture Grower) accepted into the Project on or before 15 June 2005 may claim, on a per Mangolot basis, tax deductions for the following expenditure.

72. However, if for any reason, an amount shown or referred to in the Table below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' (for the 2005 income year) or an 'STS taxpayer' using the cash accounting method (for the 2006 and 2007 income years), then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. For these Growers, any amount or part of an amount shown in the Table below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

<b>Fee Type</b>	<b>Year ended 30 June 2005</b>	<b>Year ended 30 June 2006</b>	<b>Year ended 30 June 2007</b>
<b>Management Fees</b>	\$8,800 See Notes (i) & (ii) & (v)	\$2,200 plus 2.2% of any 'Gross Proceeds' See Notes (i), (iii), (iv) & (v)	\$2,800 plus 2.2% of any 'Gross Proceeds' See Notes (i), (iii), (iv) & (v)
<b>Licence Fees</b>	nil	nil	\$400 See Notes (i), (iii), (iv) & (v)

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<b>PBR and marketing fee, Royalty fees, and other marketing and sale costs</b>	n/a	n/a	As incurred See Notes (i), (v) & (vi)
<b>Interest on loans with Timbercorp Finance Pty Ltd</b>	As incurred <b>(Non-STS taxpayers)</b> Or as paid <b>(STS taxpayers)</b> See Notes (ii), (v) & (vii)	As incurred <b>(Non-STS taxpayers &amp; STS taxpayers using accruals accounting)</b> Or as paid <b>(STS taxpayers using cash accounting)</b> See Notes (iii), (iv), (v) & (vii)	As incurred <b>(Non-STS taxpayers &amp; STS taxpayers using accruals accounting)</b> Or as paid <b>(STS taxpayers using cash accounting)</b> See Notes (iii), (iv), (v) & (vii)
<b>Loan Application Fee for loans with Timbercorp Finance Pty Ltd</b>	Must be calculated – See Note (viii)	Must be calculated – See Note (viii)	Must be calculated – See Note (viii)

**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 119.
- (ii) For the 2004-05 income year, where a Grower pays the Management Fee under the Mangolot Management Agreement, and any interest under a loan agreement with Timbercorp Finance Pty Ltd, those amounts are deductible in full in the year incurred (where the Grower is **not an 'STS taxpayer'**) or the year paid (where the Grower is an STS taxpayer).
- (iii) For the 2005-06 income year and later years where a Grower pays the Management Fee, the Licence Fee, and interest in the relevant income years shown in the Mangolot Management Agreement, the Licence Agreements, and a loan agreement with Timbercorp Finance Pty Ltd, those amounts are deductible in full in the year incurred where the Grower is not an

- 'STS taxpayer' or, where the Grower is an 'STS taxpayer' using the accruals accounting method.
- (iv) For the 2005-06 income year and later years, where a Grower pays the Management Fee, the Licence Fee, and interest in the relevant income years shown in the Mangolot Management Agreement, the Licence Agreements, and a loan agreement with Timbercorp Finance Pty Ltd, those amounts are deductible in full in the year paid where the Grower is an 'STS taxpayer' who uses the cash accounting method.
- (v) This Ruling does not apply to Growers who choose to prepay fees or who choose, or who are required to prepay interest under a loan agreement (see paragraph 104). 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 Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (vi) A PBR & marketing fee of 1.65%, and Royalty Fee of 3.3%, of the Proceeds of Sale of the Crop, and other marketing and sale costs, in each Financial Year payable out of and at the time Proceeds are received by TSL. In any year where Mangoes are not harvested and sold, Proceeds will be zero and, therefore, no PBR & marketing fee, no Royalty Fee amount based on the percentages shown above, and no marketing and sale costs will be payable.
- (vii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd is outside the scope of this Ruling. Growers who borrow from lenders other than Timbercorp Finance Pty Ltd may request a private ruling on the deductibility of the interest incurred.
- (viii) The Loan Application Fee payable to Timbercorp Finance Pty Ltd is a borrowing expense and is deductible under subsection 25-25(1). It is incurred for borrowing moneys that are used or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Timbercorp Finance Pty Ltd is outside the scope of this Ruling.

**Joint Venture Growers**

73. If a Joint Venture 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). See the Example at paragraph 119.

74. For 2004-05 income year *First Joint Venture Growers* who are **not** 'STS taxpayers' may claim deductions under section 8-1 for the following expenditures as set out in the table and Notes in paragraph 72:

- \$8,800 for Management Fees; and
- any interest incurred on funds borrowed from Timbercorp Finance Pty Ltd.

75. For 2005-06 and 2006-07 income years Joint Venture Growers who are **not** 'STS taxpayers' or are STS taxpayers using the accruals accounting method may claim deductions under section 8-1 for the following expenditures as set out in the table and Notes in paragraph 72:

*First Joint Venture Grower*

- in the years ending 30 June 2006 and 2007 55% of the amount incurred for deferred management fees set out in subparagraphs 49(ii) and 49(iii) respectively;
- in the year ending 30 June 2007, 55% of any Royalty fee, Commission, other marketing costs, and PBR & marketing fee set out in subparagraph 49(vi); and
- in the years ending 30 June 2006 and 2007, any interest incurred on funds borrowed from Timbercorp Finance Pty Ltd.

*Second Joint Venture Grower*

- in the year ending 30 June 2006, for fixed management fees of \$2,200 and 45% of the amount incurred for deferred management fees set out in subparagraph 49(ii);
- in the year ending 30 June 2007, for fixed management fees of \$2,800 and 45% of the amount incurred for deferred management fees set out in subparagraph 49(iii) and \$400 for Licence Fees set out in subparagraph 49(ix); and
- in the years ending 30 June 2007, 45% of the Royalty fee, Commission, other marketing costs, and PBR & marketing fee set out in subparagraph 49(vi).

76. For Joint Venture Growers who **are** 'STS taxpayers' (for the 2005 income year) or are 'STS taxpayers' using the cash accounting method (for the 2006 and 2007 income year), the deductions referred to in paragraphs 74 and 75 are deductible in the income year in which they are paid by, or paid on behalf of the Joint Venturer.

77. First Joint Venture Growers can also claim under subsection 25-25(1) the Loan Application Fee payable to Timbercorp Finance Pty Ltd (see Note (viii) above). Each Joint Venturer can also claim deductions for its proportional share of the horticultural plant write-off as explained in paragraphs 78 to 80.

### **Deductions for capital expenditure**

#### ***Division 40***

78. Each Grower will also be entitled to tax deductions relating to the Mango Trees planted on the Mangolot. If the Grower is registered or required to be registered for GST, amounts of outgoings would need to be adjusted as relevant for GST (for example input tax credits): Division 27. See the Example at paragraph 119.

79. A Mango Tree is considered to be a 'horticultural plant' as defined in subsection 40-520(2). A Grower holds a licence to cultivate the Mango Trees on a designated area of land called a Mangolot for the growing of Mangoes for commercial gain. As a Grower holds the Mangolot under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value.

80. The deduction is determined using the formula in section 40-545. Mango Trees have an 'effective life' of 30 years and for the purposes of section 40-545, the result is a straight-line write-off at a rate of 7%. The deduction is allowable when the Mango Trees enter their first commercial season (section 40-530, item 2). TSL will notify Growers when their Mango Trees enter their first commercial season and the amount that may be claimed.

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

#### ***Section 35-55 – exercise of Commissioner's discretion***

81. A Grower, who is an individual accepted into the Project by 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 2010**. 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, 82KZMF and 82KL and Part IVA

82. For a Grower who participates in the Project and incurs expenditure as required by the Mangolot Management Agreement, Grower PBR Sub-Licence & Marketing Agreement and the Licence Agreements the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of 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

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### Is the Grower carrying on a business?

83. For the amounts set out in the Ruling section above to constitute allowable deductions the Grower's horticulture activities of cultivating and harvesting Mangoes for eventual sale as a participant in the 2005 Timbercorp Mango Project must amount to the carrying on of a business of primary production.

84. Where there is a business, or a future business, the gross proceeds from the sale of the Mangoes 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.

85. For schemes such as the 2005 Timbercorp Mango Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

86. Generally, a Grower will be carrying on a business of horticulture, and hence primary production, if:

- the Grower has an identifiable interest in land (by lease) or rights over the land (by licence) on which the Grower's Mango Trees are established;
- the Grower has a right to harvest and sell the harvested Mangoes from the licensed Mangolots;
- the horticulture activities are carried out on the Grower's behalf;

- the horticulture activities of the Grower are typical of those associated with a horticulture business; and
- the weight and influence of general indicators point to the carrying on of a business.

87. In this Project, each Grower enters into a Management Agreement and a Licence Agreements (Licence).

88. Under the Licence Agreements (or Licence) each individual Grower will have rights over 2 or more specific and identifiable areas of 0.25 hectares of land. The Licence Agreements provide the Grower with an ongoing interest in the specific Mango Crop on the licensed area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out horticulture activities, and for no other purpose. The licence allows TSL to come onto to the land to carry out its obligations under the Mangolot Management Agreement.

89. Under the Mangolot Management Agreement TSL is engaged by the Grower to establish and maintain the Grower's Mangolots on the Grower's identifiable areas of land during the term of the Project. TSL has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Mangolots on the Grower's behalf.

90. TSL is also engaged to harvest and sell, on the Grower's behalf, the harvested Mangoes grown on the Grower's Mangolots.

91. 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.

92. 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 the harvested Mangoes 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.

93. The pooling of harvested Mangoes grown on the Grower's Mangolots with the harvested Mangoes of other Growers is consistent with general agricultural practices. Each Grower's proportionate share of the Proceeds of the pooled Mangoes will reflect the proportion of the Mangoes harvested from their Mangolots and contributed to the pool.

94. TSL's services are also consistent with general horticultural practices. They are of the type that would be found in horticulture ventures and be said to be businesses. The 2 Mangolots (0.5 hectares) that a Grower is required to subscribe for is of a size and scale to allow it to be commercially viable.

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

96. The horticulture activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers horticulture activities in the 2005 Timbercorp Mango Project will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

97. 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.

98. Changes to the STS rules apply from 1 July 2005. 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***

99. Consideration of whether the fees and expenses payable under the Mangolot Management Agreement, Grower PBR Sub-Licence & Marketing Agreement and the Licence Agreements 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.

100. The fees payable under the Mangolot Management Agreement, Grower PBR Sub-Licence & Marketing Agreement and the Licence Agreements will relate to the gaining of income from the Grower's horticulture business (see above), and hence have a sufficient connection to the operations by which income (from the sale of harvested Mangoes) 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) Growers who use Timbercorp Finance Pty Ltd as the finance provider*

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

102. The interest incurred for the year ended 30 June 2005 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations – the cultivation and growing of Mango Trees and the licence of the land on which the Mango Trees will have been planted – that will continue to be directly connected with the gaining of business income from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

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

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

**Prepayment provisions*****Sections 82KZL to 82KZMF***

104. 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 services under the Mangolot Management Agreement or the licensing of land under the Licence Agreements) 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***

105. Under the Arrangement to which this Product Ruling applies management Fees and Licence Fees are incurred annually and interest payable to Timbercorp Finance Pty Ltd is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this expenditure. A Grower who is an 'STS taxpayer' (for the year ending 30 June 2005) or is an 'STS taxpayer using the cash accounting method (for the years ending 30 June 2006 and 30 June 2007) 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. All other Growers can claim a deduction for each of the relevant amounts in the income year in which the fee is incurred.

106. However, sections 82KZME and 82KZMF may have relevance if a Grower in this Project chooses to prepay all or some of the expenditure payable under the Mangolot Management Agreement and the Licence Agreements or chooses or is required to prepay interest under a loan agreement (including loan agreements with lenders other than Timbercorp Finance Pty Ltd).

107. 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.

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

108. 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.

109. 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.

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

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

### **Expenditure of a capital nature**

#### ***Division 40***

112. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to the establishment of the Mango Trees is of a capital nature. This expenditure falls for consideration under Division 40 of the ITAA 1997.

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

#### ***Section 35-55 – exercise of Commissioner's discretion***

113. 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 2010**, 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 the income years ended 30 June 2005 to 30 June 2010:

- 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 horticulture 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.

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

### **Section 82KL – recouped expenditure**

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

### **Part IVA – general tax avoidance provisions**

116. 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).

117. The 2005 Timbercorp Mango Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 71 to 80 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.

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

119. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2003, Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2004 to 30/6/2004	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2004 (includes GST of \$600)	<u>\$6,600</u>

\*Taxable supply

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

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

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

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

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

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

In preparing her income tax return for the year ended 30 June 2004, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2,000 only, not one tenth of \$2,200).

**Detailed contents list**

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

	<b>Paragraph</b>
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## Commissioner of Taxation

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*Related Rulings/Determinations:*

PR 1999/95; PR 2005/63;  
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TR 2001/14; TD 93/34

*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

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