PR 2005/66 - Income tax: the 2005 Grain Co-Production Project

Product Ruling

Income tax: the 2005 Grain Co-Production Project

Contents Para

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 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 Grain Co-Production 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;
- 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;
- sections 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 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 and on or before 16 May 2005. 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.

8. In this Ruling, each of these persons, referred to as 'Growers' will be wholesale clients for the purpose of the *Corporations Act 2001* or will have accepted an offer which qualifies as a small scale offer for the purpose of the *Corporations Act 2001*.

9. The Ruling does not apply to persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

10. 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

12. 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).

13. 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

14. 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

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

- Application for a Product Ruling dated 14 December 2004 as constituted by documents provided on 14 December 2004, 17 February 2005 and 15 April 2005 and additional correspondence dated 18 February 2005, 8 March 2005, 29 March 2005, 1 April 2005, 6 April 2005 and 19 April 2005;
- Information Memorandum received 15 April 2005;
- Draft **Sub-Lease** between Australian Agricultural Contracts Ltd ('the Lessee') and the Grower, received 8 April 2005;
- Draft **Management Agreement** between Australian Agricultural Contracts Ltd ('the Manager') and the Grower, received 15 April 2005;

- Draft Grain Co-Production Agreement between Australian Agricultural Contracts Ltd ('the Manager') and the Farmer, received 11 April 2005;
- Draft Lease Agreement between the Lessor and Australian Agricultural Contracts Ltd ('the Lessee') received 11 April 2005;
- Expert Agronomist Report dated 5 November 2004; and
- Expert Risk Management Report dated 22 November 2004.

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

16. 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 below.

17. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client or have accepted an offer that is a small scale offering. **This Ruling does not apply unless:**

- the Grower is a wholesale client as defined in section 761G of the *Corporations Act 2001*; or
- not being a retail client, the Grower has accepted a 'personal offer' of a small scale offering for the purpose of the *Corporations Act 2001*.

18. Each of these categories is explained in paragraphs 77 to 83 in the Explanation area of this Product Ruling.

19. 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

20. The salient features of the 2005 Grain Co-Production Project are as follows:

Location	The Wheatbelt, Western Australia
Type of business to be carried on by each participant	Wheat Farming
Number of hectares offered for cultivation	Up to 50,000 hectares
Size of each Co-Production Unit	Between 12 to 34 hectares (depending on productivity)
Minimum interest	6 Co-Production Units
Term of the Project	3.5 years
Initial cost per Co-Production Unit	$4,141.50
Initial cost per Interest (6 Co-Production Units)	$24,849
Ongoing costs	• Initial Period Fees; • Rent; • Management Bonus • Rent Bonus; • Harvest Management Fee; • Grain Marketing Fees; • Harvesting Period costs; and • Crop insurance.

21. The Manager of the 2005 Grain Co-Production Project is Australian Agricultural Contracts Ltd ('AACL'). The Project will be conducted across a number of wheat production zones located in the Wheatbelt area of Western Australia.

22. The Term of the Project is approximately 3.5 years, commencing on 16 May 2005. The Project will cover three wheat growing Seasons. There is no minimum subscription.

23. Each Applicant in the 2005 Grain Co-Production Project is required to have a minimum interest consisting of 6 Co-Production Units. Applicants may increase the size of their interest in the Project by increments of one Co-Production Unit. Each Co-Production Unit ('CPU') is a parcel of land which is expected to yield 40 Tonnes of Australian Premium White (APW) wheat per Season. The size of a CPU will depend on the productivity of the land.

24. The Manager will enter into Lease Agreements with landholders in the Wheatbelt for the provision of land for the purpose of growing wheat. The Manager will then sub-lease areas of the leased land to the Growers in the form of allocated CPUs.

25. The Grower will enter into a Management Agreement with the Manager to plant, manage, harvest, transport, market and sell the wheat crops grown on the Grower's CPUs. The Manager will enter into Grain Co-Production Agreements with Contract Farmers to perform the wheat farming services required under the Management Agreement on behalf of the Growers.

26. The Grower will sign a Power of Attorney to authorise AACL to execute, on behalf of the Grower, the Management Agreement and the Sub-Lease Agreements.

Lease Agreement

27. AACL, as Lessee, will enter into Lease Agreements each year with various Lessors for the use of suitable land for purpose of growing wheat. The Term of each Lease Agreement is from the Commencement Date until the harvest of the Crop from the land, but no later than 10 months from the Commencement Date.

28. AACL will divide the leased land into Co-Production Units. The area required for a CPU to produce the Project Yield (40 tonnes) and the Project Grade (Australian Premium White) will vary depending on a number of factors such as rainfall, climatic parameters, soil types and nutrition. CPUs will range in size from 12 to 34 hectares, based on productivity levels of between 1.2 and 3.5 tonnes of wheat per hectare.

Sub-Lease Agreement

29. The Grower will enter into a Sub-Lease Agreement with AACL for the sub-lease of the Co-Production Units. The Sub-Lease Agreement is conditional on the Grower executing a Management Agreement with AACL. The Term of each Sub-Lease Agreement reflects the wheat growing Season, being the period each year in which the Crop is planted, grown and harvested.

30. A new Sub-Lease Agreement between the Grower and AACL will be entered into for each Season. In the first Season, the Term is from the Commencement Date (16 May 2005) to the day after the Crop has been harvested from the Co-Production Units. The Commencement Date for the Sub-Lease Agreements in the two subsequent Seasons will be no later than 1st May in the relevant year and the agreements will terminate at harvest.

Management Agreement

31. Under the Management Agreement, AACL agrees to manage the production of wheat on the Grower's CPUs. The Management Agreement is conditional on the Grower entering a Sub-Lease Agreement for the use of the CPUs to plant and farm wheat.

32. The Term of the Management Agreement shall be the later of three years from the Commencement Date (16 May 2005), or until the final sale and distribution of funds derived from the sale of the Net Proceeds from the 2007 Project Pool. 'Project Pool' refers to the collective pool of all the Growers Crop in the Project. 'Crop' means the Wheat from it's germination from seed which grows into Wheat suitable for harvesting.

33. Each year the Grower pays an Initial Period Fee in consideration for the Manager performing the following services during the Initial Period:

- establish and maintain suitable access to each of the individual Co-Production Units;
- supply, propagate and husband the Seed for the Co-Production Unit;
- carry out the planting and sowing of the Seed;
- supply and maintain a pest and weed control programme including spraying;
- supply and spread fertiliser on the Co-Production Unit;
- provide general care and maintenance as required;
- maintain firebreaks;
- conduct regular checks on the progress of the Crop on each of the Co-Production Units; and
- conduct all other duties as are reasonably required and considered good farming practice for a Project of this type.

34. The Initial Period is from 16 May 2005 to 30 June 2005 in the first Season of the Project. In the two subsequent Seasons, the Initial Period is from the date the new Crop planting is commenced, being no later than 15 June each year, until the end of each respective financial year.

35. If the weather conditions are such that there is no good reason for the Wheat to be planted on the land, and the Manager is unable to find any other suitable land by 15 June each year, the Manager must repay the Initial Period Fees on or before 30 June of that financial year.

36. In the Subsequent Period, from 1 July to the date on which the Crop is harvested each Season, the Manager will perform the following services for the Grower:

- maintain suitable access to each of the individual Co-Production Units;
- maintain firebreaks;
- maintain a pest and weed control programme including spraying as required;
- supply and spread fertiliser on the Co-Production Unit as required;
- provide general care and maintenance as required;
- conduct regular checks on the progress of the Crop on each of the Co-Production Units;
- arrange compulsory crop insurance for the Grower;
- conduct all other duties as are reasonably required and considered good farming practice for a Project of this type;
- harvest the Crop from the Co-Production Unit by such means as the Manager in its absolute discretion shall deem reasonably necessary;
- transport, store, stock or handle the Crop in such manner so as to ensure the Crop is preserved and protected until such time as it can be sold;
- undertake by marketing or other means the sale of the Crop as soon as practically possible after its harvest; and
- account to the Grower for profits generated from the sale of the Crop.

37. The Grower is entitled to terminate the Management Agreement should the Manager breach any term of the Agreement or become insolvent.

Pooling and Sale of the Crop

38. The Crop harvested from a Grower's Co-Production Unit is referred to as 'Farm Proceeds'. The 'Gross Proceeds' is all the Farm Proceeds derived from all the Co-Production Units in the Project and pooled in the Project Pool, prior to the deduction of the Management Bonus and Rent Bonus.

39. After the Management Bonus and Rent Bonus are deducted from the Gross Proceeds, the balance of the Crop in the Project Pool is called the 'Net Proceeds'.

40. The Manager will market and sell the Net Proceeds and the Grower will be entitled to a distribution of the sale proceeds pro rata to the number of Co-Production Units held by the Grower in the Project Pool.

41. Where part of a Grower's Co-Production Unit is destroyed or damaged during the Term, the Grower will be entitled to receive a distribution in relation to the CPU where Farm Proceeds, including any insurance proceeds, from the CPU has been contributed to the Project Pool. If the Grower's entire Crop on a CPU is destroyed, the Grower will not be entitled to a distribution of sale proceeds in relation to that CPU.

Distribution of Proceeds

42. The Manager will hold the proceeds from the sale of the Net Proceeds in the Project Fund. Each Grower will have an interest in the Project Fund in proportion to the number of CPUs held by the Grower compared to the total number of CPU's held by all Growers in the Project Pool each Season.

43. The Manager is entitled to deduct certain fees from the sale of Net Proceeds, including the Initial Period Fees and Rent for the following Season. The Manager will provide a statement to the Grower showing the income (or loss) from the Grower's share of the sale of the Net Proceeds and the Initial Period Fees and Rent deducted from the sale of Net Proceeds.

44. The Manager will retain the balance from the sale of Net Proceeds from the 2005 and 2006 Project Pool, less any authorised deductions, in the Project Fund. The distribution of proceeds will not occur until after the completion of the sale of Net Proceeds from the 2007 Project Pool.

Fees

45. In consideration for the services to be performed under the Management Agreement, the following fees are payable by the Grower each Season:

- Initial Period Fee;
- Harvest Period Costs;
- Harvest Management Fee;
- Grain Marketing Fee;
- Crop Insurance; and
- the Management Bonus.

46. Under the Sub-Lease Agreement, the following fees are payable by the Grower each Season:

- Initial Period Rent;
- Subsequent Period Rent; and
- the Rent Bonus.

Initial Period Fee

47. The Initial Period Fee of $4,042.50 per CPU is payable in each year of the Project. On application, the Initial Period Fee is paid for services from the Commencement Date to 30 June 2005. For the minimum interest of 6 CPUs, the total of the Initial Period Fees payable on application is $24,255.

48. For the 2006 and 2007 Seasons, the Initial Period Fees (plus CPI) must be paid by 31 March 2006 and 31 March 2007, respectively. The Manager may recover the Initial Period Fees from the sale of Net Proceeds. If the sale of Net Proceeds is insufficient the Grower is liable to pay the shortfall.

Harvest Period Costs

49. The Manager is entitled to charge the Grower the costs and disbursements incurred relating to transportation, marketing and sale of the Crop. The Manager will deduct these fees and charges from the sale of Net Proceeds.

Harvest Management Fee and the Grain Marketing Fee

50. The Harvest Management Fee and the Grain Marketing Fee will become payable on the completion of harvest in each Season. The Harvest Management Fee is $198 per CPU. The Grain Marketing Fee is $2.20 per tonne of the Grower's Wheat delivered, marketed and sold in the Project Pool by the Manager. Both fees are payable from the sale of Net Proceeds and are subject to increases in CPI after the first year of the Project.

Crop Insurance

51. The Manager will arrange compulsory crop insurance for each CPU to cover the Grower against the risks of fire and hail. The cost of the crop insurance will be at the expense of the Grower and will be payable from the sale of Net Proceeds or recovered from the Grower where the funds from the sale proceeds are insufficient. The cost of the Crop Insurance is estimated to be approximately $1.65 per tonne.

Management Bonus

52. In consideration for the performance by the Manager of services in the Subsequent Period, the Manager is entitled to be paid a Management Bonus based on 50% of the Harvest Bonus.

53. The 'Harvest Bonus' means the Crop harvested from the CPU above the Target Value of $6,600. The Harvest Bonus is calculated by deducting the Target Value from the Delivered Value of Farm Proceeds.

54. The Delivered Value of Farm Proceeds attributes a dollar value per tonne of Farm Proceeds. The Delivered Value is calculated by multiplying the Farm Proceeds per CPU by the Estimated Pool Return price. The Estimated Pool Return price is the price per tonne as quoted by the Australian Wheat Board Ltd on 15th October each Season.

55. The Management Bonus is deducted from the Gross Proceeds and is paid in the form of wheat.

Rent

56. The Grower will pay the Lessee Rent of $445.50 for the 2005 Season of the Project, consisting of

- $99 payable on application, for the Initial Period from the Commencement Date to the end of the financial year; and
- $346.50 payable from the sale of Net Proceeds, for the Subsequent Period, from 1 July till the completion of the harvest.

57. For the 2006 and 2007 Seasons the amount of the $445.50 will be increased by the CPI adjustment and will be payable from the sale of Net Proceeds.

Rent Bonus

58. In consideration for the performance by the Lessee in the selection of the land, the Lessee will be entitled to a Rent Bonus. The Rent Bonus will be calculated as 40% of the Harvest Bonus and be deducted from the Gross Proceeds of the Project Pool and paid in the form of Wheat.

Grain Co-Production Agreement

59. The Manager will enter into a Grain Co-Production Agreement with a Farmer to provide the services necessary to plant, manage and harvest the Crop on the Land described in the Lease Agreement. In the Initial Period each Season, the Farmer must plant, spray and fertilise the Crop. In the Subsequent Period each Season, the Farmer shall provide spraying and fertilising (as required), and harvest and transport the Crop.

60. The Farmer must keep the Crop identified as the property of the Manager, on behalf of the Grower, at all times and in all forms of storage between harvest and delivery of the Crop to the Receival Bin.

Finance

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

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

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

Ruling

Application of this Ruling

63. This Ruling applies only to Growers who:

- are accepted to participate in the Project on or before 16 May 2005;
- have executed a Management Agreement and a Sub-Lease Agreement on or before that date; and
- are either a wholesale client (section 761G of the *Corporations Act 2001*) or have accepted a 'personal offer' of a small scale offering (section 1012E of the *Corporations Act 2001*).

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

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

69. Other than Growers referred to in paragraph 70, for the 2005-06 income year and later years, a Grower will be assessable on ordinary income from carrying on their business of wheat farming 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 wheat farming in the income year in which that income is received, or dealt with on their behalf.

Deductions for Initial Period Fees, Harvest Period Costs, Harvest Management Fees, Grain Marketing Fees, Crop Insurance, Management Bonus, Rent and Rent Bonus

Section 8-1 and section 328-105

71. A Grower may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the Table below.

72. However, if for any reason, an amount shown or referred to in the Tables 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. Any amount or part of an amount shown in the Table(s) 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.

73. Deductions available for a Grower per CPU are as follows:

Fee Type	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Initial Period Fee	$4,040.50 See Notes (i) and (ii)	$4,040.50 (plus CPI) See Notes (i) and (iii)	$4,040.50 (plus CPI) See Notes (i) and (iii)
Harvest Period Costs		As incurred. See Notes (i) and (iii)	As incurred. See Notes (i) and (iii)
Harvest Management Fee		$198 See Notes (i) and (iii)	$198 (plus CPI) See Notes (i) and (iii)
Grain Marketing Fee		$2.20 per tonne See Notes (i) and (iii)	$2.20 (plus CPI) per tonne. See Notes (i) and (iii)
Crop insurance		See Notes (i) and (iii)	See Notes (i) and (iii)
Management Bonus		See Notes (i) and (iii)	See Notes (i) and (iii)
Rent	$99 See Notes (i) and (ii)	$445.50 (plus CPI) See Notes (i) and (iii)	$445.50 (plus CPI) See Notes (i) and (iii)
Rent Bonus		See Notes (i) and (iii)	See Notes (i) and (iii)

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 1 at paragraph 111.

(ii) The Initial Period Fee and Rent shown in the Management Agreement and the Sub-Lease Agreement are deductible in full in the year that they are incurred where the Grower is not an 'STS taxpayer' and when paid where the Grower is an 'STS taxpayer'.

(iii) The Initial Period Fees, Harvest Period Costs, Harvest Management Fees, Grain Marketing Fees, Crop insurance, Management Bonus, Rent and Rent Bonus shown in the Management Agreement and the Sub-Lease Agreement, are deductible in full in the year they are incurred where the Grower is not an 'STS taxpayer' or an 'STS taxpayer' using the accruals accounting method, and when the Fees are paid by a Grower who is an 'STS taxpayer' who uses the cash accounting method.

Interest

74. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 102 to 104 as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

Section 35-55 – exercise of Commissioner's discretion

75. A Grower who is an individual accepted into the Project by 16 May 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 year ending **30 June 2005**. 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

76. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Sub-Lease Agreement 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 (but see paragraphs 102 to 104);
- 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

Corporations Act 2001

77. For this Ruling to apply, an offer for an interest in the Project must:

- have been made to, and accepted by a Grower, who qualifies as a wholesale client as defined in section 761G of the *Corporations Act 2001*; or
- be an offer which qualifies as a small scale offering as defined in section 1012E of the *Corporations Act 2001*.

Small scale offers and offers to wholesale clients do not require a prospectus or product disclosure statement.

78. A Grower in the Project may be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the person satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c)); or
- the 'professional investor test' (paragraph 761G(7)(d)).

79. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'product value test' where:

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least $500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least $500,000.

80. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'individual wealth test' where, it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made, that the person to whom the offer is made:

- has net assets of at least $2.5 million; or
- has a gross income for each of the last 2 financial years of at least $250,000 a year.

81. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'professional investor test' where:

- the person is a financial services licensee; or
- the person controls at least $10 million for the purposes of investment in securities.

82. Alternatively, under section 1012E, a Grower may participate in the project by accepting a 'personal offer' for an interest in the project. Offers made under section 1012E cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than $2 million dollars (subsection 1012E(2)).

83. An offer will be a 'personal offer' where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 1012E(5)).

Is the Grower carrying on a business?

84. For the amounts set out in the Table at paragraph 73 to constitute allowable deductions the Grower's wheat growing activities as a participant in the 2005 Grain Co-Production Project must amount to the carrying on of a business of primary production.

85. Where there is a business, or a future business, the gross proceeds from the sale of the Crop 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.

86. For schemes such as that of the 2005 Grain Co-Production 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.

87. Generally, a Grower will be carrying on a business of wheat growing, and hence primary production, if:

- the Grower has an identifiable interest (by sub-lease) in the land on which the Grower's Crop is planted, grown and harvested;
- the Grower has a right to harvest and sell the Crop;

- the wheat farming activities are carried out on the Grower's behalf;
- the wheat farming activities of the Grower are typical of those associated with a wheat farming business; and
- the weight and influence of general indicators point to the carrying on of a business.

88. In this Project, each Grower enters into a Management Agreement and a Sub-Lease Agreement.

89. Under the Sub-Lease Agreement each individual Grower will have rights over a specific and identifiable area of land known as a Co-Production Unit. The Sub-Lease Agreement provides the Grower with an interest in the Crop growing on the leased CPU for the term of the Sub-Lease Agreement. Under the Sub-Lease the Grower must use the land in question for the purpose of carrying out wheat farming activities, and for no other purpose. The Sub-Lease allows the Manager to come on to the land to carry out its obligations under the Management Agreement.

90. Under the Management Agreement the Manager is engaged by the Grower for the purpose of managing and producing wheat on the Grower's CPUs during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services on the Grower's behalf.

91. The Manager is also engaged to harvest and sell, on the Grower's behalf, the Crop grown on the Grower's CPUs.

92. 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.

93. 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 Crop 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.

94. The pooling of Crop grown on the Grower's CPUs with the Crop of other Growers is consistent with general wheat farming practices. Each Grower's proportionate share of the sale proceeds of the pooled Crop will reflect the proportion of the Grower's CPUs contributing to the Project Pool.

95. The Manager's services are also consistent with general wheat farming practices. They are of the type ordinarily found in wheat farming ventures that would commonly be said to be businesses. While the size of a CPU is relatively small, it is of a size and scale to allow it to be commercially viable.

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

97. The wheat farming 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' wheat farming activities in the 2005 Grain Co-Production Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

98. 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.

99. 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'.

Deductions for Initial Period Fees, Harvest Period Costs, Harvest Management Fees, Grain Marketing Fees, Crop Insurance, Management Bonus, Rent and Rent Bonus

Section 8-1

100. Consideration of whether the fees payable under the Management Agreement and the Sub-Lease 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.

101. The fees payable under the Management Agreement and the Sub-Lease Agreement associated with the wheat farming activities will relate to the gaining of income from the Grower's business of wheat farming (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of the Crop) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the fees payable under the Management Agreement. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZL to 82KZMF

102. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (for example, the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

Application of the prepayment provisions to this Project

103. Under the Arrangement to which this Product Ruling applies the fees payable under the Management Agreement and the Sub-Lease Agreement are incurred annually. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this Arrangement.

104. However, sections 82KZME and 82KZMF may have relevance if a Grower prepays interest under a loan agreement. 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.

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

Section 35-55 – exercise of Commissioner's discretion

105. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income year ending **30 June 2005** 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 year ended 30 June 2005:

- 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 wheat farming industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

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

Section 82KL – recouped expenditure

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

Part IVA – general tax avoidance provisions

108. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

109. The 2005 Grain Co-Production 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 73 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

Example

Entitlement to GST input tax credits

111. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 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	$2,200*
Total due and payable by 1 January 2004 (includes GST of $600)	$6,600

*Taxable supply

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

$$^{1}/_{11} \times \$4,400 = \$400.$$

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

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

$$^{1}/_{11} \times \$2,200 = \$200.$$

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

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

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

Commissioner of Taxation
27 April 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Subdiv 61-J
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- TAA 1953 Pt IVAAA
- Copyright Act 1968
- Corporations Act 2001
- Corporations Act 2001 761G
- Corporations Act 2001 761G(a)
- Corporations Act 2001 761G(c)
- Corporations Act 2001 761G(d)
- Corporations Act 2001 1012E
- Corporations Act 2001 1012E(2)
- Corporations Act 2001 1012E(5)

Case references:

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

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