


# ***PR 2006/49W - Income tax: Australian South Sea Pearl Project 2006 (Retail)***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *24 July 2013*



## Product Ruling

### Income tax: Australian South Sea Pearl Project 2006 (Retail)

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

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## Withdrawal

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1. Product Ruling PR 2006/49 set out the Commissioner's opinion on the tax consequences for a defined class of entities ('the Growers') participating in the Australian South Sea Pearl Project 2006 (Retail) ('the Project'), an aquaculture managed investment scheme with the purpose of carrying on a commercial project involving the cultivation, harvest and sale of pearls.
2. This Product Ruling was withdrawn in accordance with subsection 358-20(1) of Schedule 1 to the *Taxation Administration Act 1953*, which states the Commissioner may withdraw a public ruling either wholly or to an extent. Where the scheme described in the ruling is materially different from the scheme actually carried out, the ruling does not have any binding effect on the Commissioner, as the scheme entered into is not the scheme being ruled upon.
3. Provided that up until 17 July 2012 the Project was carried out as described in PR 2006/49, the events described below do not disturb the tax treatment of the Grower's previous outgoings, up until 17 July 2012, as set out in PR 2006/49.
4. All legislative references in this withdrawal notice are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise stated.

### Events since 21 April 2011

5. On 21 April 2011, Voluntary Administrators (the Administrators) were appointed to Arafura Pearls Holdings Limited (the Responsible Entity).
6. On 1 March 2012, the Administrators issued a Report to Growers, which stated that a first harvest of the Project occurred in 2010.
7. On 24 April 2012, the Federal Court directed the Administrators to wind up the Project, and that the Administrators be appointed as Receivers of the property of the Project to ensure its orderly winding up.

8. On 28 May 2012, the Federal Court directed that the Administrators may properly enter into and perform the Grower Rights Termination Agreement (GRTA). The Federal Court also gave directions as to the manner and proportion of shares and options in GP No. 2 Limited (acquirer of the pearl farming assets of the Responsible Entity with a view to continue the farming operations) to be allocated amongst Growers in consideration for performing the GRTA. The rights of Growers to any net sale proceeds from pearls already harvested prior to the settlement of GRTA are unaffected.

9. On 17 July 2012, the GRTA was settled, which resulted in the termination of Project Growers' rights to access the pearl shell and panels used in the pearl farms, and the issue of shares and options in GP No. 2 Limited to Growers in consideration for the termination of Project Grower's rights.

10. On 16 May 2013, the Administrators advised the ATO that no fees have been invoiced to Growers since their appointment on 21 April 2011. However, the Deferred Management Fee, the Sales and Marketing Fee, and the Administrators and Deed Administrators' costs incurred in securing and realising the pearl harvest will be taken from the Gross Pearl Sales and the balance distributed to Growers. The Growers will not be liable for any of the Deferred Management Fee, the Sales and Marketing Fee, and the Administrators and Deed Administrators' costs in excess of the Gross Pearl Sale proceeds.

11. The settlement of the GRTA resulted in the Project being carried out in a materially different manner from the Project described in PR 2006/49. Consequently, PR 2006/49 has no binding effect on the Commissioner after 17 July 2012, and the Commissioner has withdrawn PR 2006/49 as per paragraph 10 of PR 2006/49.

## **Carrying on a business**

12. A Grower is no longer carrying on a primary production business of aquaculture from the date that the GRTA was settled on 17 July 2012.

## **Deferral of losses from non-commercial business activities**

13. Division 35 applies only to individuals, alone or in partnership, who are carrying on a business activity. Under paragraph 77 of PR 2006/49, the Commissioner conditionally undertook to exercise his discretion under paragraph 35-55(1)(b) to allow losses incurred by Growers that are individuals to be offset against other assessable income in the income year in which the losses arise for the income years ending 30 June 2006 to 30 June 2010.

14. As the Commissioner has not exercised his discretion for the income year ending 30 June 2011 and subsequent income years any losses from the individual Grower's business activity will have to be deferred under subsection 35-10(2) unless for each income year ending 30 June 2011 and subsequent income years, the individual:

- meets the income requirement test in subsection 35-10(2E), and the business activity meets at least one of the four business activity tests in Division 35; or
- comes within the exception in subsection 35-10(4).

15. amounts deferred under subsection 35-10(2) as outlined in paragraph 14 will only be deductible in a subsequent year if the business activity that gave rise to this amount or a business activity 'of a similar kind' is carried on in that subsequent year. If the business activity, or a business activity that is 'of a similar kind', is never carried on again, the entitlement to deduct the amount will be lost. For more information regarding 'business activity of a similar kind' see paragraphs 49 to 54 of Taxation Ruling TR 2001/14 *Income tax: Division 35 - non-commercial business losses*.

16. Due to the cessation of a Grower's business activity on 17 July 2012 as per paragraphs 9, 11 and 12, the Project is no longer implemented in accordance with PR 2006/49, and as such the Commissioner's discretion is no longer required after 17 July 2012.

### **Costs after business activities cease**

17. Amounts incurred after the business activity ceases, for example interest (refer to paragraphs 30 and 31 below), may still be deductible as such deductions are not subject to Division 35.

18. A Grower who incurs capital expenditure after the business ceases will be entitled to claim a deduction under section 40-880 so long as the expenditure is related to the aquaculture business activity, as the Commissioner has exercised his discretion in section 35-55 in relation to one or more income years prior to the cessation of business activity (subsection 35-10(2A)).

### **Treatment of harvested Pearls as trading stock**

19. Paragraphs 71 to 75 of PR 2006/49 ruled on the deductibility of harvested pearls. It indicated that harvested pearls are trading stock on hand.

20. The Administrators have announced that the Growers' rights in relation to any pearls harvested in 2010 will remain unaffected by the GRTA. As such, the Growers remains entitled to proceeds from first harvest which occurred in 2010.

21. As the Growers were carrying on a business at the time of harvesting, the harvested pearls in 2010 are considered to be the Growers' trading stock.

22. In conjunction with the ceasing of carrying on a business on 17 July 2012, the pearls cease to be treated as trading stock, however as the Growers still retain the rights to the harvested pearls, section 70-110 applies. Growers are treated as if having sold the pearls in the ordinary course of business on 17 July 2012 for its cost, and immediately bought it back for the same amount.

23. In accordance with the treatment at paragraph 22 above, each Grower is considered to have acquired a CGT asset on 17 July 2012. The cost of the pearls would be included in the cost base and reduced cost base. In calculating the cost base and reduced cost base of the CGT asset, Growers do not include costs if they have claimed a tax deduction or are able to claim a deduction for them in any year, as per sections 110-25 (cost base) and 110-55 (reduced cost base). As all costs prior to 17 July 2012 associated with the pearls would have been deducted or be deductible to the Growers, these costs would not be included in the cost base and reduced cost base of the pearls.

24. CGT Event A1 occurs on the date that Growers receive proceeds distributed by the Administrators from the harvested pearls, as they are no longer the beneficial owner of the harvested pearls. Capital proceeds for the CGT Event includes Gross Pearl Sales from the harvested pearls, less any GST payable on these proceeds (section 17-5). Where proceeds from the Gross Pearl Sales are distributed after 17 July 2013, Growers who are individuals, complying superannuation funds, or trusts are eligible for discount capital gain on capital gains from the CGT Event, with discount percentage of either 50% for individual and trust Growers, or 33% for Growers who are complying superannuation funds. In calculating a Grower's net capital loss for an income year, the discount percentage is to be calculated after applying net capital losses for previous income years (section 100-50).

25. The Administrators have advised the ATO that no fees have been invoiced to Growers since their appointment on 21 April 2011. However, the Deferred Management Fee, the Sales and Marketing Fee, and the Administrators and Deed Administrators' costs incurred in securing and realising the pearl harvest will be taken from the Gross Pearl Sales and the balance distributed to Growers. The Growers will not be liable for any of the Deferred Management Fee, the Sales and Marketing Fee, and the Administrators and Deed Administrators' costs in excess of the Gross Pearl Sale proceeds.

26. Any invoiced fees as discussed above will form part of the cost base for the pearls, and the Gross Pearl Sales will form the capital proceeds.

## **Deductibility of Sales and Marketing Fees, Insurance Premiums, Deferred Management Fees, Deferred Management Fee Shortfall and Bonus**

27. The Commissioner described the following fees in PR 2006/49: Sales and Marketing Fees, Insurance Premiums, Deferred Management Fees, Deferred Management Fee Shortfall and Bonus. The Sales and Marketing Fees were ruled to be deductible under section 8-1, in the income year in which they were incurred.

28. Prior to the cessation of the business on 17 July 2012, the Deferred Management Fees, Deferred Management Fee Shortfall, Sales and Marketing Fee, and Bonus, were payable from the Grower's share of the Gross Pearl Sales at the conclusion of each Harvest. The tax treatments of these fees are discussed above at paragraphs 25 and 26 and are otherwise not deductible.

29. The Insurance Premiums were ruled to be deductible in full in the year that they were incurred. However, individual Growers are subject to Division 35 which may affect the deductibility of the fees. See paragraphs 13 to 16 for further details. The Administrators have advised that they may invoice the Growers for reimbursement of Insurance Premiums that the Administrators have paid on the Project shells, these amounts are deductible to Growers in the year that they were incurred.

#### **Interest on Loans with Momentum Finance**

30. Prior to the cessation of the business, interest on loans with Momentum Finance is deductible in the income year that it was incurred. However, individual Growers are subject to Division 35 which may affect the deductibility of the fees. See paragraphs 13 to 16 for further details.

31. Interest expenses incurred following the cessation of the business may continue to be deductible upon meeting the requirements outlined in Taxation Ruling TR 2004/4 *Income Tax deductions for interest incurred prior to the commencement of, or following the cessation of, relevant income earning activities*.

#### **Deductibility of the Loan Application Fee**

32. Note (vi) to paragraph 76 of PR 2006/49 ruled that the Loan Application Fee payable to Momentum Finance is deductible under section 25-25 of the ITAA 1997 over the period of the loan or 5 years, whichever is the shorter. For the income year ending 30 June 2011 until the cessation of the business, the Loan Establishment Fee is deductible in the income year that it was incurred. However, individual Growers are subject to Division 35 which may affect the deductibility of the fees. See paragraphs 13 to 16 for further information.

33. Upon settlement of the GRTA on 17 July 2012, Growers may have had a balance of undeducted Loan Establishment Fees. The Loan Establishment Fees will continue to be deductible.

## **CGT event C2 on settlement of GRTA**

34. CGT event C2 occurs upon settlement of GRTA as per section 104-25, as Grower's rights as mentioned in paragraph 9 above has been terminated, consequently cancelling the Grower's rights.

35. The cost base and reduced cost base for the Grower's Rights will not include any money that was paid in relation to entering into and obtaining the Grower's interest in the Project (the Application Fee) as these costs are otherwise deductible as per sections 110-45 and 110-55. In calculating the cost base and reduced cost base, none of the fees mentioned above are included, as these fees were deductible under provisions outside of the CGT provision.

36. As Growers received shares and options in GP No. 2 Limited (GP2) in consideration for the settlement of the GRTA, the capital proceeds will include the market value, if any, of the shares and options on the day of allotment to the Growers.

## **Shares received on settlement of the GRTA**

37. Shares in GP2 were issued to Growers in consideration for the termination of Project Grower's rights through settlement of the GRTA on 17 July 2012.

38. Each Grower is taken to have acquired a CGT asset, being shares in GP2. The cost base and reduced cost base of these shares will include an amount for consideration, being the market value, if any, of the shares on the day of allotment to Growers.

39. Where GP2 is being wound up and in the course of winding up, the Liquidator or Administrator announce, in writing, that they have reasonable grounds to believe that there is no likelihood that shareholders will receive any further distributions, CGT event G3 will occur in relation to GP2 shares held by the Grower.

40. Where the Grower's shares in GP2 are cancelled, or where GP2 is deregistered under the Corporations Law, CGT event C2 will occur. CGT Event C2 may occur in relation to the shares if GP2 is deregistered as per Taxation Determination TD 2000/7 *Income tax: capital gains: when does a CGT event happen to shares in a company for the purposes of Part 3-1 and Part 3-3 of the Income Tax Assessment Act 1997, if the company is deregistered under the Corporations Law?*

41. In calculating capital gains or losses from CGT Events relating to the shares in GP2, the cost base and reduced cost base excludes amounts that the Grower has deducted, or can deduct, under other provisions outside of the CGT provisions as per sections 110-45 and 110-55.

42. Deductions deferred under the non-commercial business activities provisions (Division 35) do not form part of the cost base or reduced cost base of shares in GP2 and therefore are not taken into account when calculating any capital gains or losses on the shares when CGT event C2 or G3 occurs.

### **Distributions relating to Shares in GP2**

43. Distributions or payments made to Growers in relation to their shares held in GP2 will not be treated as income from carrying on a business of pearl cultivation, and losses from carrying on a business cannot be used to offset these distributions or payments.

### **Options received on settlement of the GRTA**

44. Options in GP2 were issued to Growers in consideration for the termination of Project Grower's rights through settlement of the GRTA on 17 July 2012.

45. Each Grower is taken to have acquired a CGT asset, being options in GP2. The cost base and reduced cost base of these options will include an amount for consideration, being the market value, if any, of the options on the day of allotment to Growers.

46. CGT Event C2 occurs when the Grower's ownership in the option ends by the option being exercised, or when the option expires. In relation to the option being exercised, section 134-1 states that:

- (a) the first element of the Grower's cost base and reduced cost base for the CGT asset is what the Grower paid for the option, plus any amount the Grower paid to exercise it; and
- (b) a capital gain or loss that the Grower makes from exercising the option is disregarded.

47. Where GP2 is being wound up and in the course of winding up, the Liquidator or Administrator announce, in writing, that they have reasonable grounds to believe that the option (or a class of financial instruments that include options) has no value or has only negligible value, CGT event G3 will occur in relation to GP2 options held by the Grower.

48. Deductions deferred under the non-commercial business activities provisions (Division 35) do not form part of the cost base or reduced cost base of options in GP2 and therefore are not taken into account when calculating any capital gains or losses on the options when CGT event C2 occurs.



## References

### *Previous draft:*

Not previously issued as a draft

### *Related Rulings/Determinations:*

TR 97/11; TR 98/22; TR 2000/8;  
TR 2001/14; TR 2002/6;  
TR 2002/11

### *Subject references:*

- borrowing expenses
- 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
- taxation administration

### *Legislative references:*

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
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- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 25-5
- ITAA 1997 25-25
- 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 70
- ITAA 1997 70-35
- ITAA 1997 70-45
- ITAA 1997 Div 328
- ITAA 1997 328-285
- ITAA 1997 328-285(1)
- ITAA 1997 328-285(2)
- ITAA 1997 Subdiv 328-F
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- IT(TP)A 1997 328-120
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- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- Corporations Act 2001
- Fisheries Act 1988 (NT)
- Fisheries Act 1988 (NT) 17(1)(e)
- Fisheries Regulations 1992 (NT)

### *Case references:*

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

### ATO references

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