PR 2007/17 - Income tax: 2007 Grain Co-Production Project

Product Ruling

Income tax: 2007 Grain Co-Production Project

Contents Para

This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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. 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 scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product 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 Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. In this Product Ruling this scheme is referred to as the 2007 Grain Co-Production Project or simply as 'the Project'.

Class of entities

2. This part of the Product Ruling specifies which entities can rely on the tax benefits set out in the Ruling section of this Product Ruling and which entities cannot rely on those tax benefits. In this Product Ruling, those entities that can rely on the tax benefits set out in this Ruling are referred to as Grower.

3. The class of entities who can rely on those tax benefits consists of entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and which execute relevant Project Agreements mentioned in paragraph 26 of this Ruling on or before 31 May 2007. They must have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement.

4. The class of entities who can rely on the tax benefits set out in the Ruling section of this Product Ruling does **not** include entities who:

- intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- are accepted into this Project before the date of this Ruling or after 31 May 2007;
- participate in the scheme through offers made other than through the Product Disclosure Statement;
- finance their participation in the Project through loans with entities associated with the Macro Funds Ltd other than those described at paragraphs 97 to 107 of this Ruling; or
- are Macro Funds Ltd or its associates.

Qualifications

5. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 26 to 107 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then:

- this Product Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Product Ruling may be withdrawn or modified.

Date of effect

8. This Product Ruling applies prospectively from 14 March 2007, the date this Product Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 14 March 2007 until 31 May 2007, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities up to 30 June 2009. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

9. However the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Changes in the Law

13. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to that extent, this Product Ruling will have no effect.

14. Entities who are considering participating in the scheme 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

15. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes 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 Product Ruling is issued.

Goods and Services Tax

16. All fees and expenditure referred to in this Product 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.

Ruling

Application of this Ruling

17. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 26 to 107 of this Ruling.

18. The Grower's participation in the Project must constitute the carrying on a business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of execution of their Grower Sub-Lease Agreement and Grower Management Agreement.

The Simplified Tax System (STS)

Division 328

19. To be an 'STS taxpayer', a Grower must be eligible to be an 'STS taxpayer' and must have elected to an 'STS taxpayer' (Division 328 of the ITAA 1997). For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act* 1997.

20. For such Growers, a reference in this Ruling to an amount being deductible when 'incurred' will mean that amount is deductible when paid and a reference to an amount being included in assessable income when 'derived' will mean that amount is included in assessable income when received.

25% entrepreneurs tax offset

Subdivision 61-J

21. For the first income year starting on or after 1 July 2005, Subdivision 61-J 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 and section 17-5

22. 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), plus any receipts from the Responsible Entity will be assessable income of the Grower under section 6-5.

Grower's deductions

Section 8-1, section 25-25 and Division 27

23. A Grower may claim tax deductions for the following fees and expenses on a per Co-Production Unit basis, as set out in the table below:

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Initial Period Fee	$4,334 See Notes (i) and (ii)	$3,850 (plus CPI) See Notes (i), (ii) and (iv)	$3,850 (plus CPI) See Notes (i), (ii) and (iv)
Subsequent Period Fee		$445.50 See Notes (i) , (ii) and (iv)	$445.50 (plus CPI) See Notes (i), (ii) and (iv)
Harvest Period Costs		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Warehouse Costs		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Harvest Loan Costs		As incurred See Notes (i), (ii) and (iii)	As incurred See Notes (i), (ii) and (iii)
Management Production Bonus		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Harvest Bonus Adjustment		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Crop & Multi Peril Insurance		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Rent	$55 See Notes (i) and (ii)	$192.50 See Notes (i), (ii) and (iv)	$247.50 (plus CPI) See Notes (i), (ii) and (iv)
Rent Bonus		As incurred See Notes (i) and (ii)	As incurred See Notes (i) and (ii)
Interest on loans with Preferred Financiers	As incurred See Notes (ii), (iv) and (v)	As incurred See Notes (ii), (iv) and (v)	As incurred See Notes (ii), (iv)and (v)
Borrowing Expenses for loans with Preferred Financiers	Must be calculated See Note (vi)	Must be calculated See Note (vi)	Must be calculated See Note (vi)

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.

(ii) The Initial Period Fee, Subsequent Period Fee, Harvest Period Costs, Warehouse Costs, Harvest Loan Costs, Management Production Bonus, Harvest Bonus Adjustment, Crop and Multi Peril Insurance, Rent, Rent Bonus and interest on loans with the Preferred Financiers are deductible under section 8-1 in the income year in which they are incurred.

(iii) The Responsible Entity will inform the Grower each Season of the amount of any Harvest Loan Costs and in which financial year the amount is paid and therefore incurred.

(iv) This Ruling does not apply to Growers who choose to prepay fees or who choose, or are required to prepay interest under a loan agreement (see paragraphs 119 to 123 of this Ruling). Subject to certain exclusions, 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 *Income Tax Assessment Act 1936* (ITAA 1936). Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.

(v) The deductibility or otherwise of interest arising from agreements entered into with financiers other than United Pacific Finance Pty Ltd and Momentum (the Preferred Financiers), is outside the scope of this Ruling. Growers who enter into agreements with other financiers may request a private ruling on the deductibility of the interest incurred.

(vi) The loan Application Fee payable to Momentum and the loan Establishment Fee and stamp duty payable to United Pacific Finance Pty Ltd are borrowing costs and are deductible under section 25-25. They are incurred for borrowing funds that are used or are to be used during the 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 the Preferred Financiers is outside the scope of this Ruling.

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

Section 35-55 – exercise of Commissioner's discretion

24. A Grower who is an individual accepted into the Project by 31 May 2007 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 Growers for the income year ended **30 June 2007**. 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.

Prepayment provisions and anti-avoidance provisions

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

25. For a Grower who participates in the Project and incurs the expenditure set out in the Grower Management Agreement and the Grower 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;
- 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.

Scheme

26. The scheme that is the subject of this Ruling is identified and described in the following documents:

- Application for a Product Ruling as constituted by documents provided on 8 December 2006, and additional correspondence, including emails, dated 14 December 2006, 8 January 2007, 27 January 2007, 29 January 2007, 1 February 2007 and 20 February 2007;
- Draft Product Disclosure Statement for the 2007 Grain Co-Production Project, received 20 February 2007;
- Draft Constitution of the 2007 Grain Co-Production Project, received 20 February 2007;
- Draft Compliance Plan for the 2007 Grain Co-Production Project, received 8 December 2006;

- Draft **Grower Sub-Lease Agreement (2007)** between Macro Funds Ltd (as Responsible Entity) and the Grower, received 20 February 2007;
- Draft **Grower Sub-Lease Agreement (Subsequent Years)** between Macro Funds Ltd (as Responsible Entity) and the Grower, received 20 February 2007;
- Draft **Grower Management Agreement** between Macro Funds Ltd (as Responsible Entity) and the Grower, received 20 February 2007;
- Draft Farmer Management Agreement between Australian Agricultural Contracts Ltd (ACCL) and the Farmer, received 29 January 2007;
- Draft Service Agreement between Macro Funds Ltd and AACL, received 29 January 2007;
- Draft Farm Lease Agreement between the Farm Lessor and AACL, received 8 December 2006;
- Draft 2007 Lease Agreement between Macro Funds Ltd and AACL, received 27 January 2007;
- Draft **Finance Application (including Loan Terms)** between Allco Managed Investments Limited as Trustee of the Gateway Momentum Funding Trust No. 1 (Momentum) and the borrowing Grower, received 8 December 2006 and 29 January 2007; and
- Draft **Finance Application (including Loan Terms)** between United Pacific Finance Pty Ltd and the borrowing Grower, received 14 December 2006 and 29 January 2007.

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

27. The documents highlighted are those that a Grower may enter into. For the purposes of describing the scheme 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 scheme. The effect of these agreements is summarised as follows.

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

Overview

29. The main features of the 2007 Co-Production Project are as follows:

Location	The Wheat-belt, Western Australia
Type of business to be carried on by each participant	Wheat Farming
Number of hectares offered for cultivation	Approximately 100,000 hectares
Size of each Co-Production Unit	Between 12 and 34 hectares (depending on productivity)
Minimum interest	4 Co-Production Units
Term of the Project	Approximately 52 months
Initial cost per Co-Production Unit (2007 Season)	$4,389
Initial cost per Interest (4 Co-Production Units – 2007 Season)	$17,556
Ongoing costs	• Initial Period Fees; • Rent; • Subsequent Period Fee; • Harvest Period Costs; • Warehouse Costs; • Harvest Loan Costs; • Project Finalisation Fee; • Management Production Bonus; • Rent Bonus; • Harvest Bonus Adjustment • Crop insurance; and • Multi peril insurance (subject to availability and market conditions).

30. The Project is registered as a managed investment scheme under the *Corporations Act 2001*. Macro Funds Ltd (Macro) has been issued with Australian Financial Service Licence No 254421 and will be the Responsible Entity for the Project.

31. The Project will involve the planting, growing and harvesting of wheat for sale. A wheat crop will be planted in the 2007, 2008 and 2009 Seasons.

32. An offer to participate in the Project will be made on the Application Form included in the Product Disclosure Statement (PDS). The offer under the PDS is for approximately 100,000 hectares of land to be planted with wheat. There is no minimum amount to be raised under the PDS.

33. A Grower that participates in the Project will do so by acquiring an interest in the Project which will consist of a minimum of 4 Co-Production Units. Thereafter, a Grower may apply for interests in increments of 1 Co-Production Unit (CPU). Each CPU is a parcel of land which is expected to yield 40 tonnes of Australian Premium White wheat per Season. The size of a CPU will range from 12 to 34 hectares based on productivity of between 1.2 and 3.5 tonnes of wheat per hectare. The actual size of a CPU will depend on the expected yield.

34. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints Macro to enter into, on behalf of the Grower, a Grower Sub-Lease Agreement and a Grower Management Agreement and any other documents required to hold an interest in the Project.

35. The land on which the Project will be conducted is situated on various wheat properties spread across the Western Australian Wheat-belt. Australian Agricultural Contracts Ltd (AACL) will enter into Farm Lease Agreements with various Farm Lessors for the provision of land for the Project. Under a Head Lease Agreement, AACL will then lease the land to Macro who in turn will sub-lease the land to Growers in the form of allocated CPUs.

36. Each Grower will use their CPUs for the purpose of carrying on a business of cultivating and harvesting wheat and the sale of the harvested produce.

Constitution

37. The Constitution establishes the Project and operates as a deed binding on all of the Project's Growers and Macro. The Constitution sets out the terms and conditions under which Macro agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

38. In order to acquire an interest in the Project, the Grower must make an application for CPUs in accordance with clause 10. Among other things, the application must be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant, lodged at the registered office of the Responsible Entity and accompanied by payment of the Application money in a form acceptable by the Responsible Entity.

39. Under clause 11 of the Constitution, the Responsible Entity holds the Application funds as bare trustee. The Responsible Entity will deposit all Application money in the Project Fund (clause 3.5).

40. Once the Responsible Entity has accepted the Application and the Grower Sub-Lease Agreement and Grower Management Agreement have been executed and sealed, the Application funds may be released and applied against the fees due to the Responsible Entity (clause 11.6).

41. Amongst other things, the Constitution sets out provisions relating to:

- how the Responsible Entity is to hold property for the Growers (clause 4);
- complaint handling (clause 5);
- the obligations and powers of the Responsible Entity (clause 9);
- Growers' income and distributions (clause 12);
- general powers and duties of the Responsible Entity (clause 15);
- register of Growers (clause 16); and
- winding up of the Project (clause 24).

Compliance Plan

42. As required by the Corporations Act, a Compliance Plan has been adopted by Macro for the Project. The purpose of the Compliance Plan is to ensure that Macro manages the Project in accordance with the obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Head Lease

43. Subject to the execution of a Service Agreement, Macro will enter into a Head Lease Agreement with AACL each Season to lease CPUs for the Project. The Property for each Subsequent Years Lease Agreement (for the 2008 and 2009 Seasons) may change at the discretion of the Project Manager.

44. The Responsible Entity must use the CPUs for the purpose of growing wheat for sale.

45. The Responsible Entity may sub-lease the CPUs for a term equivalent to the Term of the Lease. The Term of the Lease Agreement is from the Commencement Date (on or before 31 May for the relevant Season) to the day after the wheat has been harvested but no later than 10 months from the Commencement Date.

Grower Sub-Lease Agreement

46. Each year the Grower will execute a Grower Sub-Lease Agreement with the Responsible Entity as the Lessor. The Responsible Entity will grant to the Grower the right to use the CPUs for the purposes of managing the Scheme and developing the Growers' CPUs. The Grower Sub-Lease Agreement is conditional on the Grower executing a Grower Management Agreement with the Responsible Entity.

47. A Grower's allocated CPUs for each Subsequent Years Sub-Lease Agreement may change at the Responsible Entity's discretion (clause 2.3).

48. The Sub-Lease sets out the right and obligations of the parties to the Agreement.

49. The Term of each Grower Sub-Lease Agreement reflects the wheat growing season, being the period each year in which the Crop is planted, grown and harvested. In the first Season, the Term is from the Commencement Date (on or before 31 May 2007) to the day after the wheat has been harvested from the CPUs. The Commencement Date for the Sub-Lease Agreements in the two subsequent Seasons will be prior to planting but before 31 May of the relevant year.

50. If the Grower is unable to plant a Crop on a CPU in any Season due to weather conditions or the inability of the Responsible Entity to source suitable land by 15 June each year, then the Responsible Entity must repay any Rent already paid by the Grower by no later than 20 June in the financial year in which it was paid (clause 10).

Grower Management Agreement

51. Under the Grower Management Agreement the Grower appoints the Responsible Entity to manage the CPUs and to carry out management services subject to the terms and conditions of the Agreement. The Grower Management Agreement is conditional on the Grower entering into a Grower Sub-Lease Agreement with the Responsible Entity (clause 2).

52. The Agreement will commence on the date the Responsible Entity accepts the Grower's application under the PDS and shall continue until its termination under clause 14.

53. The Responsible Entity will commence the provision of services in the Initial Period from Season Commencement and will complete the services by 30 June in the relevant Season. Season Commencement is the date the new Crop planting is commenced, being no later than 15 June for each Season.

54. Clause 3.1 of the Grower Management Agreement specifies the services to be provided by the Responsible Entity in the Initial Period. These include:

- supply, propagate and husband the Seed for the CPU;

- carry out planting and sowing of the Seed;
- supply and maintain a pest and weed control programme including spraying;
- supply and spread fertiliser on the CPU;
- maintain firebreaks; and
- conduct regular checks on the progress of the Crop on each of the CPUs.

55. In each Season of the Project, the Responsible Entity will commence services in the Subsequent Period from 1 July to the date on which the Crop is harvested.

56. Clause 3.2 of the Grower Management Agreement specifies the services to be provided by the Responsible Entity in the Subsequent Period. These include:

- maintain firebreaks;
- maintain a pest and weed control programme including spraying as required;
- supply and spread fertiliser on the CPU as required;
- arrange compulsory crop insurance and multi-peril insurance (if available) for the Grower;
- harvest the Crop from the CPU 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; and
- undertake by marketing or other means the sale of the Crop as soon as practically possible after its harvest.

57. If the Grower is unable to plant a Crop on a CPU in any Season due to weather conditions or the inability of the Responsible Entity to source suitable land by 15 June each year, then the Responsible Entity must repay any Initial Period Fees already paid by the Grower by no later than 20 June in the financial year in which they were paid (clause 10).

Service Agreement and Farm Management Agreement

58. The Responsible Entity will enter into a Service Agreement with AACL engaging them as Project Manager for the purpose of managing and producing wheat subject to the terms and conditions of the Agreement. AACL will in turn enter into a Farm Management Agreement with various Farmers engaging them to carry out management duties on their behalf.

59. The Service Agreement is conditional on execution of a Head Lease Agreement.

Crop insurance and multi peril insurance

60. The Responsible Entity will arrange compulsory crop insurance and multi peril insurance (subject to availability and market conditions) for each CPU. Crop insurance will cover the Grower against risks such as fire and hail. Multi peril insurance, if arranged, will provide cover for all perils outside of those covered by the crop insurance policy for all CPUs in the project up to a value of approximately 90% of each CPU's Initial Period Fees each Season.

61. The cost of the crop insurance and multi peril insurance will be at the expense of the Grower and will be payable prior to 30 June of the year immediately following Harvest from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall.

Pooling and distribution of net proceeds

62. Clause 12 of the Constitution and clauses 7 and 8 of the Grower Management Agreement set out the provisions relating to the Grower's entitlement to harvest proceeds. Each Grower's wheat will be pooled with the wheat of other Growers in the Project to form the Gross Pool Produce.

63. After the Harvest Bonus is deducted from the Gross Pool Produce, the Responsible Entity will market and sell the balance of the Crop in the Project Pool, called the Net Pool Produce.

64. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Growers who have contributed wheat or insurance proceeds are entitled to benefit from distributions of harvest proceeds from the pool; and
- any pooled wheat must consist only of wheat contributed by Growers of the same Project class.

65. The proceeds from the Net Pool Produce will be deposited into the Project Fund. The Grower will be entitled to a distribution of the sale proceeds pro rata to the number of CPUs held by the Grower in the Project Pool.

66. The Responsible Entity is entitled to deduct from the Grower's share of the sale proceeds any Project Pool Outgoings. The balance will then be distributed to the Growers on a proportionate basis.

Fees and outgoings

67. Under the terms of the Grower Management Agreement and the Grower Sub-Lease, a Grower will make payments as described below on a CPU basis.

Fees and outgoings payable under the Grower Management Agreement

68. The following fees and outgoings are payable by the Grower under the Grower Management Agreement:

- Initial Period Fee (clause 9.1);
- Subsequent Period Fee (clause 9.3);
- Management Production Bonus (clause 9.4);
- Harvest Bonus Adjustment (clause 9.9);
- Project Finalisation Fee (clause 9.13);
- Crop insurance (clause 4.2.5); and
- Multi peril insurance (if available) (clause 4.2.6).

69. In addition, under clause 8.2 of the Grower Management Agreement, the Responsible Entity will pay all Project Pool Outgoings for each Season from the Project Fund. Project Pool Outgoings include Harvest Period Costs, Warehouse Costs and Harvest Loan Costs.

70. If the funds available in the Project Fund are insufficient to pay the Harvest Period Costs and the Warehouse Costs then the Grower must pay the shortfall prior to 30 June immediately following Harvest.

Initial Period Fee

71. For the 2007 Season, the Initial Period Fee is $4,334 per CPU. The Initial Period Fee is paid for services from the Commencement Date to 30 June 2007.

72. For each of the 2008 and 2009 Seasons the Initial Period Fee is $3,850 per CPU (indexed for CPI). The Responsible Entity may recover the Initial Period Fees from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient, the Grower must pay the shortfall to the Responsible Entity by 31 May 2008 and 31 May 2009, respectively (clause 9.11).

Subsequent Period Fee

73. The Subsequent Period Fee of $445.50 per CPU (indexed for CPI) is payable in each year of the Project for services performed by the Responsible Entity from 1 July to the date on which the Crop has been harvested from the CPU.

74. The Subsequent Period Fee is payable prior to 30 June of the year immediately following Harvest from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall (clause 9.3).

Management Production Bonus

75. In consideration for the performance by the Responsible Entity of Initial Period Services and Subsequent Period Services the Responsible Entity is entitled to be paid a Management Production Bonus at Harvest each Season.

76. The Management Production Bonus forms part of the Harvest Bonus and is paid where the Grower's CPU achieves a Harvest Surplus (clause 9.5). A Harvest Surplus will arise where the value of the Crop harvested from the Grower's CPU is greater than the Target Value – Tier 1 of $5,230.50.

77. The Responsible Entity will retain 20% of the Harvest Surplus in the Project Fund pending the calculation of the Harvest Bonus Adjustment. This is called the Harvest Bonus Retention.

78. The Management Production Bonus is 50% of the Distributable Harvest Surplus (Harvest Surplus less the Harvest Bonus Retention).

79. The Management Production Bonus is deducted from the Gross Pool Produce and paid in the form of wheat. The calculation of the Management Production Bonus is set out in Item 14 of the Schedule to the Grower Management Agreement.

80. In calculating the Management Production Bonus the Responsible Entity must determine the Delivered Price. If the Responsible Entity determines that the method for calculating the Delivered Price as set out in Item 11 of the Schedule to the Grower Management Agreement does not provide an appropriate benchmark for the price of wheat the Responsible Entity must select another method which it considers is an appropriate benchmark (clause 9.5).

Harvest Bonus Adjustment

81. The Harvest Bonus Adjustment is made up of the Harvest Bonus Adjustment – Tier 1 and the Harvest Bonus Adjustment – Tier 2.

82. The Harvest Bonus Adjustment – Tier 1 is essentially a recalculation of the Harvest Bonus (Management Production Bonus and Rent Bonus) at the Determination Date and is based on the Final Value of the wheat rather than the Delivered Value.

83. The Determination Date means the earliest of:

(a) the date that all proceeds from the sale of the Net Pool Produce have been received as determined by the Responsible Entity; or

(b) in respect of each season the following dates:

- Season 2007 – 30 April 2008;
- Season 2008 – 30 April 2009; or
- Season 2009 – 30 April 2010.

84. The Harvest Bonus Adjustment Tier 2 is calculated as 90% of the Performance Surplus. A Performance Surplus will arise where the Farm Surplus is greater than the Target Value – Tier 2 of $5,500. The Farm Surplus is the Net Proceeds before the Harvest Bonus Adjustment less the Harvest Bonus Adjustment – Tier 1.

85. The calculation of the Harvest Bonus Adjustment is set out in Item 18 of the Schedule to the Grower Management Agreement.

86. The Harvest Bonus Adjustment is payable in each Season of the Project and is paid from the proceeds in the Project Fund on the Determination Date. If the funds available in the Project Fund are insufficient then the Grower must pay the shortfall prior to 30 June immediately following Harvest (clause 9.9).

Project Finalisation Fee

87. The Responsible Entity is entitled to be paid the Project Finalisation Fee of $132 per CPU at the earlier of the receipt of all Project Pool Proceeds from each Season's Project Pool or the Determination Date for Season 2009 (clause 9.13).

88. The Project Finalisation Fee is paid from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall prior to 30 June 2010.

Fees payable under the Grower Sub-Lease Agreements

89. Under the Grower Sub-Lease Agreements, the following fees are payable by the Grower:

- Initial Period Rent;
- Subsequent Period Rent; and
- Rent Bonus (clause 5).

Rent

90. The Grower will pay the Responsible Entity Rent of $247.50 for the 2007 Season of the Project consisting of:

- $55 payable on Application, for the Initial Period from the Commencement Date to 30 June 2007; and

- $192.50 for the Subsequent Period, from 1 July 2007 until the completion of Harvest. The Subsequent Period Rent is payable prior to 30 June 2008 from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall.

91. For the 2008 and 2009 Seasons the amount of $247.50 will be increased by CPI and will be payable prior to 30 June of the year immediately following Harvest from the Grower's share of the proceeds in the Project Fund. If the proceeds are insufficient the Grower must pay the shortfall.

Rent Bonus

92. In consideration of the performance by the Responsible Entity in the selection of the land for the Project the Responsible Entity is entitled to a Rent Bonus.

93. The Rent Bonus forms part of the Harvest Bonus and is paid where the Grower's CPU achieves the Target Value – Tier 1 of $5,230.50 (clause 5.6).

94. The Rent Bonus is calculated as 40% of the Distributable Harvest Surplus and is deducted from the Gross Pool Produce of the Project Pool and paid in the form of wheat at Harvest.

95. The calculation of the Management Production Bonus is set out in Item 12 of the Schedule to the Grower Sub-Lease Agreement.

96. In calculating the Rent Bonus the Responsible Entity must determine the Delivered Price. If the Responsible Entity determines that the method for calculating the Delivered Price as set out in Item 9 of the Schedule to the Grower Management Agreement does not provide an appropriate benchmark for the price of wheat the Responsible Entity must select another method which it considers is an appropriate benchmark (clause 5.5).

Finance

97. A Grower who does not pay the Initial Period Costs in full upon application may borrow from the Preferred Financiers or from an independent lender external to the Project.

98. Only the finance arrangements set out below are covered by this Product Ruling. A Grower cannot rely on this Product Ruling if the Grower enters into a finance arrangement with the Preferred Financiers that materially differs from that set out in the documentation provided to the Tax Office with the application for the Product Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project other than the Preferred Financiers may request a private ruling on the deductibility or otherwise of interest under finance arrangements not covered by this Product Ruling.

99. Growers cannot rely on any part of this Ruling if the Application Amount is not paid in full on or before 30 June 2007 by the Grower or, on the Grower's behalf, by a lending institution. Where an application is accepted subject to finance approval by any lending institution other than the Preferred Financiers, Growers cannot rely on this Ruling if written evidence of that approval has not been given to the Responsible Entity by the lending institution by 30 June 2007.

Finance offered by United Pacific Finance Pty Ltd

100. Subject to the terms and conditions of the Loan Agreement a Grower can finance their Initial Period Costs, payable on Application, by borrowing that amount from United Pacific Finance Pty Ltd.

101. Subject to United Pacific Finance Pty Ltd accepting the Grower's application, the Grower will be bound by the terms and conditions of the Loan Agreement.

102. The Loan Agreement has the following features:

- 10 months interest only plus 31 months principal and interest instalments payable monthly in arrears;
- an Establishment Fee of $250 plus 0.10% of the loan amount to a maximum of $1,250 is payable on application. This fee may be added to the loan;
- the interest rate payable for the loan is 10.75% per annum, based on current interest rates (this is an indicative term only). Interest will accrue on the unpaid balance of the loan on the date each scheduled payment is due and is charged monthly in arrears; and
- stamp duty at the rate of 0.40% is payable on the loan amount and establishment fee.

Finance offered by Momentum

103. Subject to the terms and conditions of the Loan Agreement a Grower can finance their Initial Period Costs, payable on Application, by borrowing that amount from Momentum.

104. Subject to Momentum accepting the Grower's application, the Grower will be bound by the terms and conditions of the Loan Agreement.

105. The Loan Agreement has the following features:

- 10 months interest only plus 31 months principal and interest instalments payable monthly in arrears;
- an Application Fee of $250 plus 0.5% of the loan amount is payable on application. This fee may be added to the loan;

- the interest rate payable for the loan is 11.00% per annum, based on current interest rates (this is an indicative term only). Interest will accrue on the unpaid balance of the loan on the date each scheduled payment is due and is charged monthly in arrears;
- the maximum loan size is $250,000; and
- a break cost fee of $400 will be charged on early repayments of loans.

106. The loans from the Preferred Financiers are made on a full recourse commercial basis and normal debt recovery procedures, including legal action, will be taken in the case of defaulting borrowers. The loans will be secured by a mortgage over the Grower's interest(s) in the Project.

107. 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 of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 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 the Preferred Financiers are involved or become involved in the provision of finance to Growers for the Project.

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Is the Grower carrying on a business?

108. For the amounts set out in the table at paragraph 23 of this Ruling to constitute allowable deductions the Grower's wheat growing activities as a participant in the 2007 Grain Co-Production Project must amount to the carrying on of a business of primary production.

109. Two Taxation Rulings are relevant in determining whether a Grower will be carrying on a business of primary production.

110. The general indicators used by the Courts are set out in Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production.

111. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the 2007 Grain Co-Production Project. As Taxation Ruling TR 2000/8 sets out, the relevant principles have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

112. Having applied these principles to the arrangement set out above, a Grower in the 2007 Grain Co-Production Project is accepted to be carrying on a business of growing and harvesting wheat for sale.

The Simplified Tax System

Division 328

113. 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.

114. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (but refer to Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11). Therefore, any 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 Project Pool Outgoings and interest on loans with Preferred Financiers

Section 8-1

115. The Fees payable under the Grower Management Agreement and Grower Sub-Lease Agreement as well as insurance premiums, Harvest Period Costs, Warehouse Costs, and Harvest Loan Costs are deductible under section 8-1 (see paragraphs 43 and 44 of Taxation Ruling TR 2000/8). A 'non-income producing' purpose (see paragraphs 47 and 48 of Taxation Ruling TR 2000/8) is not identifiable in the arrangement and there is no capital component evident in the Initial Period Fee or the Initial Period Rent.

116. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply. Provided that the prepayment provisions do not apply (see paragraphs 119 to 123 of this Ruling) a deduction for these amounts may be claimed in the year in which they are incurred (Note: The meaning of incurred is explained in Taxation Ruling TR 97/7).

117. Some Growers may finance their participation in the Project through a Loan Agreement with the Preferred Financiers. Applying the same principles as that used for the deductibility of fees payable under the Grower Management Agreement and the Grower Sub-Lease Agreement, interest incurred under such a loan has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

118. Other than where the prepayment provisions apply (see paragraphs 119 to 123 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

Prepayment provisions

Sections 82KZL to 82KZMF

119. 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.

120. For this Project, the only prepayment provisions that are relevant are section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME and 82KZMF of the ITAA 1936 (operative provisions).

Application of the prepayment provisions to this Project

121. Under the Scheme to which this Product Ruling applies the Fees and other costs are incurred annually and interest payable to the Preferred Financiers is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this Scheme.

122. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower prepays interest under a loan agreement (including loan agreements with lenders other than the Preferred Financiers). 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.

123. As noted in the Ruling section above, Growers who prepay 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.

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

Section 35-55 – exercise of Commissioner's discretion

124. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income year ending **30 June 2007**, the Commissioner has determined that for that income year:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35; and
- there is an objective expectation that within a period that is commercially viable for the 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.

125. 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.

126. 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

127. The operation of section 82KL of the ITAA 1936 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 of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

128. For Part IVA of the ITAA 1936 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).

129. The 2007 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 paragraph 23 of this Ruling 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.

130. 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) of the ITAA 1936 it cannot be concluded on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Appendix 2 – Detailed contents list

131. The following is a detailed contents list for this Ruling:

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 97/11; TR 98/22;
TR 2000/8; 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
- primary production
- primary production expenses
- 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 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 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 328
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- IT(TP)A 1997 Div 328
- IT(TP)A 1997 328-120
- IT(TP)A 1997 328-125
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- Corporations Act 2001

Case references:

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

ATO references
NO: 2006/25425
ISSN: 1441-1172
ATOlaw topic: Income Tax ~~ Product ~~ crops - other