



PR 2007/31 - Income tax: Early Season Apple Project - Early Growers

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 This document has changed over time. This is a consolidated version of the ruling which was published on *20 June 2007*



Product Ruling

Income tax: Early Season Apple Project – Early Growers

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

① 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 'Early Season Apple Project – Early Growers' 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.

3. The class of entities who can rely on those tax benefits are referred to as Growers. Growers will be those entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and who have executed the relevant Project Agreements set out in paragraph 36 of this Ruling on or before 15 June 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 15 June 2007;
- are accepted into the Project before the Pre-Planting Capital Works have been completed;
- are accepted into the Project and the Land Owner's Planting Services in relation to an entity's Applelot(s) are not completed by 23 June 2007;
- participate in the scheme through offers made other than through the Product Disclosure Statement (PDS);
or
- enter into finance arrangements with entities associated with the Project.

Superannuation Industry (Supervision Act) 1993

5. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product ruling as to whether investment in this product may contravene the provisions of SISA 1993.

Qualifications

6. 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 36 to 79 of this Ruling.

7. 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.

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Date of effect

9. This Product Ruling applies prospectively from 11 April 2007, the date this Product Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 11 April 2007 until 15 June 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.

10. 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.

11. 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)).

12. 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.

13. 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

14. 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 the extent of those amendments this Product Ruling will be superseded.

15. 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

16. 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

17. 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

18. 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 36 to 79 of this Ruling.

19. 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's Agreement, on or before 15 June 2007.

Minimum subscription

20. 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. Under the terms of the Project Disclosure Statement and the Constitution, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 60 Applelots is achieved.

The Simplified Tax System (STS)

Division 328

21. 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*.

22. 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**

23. 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**

24. 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.

25. In the case of Joint Venture Growers, each Joint Venturer will be assessable on 50% of the gross sale proceeds (less any GST payable on those proceeds).

26. The Grower recognises ordinary income from carrying on the business of horticulture at the time that income is derived.

Deductions for Management Fees, Occupation Fees, Administration Fees and Harvest Costs**Section 8-1**

27. A Grower who is not a Joint Venture Grower may claim tax deductions for the following fees and expenses on a **per 'Applelot' basis**, as set out in the Table below.

Fee Type	2007 Income Year	2008 Income Year	2009 Income Year
Initial Management Fee	\$7,850 See Notes (i), (ii) & (iv)		
Management Fees		\$3,049.50 See Notes (i), (ii) & (iv)	\$2,936.50 See Notes (i), (ii) & (iv)
Occupation Fees	See Notes (i), (ii), (iii) & (iv)	\$1,925 See Notes (i), (ii) & (iv)	\$2,200 See Notes (i), (ii) & (iv)
Administration Fees		\$82.50 See Notes (i), (ii) & (iv)	Previous years fee indexed See Notes (i), (ii) & (iv)
Harvest Costs		Actual Costs See Notes (i), (ii) & (iv)	Actual Costs See Notes (i), (ii) & (iv)

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) Subject to Note (iii) the Management Fees, Occupation Fees, Administration Fees and Harvest Costs are deductible under section 8-1 in the year in which they are incurred.
- (iii) In the Initial Period (from Settlement Date to 30 June 2007), the deduction for Occupation Fees is \$37 per week for each week or part week that the Grower is granted the licence to use the Applelot. This means that the full Occupation Fee of \$440 is not deductible in the 2006-07 income year, depending on when the Grower is accepted into the Project.
- (iv) This Ruling does not apply to Growers who choose to prepay fees or who choose to, or are required to prepay interest under a loan agreement. 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.

28. A Joint Venture Grower may claim deductions on a **per 'Applelot' basis** as follows:

First Joint Venturer

- 100% of the Initial Management Fee and Occupation Fee for the 2006-07 income year; and
- 50% of the actual Harvest Costs each income year.

Second Joint Venturer

- 100% of the Management Fees, Occupation Fees and Administration Fees for the 2007-08 and the 2008-09 income years; and
- 50% of the actual Harvest Costs each income year.

Interest

29. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with an independent lender external to the Project is outside the scope of this Ruling. Such Growers may request a private ruling on the deductibility or otherwise of interest under finance arrangements not covered by this Product Ruling.

Deductions for capital expenditure

Division 40

30. A Grower will be entitled to tax deductions relating to the establishment of the Apple Trees.

31. A 'horticultural plant' is a 'depreciating asset' as defined in section 40-30 and Apple Trees are 'horticultural plants' as defined in subsection 40-520(2). As Growers hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the Apple Trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred that is attributable to their establishment. The Commissioner has determined (at Table A in TR 2006/15) that the effective life of apple trees is 20 years. Subject to subsection 40-545(3), for the purposes of section 40-545, this results in a straight-line write-off rate of 13% beginning in the income year in which the first commercial season starts. The Responsible Entity will inform Growers of when the Apple Trees enter their first commercial season and the amount that may be claimed.

32. Each Joint Venture Grower can claim 50% of the deduction for the decline in value of the Apple Trees on their Applelot(s).

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

Section 35-55 – exercise of Commissioner's discretion

33. A Grower who is an individual accepted into the Project by 15 June 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 below, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers as follows:

- for the First Joint Venturers, for the 2006-07 income year;

- for the Second Joint Venturers, for the 2006-07 to 2009-10 income years; and
- for all other Growers, for the 2006-07 to 2008-09 income years.

34. 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.

Section 82KL and Part IVA

35. For a Grower who participates in the Project and incurs expenditure as required by the Grower's Agreement the following provisions of the ITAA 1936 have application as indicated:

- 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

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

- Application for a Product Ruling received on 24 October 2006 as constituted by the following documents and additional correspondence including emails received 27 November 2006, 8 December 2006, 18 December 2006, 12 January 2007, 6 February 2007, 12 February 2007, 21 February 2007, 8 March 2007, 15 March 2007, 16 March 2007, 19 March 2007, 22 March 2007 and 29 March 2007;
- Product Disclosure Statement (PDS) for the Early Season Apple Project, received 4 June 2007;
- Additional correspondence received 28 May 2007, 4 June 2007 and 8 June 2007;
- Draft **Constitution** for the Early Season Apple Project, received 19 March 2007;
- Draft **Grower's Agreement** between Advanced Horticultural Management Limited (Responsible Entity), Rivercorp Land & Water Limited (Land Owner) and the Grower, received 19 March 2007;

- Draft Operational Management Agreement – Early Season Apple Project between Advanced Horticultural Management Limited (Responsible Entity) and Rivapp Pty Limited (Operational Manager), received 6 February 2007;
- Draft Early Season Apple Project Operations Agreement between Rivercorp Land & Water Limited (Land Owner) and Rivapp Pty Limited (Operational Manager) received 6 February 2007;
- Draft Apple Marketing Agreement between Advanced Horticultural Management Limited (Responsible Entity) and BP Fruits Pty Limited, received 12 February 2007;
- Draft Compliance Plan for the Early Season Apple Project, received 24 October 2006;
- Draft Deed (Option) for the purchase of land between the owner and Advanced Horticultural Management Limited, received 24 October 2006;
- Draft Memorandum of Lease between Rivercorp Land & Water Limited (Land Owner) and Huntley Custodians Limited (as Custodian), received 18 December 2006; and
- Draft Custodial Agency Agreement between Advanced Horticultural Management Limited and Huntley Custodians Limited, received 31 October 2006.

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

37. The documents highlighted (in bold) 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.

38. 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

39. The main features of the 'Early Season Apple Project – Early Growers' are as follows:

Location	Near Loxton, South Australia
Type of business to be carried on by each participant	Commercial growing, cultivation and harvesting of apples (specifically Galaxy, Rosy Glow and Granny Smith varieties) for sale
Number of hectares offered for cultivation	97 hectares
Size of each Applelot	0.25 hectares comprising 0.02 hectares planted with mature trees and 0.23 hectares planted with new trees
Number of trees per hectare	Approximately 2,200
Term of the Project	15 years (may be extended)
Initial Cost per Applelot	\$8,290
Ongoing and other costs	<ul style="list-style-type: none"> • Management Fees; • Occupation Fees; • Administration Fees; • Harvest Costs; • Incentive Fee; and • optional insurance

40. The Project has been registered as a Managed Investment Scheme under the *Corporations Act 2001*. Advanced Horticultural Management Limited has been issued with Financial Services Licence Number 246451 and will be the Responsible Entity for the Project.

41. The Project involves the cultivation of Apple Trees and the harvest and sale of the apples.

42. The Project will be conducted on land located in Loxton North, South Australia. The land is described as:

- Volume 533, Folio 240, known as section 414, Anderson Road;
- Volume 1095, Folio 43, known as section 415 (allotment 4) and section 420, Anderson Road;
- Volume 1095, Folio 24, known as section 416 (allotment 1), Anderson Road;
- Volume 1095, Folio 31, known as section 359, Briers Road;

- Volume 5954, Folio 123, known as section 81 and 200, Casson Avenue;
- Volume 1095, Folio 32, known as section 360, Briers Road;
- Folio 1095-IP, known as section 423 Derrick Road; and
- Volume 1095, Folio 25, known as section 417, Anderson Road.

43. The Custodian (as agent for the Responsible Entity) will secure the right to acquire the land pursuant to Options to purchase with the current owners of the land. The Responsible Entity will nominate the Land Owner as purchaser.

44. The Responsible Entity will enter into a head lease with the Land Owner for the land and all the improvements on it, plus access to the water licences. The acquisition of the land includes the rights to water under licence from the Loxton Irrigation Scheme and the Riley Irrigation Scheme.

45. A Grower that participates in the Project will do so by acquiring an interest in the Project which will consist of a minimum of one Applelot of 0.25 hectares in size. Each Applelot will consist of two separate parcels of land. One parcel (Part A, 0.02 hectares) will contain mature apple trees, while the other parcel (Part B, 0.23 hectares) will be planted with new apple trees. The Applelots will be planted at the rate of approximately 2,200 trees per hectare.

46. The Land Owner will be responsible for all development work on the land to establish the unplanted part of the apple orchard. Under the Early Season Apple Project Operations Agreement, the Land Owner will engage the Operational Manager to perform the establishment services, including the Pre-Planting Capital Works and the Land Owner's Planting Services.

47. A Grower who acquires an interest in the Project may subscribe for a parcel of 7,000 ordinary shares in the Land Owner.

48. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer made under the PDS is for 97 hectares which corresponds to 388 Applelots in the Project. The term of the project is a minimum of 15 years with the opportunity to extend the term for up to 6 years. The Project will not commence if the minimum subscription of 60 Applelots has not been reached by 15 June 2007.

49. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints the Responsible Entity to enter into, on behalf of the Grower, a Grower's Agreement and any other agreements required to hold an interest in the Project.

50. For the purposes of this Ruling, Applicants who are accepted to participate in the Project and who execute a Grower's Agreement on or before 15 June 2007 will become 'Early Growers'.

Constitution

51. The Constitution establishes the Project and operates as a deed binding on all Growers and Advanced Horticultural Management Limited. The Constitution sets out the terms and conditions under which Advanced Horticultural Management Limited 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.

52. In order to acquire an interest in the Project, the Grower must make an application for Applelots in accordance with clause 15. 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 to the Responsible Entity.

53. Under the terms of the Constitution, all moneys received from applications shall be paid to the Responsible Entity. The Responsible Entity shall deposit those moneys into the Applications Bank Account in the name of the Custodian. Subject to the minimum subscription being reached, the application monies will be released to the Project on acceptance of the Grower's application.

54. Under clause 28 of the Constitution, the Responsible Entity may accept applications from two Joint Venturers (the First Joint Venturer and the Second Joint Venturer) that wish to conduct an unincorporated joint venture to participate in the Project. Under the joint venture, each Joint Venturer is entitled to a Prescribed Proportion of 50% of the Joint Venture Assets.

55. Under clause 27 of the Constitution, the Responsible Entity is required to hold Asset Risk and Public Liability Insurance on behalf of the Growers. If the Responsible Entity is able to obtain insurance for the Grower's Produce at a reasonable premium, the Responsible Entity will do so and the Grower must reimburse the Responsible Entity for the Grower's Proportional Interest of such a premium.

56. The Constitution also sets out (among other things) provisions relating to:

- register of Growers, clause 17;
- Grower's income and distributions, clause 18;
- appointment of agents, clause 13;
- complaints handling, clause 6; and
- winding up the Project, clause 7.

Compliance Plan

57. As required by the Corporations Act, a Compliance Plan has been prepared for the Project. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Head Lease

58. The Custodian (as agent for the Responsible Entity) will enter into a Lease with the Lessor (Land Owner) in respect of Land required for the Project.

59. The Responsible Entity must use the Land only for the purposes of the Early Season Apple Project.

60. The Responsible Entity may licence the land or any part of the land to Growers in the Early Season Apple Project for a term equivalent to the term of the Lease.

Grower's Agreement

61. Growers participating in the scheme will enter into a Grower's Agreement with the Land Owner and the Responsible Entity.

62. The Land Owner must at its own cost establish the Applelots in accordance with good horticultural practice. This includes carrying out the Pre-Planting Capital Works and the Land Owner's Planting Services.

63. The Pre-Planting Capital Works must be completed by 31 May 2007 (clause 3.2). They include:

- identify suitable parts of the Land;
- organise soil surveys;
- organise block layout;
- construct and install the Irrigation Equipment and Infrastructure;
- carry out drainage work;
- clear vegetation or trees from the Orchard and perform broadacre weed spraying;
- rip and mound tree rows; and
- install trellising.

64. The Land Owner must plant out Part B of the Applelots with Apple Tree seedlings and conduct all grafting work on or before 23 June 2007 subject to planting taking place in appropriate climatic and horticultural conditions (clause 3.3).

65. This Ruling does not apply to Growers who are accepted into the Project and the Pre-Planting Capital Works are not completed on or before 31 May 2007 and the Land Owner's Planting Services in respect of their Applelot(s) are not completed by 23 June 2007.

66. The Grower's Agreement will commence on the date of acceptance of the Grower's application (Settlement Date) and will continue for a period of approximately 15 years or until the Project is terminated or extended as provided for by clause 2.3 of the Grower's Agreement.

67. Under clause 2 of the Grower's Agreement, the Responsible Entity will grant to the Grower an interest in the Orchard in the form of a licence to use their Applelot(s) for the conduct of the Grower's Business of growing and cultivation of Apple Trees and the harvesting, marketing and sale of the Apples produced from the Apple Trees. The Land Owner consents to the grant of the Grower's Agreement to the Grower.

68. Under clause 5, the Grower appoints the Responsible Entity to carry out the Early Grower's Management Services, the Management Services and the Harvest Services subject to the terms and conditions of the Agreement. These services are defined in the Constitution at clause 30. The Responsible Entity must carry out the services with a view to maximising the yield of the Apple Trees from the Grower's Applelot.

69. The Responsible Entity must perform the Early Grower's Management Services in the Initial Period from Settlement Date to 30 June 2007. The Management Services and the Harvest Services must be performed as required and in accordance with good horticultural practice during each income year from 1 July 2007 to the end of the Project.

70. The Responsible Entity may engage contractors or others to perform its obligations under the Grower's Agreement. Under the Operational Management Agreement, the Responsible Entity will engage the Operational Manager as an independent contractor to perform the duties, including the Operational Management Services, set out in clause 6 of the Operational Management Agreement.

Pooling of Growers' Produce and Growers' Entitlement to Net Proceeds

71. Under clause 7.2 of the Grower's Agreement, the Responsible Entity is authorised to pool the Apples harvested from the Grower's Applelot(s) with Apples harvested from the Applelots of other Growers in the Project. This product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Growers who contribute Apples are entitled to benefit from distributions of Gross Harvest Proceeds from the pool; and
- any pooled Apples must consist only of Apples contributed by Growers of the same Project class.

72. The Grower's Agreement (clause 7.1) and the Constitution (clause 18) set out the provisions relating to the Grower's entitlement to the Gross Harvest Proceeds. The Responsible Entity must deposit the Grower's Business Income (Gross Harvest Proceeds less all fees, cost and expenses to be deducted as specified in the Constitution and the Grower's Agreement) into the Scheme Bank Account. The Grower's Business Income must be transferred to a distribution account and distributed to the Grower in accordance with the Grower's Proportional Interest, after deducting any outstanding fees and taxes.

73. If part of the Grower's Applelot is destroyed, the Grower's Proportional Interest will be adjusted accordingly (clause 10.4 of the Grower's Agreement).

Fees

74. Under the terms of the Grower's Agreement, a Grower will make payments as described below on a per Applelot basis.

Management Fees

- Initial Management Fee of \$7,850 payable to the Responsible Entity on application for the Early Grower's Management Services which will be provided during the Initial Period from Settlement Date to 30 June 2007;
- Management Fee of \$3,049.50 for the 2007-08 income year payable on 1 July 2007 plus 5.5% of the Gross Harvest Proceeds received in that income year;
- Management Fee of \$2,936.50 for the 2008-09 income year payable on 1 July 2008 plus 5.5% of the Gross Harvest Proceeds received in that income year;
- Management Fee of \$2,800 for the 2009-10 income year payable on 1 July 2009 plus 5.5% of Gross Harvest Proceeds received in that income year; and
- Management Fees for the 2010-11 to 2021-22 income years consisting of estimated Applelot Operating Costs plus 5.5% of the estimated Gross Harvest Proceeds payable annually commencing on 1 July 2010.

The Operating Costs and Harvest Proceeds will be estimated 12 months in advance for the purposes of calculating the Management Fees for the 2010-11 to 2021-22 income years. At the end of the relevant income year, the Responsible Entity will adjust the amount payable depending on the actual costs incurred and the actual Gross Harvest Proceeds.

Occupation Fees

- \$440 payable on application for the Initial Period;
- \$1,925 for the 2007-08 income year, \$2,200 for the 2008-09 income year, \$2,420 for the 2009-10 income year and \$2,860 for the 2010-11 income year payable on 1 July each income year; and
- for the 2011-12 to 2021-22 income years, the fee payable for the previous income year indexed by the Consumer Price Index (CPI) payable on 1 July each income year.

Administration Fees

- \$82.50 for the 2007-08 income year payable by 1 July 2007; and
- for the 2008-09 to 2021-22 income years, the fee payable for the previous income year indexed by CPI payable annually commencing on 1 July 2008.

Harvest Costs

- actual Harvest Costs payable out of Gross Harvest Proceeds in each income year in which a harvest occurs.

Incentive Fee

- for each income year from the 2009-10 income year till the end of the Project, 33% of the Average Net Proceeds which exceed an Incentive Fee Threshold in the income year, payable annually commencing on 1 July 2009. 'Average Net Proceeds' and 'Incentive Fee Threshold' are described in clause 6.4 of the Grower's Agreement.

Joint Venture Growers

75. The First Joint Venturer will be responsible for the following fees:

- 100% of the Initial Management Fee;
- 100% of the Occupation Fee for the Initial Period;
- 50% of the Management Fees, Administration Fees and Occupation Fees for the 2010-11 to 2021-22 income years; and
- 50% of the Harvest Costs and the Incentive Fees.

76. The Second Joint Venturer will be responsible for the following fees:

- 100% of the Management Fees, Administration Fees and Occupation Fees for the 2007-08 to 2009-10 income years;

- 50% of the Management Fees, Administration Fees and Occupation Fees for the 2010-11 to 2021-22 income years; and
- 50% of the Harvest Costs and the Incentive Fees.

Finance

77. A Grower who does not pay the application fee in full upon application can borrow from an independent lender external to the Project. A Grower who enters into a finance arrangement with an independent lender external to the Project may request a private ruling on the deductibility or otherwise of interest incurred under finance arrangements not covered by this Product Ruling.

78. Growers cannot rely on any part of this Ruling if the application fee is not paid in full on or before 15 June 2007 by the Grower or, on the Grower's behalf, by a lending institution.

79. 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 are involved or become involved in the provision of finance to Growers for the Project.

Appendix 1 – Explanation

❶ *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?

80. For the amounts set out in paragraphs 27 and 30 of this Ruling to constitute allowable deductions, the Grower's horticulture activities as a participant in the Early Season Apple Project must amount to the carrying on of a business of primary production.

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

82. 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?

83. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the Early Season Apple 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.

84. Having applied these principles to the arrangement set out above, a Grower in the Early Season Apple Project is accepted to be carrying on a business of growing and harvesting apples for sale.

The Simplified Tax System

Division 328

85. 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.

86. 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 Management Fees, Occupation Fees, Administration Fees and Harvest Costs

Section 8-1

87. Other than part of the Occupation Fee for the Initial Period, the Management Fees, Occupation Fees, Administration Fees and Harvest 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 other than part of the Occupation Fee for the Initial Period, there is no capital component evident in the Management Fees, Occupation Fees, Administration Fees and Harvest Costs.

88. Subject to paragraphs 89 and 90 of this Ruling the tests of deductibility under the first limb of section 8-1 are met and the exclusions do not apply.

89. One of the exclusions under section 8-1 relates to expenditure that is capital, or is capital in nature. Any part of the expenditure of a Grower entering into a horticulture business which is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and hence will not be deductible under section 8-1. The Commissioner is of the view that a portion of the Occupation Fee payable by a Grower for the Initial Period will be capital expenditure.

90. A Grower who enters the Project on or before 15 June 2007, is granted a licence to use their Applelot(s) during the Term of the Project. It is considered that part of the Occupation Fee of \$440 payable for the Initial Period is a premium paid by the Grower for the grant of the licence and is capital in nature. Therefore, under section 8-1 Growers will be entitled to a deduction of \$37 per week calculated on a pro-rata weekly basis for each week or part week that the Grower is granted the licence to use the Applelot(s) in the Initial Period. This is based on the Occupation Fee of \$440 being the fee for a period of approximately 3 months.

91. Subject to the above qualification, and provided the prepayment provisions do not apply (see paragraphs 92 to 96 of this Ruling), a deduction for the Management Fees, Occupation Fees, Administration Fees and Harvest Costs may be claimed in the year in which they are incurred. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7.)

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

92. 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.

93. 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

94. Under the scheme to which this Product Ruling applies the Management Fees, Occupation Fees and other fees are incurred annually. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this scheme.

95. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project prepays all or some of the expenditure payable under the Grower's Agreement, or 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.

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

Expenditure of a capital nature***Division 40***

97. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to the establishment of the apple trees and that portion of the Occupation Fee for the 2006-07 income year that is considered a lease premium (refer paragraphs 89 and 90 of this Ruling) are of a capital nature. The expenditure attributable to the establishment of the apple trees falls for consideration under Division 40.

98. The tax treatment of capital expenditure on the establishment of apple trees has been dealt with in a representative way in paragraphs 30 and 31 of this Ruling.

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

Section 35-55 – exercise of Commissioner’s discretion

99. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis:

- for the 2006-07 income year (for the First Joint Venturers);
- for the 2006-07 to 2009-10 income years (for the Second Joint Venturers); and
- for the 2006-07 to 2008-09 income years (for all other Growers),

the Commissioner has determined that for those income years:

- 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 horticulture industry of growing apple trees, a Grower’s business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

100. 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.

101. 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

102. 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

103. 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).

104. The Early Season Apple Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions as detailed at paragraphs 27 and 30 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.

105. 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 apples. 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

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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; TR 2006/15

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 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
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- ITAA 1997 6-5
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- ITAA 1997 17-5
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- ITAA 1997 35-10(2)
- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
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- ITAA 1997 40-30
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- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
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