



# ***PR 2007/39 - Income tax: Mort & Co No. 5 Project***

 This cover sheet is provided for information only. It does not form part of *PR 2007/39 - Income tax: Mort & Co No. 5 Project*

 This document has changed over time. This is a consolidated version of the ruling which was published on *2 April 2008*



## Product Ruling

### Income tax: Mort & Co No. 5 Project

---

Contents	Para
<b>LEGALLY BINDING SECTION:</b>	
What this Ruling is about	1
Date of effect	9
Ruling	18
Scheme	31
<b>NOT LEGALLY BINDING SECTION:</b>	
Appendix 1:	
Explanation	92
Appendix 2:	
Detailed contents list	115

#### **❗ 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.

**[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.]

### **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 Mort & Co No. 5 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 Producer.

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 31 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;
- entities who are accepted into this Project before the date of this Ruling or after 15 June 2007;
- entities who participate in the scheme through offers made other than through the Information Memorandum; or
- Mort & Co Ltd or its associates.

### 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 31 to 91 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.

8. This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration  
Attorney General's Department  
Robert Garran Offices  
National Circuit  
Barton ACT 2600

or posted at: <http://www.ag.gov.au/cca>

### Date of effect

9. This Product Ruling applies prospectively from 24 April 2007, the date this Product Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 24 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. 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.

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 that extent, this Product Ruling will have no effect.

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 Producer) 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 Producer in the defined class of entities who enters into the scheme described at paragraphs 31 to 91 of this Ruling.

19. The Producer's participation in the Project must constitute the carrying on of business of primary production. Provided the Project is carried out as described below, the Producer's business of primary production will commence at the time of execution of their Management Agreement.

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

#### ***Division 328***

20. To be an 'STS taxpayer' a Producer must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer' (Division 328 of the ITAA 1997). For a Producer participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Producer was an 'STS taxpayer' prior to 1 July 2005 and 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*.

21. For such Producers, 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***

22. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides for a tax offset of up to 25% 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**

#### ***Sections 6-5 and 17-5***

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

**Deduction for Initial Management Fee, Management Fee, Costs and Expenses, Buyers Fee, Interest and Borrowing Costs*****Section 8-1, section 25-25 and Division 27 of the ITAA 1997 and sections 82KZME and 82KZMF of the Income Tax Assessment Act 1936***

24. A Producer may claim tax deductions for the following fees and expenses on a per Herd basis, as set out in the Table below.

<b>Fee Type</b>	<b>Year ended 30 June 2007</b>	<b>Year ended 30 June 2008</b>	<b>Year ended 30 June 2009</b>
<b>Initial Management Fee</b>	\$50,926 See Note (i)		
<b>Management Fee</b>		Must be calculated See Notes (i), (ii) & (iii)	Must be calculated See Notes (i), (ii) & (iii)
<b>Costs and Expenses</b>		Must be calculated See Notes (i), (ii) & (iii)	Must be calculated See Notes (i), (ii) & (iii)
<b>Buyers Fee</b>		Must be calculated See Notes (i), (ii) & (iii)	Must be calculated See Notes (i), (ii) & (iii)
<b>Interest</b>		As incurred See Notes (iii) & (iv)	As incurred See Notes (iii) & (iv)
<b>Borrowing costs</b>	Must be calculated See Note (v)	Must be calculated See Note (v)	Must be calculated See Note (v)

**Notes:**

- (i) If the Producer 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 management fees, costs and expenses and buyers fee are deductible under section 8-1 in the income year that the relevant fee is incurred. The amount of the deduction allowable will be the costs incurred and will depend upon the number of Lots sold by the Producer during the year of income.

- (iii) This Ruling does not apply to Producers who choose to prepay fees or who choose, or who are required to prepay interest under a loan agreement (see paragraphs 88 to 91 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 Producer who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (iv) The deductibility or otherwise of interest arising from agreements entered into with financiers other than the Financier or in respect of the Initial Management Fee, is outside the scope of this Ruling. Prepayments of interest to any lender, including the Financier, are not covered by this Product Ruling. Producers who enter into agreements with other financiers and/or prepay interest may request a private ruling on the deductibility of the interest incurred.
- (v) The Initial Management Fee incorporates \$600 for the establishment of the finance arrangement by Mort on behalf of Producers. The \$600 is considered to be a borrowing expense and is deductible under section 25-25. It is incurred for borrowing money that is used or is to be used during that income year solely for income producing purposes.

## **Trading stock**

### **Section 70-35**

25. A Producer who is not an 'STS taxpayer' will, in some years, hold cattle that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the end of an income year exceeds the value of trading stock on hand at the start of an income year a Producer must include the amount of that excess in assessable income.

26. Alternatively, where the value of trading stock on hand at the start of an income year exceeds the value of trading stock on hand at the end of an income year, a Producer may claim the amount of that excess as an allowable deduction.

**Section 328-285**

27. A Producer who is an 'STS taxpayer' may, in some years, hold cattle that will constitute trading stock on hand. Where, for such a Producer, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than \$5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

28. Alternatively, a Producer who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

**Division 35 – deferral of losses from non-commercial business activities****Section 35-55 – exercise of Commissioner's discretion**

29. A Producer 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 above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for Producers for the income year ended **30 June 2007**. This conditional exercise of the discretion will allow those losses to be offset against the Producer'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**

30. For a Producer who commences participation in the Project and incurs expenditure as required by the Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Producer does not fall within the scope of sections 82KZME and 82KZMF (but see paragraphs 103 to 107 of this Ruling);
- 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

---

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

- Application for a Product Ruling undated as constituted by documents received on 4 January 2007 and 27 February 2007; and additional correspondence, emails and telephone conversations dated 25 January 2007, 15, 19 and 21 February 2007, 7, 15 and 21 March 2007;
- Draft Information Memorandum for the 'Mort Feedlot Services Project' (IM), undated, received on 15 March 2007;
- Constitution of Mort & Co Ltd, received on 4 January 2007;
- Draft **Management Agreement** between Mort & Co Ltd ('Mort' or the 'Manager') and the Producer, undated, received on 15 March 2007;
- Draft **Loan Agreement** between the Producer and National Cattle Feeders Pty Ltd (the 'Financier') undated, received on 15 March 2007;
- Draft **Addendum to Loan Agreement and Livestock Mortgage**, undated, received 15 March 2007;
- Draft **Stock Mortgage Agreement** between the Financier and the Producer, undated, received on 15 March 2007; and
- Draft Custom Cattle Feeding Agreement between the Manager and the Feedlot Operator, undated, received on 4 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.

32. The documents highlighted are those that a Producer 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 Producer, or any associate of a Producer, will be a party to, which are a part of the scheme. The effect of these agreements is summarised below.

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

**Overview**

34. Following is a summary of the scheme:

Location	Existing feedlot facilities in Northern NSW and the Darling Downs region of Queensland
Type of business to be carried on by each Producer	The purchase, lot feeding and sale of beef cattle
Number of Herds offered under the project	There are no minimum or maximum number of Herds
Size of each Herd	1,500 head of beef cattle
No. of Lots per Herd	15 Lots
Number of beef cattle per Lot	Approximately 100
Minimum allocation	1 Herd
Term of the Project	Between 5 to 7 years depending on purchase/sale cycle
Initial cost per Herd	Initial Management Fee of \$51,526 (which includes a \$600 finance establishment fee) plus costs of purchasing first Lot as determined by the market
Ongoing costs	Costs and Expenses, including feed, veterinary, transport and sale costs Management Fees of \$28.60 per head Buyers Fee of \$3.85 per head Interest and finance costs

35. Applicants that are accepted to participate in the Project will carry on the business of acquiring, fattening and selling beef cattle. Each applicant will subscribe to a minimum of one Herd. Each Herd will consist of 1,500 head of cattle. The cattle will be acquired throughout the life of the project in Lots of approximately 100 hundred head per Lot. Producers with an interest in a single Herd will only hold a single Lot at any time. The cattle will be placed in existing feedlot facilities in northern NSW or the Darling Downs area of Queensland. Each Lot will be kept in the feedlot for a period between 100 and 125 days.

36. There will be a maximum subscription of 400 Herds, however, there is no minimum subscription for the Project. The Producer's Herd will be acquired and sold in the period between 5 and 7 years from the date of acceptance into the Project.

37. Producers accepted to participate in the Project will enter a Management Agreement with Mort & Co Ltd who will act as Manager for the project. The Manager will acquire the cattle on behalf of the Producer, enter into agreements with the feedlot operators and arrange for the sale of the cattle at the end of the feedlot process.

38. Producers may utilise a Finance Facility (the 'Facility') provided by the Financier for the purchase of each Lot. The Producer will grant the Financier a stock mortgage over each Lot of cattle as security for the Facility.

39. Producers may elect to self fund the acquisition of cattle (a 'Self Funded Producer'). Where a Producer elects to self fund they must deposit at the time of application, in addition to the Initial Management Fee, the sum of \$100,000 per Herd with the Manager. These funds are to be used by the Manager to fund the purchase of cattle on behalf of the Producer.

#### **Information Memorandum**

40. The Manager is offering interests in the Project via the IM for Mort & Co No. 5 Project. Mort & Co Ltd are holders of Australian Financial Services Licence Number 228989. Offers under the IM are strictly limited to persons who are either a 'wholesale client' for the purposes of the Corporations Act or receive a personal invitation from Mort & Co Ltd to participate in the Project as part of a small scale offering. The IM is not required to be lodged with ASIC.

41. Applications to participate in the Project must be made on the application form contained in the IM.

42. A Producer's application must be accompanied by the payment in full of the Initial Management Fee of \$51,526 per Herd. A Self Funded Producer must also include payment of \$100,000 per Herd, in addition to the Initial Management Fee, to fund the acquisition of cattle under the arrangement.

43. Producers execute a Power of Attorney which authorises the Manager to act on their behalf in relation to the arrangement, including executing the Management Agreement and, where the Producer is to utilise the Facility, entering the Loan Agreement and Stock Mortgage with the Financier.

44. Following the execution of the Management Agreement at the time of acceptance the Manager will commence the process of acquiring the Producer's first Lot. The Manager will be responsible for arranging the acquisition, lot feeding and negotiating the sale of each Lot.

## Management Agreement

45. The Producer will enter into a Management Agreement with the Manager where the Producer undertakes to conduct a business of backgrounding and feedlotting cattle and the Manager undertakes to provide certain services to assist the operation of the Producer's business.

46. The Manager will provide Management Services to the Producer for the Herd. The services will only be provided in respect of one Lot at a time for each Herd owned (clause 4.1). A Herd is defined as 1,500 head of cattle and a Lot as approximately 100 head (clause 1.1). The total number of cattle across all Lots will be equal to the Herd size.

47. Clause 4.2 specifies that the parties agree that the business will be conducted as follows:

- (a) the Manager will source and acquire the Lot with the cost of acquisition to be funded through either the Facility or the Producer's own funds and retained earnings generated from the Producer's business, where available;
- (b) the Manager will manage the Lot through the backgrounding and feedlot process;
- (c) the Manager will arrange the sale of the Lot;
- (d) the Manager will finance, with the Producer ultimately being responsible for, costs associated with the purchase, transportation, feeding and sale of the Producer's cattle;
- (e) proceeds from the sale of each Lot will, after repayment of the loan funds and finance expenses, be applied to the payment of management fees, costs, interest and expenses associated with the Lot in accordance with the Management Agreement;
- (f) the balance of the Producer's account will be applied to the acquisition of future Lots;
- (g) at the end of each 6 month period, the Producer's proportional share of net proceeds, calculated in accordance with the Management Agreement, will be allocated to the Producer's Account; and
- (h) if sufficient funds have been generated a portion will be distributed periodically to the Producer.

48. The process in clause 4.2 will be repeated until the entire Herd has been acquired and sold or the Management Agreement is terminated. The balance of proceeds will be distributed to the Producer following the sale of the Final Lot and payment of any amounts owing by the Producer (clause 4.3).

49. It is intended that the Management Services will be provided in respect of up to 3 Lots each full financial year until the completion of the agreement. However the Manager reserves the right not to acquire a Lot at a particular time having regard to market conditions and other factors. The Producer may direct the Manager to acquire and manage a Lot against the recommendation of the Manager (clause 4.4).

50. Where the Producer directs the Manager to acquire a Lot contrary to the Manager's recommendation the Manager is under no obligation to draw down the Facility to fund the purchase of such a Lot (clause 4.6).

51. Where a Self Funded Producer directs the Manager to acquire and manage a Lot contrary to the Manager's recommendation, the Manager will acquire such a Lot subject to there being sufficient funds in the Producer's Account to meet both the purchase cost of the Lot and, subject to the Manager's discretion, the amount of all fees, costs and expenses the Manager reasonably expects to be incurred in the management of that Lot (clause 4.7).

52. The Manager may delegate some or all of its functions under the Management Agreement. Delegation of functions does not release the Manager from liability under the Agreement (clause 5.5).

53. The Producer appoints the Manager to perform all rights, duties and obligations of the Producer under the Finance Documents.

54. The Initial Management Fee is payable in respect of the Initial Management Services listed in clause 7.1 of the Agreement. Initial Management Services include establishing relevant accounting and reporting systems, establishment of Finance Facility, inspecting feedlot facilities, negotiating with feedlot owners for placement of cattle, development of ration and feeding systems, market analysis and negotiation with beef processors.

55. Once accepted into the Project the Producer is irrevocably committed to the Project and the Initial Management Fee is not refundable (clause 7.2).

56. The Producer must pay the Manager the Initial Management Fee and reimburse the Manager the Costs and Expenses associated with the Lot. Specifically the Producer irrevocably authorises the Manager to pay the following amounts from the Gross Sales Proceeds:

- (i) Facility Principal;
- (ii) Finance Expenses;
- (iii) Management Charges;
- (iv) Costs and Expenses;
- (v) taxes; and
- (vi) all other costs and charges payable under the Agreement (excluding any Shortfall).

Payments will be made in the order specified above (clause 9.2).

57. Costs and Expenses are defined as all costs, fees, charges, expenses and liabilities incurred by the Manager in providing the Management Services, including but not limited to freight costs, feed costs, induction fees and health costs, but excluding finance costs (clause 1.1).

58. The Manager will establish a separate sub-account for each Producer to record:

- (a) Gross Sale Proceeds from sale of Lots;
- (b) Drawdown and repayment of the Facility;
- (c) any Shortfall paid by the Producer;
- (d) details of expenses incurred such as finance expenses, management charges, costs and expenses and the payment of those amounts from Gross Sales Proceeds; and
- (e) for each Lot the Net Sales Proceeds earned and either pooled or dealt with in accordance with clause 9.4.

## ***Pooling***

59. Clause 9.3 specifies that within 14 days after the end of each Half-Year during the term of the arrangement the Manager must:

- (a) subject to clause 9.4, pool the Net Sales Proceeds from each Lot sold on behalf of the Producer during the period with the Net Sales Proceeds from all Lots sold during the period;
- (b) determine the Producer's entitlement to a proportional share of Total Net Sales Proceeds in accordance with the formula:

$$\frac{\text{average acquisition cost}}{\text{total average acquisition cost}} \times \text{total net sales proceeds}$$

- (c) allocate the Producer's Net Return to their Account.

60. Net Sale Proceeds is Gross Sale Proceeds less repayment of the Facility Principal and payment of Management Charges, Costs and Expenses, Finance Expenses and Taxes (clause 1.1).

61. Average Acquisition Cost for all Lots is the average cost of acquisition less the purchase costs (excluding GST) of any cattle from the relevant Lot which have died prior to processing (clause 1.1).

62. Where the Net Sales Proceeds from a Lot is negative then the provisions of clause 9.3 will not apply and the Net Sales Proceeds will be treated as a Shortfall and will be dealt with in accordance with clause 9.8.

63. Within 21 days of the end of the financial years ending 30 June 2008 and 2009 the Manager must distribute 25% of the Total Net Returns for that financial year. The remaining 75% will be retained in the Account to assist funding the acquisition of future Lots (clause 9.5(a)).

64. Within 21 days of the end of each financial year commencing 30 June 2010 for the term of the Agreement the Manager must distribute 100% of the Total Net Returns for that financial year provided that the post distribution balance of the Producer's Account exceeds 20% of the expected purchase cost of any subsequent Lot (clause 9.5(b)).

65. In accordance with clause 9.7 and within 30 days of the sale of the Final Lot the Manager must:

- (i) deduct from the Account any money owing to the Manager; and
- (ii) where there is a Surplus in the Account, distribute the Surplus to the Producer; or
- (iii) where there is a Deficit in the Account, render an invoice to the Producer requiring payment of that Deficit.

66. Clause 9.8 provides that where Gross Sales Proceeds from a Lot are not sufficient to pay amounts due by a Producer to the Manager there is a Shortfall. The Manager may demand payment in writing. Where a demand has been made the Producer must pay the amount within 30 working days (clause 9.8(b)(ii)).

67. The Manager may choose not to demand payment but elect to recoup the Shortfall from the Gross Sales Proceeds of a subsequent Lot (clause 9.10(a)). However, notwithstanding clause 9.10(a), the Producer must, within 90 days of the end of a Financial Year, pay in full any Shortfall amounts owing on the last day of that Financial Year (clause 9.10(b)).

68. If there is a failure to make a payment (excluding Loan Principal) by the relevant due date the Manager will be entitled to recover compound interest accruing daily on the outstanding amount (clause 9.12).

69. The Manager may co-locate the Producer's cattle with another Producer's cattle for the provision of management services and/or for the purposes of selling the cattle to meet the requirements of a purchaser for a specific number of cattle (clause 11.2).

70. The Producer owns all cattle acquired by the Manager on their behalf. The Manager must tag and lot number the Producer's cattle as soon as practicable after their purchase (clause 13).

## Self Funded Producers

71. A Producer may elect to fund the purchase cost of each Lot from their own funds (see paragraph 34 of this Ruling). Where the Producer's account has a positive balance in the Producer's favour the Manager must pay interest on those funds in accordance with clause 23.3.

72. The Producer must, if requested by the Manager, pay any amount necessary to ensure that the balance of the Producer's account equals the facility limit of other Producers, such payment must be within 14 days of the demand being made (clause 23.6).

## Custom Cattle Feeding Agreement

73. The Manager will enter into a Custom Cattle Feeding Agreement with a Feedlot Operator (the 'Feeder') for the purpose of feeding the Producer's cattle at the feedlot under the terms set out in the agreement. A Producer's cattle may be pooled with the cattle of other Producers when placed in the feedlot, however at all times the Producer's cattle will remain separately identifiable.

74. The cattle will be delivered by the Manager in individual consignments. The consignments will be grouped into commonly identified 'lots' upon induction into the Feedlot. The Feeder will implement additional identification procedures as requested by the Manager to enable the Manager to meet its obligations to separately identify each Producer's cattle (clause 2.2).

75. Cattle lots entering the feedlot over a predetermined time period and comprising a predetermined number of cattle are referred to as a Cattle Batch (clause 2.3).

76. The terms and conditions for the custom feeding are as contained in the agreement and the corresponding cattle Feeding Schedule.

77. Clause 2.5 requires the cattle Feeding Schedule to specify:

- (a) maximum and minimum number of cattle that will comprise a Cattle Batch;
- (b) the maximum and minimum number that will be on feed through the specified Cattle Intake Period;
- (c) the date range over which the Cattle Batch will enter the feedlot;
- (d) the maximum number of days for which the Cattle Batch will be fed;
- (e) ration and induction charge out rates for individual cattle Batches for the time the Cattle Batch will be in the feedlot; and
- (f) the ration makeup, dry matter and energy content of the ration to be fed to the Cattle Batch.

78. The Manager or the Producer may enter the feedlot at any time without notice and in the presence of the Feeder to ensure that the Feeder is complying with their obligations under the agreement or to check stock numbers (clause 3.1).

79. The Manager will, on behalf of the Producer, be responsible for the delivery to and removal of the cattle from the feedlot, including all the necessary documentation and identification in relation to the cattle. The cattle will be weighed on a registered weighbridge on entry to and exit from the feedlot.

80. Clause 5.6 states that the Feeder will be responsible for:

- (a) provision of minimum space in the normal feed pens;
- (b) provision of feedlot bunk space;
- (c) provision of feed and water to at least the standard required by the National Feedlot Accreditation Scheme (NFAS);
- (d) daily monitoring of the health and welfare of the cattle and taking steps as necessary to maintain such health and well being such as the provision of medicines or veterinary services; and
- (e) monthly monitoring chemical residue state of feed ensuring that it meets the minimum standard determined by NFAS.

81. The Producer at all times remains the owner of the cattle. The Producer will bear the risk of the mortality and morbidity of the cattle and any adverse climatic effect on the cattle except in the event of the Feeder breaching their responsibilities under the agreement. In the event of Feeder Breach the Feeder will pay the Manager the inventory value of the animal at the time of death (clause 6).

82. Clause 7 of the agreement details the fees and charges to be levied under the agreement. The charges levied will be consistent with industry standards and prevailing market conditions.

### **Stock Mortgage**

83. The Producer mortgages all its right title and interest to the Mortgaged Stock to the Financier as security for the Facility. The Producer will be responsible for all costs in relation to the Mortgage.

## **Guarantee and Indemnity**

84. The Manager grants to the Financier a guarantee in respect of Guaranteed Moneys under the Facility. Guaranteed Moneys is defined to mean all amounts, including principal, interest, fees, charges, costs and expenses, debts and other monetary liabilities owing under the Loan Agreement. Where a Producer defaults on the repayment of Guaranteed Moneys the Manager may be called on to pay to the Financier the Guaranteed Amount. The Guaranteed Amount is defined as an amount equal to 20% of the Guaranteed Moneys, up to a maximum of 20% of the Facility limit.

85. The Guaranteed Amount is payable by the Manager in the event of default of a Producer in respect of the Facility. However, the guarantee cannot be enforced until after the Financier has exercised its rights under the Stock Mortgage.

86. Where payment of the Guaranteed Amount under the agreement is enforced the Manager will pursue payment of that amount from the defaulting Producer.

## **Project Fees**

87. Upon application a Producer is required to pay an Initial Management Fee of \$51,526. The Initial Management Fee includes \$600 which relates to the establishment of the Producer's Facility under the arrangement.

## **Finance**

88. In accordance with clause 21 of the Management Agreement, a Producer, who is not a Self Funded Producer per clause 23, will enter into a Loan Agreement with the Financier to establish the Facility.

89. Pursuant to the Loan Agreement the Financier will provide to the Producer access to a Facility on the following terms and conditions:

- the Facility may only be used for the purchase of Lots in the Project;
- in return the Producer must grant in favour of the Financier a mortgage over the Lot;
- interest will accrue daily on the Loan at the official cash rate as set by the Reserve Bank plus a margin of 3.94%; and
- when a Lot is sold the loan principal and interest is to be repaid by the Manager on the Producer's behalf from the Gross Sale Proceeds. The Producer is required to make up any Shortfall that might arise.

90. There will be no finance offered by the Financier or the Manager or any related entity in relation to a Producer's Initial Management Fee.

91. This Ruling also does not apply if the finance scheme entered into by the Producer with the Manager or any other lender includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity schemes 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 schemes 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 Financier, are involved or become involved in the provision of finance to Producers for the Project.

---

**Commissioner of Taxation**

24 April 2007

---

## 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 Producer carrying on a business?**

92. For the amounts set out in paragraph 24 of this Ruling to constitute allowable deductions the Producer's cattle feedlot and sale activities as a participant in the Mort & Co No. 5 Project must amount to the carrying on of a business of primary production.

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

94. 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?

95. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the Mort & Co No. 5 Project. 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.

96. Having applied these principles to the arrangement set out above, a Producer in the Mort & Co No. 5 Project is accepted to be carrying on a business of purchase and feedlotting cattle for sale.

### **The Simplified Tax System**

#### **Division 328**

97. Subdivision 328-F sets out the eligibility requirements that a Producer must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

98. Changes to the STS rules apply from 1 July 2005. The question of whether a Producer 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 Producer 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 Initial Management Fee, Management Fees, Costs and Expenses, Buyers Fee and interest on the Facility with Financier****Section 8-1**

99. The Initial Management Fee, Management Fees, Costs and Expenses and Buyers Fee are deductible under section 8-1 (see paragraphs 43 and 44 of TR 2000/8). A 'non-income producing' purpose (see paragraphs 47 and 48 of TR 2000/8) is not identifiable in the arrangement and there is no capital component evident in the Initial Management Fee, Management Fees, Costs and Expenses and Buyers Fee (see paragraphs 49 to 51 of TR 2000/8).

100. 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 103 to 107 of this Ruling) a deduction for these amounts can be claimed in the year in which they are incurred. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7.)

101. Some Producers may finance their participation in the Project through a Loan Agreement with the Financier. Applying the same principles as that used for Initial Management Fee, Management Fees, Costs and Expenses and Buyers Fee, interest incurred under such a loan has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

102. Other than where the prepayment provisions apply (see paragraphs 103 to 107 of this Ruling), a Producer can claim a deduction for such interest in the year in which it is incurred.

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

103. 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) 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.

104. 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***

105. Under the scheme to which this Product Ruling applies Initial Management Fee, Management Fees, Costs and Expenses and Buyers Fee are incurred annually and the interest payable to the Financier is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this scheme.

106. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Producer in this Project prepays all or some of the expenditure payable under the Management Agreement or prepays interest under a loan agreement (including loan agreements with lenders other than the Financier). 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.

107. As noted in the Ruling section above, Producers 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.

## **Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner's discretion**

108. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income year 30 June 2007, based on the evidence supplied, the Commissioner has determined that for those income years:

- it is because of its nature the business activity of a Producer 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 cattle industry, a Producer's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit.

109. A Producer 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.

110. 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 Producer will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

**Section 82KL – recouped expenditure**

111. 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**

112. 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).

113. The Mort & Co No. 5 Project will be a 'scheme'. A Producer will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraph 24 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.

114. Producers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the purchase, feedlotting and sale of cattle. There are no facts that would suggest that Producers 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

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

	<b>Paragraph</b>
<b>What this Ruling is about</b>	<b>1</b>
Class of entities	2
Superannuation Industry (Supervision) Act 1993	5
Qualifications	6
<b>Date of effect</b>	<b>9</b>
Changes in the law	14
Note to promoters and advisers	16
Goods and Services Tax	17
<b>Ruling</b>	<b>18</b>
Application of this Ruling	18
The Simplified Tax System (STS)	20
<i>Division 328</i>	20
25% entrepreneurs tax offset	22
<i>Subdivision 61-J</i>	22
Assessable income	23
<i>Sections 6-5 and 17-5</i>	24
Deduction for Initial Management Fee, Management Fee, Costs and Expenses, Buyers Fee, Interest and Borrowing Costs	24
<i>Section 8-1, section 25-25 and Division 27 of the ITAA 1997 and sections 82KZME and 82KZMF of the Income Tax Assessment Act 1936</i>	24
Trading stock	25
<i>Section 70-35</i>	25
<i>Section 328-285</i>	27
Division 35 – deferral of losses from non-commercial business activities	29
<i>Section 35-55 – exercise of Commissioner’s discretion</i>	29
Prepayment provisions and anti-avoidance provisions	30
<i>Sections 82KZME, 82KZMF and 82KL and Part IVA</i>	30
<b>Scheme</b>	<b>31</b>
Overview	34
Information Memorandum	40

Management Agreement	45
<i>Pooling</i>	59
Self Funded Producers	71
Custom cattle Feeding Agreement	73
Stock Mortgage	83
Guarantee and Indemnity	84
Project Fees	87
Finance	88
<b>Appendix 1 – Explanation</b>	<b>92</b>
Is the Producer carrying on a business?	92
The Simplified Tax System	97
<i>Division 328</i>	97
Deductibility of Initial Management Fee, Management Fees, Costs and Expenses, Buyers Fee and interest on the Facility with Financier	99
<i>Section 8-1</i>	99
Prepayment provisions	103
<i>Sections 82KZL to 82KZMF</i>	103
<i>Application of the prepayment provisions to this Project</i>	105
Sections 35-10 and 35-55 – deferral of losses from non-commercial business activities and the Commissioner’s discretion	108
Section 82KL – recouped expenditure	111
Part IVA – general tax avoidance provisions	112
<b>Appendix 2 – Detailed contents list</b>	<b>115</b>

## 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:*

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- non-commercial losses
- producing assessable income
- product rulings
- public rulings
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- taxation administration

*Legislative references:*

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA

- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 25-25
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Subdiv 61-J
- ITAA 1997 Div 70
- ITAA 1997 70-35
- ITAA 1997 Div 328
- ITAA 1997 328-285
- ITAA 1997 328-285(1)
- ITAA 1997 328-285(2)
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- 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
- SISA 1993

*Case references:*

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

---

ATO references

NO: 2007/2682

ISSN: 1441-1172

ATOlaw topic: Income Tax ~~ Product ~~ livestock