



PR 2007/8 - Income tax: Ginseng Australia Project No. 1 (Early Growers)

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Product Ruling

Income tax: Ginseng Australia Project No. 1 (Early Growers)

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ⓘ 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.

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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 'Ginseng Australia Project No. 1' or simply as 'the Project'.

Class of entities

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

3. The class of entities who can rely on those tax benefits consists of entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and which execute relevant Project Agreements mentioned in paragraph 32 of this Ruling on or before 31 May 2007. They must have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement.

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

- intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- are accepted into this Project before the date of this Ruling or after 31 May 2007; or
- participate in the scheme through offers made other than through the Product Disclosure Statement.

Qualifications

5. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 32 to 63 of this Ruling.

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

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- this Product Ruling may be withdrawn or modified.

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Date of effect

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

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

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

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

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

- the income year or other period to which the rulings relate has not begun; and

- the scheme to which the rulings relate has not begun to be carried out.

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

Changes in the Law

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

14. Entities who are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

15. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling is issued.

Goods and Services Tax

16. All fees and expenditure referred to in this Product Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a Grower to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Ruling

Application of this Ruling

17. This Ruling applies only to Growers who are accepted to participate in the Project on or before 31 May 2007 and who have executed a Licence and Management Agreement on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

18. 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 PDS, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 1,000 Farming Allotments is achieved.

The Simplified Tax System (STS)***Division 328***

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

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

25% entrepreneurs tax offset***Subdivision 61-J***

21. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides a 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***Section 6-5***

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

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

Deductions for Plant Fees, Initial Management Fees, Continuing Management Fees and Occupation Fees**Sections 8-1 and 25-25**

24. A Grower may claim tax deductions, for each 5 Farming Allotments acquired, for the revenue expenses set out in the Table below. For Growers who acquire additional Farming Allotments, the deduction allowable is increased by 1/5th for each additional Farming Allotment acquired.

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Plant Fees	\$1,100 See Notes (i) & (ii)	Nil	Nil
Initial Management Fees	\$4,720 See Notes (i) & (ii)	Nil	Nil
Continuing Management Fees	Nil	\$412.50 See Notes (i) & (ii)	Must be calculated See Notes (i) & (ii)
Occupation Fees	Must be calculated See Notes (i) & (ii)	\$82.50 See Notes (i) & (ii)	Must be calculated See Notes (i) & (ii)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.
- (ii) The Plant Fees, Initial Management Fees, Continuing Management Fees and Occupation Fees shown in the Licence and Management Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (for example, the provision of management services or the licencing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the *Income Tax Assessment Act 1936* (ITAA 1936) may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 88 of this Ruling unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception'

to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000. Reference should be made to paragraph 62 of this Ruling for the basis of calculation of the Continuing Management Fee and Occupation Fees. The Responsible Entity will advise Growers of the Continuing Management Fee to be paid for the Year Ended 30 June 2009 and Occupation Fees to be paid for the Years Ended 30 June 2007 to 30 June 2009.

Deductions for capital expenditure (non-STS taxpayers)

Division 40

25. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (for example, irrigation), a 'landcare operation' and shadecloth. All deductions shown in the following Table, representing 5 Farming Allotments, are determined under Division 40.

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Water facility (Irrigation)	\$67 See Notes (i) & (iii)	\$67 See Notes (i) & (iii)	\$66 See Notes (i) & (iii)
Landcare operations	\$317.50 See Notes (i) & (iv)	Nil	Nil
Shadecloth	Must be calculated See Notes (i) & (v)	Must be calculated See Notes (i) & (v)	Must be calculated See Notes (i) & (v)

Notes:

- (iii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one-third of the capital expenditure of \$200 (less Note (i) adjustment where applicable) incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one-third in each of the next 2 years of income (section 40-540).

- (iv) Capital expenditure of \$317.50 (less Note (i) adjustment where applicable) incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630.
- (v) Shadecloth is a 'depreciating asset'. Each Grower holds an interest in the shadecloth which is a 'low-cost asset' and can be allocated to a 'low-value pool'. Once any 'low-cost asset' of a Grower is allocated to a 'low-value pool', all other 'low-cost assets' the Grower start to 'hold' in that year or a later year must be allocated to that pool. If the Grower has already allocated an asset to a 'low-value pool', the shadecloth would also have to be allocated to that pool. Otherwise, the Grower must decide whether to create a 'low-value pool'. If the assets are allocated to a 'low-value pool', the capital expenditure on the shadecloth (less Note (i) adjustment where applicable) will be deducted under the diminishing value methodology of the pool based on a rate of 18.75% in the year the shadecloth is first used and a rate of 37.5% in subsequent years (section 40-440). If the shadecloth is not allocated to a 'low-value pool', it can be written off based on the 'effective life' of the shadecloth. As there has been no determination of the 'effective life' of shadecloth by the Commissioner, Growers must self-assess an 'effective life'. Shadecloth is not installed until after the Ginseng Plants are planted and no deduction for the decline in value is available until this installation occurs. The Responsible Entity will advise Growers of that date to enable them to calculate the deduction.

Deductions for capital expenditure (STS taxpayers)

Subdivisions 328-D, 40-F and 40-G

26. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (for example, irrigation), a 'landcare operation' and shadecloth. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F and in relation to a 'landcare operation' under Subdivision 40-G. If the 'water facility' or 'landcare operation' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328. Deductions relating to the 'cost' of shadecloth must be determined under Division 328.

27. The deductions shown in the following Table (which represent 5 Farming Allotments) assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities or a 'landcare operation' under Subdivisions 40-F or 40-G and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Notes (vii) & (viii).

28. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1,000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Water facility (irrigation)	\$67 See Notes (i) & (vi)	\$67 See Notes (i) & (vi)	\$66 See Notes (i) & (vi)
Landcare operations	\$317.50 See Notes (i) & (vii)	Nil	Nil
Shadecloth	Nil	Must be calculated See Notes (i) & (viii)	Nil

Notes:

- (vi) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1,000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2007 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply.

If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one-third of the capital expenditure of \$200 (less Note (i) adjustment where applicable) incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one-third in each of the next 2 years of income (section 40-540).

- (vii) Any capital expenditure incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630. If the expenditure of \$317.50 (less Note (i) adjustment where applicable) is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-G (although expenditure on some items of plant can only be deducted under Division 328). For the purposes of Division 328, each Grower's interest in the underlying asset is deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1,000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years, the full pool rate will apply. If the expenditure is not on a 'depreciating asset', the expenditure is fully deductible under Subdivision 40-G.
- (viii) Shadecloth is a 'depreciating asset' to which Division 40 applies. Each Grower holds an interest in the shadecloth which is a 'low-cost asset' as defined in subsection 40-425(2). It cannot be allocated to the 'general STS pool' (section 328-180). A deduction equal to the amount of the Grower's expenditure for the shadecloth (less Note (i) adjustment where applicable) is available in the income year in which they are used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. Shadecloth is not installed until after the Ginseng Plants are planted. The Responsible Entity will advise when that has occurred.

Tax outcomes that apply to all Growers

29. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 82 to 96 of this Ruling as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

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

30. A Grower who is an individual accepted into the Project by 31 May 2007 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending **30 June 2007 to 30 June 2010**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

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

31. For a Grower who participates in the Project and incurs expenditure as required by the Licence and Management Agreement the following provisions of the ITAA 1936 apply:

- expenditure by a Grower does not fall within the scope of sections 82KZME and 82KZMF (but see paragraphs 84 to 89 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

32. 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 August 2006 as constituted by documents provided on 24 August 2006, 8 September 2006, 10 and 30 October 2006, 27 November 2006, 13 December 2006, 30 January 2007, 1 February 2007 and additional correspondence dated 10 October 2006, 14 and 27 November 2006, 1 and 13 December 2006, 8 and 9 January 2007;
- Draft Product Disclosure Statement for the Ginseng Australia Project No. 1, received on 27 November 2006;
- Draft **Constitution** of the Ginseng Australia Project No. 1 between DDR Funds Management Limited (Responsible Entity) and the Growers, received on 13 December 2006;
- Draft **Licence and Management Agreement** of the Ginseng Australia Project No. 1 between the Responsible Entity and the Growers, received on 13 December 2006;
- Particulars & Conditions of Sale by Auction in relation to the Project Land received on 10 October 2006;
- Draft Memorandum of Lease between Ginseng Australia Pty Ltd (Lessor) and Huntley Custodians Limited (Lessee) received on 27 November 2006;
- Draft Compliance Plan of the Ginseng Australia Project No. 1 received with the Application for a Product Ruling on 24 August 2006;
- Draft Custodial Agreement of the Ginseng Australia Project No. 1 between DDR Funds Management Limited (Responsible Entity) and Huntley Custodians Limited (Custodian) received on 10 October 2006;
- Agricultural Report Panax Ginseng Development Plan in relation to the Ginseng Australia Project No. 1 received on 30 October 2006; and
- Soil Report Panax Ginseng Development in relation to the Ginseng Australia Project No. 1 received on 30 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.

33. The documents highlighted are those that a Grower may enter into. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the scheme.

34. 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

35. Following is a summary of the scheme:

Location	Natone, Tasmania
Type of business to be carried on by each participant	Commercial cultivation of Ginseng Plants
Number of hectares offered for cultivation	108
Size of each Farming Allotment	33.3 square metres
Minimum allocation	5 Farming Allotments
Minimum subscription	1,000 Farming Allotments
Number of Ginseng Plants per hectare	180,180
Term of the Project	7 years
Initial cost per 5 Farming Allotments	\$6,875
Initial cost per hectare	\$412,913
Ongoing costs	Continuing Management Fee and Occupation Fee
Other costs	Harvest Fee

36. The Ginseng Australia Project No. 1 is a Managed Investment Scheme under the *Corporations Act 2001*. The Responsible Entity for the Project is DDR Funds Management Limited (DDR). Under the Product Disclosure Statement & Prospectus (PDS), DDR proposes to offer interests called 'Farming Allotments' of 33.3 square metres each. Upon application, Growers will execute a Power of Attorney enabling DDR to act on their behalf as required. Growers are required to apply for a minimum of 5 Farming Allotments. There is a minimum subscription of 1,000 Farming Allotments for this Project.

37. The Project will be situated in the Natone region of Tasmania. The land for the Project has been purchased by the Lessor, which will lease the land to Huntley Custodians Limited (Lessee) (Custodian). The Responsible Entity will grant a licence to the Growers to carry on the Grower's Business, being the acquisition, planting, growing and cultivation of Ginseng Plants for the production, harvesting, marketing and sale of the ginseng produced therefrom. A Grower acquiring the minimum number of interests in the Project will hold a licence over Farming Allotments on which the Grower can plant and maintain Ginseng Plants.

38. Growers enter into a Licence and Management Agreement with DDR to manage their Farming Allotments for the eventual harvest and sale of their ginseng. DDR will manage and cultivate the Ginseng Plants and will be responsible for harvesting and selling the ginseng.

39. Under the PDS offer, Growers can enter the Project during the period up to 31 May 2007 and during the period 1 July 2007 to 31 May 2008. Applicants will not be accepted into the Project from 1 June 2007 to 30 June 2007 and after 31 May 2008. This Ruling only applies to Growers who enter into the Project from the date of this Ruling up to 31 May 2007.

Constitution

40. The Constitution establishes the Project and operates as a deed binding on all the Project's Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which DDR 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.

41. The Scheme shall, unless it is wound up earlier pursuant to the Constitution, determine on the 30 November 2014. However, if the Farming Allotments have not been harvested at that date, then the Scheme shall determine on the date that the Farming Allotments are harvested, the ginseng sold and the proceeds of the sale thereof are received by the Responsible Entity and are distributed to Growers in accordance with the Constitution.

42. The procedure for applying for Interests in the Project is stated at clause 15 and the Responsible Entity may accept or reject applications in its absolute discretion. If an application is not rejected, the Responsible Entity must, on receipt of the completed Application Form and application monies, pay those monies into the Applications Bank Account not later than the next working day after receipt.

43. Subject to the Minimum Subscription having been reached, within 30 days of receipt of the completed Application Form and application monies, the Responsible Entity must:

- (a) where the Application Form is not accepted, notify the applicant in writing of non-acceptance and return the application monies to the Applicant; and
- (b) where the Application Form is accepted, notify the applicant of acceptance and enter the applicants name in the Register as a Grower.

44. Where an Application Form is accepted, the application monies must be transferred to the Scheme Bank Account. However, no monies will be released from the Applications Bank Account until a Lease is granted by the Land Owner to the Custodian.

45. The Fees payable by the Growers to the Responsible Entity are those listed at clauses 4.1 to 4.7 and are described at paragraph 62 of this Product Ruling.

46. All Growers' Business Income (as defined below) must be paid by the Responsible Entity into the Scheme Bank Account. The Responsible Entity shall be entitled to pay all monies required to be paid by or for and on behalf of the Growers pursuant to the Constitution or the Licence and Management Agreement out of the Scheme Bank Account.

47. Grower's Business Income means the amount left after deduction of the Harvest Fees from the total amount received by Growers from the sale of ginseng which has been harvested from the Grower's Farming Allotment, together with any other amounts which would be included in the Grower's taxable income from the carrying on of the Grower's Business.

48. The Grower's Business Income, after deduction of all amounts permitted to be deducted therefrom pursuant to the Constitution and/or the Licence and Management Agreement must be distributed to the Grower or at his direction in accordance with his entitlement thereto within five months after the last day of each Financial Year or at such lesser intervals as the Responsible Entity may determine.

Licence and Management Agreement

49. By entering this Agreement, the Grower agrees to:

- licence the Grower's Farming Allotment;
- carry out the Grower's Business on the Farming Allotment; and
- appoint the Responsible Entity as the manager of the Grower's Business.

50. The Grower appoints the Responsible Entity as the manager of the Grower's Business to carry out for the Grower the:

- Initial Management Services (clause 5.1(a)(1)) during the Initial Period;
- Ongoing Management Services (clause 5.1(a)(2)) during each Financial Year after the Initial Period;
- Acquisition of a minimum of 600 Ginseng seeds to be planted on the Grower's Farming Allotment (clause 5.2);
- Landcare Operations (clause 5.2(c)(1));
- Provision of water facilities including irrigation (clause 5.2(c)(2));
- Provision of shade cloth and shade cloth structures (clause 5.2(c)(3)); and
- Harvest Services (as defined in Clause 29 of the Constitution),

and to do all things as may be necessary for the Grower to carry out the Grower's Business.

51. In consideration of the Responsible Entity performing the services specified in paragraph 50 of this Ruling, the Growers are required to pay fees as follows:

- Initial Management Fees (as specified at clause 6.2);
- Continuing Management Fees (as specified at clause 6.4);
- Plant Fees (as specified at clause 6.1);
- Initial Fees (as specified at clause 6.3 (a), (b) and (c)); and
- Harvest Fees (as specified at clause 6.5).

52. In addition, each Grower must pay to the Responsible Entity the Occupation Fee as specified in clause 4, for the licence of the Farming Allotments.

53. The Agreement shall, determine on the 30 November 2014 or if the Farming Allotments have not been harvested at that date, then the date that the Farming Allotments are harvested, the ginseng sold and the Grower's Business Income is distributed to the Grower in accordance with the Constitution.

54. The Growers authorise the Responsible Entity to pool the ginseng harvested from the Farming Allotment with ginseng harvested from the Farming Allotments of other Growers in the Scheme.

55. The Growers are entitled to be paid the Grower's Business Income in accordance with the Constitution.

56. The Responsible Entity may in its absolute discretion arrange for the Grower's Ginseng Plants to be insured against loss from fire, storm, tempest and such other insurable risks of the Growers Allotment at the cost of the Growers. The Responsible Entity shall be entitled to invoice each Grower for the cost of such insurance, proportionate to the number of Grower's Allotments held by each Grower. The Responsible Entity shall not be required to insure or cause insurance to be taken out if in the Responsible Entity's reasonable opinion the relative cost of the premium is not justified.

57. Any insurance proceeds received shall be apportioned among the Growers whose crop is the subject of the relevant insurance claim with respect to the proportion of the crop of those Growers that forms part of the insurance proceeds.

Memorandum of Lease

58. Under the Lease, the Lessor leases the Project Land to the Lessee for the Term in exchange for payment of the Annual Rent. The Term is the period from the Commencement Date (being the date minimum subscription is reached) to the Termination Date, being 30 November 2014.

59. The Annual Rent payable by the Lessee is the sum of the Occupation Fees received by the Lessee from each Grower during the relevant Rent Period. The Annual Rent (as defined in clause 3) shall be paid as follows:

- for the first Rent Period, the dates on which each Grower's application is accepted by the Responsible Entity; and
- for each period thereafter, at commencement of such Rent Period or if Occupation Fees are received thereafter during that Rent Period on the day the same are received.

60. The Lessee must only use the Premises for the Permitted Use specified in Item 8 of the Lease and the Lessee must obtain any consent needed from any authority for the use of the Land for the Lessee's Business.

Compliance Plan

61. As required by the Corporations Law, a Compliance Plan has been prepared for the Project. The purpose of the Compliance Plan is to provide sufficient detail on:

- (i) the obligations which must be met by the Responsible Entity;
- (ii) what measures or procedures are in place to comply with these obligations; and

- (iii) how compliance with those measures and procedures will be monitored.

Fees

62. Under the Constitution and Licence and Management Agreement a Grower is required to pay the following fees to the Responsible Entity for each Farming Allotment:

Plant Fees

- \$220 payable on the Settlement Date (being the day the Responsible Entity has accepted the signed Application Form from the Grower).

Initial Management Fees

- \$944 payable on the Settlement Date.

Other Initial Fees

- \$63.50 for Landcare Operations;
- \$40 for the water facilities and irrigation system; and
- \$91 for shadecloth and shadecloth structures,
payable on the Settlement Date

Continuing Management Fees

- \$82.50 payable on 1 July 2007; and
- for each Financial Year thereafter, an amount being the greater of \$82.50 increased annually by the CPI or the Continuing Management Fee for the Previous Financial Year plus an increment of 3% thereof, payable in advance.

Occupation Fees

- for the period from the date of acceptance of a Grower's Application to 30 June 2007 (the period), \$16.50 multiplied by the number of days in the period divided by 365, provided that if the Grower pays the sum of \$16.50 with the Grower's Application then the proportion of overpayment shall be applied to the Occupation Fees for the next ensuing Financial Year;
- for the Financial Year commencing on 1 July 2007, \$16.50, payable in advance; and
- for each Financial Year thereafter, an amount being the greater of \$16.50 increased annually by the CPI or the Occupation Fee for the previous 12 months plus an increment of 3% thereof, payable annually in advance on 1 July in each Financial Year.

Harvest Fees

- the sum of the Harvest Costs plus an amount equal to 20% of those Harvest Costs, payable out of the Product Sale Proceeds.

Finance

63. 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; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Commissioner of Taxation14 February 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 Grower carrying on a business?

64. For the amounts set out in the Tables above to constitute allowable deductions, the Grower's ginseng cultivation activities as a participant in the Ginseng Australia Project No. 1 must amount to the carrying on of a business of primary production.

65. Where there is a business, or a future business, the gross proceeds from the sale of the ginseng will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

66. For schemes such as that of the Ginseng Australia Project No. 1, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

67. Generally, a Grower will be carrying on a business of ginseng cultivation, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's Ginseng Plants are established;
- the Grower has a right to harvest and sell the ginseng from those Ginseng Plants;
- the ginseng cultivation activities are carried out on the Grower's behalf;
- the ginseng cultivation activities of the Grower are typical of those associated with a ginseng cultivation business; and
- the weight and influence of general indicators point to the carrying on of a business.

68. In this Project, each Grower enters into a Licence and Management Agreement.

69. Under the Licence and Management Agreement each individual Grower will have rights over a specific and identifiable area of land. The Licence and Management Agreement provides the Grower with an ongoing interest in the specific Ginseng Plants on the licensed area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out ginseng cultivation activities, and for no other purpose. The licence allows the Responsible Entity to come onto the land to carry out its obligations under the Licence and Management Agreement.

70. Under the Licence and Management Agreement the Responsible Entity is engaged by the Grower to establish and maintain Farming Allotments on the Grower's identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Farming Allotments on the Grower's behalf.

71. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the ginseng grown on the Grower's Farming Allotments.

72. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the Project's description for all the indicators.

73. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of the ginseng that will return a before-tax profit, which is a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

74. The pooling of ginseng from Ginseng Plants grown on the Grower's Farming Allotment with the ginseng of other Growers is consistent with general ginseng cultivation practices. Each Grower's proportionate share of the sale proceeds of the pooled ginseng will reflect the proportion of the roots contributed from their Farming Allotments.

75. The Responsible Entity's services are also consistent with general ginseng cultivation practices. They are of the type ordinarily found in ginseng cultivation ventures that would commonly be said to be businesses. While the size of a Farming Allotment is relatively small, it is of a size and scale to allow it to be commercially viable.

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

77. The ginseng cultivation activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' ginseng cultivation activities in the Ginseng Australia Project No. 1 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

78. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the Simplified Tax System (STS) and Subdivision 328-G sets out the rules for entering and leaving the STS.

79. 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 Plant Fees, Initial Management Fees, Continual Management Fees and Occupation Fees

Section 8-1

80. Consideration of whether the Plant Fees, Initial Management Fees, Continual Management Fees and Occupation Fees (the Fees) are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer is contractually committed to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

81. The Fees associated with the ginseng cultivation activities will relate to the gaining of income from the Grower's business of ginseng cultivation (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of ginseng) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the Fees is identifiable from the scheme. The Fees appear to be reasonable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZME, 82KZMF and 82KZL

82. 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.

83. For this Project only section 82KZL of the ITAA 1936 (an interpretative provision) and sections 82KZME and 82KZMF of the ITAA 1936 are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

84. Where the requirements of subsections 82KZME(2) and (3) of the ITAA 1936 are met, the formula in subsection 82KZMF(1) of the ITAA 1936 (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) of the ITAA 1936 will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1) of the ITAA 1936).

85. The requirements of subsection 82KZME(3) of the ITAA 1936 will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year;
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either:
 - a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

86. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4) of the ITAA 1936). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deductions are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF of the ITAA 1936.

87. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) of the ITAA 1936 is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1) of the ITAA 1936. However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

88. Where the requirements of section 82KZME of the ITAA 1936 are met, section 82KZMF of the ITAA 1936 applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

89. In the formula 'eligible service period' (defined in subsection 82KZL(1) of the ITAA 1936) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Application of the prepayment provisions to this Project

90. In this Project, an Initial Management Fee of \$944 and an initial Occupation Fee of up to \$16.50 per Farming Allotment will be incurred on execution of the Licence and Management Agreement. The Initial Management Fee and the Occupation Fee are charged for providing management services or licencing land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

91. In particular, the Initial Management Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Initial Management Fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

92. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the Initial Management Fee, and the fees for subsequent years, is for the Project Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Licence and Management Agreement, Occupation Fees are payable annually in advance for the licence of the land during the expenditure year.

93. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 51 of this Ruling, then the basic precondition in subsection 82KZME(2) of the ITAA 1936 is not satisfied and, in these circumstances, section 82KZMF of the ITAA 1936 will have no application.

Growers who choose to pay fees for a period in excess of that required by the Project's agreements

94. Although not required under the Licence and Management Agreement, a Grower participating in the Project may choose to prepay fees/interest for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 93 of this Ruling, section 82KZMF of the ITAA 1936 will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

95. For these Growers, the amount and timing of deductions for any relevant prepaid Management Fees, prepaid Occupation Fees, or prepaid interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

96. However, as noted above, prepaid fees of less than \$1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF of the ITAA 1936.

Expenditure of a capital nature

Division 40 and Division 328

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 shade cloth, water facilities, and a 'landcare operation' is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328.

98. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

99. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 25 and 28 of this Ruling in the Tables and accompanying notes.

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

Section 35-55 – exercise of Commissioner's discretion

100. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2007 to 30 June 2010** the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 Income tax: Division 35 – non-commercial business losses. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2007 up to and including 30 June 2010:

- it is because of its nature the business activity of a Grower that will not satisfy one of the four tests in Division 35;
- there is an objective expectation that within a period that is commercially viable for the ginseng cultivation industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and

- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

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 Ginseng Australia Project No. 1 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 24, 25 and 28 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 ginseng. 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.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

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

Subject references:

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

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
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- ITAA 1936 Pt IVA
- ITAA 1936 177A

- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
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- ITAA 1997 17-5
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- ITAA 1997 Div 35
- ITAA 1997 35-10
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ATO references

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