



# ***PR 2007/83W - Income tax: Arafura Pearl Project 2008***

 This cover sheet is provided for information only. It does not form part of *PR 2007/83W - Income tax: Arafura Pearl Project 2008*

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



# Notice of Withdrawal

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## Product Ruling

### Income tax: Arafura Pearl Project 2008

Product Ruling PR 2007/83 is withdrawn with effect from today.

1. Product Ruling PR 2007/83 set out the Commissioner's opinion on the tax consequences for a defined class of entities ('the Growers') participating in the Arafura Pearl Project 2008 ('the Project'), an aquaculture managed investment scheme with the purpose of carrying on a commercial project involving the cultivation, harvest and sale of pearls.

2. This Product Ruling has been withdrawn in accordance with subsection 358-20(1) of Schedule 1 to the *Taxation Administration Act 1953*, which states the Commissioner may withdraw a public ruling either wholly or to an extent. Where the scheme described in the ruling is materially different from the scheme actually carried out, the ruling does not have any binding effect on the Commissioner, as the scheme entered into is not the scheme being ruled upon.

3. Provided that up until 17 July 2012 the Project was carried out as described in PR 2007/83, the events described below do not disturb the tax treatment of the Grower's previous outgoings, up until 17 July 2012, as set out in PR 2007/83.

All legislative references in this withdrawal notice are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise stated.

#### Events since 21 April 2011

4. On 21 April 2011, Voluntary Administrators (the Administrators) were appointed to Arafura Pearls Holdings Limited (the Responsible Entity).

5. On 24 April 2012, the Federal Court directed the Administrators to wind up the Project, and that the Administrators be appointed as Receivers of the property of the Project to ensure its orderly winding up.

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

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

8. In a correspondence dated 27 September 2012, the Administrators advised the ATO that there were no pearls harvested for the Project prior to the settlement of the GRTA, and as such there are no proceeds for Growers.

9. On 16 May 2013, the Administrators advised the ATO that no fees have been invoiced since their appointment, and that as Growers did not receive any proceeds as no harvest occurred, the Growers will not have an obligation to pay outstanding fees.

10. The settlement of the GRTA resulted in the Project being carried out in a materially different manner from the Project described in PR 2007/83. Consequently, PR 2007/83 has no binding effect on the Commissioner after 17 July 2012, and the Commissioner has withdrawn PR 2007/83 as per paragraph 6 of PR 2007/83.

## **Carrying on a business**

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

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

12. Division 35 applies only to individuals, alone or in partnership, who are carrying on a business activity. Under paragraph 30 of PR 2007/83, the Commissioner conditionally undertook to exercise his discretion under paragraph 35-55(1)(b) to allow losses incurred by Growers that are individuals to be offset against other assessable income in the income year in which the losses arise for the income years ending 30 June 2008 to 30 June 2014.

13. Due to the cessation of a Grower's business activity on 17 July 2012 as per paragraphs 8, 11 and 12, the Project is no longer implemented in accordance with PR 2007/83, and as such the Commissioner's discretion is no longer required after 17 July 2012.

**Costs after business activities cease**

14. Amounts incurred after the business activity ceases, for example interest (refer to paragraphs 19 and 20 below), may still be deductible as such deductions are not subject to Division 35.

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

**Deductibility of the Sales and Marketing Fees, Insurance Premiums, Deferred Management Fees, Deferred Management Fee Shortfall and Manager's Bonus**

16. The Commissioner described the following fees in PR 2007/83: Sales and Marketing Fees, insurance premiums, Deferred Management Fees, Deferred Management Fee Shortfall and Manager's Bonus. The Sales and Marketing Fees were ruled to be deductible under section 8-1, in the income year in which they were incurred. The Insurance Premiums were ruled to be deductible in full in the year that they were incurred.

17. The Administrators have advised the ATO that no fees have been invoiced since their appointment, and that as Growers did not receive any proceeds as no harvest occurred, the Growers will not have an obligation to pay outstanding fees. Consequently, no fees have been incurred after the appointment of Administrators on 21 April 2011, and no deductions will be available to the Growers in relation to the above fees after the appointment of Administrators.

**Interest on Loans with Momentum Finance**

18. Prior to the cessation of the business, interest on loans with Momentum Finance is deductible in the income year that it was incurred.

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

**Deductibility of the Loan Application Fee**

20. Note (vi) to paragraph 29 of PR 2007/83 ruled that the Loan Application Fee payable to Momentum Finance is deductible under section 25-25 of the ITAA 1997 over the period of the loan or 5 years, whichever is the shorter.

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

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

22. CGT event C2 occurs upon settlement of GRTA as per section 104-25, as Grower's rights as mentioned in paragraph 8 above has been terminated, consequently cancelling the Grower's rights.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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## **Commissioner of Taxation**

24 July 2013

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### ATO references

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