PR 2009/55W - Income tax: Arafura Pearl Project 2010

Notice of Withdrawal

Product Ruling

Income tax: Arafura Pearl Project 2010

Product Ruling PR 2009/55 is withdrawn with effect from today.

1. Product Ruling PR 2009/55 set out the Commissioner's opinion on the tax consequences for a defined class of entities ('the Growers') participating in the Arafura Pearl Project 2010 ('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 This Product Ruling has been withdrawn in accordance with subsection 358-20(1) of Schedule 1 to the *Taxation Administration Act 1953*, which states the Commissioner may withdraw a public ruling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. The failure to purchase Panels by 30 June 2010 resulted in the Project being carried out in a materially different manner from the Project described in PR 2009/55. Consequently, a Grower is not entitled to a deduction in respect to the Panels for the income year ended 30 June 2010 and 30 June 2011 (refer paragraphs 13 to 19 below).

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). The Administrators advised that the as at their appointment, no Panels had been purchased for use in the Project. This meant that at the end of the Initial Management Period on 30 June 2010 (see paragraph 78 of PR 2009/55), the Responsible Entity has not provided the Initial Management Services as described in paragraph 78 of PR 2009/55.

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:

(a) as at the date of their appointment, no Panels had been purchased for use in the Project;

(b) subsequent to their appointments, Panels were acquired and subsequently paid for in full by another entity pursuant to the Management Agreement executed on 23 June 2011; and

(c) 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. On 21 June 2013, the Administrators advised the ATO that the panels were not installed and ready for use until November 2011.

11. The failure to purchase Panels by 30 June 2010 resulted in the Project being carried out in a materially different manner from the Project described in PR 2009/55. Consequently, PR 2009/55 has no binding effect on the Commissioner, and the Commissioner has withdrawn PR 2009/55 as per paragraph 8 of PR 2009/55. A Grower can claim a deduction for the Application Fee of $1,067 per interest for the income year ended 30 June 2010.

Carrying on a business

12. 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.

Deductions for capital expenditure incurred for the Grower's Panels (small business entities)

13. Paragraphs 26 to 28 of PR 2009/55 ruled on the deductibility of the Grower's panels under Division 328 of the ITAA 1997, where the Grower is a 'small business entity' as described in paragraph 117 of PR 2009/55. The amount that was ruled to be deductible under Division 328 was $6,578 per interest.

14. The Administrators advised that the as at the date of their appointment, no Panels had been purchased for use in the Project. Subsequent to their appointments, Panels were acquired and subsequently paid for in full by another entity pursuant to the Management Agreement executed on 23 June 2011, but were not installed ready for use until November 2011.

15. The failure to purchase Panels for use by 30 June 2010 means that no Panels were used or no Panels were installed ready to use by 30 June 2010. As such, no deductions are available equal to the amount of the Grower's expenditure for the Panels in the income year ended 30 June 2010.

16. Further, as the Panels were not installed until November 2011, no deductions are available equal to the amount of the Grower's expenditure for the Panels in the income year ended 30 June 2011. Instead, deductions are available equal to the amount of the Grower's expenditure for the Panels in the income year ended 30 June 2012.

Small business and general business tax break for the Grower's Panels

17. Paragraphs 29 to 35 of PR 2009/55 ruled on the deductibility of the Grower's Panels under Division 41. A deduction may be available to the Grower's Panels in the income years ended 30 June 2010 to 30 June 2012, subject to certain requirements. The Division 41 deduction was ruled to be available to Early Growers (see paragraph 51 of PR 2009/55) at the rate of 50% of the cost of the Grower's Panels for a small business entity (i.e.: $3,289 per interest) and 10% for other entities (i.e.: $657 per interest).

18. Under paragraph 30 of PR 2009/55, Growers were only entitled to deductions under Division 41 if the requirements of subsection 41-20(1) are satisfied. As no Panels were purchased before the appointment of Administrators on 21 April 2011, the Panels were not installed ready for use by 30 June 2010; no deductions are available under Division 41 in the income year ended 30 June 2010.

19. To be eligible for deductions under Division 41 deduction in the 2011 or 2012 income year, the Grower's Panels must be installed and ready for first use before 31 December 2010. As the Grower's Panels were not installed and ready for first use before 31 December 2010, Growers are not entitled to deduct any amount under Division 41 in either the income years ended 30 June 2011 or 30 June 2012.

Deferral of losses from non-commercial business activities

20. Division 35 applies only to individuals, alone or in partnership, who are carrying on a business activity. Under paragraphs 40 and 41 of PR 2009/55, 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 year ending 30 June 2010.

21. As the Commissioner has not exercised his discretion for the income year ending 30 June 2011 and subsequent income years any losses from the individual Grower's business activity will have to be deferred under subsection 35-10(2) unless for each income year ending 30 June 2011 and subsequent income years, the individual:

- meets the income requirement test in subsection 35-10(2E), and the business activity meets at least one of the four business activity tests in Division 35; or
- comes within the exception in subsection 35-10(4).

22. Amounts deferred under subsection 35-10(2) as outlined in paragraph 22 will only be deductible in a subsequent year if the business activity that gave rise to this amount or a business activity 'of a similar kind' is carried on in that subsequent year. If the business activity, or a business activity that is 'of a similar kind', is never carried on again, the entitlement to deduct the amount will be lost. For more information regarding 'business activity of a similar kind' see paragraphs 49 to 54 of Taxation Ruling TR 2001/14 *Income tax: Division 35 – non-commercial business losses*.

23. Due to the cessation of a Grower's business activity on 17 July 2012 as per paragraphs 8 and 12, the Project is no longer implemented in accordance with PR 2009/55, and as such the Commissioner's discretion is no longer required after 17 July 2012.

Costs after business activities cease

24. Amounts incurred after the business activity ceases may still be deductible as such deductions are not subject to Division 35.

25. 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 Deferred Management Fees, Deferred Management Fee Shortfall, Sales and Marketing Fee, and Manager's Bonus

26. The Commissioner described the following fees in PR 2009/55: Deferred Management Fees, Deferred Management Fee Shortfall, Sales and Marketing Fee, and Manager's Bonus.

27. 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.

Administration Fee payable under the Terms Payment Facility

28. Growers who elected to pay their Grower's contribution under the Terms Payment facility were able to deduct the Administration Fee on a straight line basis over five income years under section 40-880. This will continue to be deductible. However, Growers who are individuals are subject to Division 35 which may affect the deductibility of the fee. See paragraphs 21 to 24 above for further information.

29. On the date that business activities ceased, a Grower may have had a balance of Administration Fee. The Administration Fee will continue to be deductible.

CGT event C2 on settlement of GRTA

30. 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.

31. 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.

32. 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

33. 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.

34. 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.

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 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.

36. 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?*

37. 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.

38. 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

39. 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 GRTA

40. 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.

41. 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.

42. 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.

43. 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.

44. 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.

Commissioner of Taxation
24 July 2013

ATO references
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