


CR 2008/27 - Income tax: tax treatment of payments received from the sale of produced seed into a seed pool under an agreement with Seed Technology & Marketing Pty Limited

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Class Ruling

Income tax: tax treatment of payments received from the sale of produced seed into a seed pool under an agreement with Seed Technology & Marketing Pty Limited

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❶ 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 (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided 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.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 70 of the ITAA 1997; and
- Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936).

All legislative references in the Ruling are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is all growers who, after 1 July 2006, enter into an agreement with Seed Technology & Marketing Pty Limited (Seedmark) for the sale of produced seed by delivery into a seed pool operated by Seedmark.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 22 of this Ruling.

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

- this 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 Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 1 July 2006 to 30 June 2007. However, the Ruling continues to apply after 30 June 2007 to all entities within the specified class who entered into the specified scheme during the term of the Ruling.

9. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this 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 Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the 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).

Scheme

13. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- Class Ruling application from MSI Tilley requesting that the Commissioner make a Class Ruling in relation to the assessability of amounts from the sale of produced seed by growers into Seedmark pools;
- sample Standard Seedmark Purchase Contracts and Standard Terms and Conditions;
- sample Pool Payment Schedules for the 2007 production year; and
- additional details regarding the Harvest Advances and pool payment schedules provided by the applicant.

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

14. Seedmark is an Australian seed company headquartered in Adelaide. The company produces proprietary and common seed varieties and markets them in Australia and internationally. Their services include:

- seed sales and distribution;
- seed multiplication;
- seed variety commercialisation; and
- grower seed production.

15. Seedmark provide a range of services to growers to help in seed production. They also offer a range of marketing alternatives, including pool marketing. They operate separate pools for each variety of produced seed species. Each pool has its own payment schedule, which allows for a Harvest Advance and a number of progress payments before the final payment is declared.¹

16. This ruling only applies to arrangements that are the subject of Seedmark's standard Purchase Contract and terms and conditions for seed pools created and operated by Seedmark in the 2007 tax year.

17. The standard Seedmark Purchase Contract details the product (including the species, variety and receival standards), the term of the agreement and, at Item 5, the product and price agreement. Where the contract type is specified as 'pool', the contract price is stated to be 'per Seedmark's final pool return' and the payment terms are 'in accordance with Seedmark's pool payment schedule'.

18. Under clause 1 of the standard terms and conditions, on entering a Seedmark pool contract, the grower is granted the right to produce seed of the variety specified at Item 3 of the contract (the 'produced seed') in accordance with the contract on condition that the grower sells all the produced seed to Seedmark.

19. The terms and conditions further provide that:

- where payment is made in advance of delivery, the transfer of title and risk in the grower-produced seed passes to Seedmark at the time payment is made. Otherwise the transfer happens when Seedmark accepts delivery of the produced seed;
- if the grower acts in breach of the contract or fails to observe their obligations under the contract, the property in any undelivered produced seed vests in Seedmark and title will pass to Seedmark. In these circumstances, Seedmark must pay an amount determined by them to be a fair amount of compensation to the grower on account of the produced seed so transferred;
- where possible, Seedmark agrees to supply, and the grower agrees to pay for, all necessary stock seed;
- the grower must harvest the seed production area annually and is responsible for ensuring the produced seed is free of extraneous plants and all prohibited, noxious and declared weeds;
- the grower is responsible for cleaning and packing the produced seed, including associated costs;

¹ The background information on Seedmark described in paragraphs 14 and 15 of this Ruling is found on their website – www.seedmark.com.au.

- produced seed is to be available for sale a maximum of 60 days after harvest or no later than 15 June in the harvest year; and
- the grower receives payment in accordance with the pool payment schedule.

20. Seedmark makes estimates from time to time of the likely pool return as a guide to growers. The estimated pool returns are subject to change and therefore future returns are unable to be quantified in absolute terms until the declarations are made. Declared distributions are made in accordance with the contract terms specified at Item 5 of the purchase contract.

21. As referred to in paragraph 15, each pool has its own payment schedule specifying the timing of the Harvest Advance payment and progress payments. The pool payment schedule is at the discretion of Seedmark and applies specifically and exclusively to each pool. Pool payments for all growers will be net of any selling costs and expenses incurred by the pool which may include a pool management fee as determined at the discretion of Seedmark.

22. For each pool, the initial payment is a Harvest Advance. This is not a distribution of sale proceeds – it is a loan from Seedmark to the grower. When the progress payments are declared, the amounts are first applied against the outstanding loan before being paid to the grower. The pool payment system is designed to avoid the possibility that the Harvest Advance and progress payments will exceed the final sales return.

Ruling

Sales of produced seed into the pool

23. For growers returning their income on a cash basis, the pool distributions are included in assessable income under section 6-5 in the income year in which the grower receives the payments.

24. For growers returning their income on an earnings or accruals basis, the pool distributions made by Seedmark are included in assessable income under section 6-5 in the income year in which Seedmark declares each distribution.

Harvest Advance

25. The Harvest Advance payment paid to growers under the terms of the Seedmark agreement is a loan and not income.

Amounts received

26. Under subsection 6-5(4) the grower is treated as having received distribution amounts when the amounts are applied or dealt with in any way on the grower's behalf or as the grower directs. This includes when amounts are applied in full or partial satisfaction of the Harvest Advance loan owing to Seedmark.

Trading stock

27. At the time Seedmark accepts delivery of the grower's produced seed, makes a payment in advance of delivery or the grower is in breach of the contract, the grower has sold and Seedmark has purchased the produced seed. The produced seed ceases to be trading stock of the grower for the purposes of Division 70 at that time.

Application of Part IVA

28. Having regard to the facts of the arrangement, Part IVA of the ITAA 1936 does not apply.

Commissioner of Taxation

9 April 2008

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.*

Sales of produced seed into the pool

29. The Standard Seedmark Purchase Contracts and Standard terms and conditions provides for the sale of the grower's produced seed, which is the grower's trading stock, when title to the produced seed passes to Seedmark. Title to the produced seed passes to Seedmark at the following times:

- if payment for the produced seed is made by Seedmark to the grower in advance of the delivery of the produced seed – at the time of payment;
- if the grower acts in breach of the contract or fails to observe the obligations of the grower under the contract – at the time of breach or failure; or
- in any other circumstances, at the time Seedmark accepts delivery of the produced seed.

30. Sales revenue is ordinary income and is included in assessable income under section 6-5 in the income year in which the ordinary income is derived.

31. For taxpayers who use the cash method of accounting to determine their assessable income, income is derived when it is received, either actually, or constructively under subsection 6-5(4).² Accordingly, growers returning income on a cash basis include distributions in their assessable income under section 6-5 in the year in which the grower receives the payments.

32. For taxpayers who use the earnings or accruals method of accounting to determine their assessable income, income is derived when it is earned. The point of derivation occurs when a recoverable debt is created.³

33. At the time growers sell their produced seed they have a right to receive payment of their share of the pool proceeds, but that right is not presently existing as the payment is neither quantified nor quantifiable. Seedmark quantifies the amount payable to growers by determining and declaring pool distributions.

² See paragraph 8 of Taxation Ruling TR 98/1.

³ See paragraph 9 of Taxation Ruling TR 98/1 and *Farnsworth v. FC of T* (1949) 78 CLR 504; (1949) 9 ATD 33 (the *Farnsworth* case); *Henderson v. FC of T* (1970) 119 CLR 612; 70 ATC 4016; (1970) 1 ATR 596; *FC of T v. Australian Gas Light Co.* (1983) 15 ATR 105; 83 ATC 4800.

34. The amount of the distribution is a presently existing recoverable debt for payment of that part of the pool return. The determination and declaration of the amount by Seedmark is the point at which this debt becomes presently existing, unconditional and not subject to any contingency.

35. Accordingly, growers returning their income on an earnings or accruals basis include distributions made by Seedmark in their assessable income under section 6-5 in the year of income in which Seedmark declares each distribution.

Harvest Advance

36. Growers selling produced seed into a Seedmark pool receive a Harvest Advance payment. Under the terms of the Seedmark agreement, this payment is a loan that is repaid in full out of the progress payments or final distribution when the seed pool is declared. It is not income.

Amounts received

37. Subsection 6-5(4) treats an amount as assessable income of a taxpayer if the amount has been applied or dealt with in any way on the taxpayer's behalf or as the taxpayer directs.

38. This means that amounts applied or dealt with by Seedmark in any way on the grower's behalf or as the grower directs, including declared distributions that are applied in full or partial satisfaction of the Harvest Advance loan owing to Seedmark, are treated under subsection 6-5(4) as having been received by the grower at the time the amount is so applied or dealt with.

Trading stock

39. Under the various Sale of Goods Acts which operate in each State or Territory of Australia, a contract for the sale of goods is made when the seller agrees to transfer the property in the goods to the buyer for the sale price. Where, under a contract, property in goods is transferred from the seller to the buyer the contract is a sale.⁴

40. Under the contract, the grower agrees to sell all produced seed to Seedmark. The contract further specifies that title to the produced seed passes to Seedmark:

- at the time Seedmark accepts delivery of the grower's produced seed after an independent seed tester certifies that the produced seed satisfies the contract specifications; or
- if Seedmark makes a payment in advance of delivery (for example a progress payment) at that time.

⁴ See paragraph 61 of Taxation Ruling TR 2001/1.

In addition, if the grower acts in breach of the contract or fails to observe their contractual obligations, property in any undelivered produced seed vests in Seedmark.

41. When accepted into the pool by Seedmark, the produced seed delivered by the grower is mixed with that of other growers. Accordingly, the grower has lost dispositive power over the produced seed as the produced seed of that particular grower is no longer identifiable. In these circumstances title in the produced seed has passed to Seedmark and the grower has disposed of the produced seed.⁵ Consequently, the produced seed ceases to be trading stock of the grower for the purposes of Division 70 at the time Seedmark accepts delivery of the grower's produced seed.

42. In circumstances where Seedmark makes a payment in advance of delivery or the grower is in breach of the contract the produced seed ceases to be trading stock of the grower for the purposes of Division 70 at the time of the advance payment or the breach.

Application of Part IVA

43. Having regard to the commercial character of the arrangement, Part IVA of the ITAA 1936 does not apply.

⁵ See the *Farnsworth* case.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 98/1; TR 2001/1

Subject references:

- crops as trading stock
- derivation of income
- primary production income

Legislative references:

- ITAA 1936 Pt IVA
- ITAA 1997 6-5
- ITAA 1997 6-5(4)

- ITAA 1997 Div 70
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968

Case references:

- Farnsworth v. FC of T (1949) 78 CLR 504; (1949) 9 ATD 33
- FC of T v. Australian Gas Light Co. (1983) 15 ATR 105; 83 ATC 4800
- Henderson v. FC of T (1970) 119 CLR 612; 70 ATC 4016; (1970) 1 ATR 596

ATO references

NO: 2008/4106

ISSN: 1445-2014

ATOLaw topic: Income Tax ~~ Assessable income ~~ primary production income
Income Tax ~~ Assessable income ~~ derivation of income