



PR 2006/72 - Income tax: Gunns Plantations Limited Walnut Project No 1 - Early Growers

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 This document has changed over time. This is a consolidated version of the ruling which was published on *10 May 2006*



Product Ruling

Income tax: Gunns Plantations Limited Walnut Project No 1 – Early Growers

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ⓘ This Ruling 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.

No guarantee of commercial success

The Tax Office **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products and how the product fits an existing portfolio. 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. Potential participants may wish to seek assurances from the promoter that the scheme will be carried out as described in this Product Ruling.

Potential participants should be aware that the Tax Office will be undertaking review activities to confirm the scheme has been implemented as described below and to ensure that the participants in the scheme include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the 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 Ruling.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant taxation provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Ruling this scheme is referred to as the 'Gunns Plantations Limited Walnut Project No 1' or simply as 'the Project'.

Relevant taxation provision(s)

2. The tax laws dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 of the ITAA 1997;
- section 17-5 of the ITAA 1997;
- section 25-25 of the ITAA 1997;
- Division 27 of the ITAA 1997;
- Division 35 of the ITAA 1997;
- Division 40 of the ITAA 1997;
- Subdivision 61-J of the ITAA 1997;
- Division 328 of the ITAA 1997;
- Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZL of the ITAA 1936;
- sections 82KZME and 82KZMF of the ITAA 1936; and
- Part IVA of the ITAA 1936.
- section 357-75 of Schedule 1 to the *Taxation Administration Act 1953* (TAA).

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

Goods and Services Tax

3. All fees and expenditure referred to in this 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.

Changes in the Law

4. Although this Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating in the Project 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

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects 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 Ruling is issued.

Class of entities

7. The class of entities to whom this Ruling applies is the entities more specifically identified in the Ruling part of this Product Ruling and who enter into the scheme specified below on or after the date this Ruling is made. They will 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 as set out in the description of the scheme. In this Ruling, these entities are referred to as 'Growers'.

8. The class of entities to whom this Ruling applies does **not** include:

- entities who intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- entities who participate in the Project through offers made other than through the Product Disclosure Statement;
- entities who enter in to this Project after 31 May 2006;
- entities who finance their participation in the Project with loans other than from Gunns Finance Pty Ltd or Allco Managed Investments, or other than as described at paragraph 55 to 63 of this Ruling; and
- Gunns Plantations Limited or its associates.

Qualifications

9. 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 17 to 63.

10. 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

12. This Ruling applies prospectively from 10 May 2006, the date this Ruling is made. However, 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.

13. 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)).

14. 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.

15. 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).

Withdrawal

16. This Product Ruling is withdrawn and ceases to have effect after 30 June 2008. The Ruling continues to apply, in respect of the relevant provision(s) ruled upon, to all entities within the specified class who enter into the scheme specified below. Thus, the Ruling continues to apply to those entities, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entity's involvement in the scheme.

Scheme

17. The scheme that is the subject of this Ruling is specified below. This scheme incorporates the following documents:

- Application for Product Ruling dated 14 December 2005 as constituted by documents received on 15 December 2005, 17 January 2006, 21 February 2006, 6, 21, 22, 31 March 2006, 12, 13, 19, 20, 21, 26, 27 April 2006 and additional correspondence dated 25 January 2006, 17 February 2006, 6, 15, 21, 22, 31 March 2006 and 12, 13, 19, 20, 21, 26, 27 April 2006;
- Draft Product Disclosure Statement ('Supplementary PDS') for the Project, received on 21 April 2006;
- Draft **Constitution** of Gunns Plantations Limited Walnut Project No 1, received on 26 April 2006;
- Draft Compliance Plan for Gunns Plantations Limited Walnut Project No 1, received on 15 December 2005;
- Draft Custody Agreement for Gunns Plantations Limited Walnut Project No 1 between Gunns Plantations Limited (Gunns Plantations or Responsible Entity) and Gunns Limited (Gunns), and draft Variation of Custody Agreement for the Project between Gunns Plantations and Gunns, received on 15 December 2005;
- Draft **Management Agreement** for Gunns Plantations Limited Walnut Project No 1 between Gunns Plantations and a Grower, as amended, received on 26 April 2006;

- Draft Lease between Gunns and Gunns Plantations, received on 26 April 2006;
- Draft **Orchard Right Agreement** between Gunns Plantations and a Grower, received on 26 April 2006;
- Draft Initial Services Sub-contracting Agreement between Gunns Plantations and Gunns, received on 26 April 2006;
- Draft Maintenance and Harvest Services Sub-contracting Agreement between Gunns and Gunns Plantations, received on 15 December 2005;
- Draft Walnut Sale Agreement between Gunns Plantations and Purchaser, received on 15 December 2005 and associated Deed Poll to be executed by Webster Limited (Webster) in favour of Growers, received on 20 April 2006;
- Draft **Walnut Finance Pack** for the Project between Gunns Finance Pty Ltd (Gunns Finance) and a Grower, received on 15 December 2005;
- Draft **Finance Application** for the Project between Allco Managed Investments Ltd as trustee for the Gateway Momentum Funding Trust No. 1 (Allco Managed Investments) and a Grower, received on 21 February 2006; and
- Draft **Terms Arrangement** for the Project between Gunns Plantations, a Grower and a Guarantor, received on 27 April 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.

18. 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. The effect of these agreements is summarised as follows.

19. 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

20. The salient features of the Project are as follows:

Location	Goolgowi in the Riverina District of New South Wales
Type of business to be carried on by each participant	Commercial growing and cultivation of Walnut trees for the purpose of harvesting Walnuts for sale
Number of hectares offered for cultivation	550 hectares
Size of each Walnut Lot	0.2 hectares
Minimum Subscription	None
Minimum allocation	None
Number of trees per hectare	310
Term of the Project	25 years
Initial cost	\$7,508
Ongoing costs per Walnut Lot	Fees in relation to orchard right, maintenance, water, harvest and processing, incentive, and sales Commission

21. The Project will be a registered as a managed investment scheme under the *Corporations Act 2001*. Applications to participate in the Project must be made during the offer period which is:

- for applications received on or before 31 May 2006, the period commencing from date of issue of the PDS to 31 May 2006; and
- for applications received on or after 1 July 2006, the period commencing from 1 July 2006 to 31 May 2007.

22. For the purposes of this Ruling, Growers whose applications are accepted on or before 31 May 2006 will become 'Early Growers'. **This Ruling only applies to 'Early Growers'. In this Ruling 'Early Growers' are referred to as 'Growers'. Note that a separate Product Ruling PR 2006/73 will issue for 'Late Growers' who are accepted into the Project from 1 July 2006 to 31 May 2007.**

23. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS) for 2,750 Walnut Lots which comprises of 550 hectares of land. The offer to participate in the Project must be made through an 'Application and Power of Attorney Form' in the PDS.

24. Growers will enter into an Orchard Right Agreement with Gunns Plantations. The Orchard Right will comprise contractual rights in relation to a parcel of land of 0.2 hectares called a Walnut Lot.

25. Each Walnut Lot will have approximately 62 Walnut Trees on it, of which 30% will be planted prior to 24 June 2006 and the balance by 31 October 2006.

26. Growers will also enter into a Management Agreement to contract with Gunns Plantations to undertake Initial Services, Maintenance Services and Harvest and Processing Services.

Constitution

27. The Constitution for the Project sets out the general functions, powers and duties under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Orchard Right Agreement and the Management Agreement are Schedules to the Constitution. These Agreements will be executed on behalf of each Grower who has signed the 'Application and Power of Attorney Form' attached to the PDS and who is accepted into the Project. After acceptance and execution of the Agreements, Growers are bound by the Constitution by virtue of their participation in the Project.

28. On acceptance of an application, the Responsible Entity will allocate the Walnut Lot(s) to the Grower and prepare the Orchard Right Agreement and Management Agreement in accordance with clause 6.

29. Before authorising or instructing the Custodian to release the Application Money, the Responsible Entity in accordance with clause 7 must be satisfied, among other things, that:

- the Orchard Right Agreements have all been duly completed and executed;
- it has the capacity to grant the rights referred to in the Orchard Right Agreement;
- all necessary consents have been obtained;
- the property that is the subject of the rights referred to in the Orchard Right Agreement is not subject to any encumbrance or restrictions which detrimentally affects the interests of Growers; and
- the Leases are registered prior to, or immediately after the acceptance of an application in respect of the Orchard Right Agreement.

30. The Responsible Entity is entitled to receive fees in accordance with clause 11 and may instruct the Custodian to invest all or part of the 'Proceeds Portion' and 'Application Portion' in accordance with clause 12.

31. Among other things the Constitution sets out in detail the following:

- general functions, powers and duties (clause 13);
- complaints (clause 14);

- compliance committee requirement under the Corporations Act (clause 15);
- the requirement for the Responsible Entity to procure a written report from the Independent Horticulturist and for Growers to receive copies of the Horticulturist's Report (clause 16);
- the transfer and transmission of a Growers' interest (clauses 18 and 19);
- the retirement or removal of the Responsible Entity (clause 22);
- the issue of a Walnut Lot Statement (clause 23);
- Register of Members (clause 24);
- Collections and payments (clause 26);
- the distribution from the Proceeds Portion of the Fund (clause 27);
- Deductions from Income or Profit (clause 28); and
- termination of the Project (clause 32).

Compliance Plan

32. As required by the *Corporations Act 2001*, Gunns Plantations has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that Gunns Plantations manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Lease Agreement

33. Gunns as Landowner will lease the Project land to Gunns Plantations. Gunns is required to carry out all Establishment Works as set out in clause 9, before 31 May 2006. Gunns is also required to plant walnut trees in the months of June 2006 to October 2006 on the Growers Walnut Lots.

Orchard Right Agreement

34. Growers will enter into the Orchard Right Agreement in respect of a Walnut Lot(s) with Gunns Plantations for the 'Term' of the Project. A Walnut Lot is a parcel of approximately 0.2 hectares of land excluding the Common Areas.

35. Under clause 3, Gunns Plantations will grant to a Grower an Orchard Right over the Walnut Lot(s) which include the following:

- access to the Walnut Lot(s);
- access to and use of the Orchard Infrastructure;

- exclusive right to access, use and enjoy the benefit of the Trees;
- exclusive right to harvest the Walnuts; and
- exclusive right to take all right, title and interest in the harvested Walnuts.

36. The Agreement also set out:

- the Orchard Right Fee payable by Growers (clause 6 and item 2 of Schedule 1);
- the rights and obligations of the Grower (clause 4);
- the obligations and warranty of Gunns Plantations (clause 5); and
- the termination provisions (clauses 5.3 and 9).

Management Agreement

37. The Grower engages Gunns Plantations as Manager to cultivate the Grower's Walnut Lot(s) and to carry out the Maintenance Services (clause 5.2) subject to the terms and conditions of this Agreement for the Term of the Project (clause 2).

38. Gunns Plantations will manage and cultivate the 'Walnut Lot(s)' on behalf of the Grower in accordance with good horticultural practice.

39. Gunns Plantations can delegate its obligations under this Agreement but delegation of the obligations does not release Gunns Plantations from liability under this agreement (clause 25.7).

40. Gunns Plantations must complete all of the Initial Services in relation to the Grower's Walnut Lot(s) before 30 June 2006 (clause 4), in return for the Initial Service Fee (clause 9.1).

41. The Manager will provide each Grower a written report from the Independent Horticulturist by 30 June 2006. The report will confirm that all initial services have been performed in accordance with good horticultural practice.

42. The Agreement also stipulates the services to be provided after 30 June 2006 and each subsequent year. Gunns Plantations will perform the Maintenance Services in a proper and efficient manner (clause 5), in return for the Maintenance Fee (clause 9.2).

43. Gunns Plantations must cause its obligations in relation to harvesting and processing of Walnuts to be carried out in a proper and efficient manner and in accordance with good horticultural practice (clause 6).

44. The Grower appoints Gunns Plantations to sell Walnuts Harvested from the Grower's Trees (clause 10).

Pooling of amounts and distribution of Proceeds

45. The Constitution and the Management Agreement set out provisions relating to the pooling of amounts held by Gunns on behalf of Growers. This Product Ruling only applies where the following principles apply to the pooling and distribution schemes:

- only Growers who have contributed Walnuts or insurance proceeds to a pool are entitled to benefit from distributions of proceeds from the pool; and
- Grower's that do not contribute to a pool will not have any interest in the proceeds from the pool.

Initial Services Sub-contracting Agreement and Maintenance and Harvest Services Sub-contracting Agreement

46. Gunns Plantations engages Gunns as its sub-contractor, to perform Initial Services under Initial Services Sub-contracting Agreement, and Maintenance and Harvest Services under the Maintenance and Harvest Services Sub-contracting Agreement, in accordance with the terms and conditions set out in these Agreements. This is in accordance with clause 25.7 of the Management Agreement under which Gunns Plantations can delegate its obligations under that Agreement.

Walnut Sale Agreement and Deed Poll

47. Gunns Plantations, as agent for each Grower will enter into a Walnut Sale Agreement for the sale of Grower's Walnuts. Websters have committed to the purchase of Grower's Walnuts via a Deed Poll. This agreement requires Websters to acquire at least 75% of the Walnut harvest in accordance with the terms of the Walnut Sale Agreement.

Project Fees***Application Fee***

48. The 'Grower' must pay an Application Fee of **\$7,508** per Walnut Lot payable on Application which will be applied towards the following:

- **\$7,480.50** for the Initial Services to be provided from the Commencement Date to 30 June 2006; and
- **\$27.50** for the Orchard Right Fee for the period ended 30 June 2006.

Orchard Right Agreement Fees

49. For the year ending 30 June 2007, the Orchard Right Fee of **\$330** is payable by a Grower on 1 June 2007. Thereafter, the annual Orchard Right Fee will be the Orchard Right Fee payable on the immediately preceding 1 June, 'Indexed', and payable on 1 June of each subsequent year.

Management Agreement Fees

50. Maintenance Fee payments payable per Walnut Lot are as follows:

Fixed Component

- for the year ending 30 June 2007, a Maintenance Fee of **\$850** payable on 1 June 2007. For each subsequent year, the Maintenance Fee will be the annual Maintenance Fee payable on the immediately preceding 1 June, 'Indexed', and payable on 1 June each year.

Variable Component

- a fee equal to **5.45%** of the Gross Proceeds Entitlement of the Grower in each year of the Project from the year ending 30 June 2010.

51. Water fee payment equal to **\$150** per mega litre per Walnut Lot per year from the year ending 30 June 2007. The first payment payable on 1 June 2007, and, thereafter, Indexed for each subsequent year and payable on 1 June each year.

52. Harvest and Processing Fee payments per Walnut Lot payable on 1 June each year from the first commercial harvest are equal to the greater of:

- **125%** of the actual costs to Gunns Plantations of providing the harvest and processing services; or
- **\$227.50** per Walnut Lot per annum indexed annually to CPI from 1 June 2007, plus \$410 per tonne of walnuts processed per Walnut Lot per year, indexed annually to CPI from 1 June 2007.

53. Incentive Fee payments equal to **27.5%** of the Growers Gross Proceeds Entitlements in excess of the Incentive Fee threshold apply as stipulated in the agreement.

54. Sales Commission payable by a Grower equals **5.5%** of the Walnut Sales Proceeds.

Finance

55. Each Grower can fund their involvement in the Project as follows:

- from their own financial resources;
- under a Terms Agreement with Gunns Plantations;
- by borrowing from Gunns Finance (a lender associated with the Responsible Entity);
- by borrowing from Allco Managed Investments; or
- by borrowing from an independent lender.

56. Growers cannot rely on this Product Ruling if they enter into a finance package with Gunns Finance or Allco Managed Investments that materially differs from those provided to the Tax Office by Gunns Plantations with the application for this Product Ruling. These finance packages are summarised below.

Terms Agreement

57. If Gunns Plantations accepts that the application fee can be paid under a Terms Arrangement the Grower must complete a terms application and Direct Debit Authority. The Grower will be required to pay their application fee as follows:

- 10% of the fee on application;
- The balance (plus stamp duty) by 11 equal consecutive monthly instalments as set out in Schedule 4, with the first instalment to be made on the last business day of the month following the month in which the Grower's application is accepted and thereafter on the last business day of each successive month until fully paid;
- Gunns Plantations will take security over the Grower's Walnut Lot(s); and
- There will be no interest levied to the Grower, unless instalments are not paid on time, then interest at a rate of 6% above the 5 year swap reference rate of the ANZ Bank (or Gunns Limited's banker at the time) will be levied.

Finance by Gunns Finance

58. The loans offered by Gunns Finance are Principal and Interest loans with terms of 3, 5, 10 or 15 years. The key features of the finance package are:

- the Grower's application to participate in the Project has been accepted by Gunns Plantations;

- the Grower pays a loan 'Establishment Fee' of \$150, which is to be paid at the time that the loan is established;
- Gunns Finance will take security over the Grower's 'Walnut Lot(s)';
- a deposit of 20% of the Application Fee is required;
- Interest is charged at 10.5% per annum for the first 5 years of the loan. The interest rate will be reviewed at the end of each 5 year period and fixed for each following 5 year period at a rate 4% above the 5 year swap reference rate of the ANZ Bank (or Gunns Limited's banker at the time); and
- an additional 2% interest per annum applies to repayments or payments in arrears.

59. The deposit required to fund the loan may be varied, at the absolute discretion of Gunns Finance, between 0-20% of the Application Fee.

60. The Borrower agrees to repay the Loan, and pay interest and all Outstanding Monies by paying by direct debit the Repayment Amount, to Gunns Finance, on the Repayment Date of each month during the term as detailed in the Loan Schedule, and all other Outstanding Monies on the Final Repayment Date.

Finance by Allco Managed Investments

61. Allco Managed Investments offers 3 types of loans. The first type is a 'Loan' with monthly principal and interest repayments and may be for 3, 5, 10 or 15 years. The second type of 'Loan' involves a two year interest only period followed by monthly principal and interest repayments and may be for 5, 7 or 10 years duration in total. The third type of 'Loan' is for a three year interest only period followed by monthly principal and interest repayments and may be for 6, 10 or 15 years duration in total. Common features contained in each of these loans are:

- the Grower's application to participate in the Project has been accepted by Gunns Plantations subject to the finance approval;
- the Grower pays a loan Application Fee (Establishment Fee) of \$250 plus 0.5% of the amount financed;
- Allco Managed Investments will take security over the Growers 'Walnut Lot(s)';
- an initial deposit of between 0% and 50% of the 'Application Fee' applies;
- interest rates will vary between 10% and 11% and will be fixed for the term of the loan at the time of approval;

- an additional 3% interest per annum applies to overdue amounts due and payable;
- Growers who enter into these finance arrangements will be required to make equal monthly repayments of the outstanding balance, commencing at the end of any interest only period; and
- Growers who break the terms of the loan will be liable for administration and break fees.

62. A Grower cannot rely on any part of this Product Ruling if the Application Fee, other than an application fee payable subject to a finance arrangement or a Terms Agreement, is not paid in full by 31 May 2006. Where an application is accepted by Gunns Plantations, subject to finance approval by any lending institution, a Grower cannot rely on this Ruling if written evidence of that approval has not been given to Gunns Plantations by 31 May 2006.

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;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, other than Gunns Finance or Allco Managed Investments, are involved or become involved in the provision of finance to any Grower in the Project.

Ruling

Application of this Ruling

64. This Ruling will only apply to a Grower who is accepted to participate in the Project on or before 31 May 2006 and who has executed a Management Agreement and an Orchard Right Agreement on or before that date.

65. The Grower's participation in the Project must constitute the carrying on of a business of primary production. 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.

The Simplified Tax System (STS)

Division 328

66. 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). For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different under the STS where a Grower who was an 'STS taxpayer' prior to the 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*.

67. 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

68. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides for a tax offset of up to 25% of income tax liability related to the business income of a business in the STS with annual group turnover of less than \$75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

Assessable income

Section 6-5

69. 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), when derived will be assessable income of the Grower under section 6-5.

Deductions for the Loan Establishment Fee payable to Gunns Finance or Allco Managed Investments**Section 25-25**

70. The Loan Establishment Fee payable to Gunns Finance or Allco Managed Investments is a borrowing expense and is deductible under section 25-25. It is incurred for borrowing moneys that are used, or are to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Gunns Finance or Allco Managed Investments is outside the scope of this Ruling.

Deductions for Initial Services Fee, Maintenance and Harvest Fee, Orchard Right Fee and Interest**Sections 8-1**

71. A Grower who is accepted to participate in the Project on or before 31 May 2006 may claim tax deductions under section 8-1 of the ITAA 1997, on a per Walnut Lot basis, for the following expenditure.

Allowable deductions	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
Initial Services Fee	\$7,480.50 See Notes (i) & (ii)	Nil	Nil
Maintenance Fee	Nil	Amount incurred See Notes (i), (iii) & (v)	Amount incurred See Notes (i), (iii) & (v)
Water Fee	Nil	Amount incurred See Notes (iii) & (iv)	Amount incurred See Notes (iii) & (iv)
Orchard Right Fee	\$27.50 See Notes (i) & (iii)	\$330 See Notes (i) & (iii)	\$330 (Indexed) See Notes (i) & (iii)
Interest	Amount incurred See Note (vi)	Amount incurred See Note (vi)	Amount incurred See Note (vi)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted for GST (for example, input tax credits): Division 27.
- (ii) For the year ended 30 June 2006, the Initial Services Fee under the Management Agreement is deductible in full in the year incurred.
- (iii) The Maintenance Fees and Water Fees under the Management Agreement and the Orchard Right Fees under the Orchard Right Agreement are deductible in full in the year incurred.
- (iv) The Water fee is equal to **\$150 (Indexed from 1 June 2007)** per mega litre per Walnut Lot per year for the years ending 30 June 2007 and 2008.
- (v) The Maintenance Fee under the Management Agreement for the 2007 year will consist of a fixed amount of \$850 plus a contingent amount based on a percentage (5.45%) of the Gross Proceeds Entitlement. For the 2008 year it will consist of an amount of \$850 (Indexed) plus a contingent amount based on a percentage (5.45%) of the Gross Proceeds Entitlement.
- (vi) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Gunns Finance or Allco Managed Investments is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with Gunns Finance or Allco Managed Investments, should read the discussion of the prepayment rules in paragraphs 98 to 101 as those rules may be applicable if interest is prepaid. A Grower who chooses, or who is required to prepay interest under a loan agreement is outside the scope of this Ruling and may request a private ruling on the taxation consequences of participation in the Project.

Deductions for capital expenditure

Division 40

72. Each Grower will also be entitled to tax deductions relating to the Walnut Trees planted on the Walnut Lot. If the Grower is registered or required to be registered for GST, amounts of outgoings would need to be adjusted as relevant for GST (for example input tax credits): Division 27.

73. A Walnut tree is considered to be a 'horticultural plant' as defined in subsection 40-520(2). A Grower holds an Orchard Right to cultivate the Walnut trees on a designated area of land called a Walnut Lot for the growing of Walnuts for commercial gain. As a Grower holds an Orchard Right over the land, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value.

74. The deduction is determined using the formula in section 40-545. Walnut trees have an 'effective life' of 25 years and for the purposes of section 40-545, the result is a straight-line write-off at a rate of 13%. The deduction is allowable when the Walnut trees enter their first commercial season (section 40-530, item 2). Gunns Plantations will advise Growers about the amount of tax deduction that they are entitled to each year in relation to the establishment of Walnut trees.

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

Section 35-55 – exercise of Commissioner's discretion

75. A Grower who is an individual accepted into the Project on or before 31 May 2006 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 each Grower for the income years ending **30 June 2006 to 30 June 2013**. This conditional exercise of the discretion will allow those losses to be offset against the Growers other assessable income in the income year in which the losses arise.

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

76. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Orchard Right Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME and 82KZMF;
- 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.

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?

77. For the amounts set out in the Ruling section above to constitute allowable deductions the Grower's horticulture activities as a participant in the Project must amount to the carrying on of a business of primary production.

78. Where there is a business, or a future business, the gross proceeds from the sale of the Walnuts 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.

79. For schemes such as that of the Project, Taxation Ruling TR 2000/8 sets out in paragraph 88 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.

80. Generally, a Grower will be carrying on a business of horticulture, and hence primary production, if:

- the Grower has an identifiable interest in the land (by lease) or rights over the land (by licence) on which the Grower's Walnut trees are established;
- the Grower has a right to harvest and sell the Walnuts each year from the licensed Walnut Lot(s);
- the horticulture activities are carried out on the Grower's behalf;
- the horticulture activities of the Grower are typical of those associated with a horticulture business; and
- the weight and influence of general indicators point to the carrying on of a business.

81. In this Project, each Grower enters into an Orchard Right Agreement and a Management Agreement.

82. Under the Orchard Right Agreement each Grower will have rights over the land on which the Walnut trees will be planted. The Orchard Right Agreement provides the Grower with an ongoing right to the Walnut trees for the term of the Project. Under the Orchard Right the Grower must use the land in question for the purpose of carrying out horticulture activities and for no other purpose. The Orchard Right allows the Manager to come onto the land to carry out its obligations under the Management Agreement.

83. Under the Management Agreement the Manager is engaged by the Grower to establish and maintain a Walnut Lot(s) during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Walnut Lot(s) on the Grower's behalf.

84. Gunns Plantations is also engaged to harvest and sell, on the Grower's behalf, the harvested Walnuts grown on the Grower's Walnut Lot(s).

85. 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 Projects' description for all the indicators.

86. 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 harvested Walnuts that will return a before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

87. The pooling of Walnuts grown on the Grower's Walnut Lot(s) with the Walnuts of other Growers is consistent with general horticulture practices. Each Grower's proportionate share of the sale proceeds of the pooled Walnuts will reflect the proportion of the Walnuts contributed from their Walnut Lot(s).

88. Gunns Plantations' services are also consistent with general horticultural practices. They are of the type that would be found in horticulture ventures and be said to be businesses. While the size of a Walnut Lot is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

89. The Grower's degree of control over Gunns Plantations as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, Gunns Plantations will provide the Grower with regular progress reports on the Grower's Walnut Lot(s) and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with Gunns Plantations in certain instances, such as cases of default or neglect.

90. The horticulture 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 Grower's horticulture activities in the Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

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

92. 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 Rulings TR 2002/6 and 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'.

Deductions for Initial Services Fee and Orchard Right Fee

Section 8-1

93. Consideration of whether the fees and expenses payable under the Management Agreement and the Orchard Right Agreement 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.

94. The fees payable under the Management Agreement and the Orchard Right Agreement will relate to the gaining of income from the Grower's horticulture business (see above), and hence have a sufficient connection to the operations by which income (from the sale of harvested Walnuts) 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 and the fees have no capital component. The tests of deductibility under the first limb of section 8-1 are met and the exclusions do not apply.

Interest deductibility**Section 8-1**

(i) Growers who use Gunns Finance or Allco Managed Investments as the finance provider

95. A Grower may finance their participation in the Project through a loan facility with Gunns Finance or Allco Managed Investments. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the fees under the Management and the Orchard Right Agreements.

96. The interest incurred for the year ended 30 June 2006 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations – growing of Walnuts and the lease (or licence) of the land on which the Walnut trees will have been planted – that will continue to be directly connected with the gaining of business income from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

(ii) Growers who DO NOT use Gunns Finance or Allco Managed Investments as the finance provider

97. The deductibility of interest incurred by a Grower who finances their participation in the Project through a loan facility with a bank or financier other than Gunns Finance or Allco Managed Investments is outside the scope of this Ruling. Product Rulings only deal with schemes where all details and documentation have been provided to, and examined by the Tax Office.

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

98. 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 services under the Management Agreement or the grant of Orchard Right under the Orchard Right Agreement) 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.

Application of the prepayment provisions to this Project

99. Under the Scheme to which this Product Ruling applies management fees and Orchard Right Fees are incurred annually and interest payable to Gunns Finance or Allco Managed Investments is incurred monthly. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this Scheme.

100. However, sections 82KZME and 82KZMF may have relevance if a Grower in this Project prepays some or all of the expenditure payable under the Walnut Lot Management Agreement and the Licence Agreements or prepays interest under a loan agreement (including loan agreements with lenders other than Gunns Finance or Allco Managed Investments). Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

101. As noted in the Ruling section above, Growers who prepay fees or interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

Expenditure of a capital nature

Division 40

102. 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 the establishment of the Walnut trees is of a capital nature. This expenditure falls for consideration under Division 40.

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

Section 35-55 – exercise of Commissioner's discretion

103. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2006 to 30 June 2013** 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 2006 up to and including 30 June 2013:

- (i) it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35;

- (ii) there is an objective expectation that within a period that is commercially viable for the Walnut horticulture industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- (iii) 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.

104. 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

105. 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. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA – general tax avoidance provisions

106. 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).

107. The Gunns Plantations Limited Walnut 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 70 to 74 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.

108. 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 Walnuts. 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:

IT 360; PR 2006/73; 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 losses
- producing assessable income
- product rulings
- public rulings
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- taxation administration

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
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- ITAA 1936 177A
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ATO references

NO: 2006/3759

ISSN: 1441-1172

ATOlaw topic: Income Tax ~~ Product ~~ crops - other