PR 2007/22 - Income tax: Oak Valley Truffle Project 2007

Product Ruling

Income tax: Oak Valley Truffle Project 2007

Contents Para

This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated. In this Product Ruling this scheme is referred to as the Oak Valley Truffle Project 2007 or simply as 'the Project'.

Class of entities

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

3. The class of entities who can rely on those tax benefits consists of entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is made and which execute relevant Project Agreements mentioned in paragraph 32 of this Ruling on or before 15 June 2007. They must have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement.

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

- intend to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it;
- are accepted into this Project before the date of this Ruling or after 15 June 2007; or
- participate in the scheme through offers made other than through the combined Prospectus and Product Disclosure Statement (PDS/Prospectus).

Qualifications

5. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 32 to 80 of this Ruling.

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

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

Date of effect

8. This Product Ruling applies prospectively from 21 March 2007, the date this Product Ruling is made. It therefore applies to the specified class of entities that enter into the scheme from 21 March 2007 until 15 June 2007, being the closing date for entry into the scheme. This Product Ruling provides advice on the availability of tax benefits to the specified class of entities up to 30 June 2009. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

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

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

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

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

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

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

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

Changes in the Law

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

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

Note to promoters and advisers

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

Goods and Services Tax

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

Ruling

Application of this Ruling

17. Subject to the stated qualifications, this part of the Product Ruling sets out in detail the taxation obligations and benefits for a Grower in the defined class of entities who enters into the scheme described at paragraphs 32 to 80 of this Ruling.

18. The Grower's participation in the Project must constitute the carrying on of a business of primary production. Provided the Project is carried out as described below, the Grower's business of primary production will commence at the time of execution of their Lease and Sub-lease for 2007 Growers (Lease and Sub-lease) and their Project Operations Agreement for 2007 Growers (Project Operations Agreement).

The Simplified Tax System (STS)

Division 328

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

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

25% entrepreneurs tax offset

Subdivision 61-J

21. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides a 25% tax offset 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

Sections 6-5 and 17-5

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

Deductions for Management Fees, Rent, interest, application fee (Terms Payment Option) and the establishment of truffles

Sections 8-1, 40-515 and 40-880 and Division 27 of the ITAA 1997 and sections 82KZME and 82KZMF of the Income Tax Assessment Act 1936

23. A Grower who is accepted to participate in the Project on or before 15 June 2007 may claim tax deductions, on a per Trufferie basis, for the expenses listed below and for the establishment of the truffles.

Fee Type	Year ending 30 June 2007	Year ending 30 June 2008	Year ending 30 June 2009
Management Fees	$8,800 See Notes (i), (ii) & (iv)	$6,600 See Notes (i), (ii) & (iv)	$4,180 See Notes (i), (ii) & (iv)
Rent	See Notes (i), (ii), (iii) & (iv)	$652.30 (indexed) See Notes (i), (ii) & (iv)	$652.30 (indexed) See Notes (i), (ii) & (iv)
Interest – Terms Payment Option	As incurred See Notes (ii), (iv) & (v)	As incurred See Notes (ii), (iv) & (v)	Nil
Application fee – Terms Payment Option	$10 See Note (vi)	$10 See Note (vi)	$10 See Note (vi)
Establishment of truffles	Nil See Note (vii)	Nil See Note (vii)	Nil See Note (vii)

Notes:

(i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.

(ii) Subject to Note (iii) the Management Fees, the Rent and the interest payable under the Terms Agreement for 2007 Terms Growers (Terms Agreement) are deductible under section 8-1 in the income year in which they are incurred.

(iii) In the initial year, the deduction for Rent is $54.35 per month for each month or part month that the Grower is granted the sub-lease to use the Trufferie. This means that the full $652.30 rent payable for the 2007 Financial Year is not deductible.

(iv) This Ruling does not apply to Growers who choose to prepay fees or who choose, or are required to prepay interest under a loan agreement (see paragraphs 97 to 101 of this Ruling). Subject to certain exclusions, amounts that are prepaid for a period that extends beyond the income year in which the expenditure is incurred may be subject to the prepayment provisions in sections 82KZME and 82KZMF of the *Income Tax Assessment Act 1936* (ITAA 1936). Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.

(v) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Watershed Premium Wines Ltd, in relation to the Terms Payment Option, is outside the scope of this Ruling. Growers who enter into agreements with other financiers may request a private ruling on the deductibility of the interest incurred.

(vi) The application fee payable to Watershed Premium Wines Ltd, in relation to the Terms Payment Option, is not deductible in full when it is incurred. Under section 40-880 it is deductible on a straight line basis over five income years (see paragraphs 95 to 96 of this Ruling).

(vii) A 'horticultural plant' is a 'depreciating asset' as defined in section 40-30 and truffles are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a lease, 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. The deduction for the truffles is determined using the formula in section 40-545 and is based on the capital expenditure incurred that is attributable to their establishment. If the truffles have an 'effective life' of 30 years or more for the purposes of section 40-545, this results in a straight-line write-off at a rate of 7%. The deduction is allowable when the truffles enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the truffles enter their first commercial season and the amount that may be claimed.

Shares in Truffle Properties Limited

Part 3-1

24. The shares in Truffle Properties Limited are CGT assets (section 108-5) and the amounts paid by a shareholder to acquire the shares are an outgoing of capital and not allowable as a deduction.

25. The amounts paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)). Any disposal of the shares by a shareholder will be a CGT event and may give rise to a capital gain or loss.

Trading stock

Section 70-35

26. A Grower who is not an 'STS taxpayer' will, in some years, hold truffles and hazelnuts that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the end of an income year exceeds the value of trading stock on hand at the start of an income year a Grower must include the amount of that excess in assessable income.

27. Alternatively, where the value of trading stock on hand at the start of an income year exceeds the value of trading stock on hand at the end of an income year, a Grower may claim the amount of that excess as an allowable deduction.

Section 328-285

28. A Grower who is an 'STS taxpayer' may, in some years, hold truffles and hazelnuts that will constitute trading stock on hand. Where, for such a Grower, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than $5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

29. Alternatively, a Grower who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

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

Section 35-55 – exercise of Commissioner's discretion

30. A Grower who is an individual accepted into the Project by 15 June 2007 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ended **30 June 2007 to 30 June 2013**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

Prepayment provisions and anti-avoidance provisions

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

31. For a Grower who commences participation in the Project and incurs expenditure as required by the Project Operations Agreement and the Lease and Sub-lease, 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 (but see paragraphs 97 to 101 of this Ruling);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Scheme

32. The scheme that is the subject of this Ruling is identified and described in the following documents:

- Application for a Product Ruling received on 27 September 2006 as constituted by documents and additional correspondence, including emails, received on 9, 27 and 29 October 2006, 24 November 2006, 12, 13, 18, 19 21, and 27 December 2006, 2 and 3 January 2007, 1, 4, 7, 12, 14 and 26 February 2007, and 2, 8, 11 and 12 March 2007;
- Draft Product Disclosure Statement/Prospectus Version F of the Oak Valley Truffle Project 2007 received 12 March 2007;
- Draft **Constitution** for the Oak Valley Truffle Project 2007 received 21 December 2006;
- **Draft Lease and Sub-lease for 2007 Growers** of the Oak Valley Truffle Project 2007, between Truffle Properties Limited (Land Owner), Watershed Premium Wines Ltd (Responsible Entity) and the Grower received 19 December 2006;
- **Draft Umbrella Lease** between Truffle Properties Limited (Lessor) and Watershed Premium Wines Ltd (Lessee) received 8 March 2007;
- **Draft Project Operations Agreement for 2007 Growers** of the Oak Valley Truffle Project 2007 between Watershed Premium Wines Ltd (Responsible Entity) and the Grower received 1 February 2007;

- Draft Compliance Plan for the Oak Valley Truffle Project 2007 received 27 September 2006;
- Draft Marketing and Management Agreement of the Oak Valley Truffle Project 2007, between Truffle Projects Pty Ltd (Manager) and Watershed Premium Wines Ltd (Responsible Entity) received 1 February 2007; and
- **Terms Agreement for 2007 Growers** for the Oak Valley Truffle Project 2007 between Watershed Premium Wines Ltd (Responsible Entity) and the 2006 Terms Grower received 1 February 2007.

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

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

34. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

Overview

35. Following is a summary of the scheme:

Location	10 kms south-west of Manjimup, Western Australia
Type of business	Commercial growing and cultivation of Oak and Hazelnut trees for the purpose of harvesting truffles and hazelnuts for sale
The term of the Project	20 years
Size of each interest	0.2 hectare
Number of hectares offered for cultivation	Up to a maximum of 60 hectares
Number of trees per interest	50 Oak and 50 Hazelnut trees
Initial cost per interest	$9,452.30
Initial costs per hectare	$47,261.50
Subscription for 3,508 Land Shares	$7,016 for 3,508 ordinary shares in Truffle Properties Limited paid on application
Ongoing costs	Annual Management Fees and Rent, Harvest Fees and insurance costs

36. The Project is registered as a managed investment scheme under the *Corporations Act 2001*. Watershed Premium Wines Ltd has been issued with Australian Financial Service Licence No 296166 and will be the Responsible Entity for the Project.

37. The Project will involve the commercial growing, cultivation and harvesting of truffles and hazelnuts.

38. An offer to participate in the Project will be made through a combined PDS/Prospectus. The offer under the PDS/Prospectus is for 60 hectares which corresponds to 300 Trufferies in the Project. There is no minimum subscription for the Project as this Project is an extension of the 'Oak Valley Truffle Project'. Product Rulings PR 2006/21 and PR 2006/122 may apply to Growers who were accepted to participate in the Oak Valley Truffle Project during the period 22 March 2006 to on or before 15 March 2007.

39. The offer under the PDS/Prospectus is a stapled interest. A Grower that participates in the Project will do so by acquiring an interest in the Project which will consist of a minimum of one Trufferie. For each Trufferie applied for, an Applicant must also apply for 3,508 ordinary shares in the Land Owner, Truffle Properties Limited. The shares can be held by any entity and can be held in a different name from the Trufferie owner. Once the Responsible Entity has allotted a Trufferie to a Grower, the offer is no longer stapled and the shares can be transferred separately to the interest in the Trufferie. This Ruling does not address the tax consequences of disposing of shares in Truffle Properties Limited.

40. Applicants execute a Power of Attorney contained in the PDS/Prospectus. The Power of Attorney irrevocably appoints Watershed Premium Wines Ltd to enter into, on behalf of the Grower, a Lease and Sub-lease, a Project Operations Agreement, the application for shares in Truffle Properties Limited and any other documents required to hold an interest in the Project.

41. For the purposes of this Ruling, Applicants who are accepted to participate in the Project and who execute the Lease and Sub-lease and the Project Operations Agreement on or before 15 June 2007 will become 2007 Growers.

42. The Project will be conducted on land located approximately 10 kilometres south-west of Manjimup, Western Australia on the corner of Seven Day Road and Appadene Road.

43. The Project land is owned by Truffle Properties Limited and will be leased to the Grower. Specifically, the property is described as Lot 102 on Deposited Plan 47397 being the whole of the land comprised in Certificate of Title Volume 2616 Folio 415 and Lot 11 on Diagram 92046 being the whole of the land comprised in Certificate of Title Volume 2156 Folio 98.

44. Each Grower will use their Trufferie for the purpose of carrying on a business of cultivating and harvesting truffles and hazelnuts.

Constitution

45. The Constitution establishes the Project and operates as a deed binding on all Growers and Watershed Premium Wines Ltd. The Constitution sets out the terms and conditions under which Watershed Premium Wines Ltd agrees to act as Responsible Entity and thereby manage the Project. Upon acceptance into the Project, Growers are bound by the Constitution by virtue of their participation in the Project.

46. In order to acquire an interest in the Project, the Grower must make an application for a Trufferie in accordance with the PDS/Prospectus. Among other things, the application must be completed in a form approved by the Responsible Entity, signed by or on behalf of the Applicant and accompanied by the payment of the Application Money in a form acceptable to the Responsible Entity.

47. Watershed Premium Wines Ltd holds the Application Money on bare trust and will deposit all Application Moneys received from applicants in a Trust Account (clause 6).

48. Once Watershed Premium Wines Ltd has accepted the application and all of the Project Documents have been executed and remain in force, the Application Money may be applied against the fees due to Watershed Premium Wines Ltd (clause 3.6).

49. Under the Constitution, the Responsible Entity will keep a register of Growers. The Constitution also sets out provisions relating to:

- the Responsible Entity's powers (clause 6);
- delegation of powers (clauses 7 and 9);
- complaints handling (clause 13); and
- winding up the Project (clause 15).

Compliance Plan

50. As required by the Corporations Act, a Compliance Plan has been prepared for the Project. Its purpose is to ensure that Watershed Premium Wines Ltd manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Lease and Sub-lease for 2007 Growers

51. Each Grower will execute a Lease and Sub-lease with Truffle Properties Limited (Land Owner) and Watershed Premium Wines Ltd. Growers are granted an interest in the Trufferie in the form of a lease to use their Trufferie for the purpose of conducting their truffle and hazelnut business upon the terms and conditions as set out in the Agreement.

52. The Lease and Sub-lease sets out the rights and obligations of the parties to the Agreement. Under the terms of the Lease and Sub-lease each Grower will lease a minimum of 1 Trufferie of 0.2 hectares. The Lease and Sub-lease shall operate from the date the Trufferie is allotted to the Grower and will continue until the Project is terminated on 30 June 2027 (Part 4 of the Schedule).

53. Clause 4 provides that the improvements on the Land, including the irrigation, are the property of the Land Owner. The Land Owner grants the Grower the non-exclusive right to use:

- the irrigation for the purpose of cultivating the trees;
- the right to draw water from any dams on the Land or any other dam or water source for which the Land Owner has access; and
- all other infrastructure, plant and equipment available to, or owned by, the Land owner in or about the Land.

54. The Land Owner has inoculated Oak and Hazelnut trees with Truffle and has planted approximately 50 Oak trees and 50 Hazelnut trees on each Trufferie.

55. The Land Owner acknowledges that subject to any provisions of the Lease and Sub-lease the Grower's truffles and hazelnuts will remain the property of the Grower during the Term of the Lease and Sub-lease (clause 2.4).

56. The Grower's obligations are set out in detail in clause 5 under which the Grower agrees to use the Trufferie for the purpose of cultivating, maintaining and harvesting the truffles and hazelnuts in accordance with sound silvicultural practices.

Project Operations Agreement

57. Under the Project Operations Agreement the Grower appoints the Responsible Entity to manage the Trufferie and to carry out management services subject to the terms and conditions of the Agreement. The Agreement will commence on the date the Responsible Entity accepts the Grower's application under the PDS/Prospectus and shall continue until its termination under clause 15.

58. The following Initial Services will be provided during the Initial Period, being from the Commencement Date to 30 June 2007:

- testing of Oak and Hazelnut trees for infection;
- certifying the trees as having been inoculated and infected with Truffle;
- irrigate the Oak and Hazelnut trees and maintain the trees in accordance with sound silvicultural practices;
- vermin control; and

- maintain the irrigation system installed by the Land Owner.

59. As part of the Initial Services the Responsible Entity will apply lime, herbicide and fertiliser to the Trufferie between 16 June 2007 and 30 June 2007.

60. The Responsible Entity will commence the provision of the Ongoing Services after completion of the Initial Services and shall continue to provide the Ongoing Services until the termination of this Agreement.

61. The Ongoing Services include:

- maintain the irrigation system installed by the Land Owner;
- irrigate the Oak and Hazelnut trees on the Land;
- maintain the Trufferies in a proper and skilful manner pursuant to the Trufferie Establishment and Maintenance Plan;
- to tend to and cultivate the Oak and Hazelnut trees according to the principles of sound silvicultural practice, including the application of fertiliser and other chemicals, as the Manager deems appropriate to promote tree and truffle growth and yields;
- to do such things as may reasonably be required to eradicate, exterminate and keep the Trufferies and the Land free from disease, vermin, noxious weeds, rabbits, kangaroos, insect pests and all other pests;
- to keep the following insurance policies current with a reputable insurer:
  - (i) a public risk insurance policy in respect of the Trufferies at the Manager's cost; and
  - (ii) insurance on behalf of all Growers' Trufferies in relation to hail, fire, malicious damage, lightning and explosions for such period as is promised to the Grower under the Project Operations Agreement; and
- to develop and continually monitor the Truffle Processing and Marketing Plan.

62. The Responsible Entity will send a report to the Grower no later than 31 July 2008 and by 31 July of each succeeding year summarising details of all hazelnuts and truffles harvested in the preceding financial year and any other comments that may reasonably affect the Project.

Marketing and Management Agreement

63. Watershed Premium Wines Ltd will enter into a Marketing and Management Agreement with Truffle Projects Pty Ltd. Under this Agreement Watershed Premium Wines Ltd engages Truffle Projects Pty Ltd (the Manager) as an independent contractor to carry out its duties and obligations under the Project Operations Agreement for the Term of the Project (clause 2). The Manager may delegate its responsibilities under this Agreement.

Pooling of truffles and hazelnuts and Grower's entitlement to Net Proceeds

64. The Project Operations Agreement sets out the provisions relating to the Grower's entitlement to harvest proceeds. This Product Ruling only applies where the following principles apply to the pooling and distribution arrangements:

- only Growers who have contributed truffles and hazelnuts are entitled to benefit from distributions of harvest proceeds from the pool; and
- any pooled proceeds must consist only of proceeds contributed by Growers who are accepted to participate in the Project on or after 21 March 2007 and on or before 15 June 2007.

65. The proceeds from the sale of the Grower's truffles and hazelnuts will be paid into a Trust Account held by the Bare Trustee (clause 4 of the Constitution). A Grower's Prescribed Proportion of the proceeds will be distributed to the Grower after deducting the fees and costs referred to in clause 12 of the Constitution. If the aggregate sum to be distributed is less than $1,000, then at the discretion of the Responsible Entity, the distribution to Growers may be postponed. The term 'Prescribed Proportion' is defined in the Constitution.

66. If part of the Grower's Trufferie is damaged or destroyed, the Grower's Prescribed Proportion of the Net Proceeds will be reduced as specified in clause 13 of the Project Operations Agreement.

Fees

67. Under the terms of the Lease and the Project Operations Agreement, a Grower will make payments as described below on a per Trufferie basis.

Fees payable under the Project Operations Agreement

- a Management Fee of $8,800 for Initial Services to be provided in the Initial Period (see paragraphs 70 and 71 of this Ruling for payment options);

- Management Fees of $6,600, $4,180 and $2,640 for Ongoing Services to be provided in each of the Financial Years ended 30 June 2008, 30 June 2009 and 30 June 2010 and payable on or before 1 June 2008, 1 June 2009 and 1 June 2010 respectively;
- for the Financial Year ended 30 June 2011 and each succeeding Financial Year until the expiry of the Lease and Sub-lease, Management Fees based on the actual cost to the Responsible Entity of performing the Ongoing Services, plus 20% of the Net Proceeds, plus the Grower's share of insurance premiums; and
- a Harvest Fee equal to 5.5% of the Grower's share of the Gross Proceeds for Harvesting, freighting and making the truffles and hazelnuts available for sale.

Fees payable under the Lease

68. Annual Rent of $652.30 (see paragraphs 70 and 71 of this Ruling for payment options).

69. For the Financial Year ended 30 June 2008, and each succeeding Financial Year, a Grower is required to pay an amount of Rent equal to the amount paid in the previous Financial Year indexed by CPI or 3%, whichever is the greater. The annual Rent is payable in arrears on 1 June of each year for the Term of the Project.

Payment of Application Money

70. The Application Money of $16,468.30 is comprised of:

- a Management Fee of $8,800;
- Rent of $652.30; and
- $7,016 for the purchase of 3,508 ordinary shares in Truffle Properties Limited.

71. Upon signing the Application Form, the Grower acknowledges that the full amount of the application money is immediately due and payable. However, under the PDS/Prospectus, the Responsible Entity is offering a Terms Payment Option as described in paragraphs 75 to 79 of this Ruling.

Finance

72. A Grower who does not pay the Application Money in full upon application may enter into a Terms Agreement with Watershed Premium Wines Ltd or borrow from an independent lender external to the Project.

73. Only the finance arrangements set out below are covered by this Product Ruling. A Grower cannot rely on this Product Ruling if the Grower enters into a finance arrangement with Watershed Premium Wines Ltd that materially differs from that set out in the documentation provided to the Tax Office with the application for the Product Ruling. A Grower who enters into a finance arrangement with an independent lender external to the Project may request a private ruling on the deductibility or otherwise of interest under finance arrangements not covered by this Product Ruling.

74. Other than where a Terms Agreement is in place Growers cannot rely on any part of this Ruling if the Application Money is not paid in full on or before 15 June 2007 by the Grower or, on the Grower's behalf, by a lending institution.

Terms Payment Option

75. If a Grower chooses to pay the Application Money under the Terms Payment Option, they must complete a Terms Application Form and Direct Debit Request. Growers must pay a non-refundable application fee of $50 per Trufferie applied for.

76. Under the Terms Payment Option a deposit of $7,925.30 is payable on application with the balance payable by 12 equal monthly instalments of $762 (including interest at 11.5% per annum daily reducing). The deposit will be applied as follows:

- $7,016 for the purchase of 3,508 Land Shares;
- $50 for the application fee for the Terms Payment Option; and
- $859.30 for the GST on the Management Fees and Rent payable in the initial year.

77. The first monthly payment is due one month from the date of Allotment. The full amount of the Application Money must be paid no later than 12 months from the date the Grower is accepted to participate in the Project.

78. If a Grower does not pay the required instalments under the Terms Payment Option, the balance of principal, interest and any additional costs payable under the Agreement becomes immediately due and payable to the Responsible Entity. In addition, the Responsible Entity may take legal action to recover the balance of principal and interest and any costs payable under this Agreement or any other legal action relating to this Agreement, take possession of the Grower's Trufferie and do anything an owner of the secured property is entitled to do (clause 9.2 of the Terms Agreement).

79. Watershed Premium Wines Ltd may charge the Grower interest on overdue amounts (clause 2.6).

80. 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 Watershed Premium Wines Ltd in relation to the Terms Payment Option, are involved or become involved in the provision of finance to Growers for the Project.

Commissioner of Taxation
21 March 2007

Appendix 1 – Explanation

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?

81. For the amounts set out in paragraph 23 of this Ruling to constitute allowable deductions, the Grower's horticulture activities as a participant in the Oak Valley Truffle Project 2007 must amount to the carrying on of a business of primary production.

82. Two Taxation Rulings are relevant in determining whether a Grower will be carrying on a business of primary production.

83. The general indicators used by the Courts are set out in Taxation Ruling TR 97/11 Income tax: am I carrying on a business of primary production?

84. Taxation Ruling TR 2000/8 Income tax: investment schemes, particularly paragraph 89, is more specific to arrangements such as the Oak Valley Truffle Project 2007. As Taxation Ruling TR 2000/8 sets out, the relevant principles have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

85. Having applied these principles to the arrangement set out above, a Grower in the Oak Valley Truffle Project 2007 is accepted to be carrying on a business of growing and harvesting truffles and hazelnuts for sale.

The Simplified Tax System

Division 328

86. 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.

87. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling (but refer to Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11). Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer.

Deductibility of Management Fees, Rent and interest on the Terms Payment Option

88. Other than part of the Rent in the initial year, the Management Fees and Rent are deductible under section 8-1 (see paragraphs 43 and 44 of TR 2000/8). A 'non-income producing' purpose (see paragraphs 47 and 48 of Taxation Ruling TR 2000/8) is not identifiable in the arrangement and, other than part of the Rent in the initial year, there is no capital component evident in the Management Fees and interest (see paragraphs 49 to 51 of TR 2000/8).

89. Subject to paragraphs 90 and 91 of this Ruling the tests of deductibility under the first limb of section 8-1 are met and the exclusions do not apply.

90. One of the exclusions under section 8-1 relates to expenditure that is capital, or is capital in nature. Any part of the expenditure of a Grower entering into a horticulture business which is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and hence will not be deductible under section 8-1. The Commissioner is of the view that a portion of the Rent payable by a Grower will be capital expenditure.

91. A Grower who enters the Project on or before 15 June 2007 does not lease the land for a full income year in the initial year. As there is no reduction in the Rent in the initial year to reflect the actual period of the lease, it is considered that part of the Rent is a premium paid by the Grower for the grant of the lease and is capital in nature. Therefore, under section 8-1 Growers will be entitled to a partial deduction of $54.35 calculated on a pro-rata monthly basis for each month or part month that the Grower is granted the lease to use the Trufferie from Truffle Properties Limited.

92. Subject to this qualification and provided that the prepayment provisions do not apply (see paragraphs 97 to 101 of this Ruling) a deduction for the Management Fees and Rent can be claimed in the year in which they are incurred. (Note: the meaning of incurred is explained in Taxation Ruling TR 97/7.)

93. Some Growers may finance their participation in the Project through a Terms Agreement with Watershed Premium Wines Ltd. Applying the same principles as that used for the Management Fees and Rent, interest incurred under the Terms Agreement has sufficient connection with the gaining of assessable income to be deductible under section 8-1.

94. Other than where the prepayment provisions apply (see paragraphs 97 to 101 of this Ruling), a Grower can claim a deduction for such interest in the year in which it is incurred.

Terms Payment Option application fee

Section 40-880

95. Growers who elect to pay their Grower's contribution under the Terms Payment Option must pay an application fee of $50 per Trufferie. This expenditure does not constitute a borrowing expense and is therefore not deductible under section 25-25. As it is capital in nature it is also not deductible under section 8-1.

96. However, section 40-880 will allow the application fee to be deducted on a straight line basis over five income years. Section 40-880 applies to capital expenditure that is incurred in relation to a business and which is not taken into account elsewhere or denied deductibility under another provision of income tax law.

Prepayment provisions

Sections 82KZL to 82KZMF

97. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (for example the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

98. For this Project, the only prepayment provisions that are relevant are section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME and 82KZMF of the ITAA 1936 (operative provisions).

Application of the prepayment provisions to this Project

99. Under the Scheme to which this Product Ruling applies the Management Fees and Rent are incurred annually and the interest payable to Watershed Premium Wines Ltd is incurred monthly in arrears. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this Scheme.

100. However, sections 82KZME and 82KZMF of the ITAA 1936 may have relevance if a Grower in this Project prepays all or some of the expenditure payable under the Project Operations Agreement and/or Lease, or prepays interest under a loan agreement (including loan agreements with lenders other than Watershed Premium Wines Ltd in relation to the Terms Agreement). 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 referred to in paragraph 23 of this Ruling 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 truffles and the application fee for the Terms Payment Option (where applicable) are of a capital nature. This expenditure falls for consideration under Division 40.

103. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 23 of this Ruling in the Table and the accompanying notes.

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

Section 35-55 – exercise of Commissioner's discretion

104. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income year ending **30 June 2007 to 30 June 2013**, the Commissioner has determined that for those income years:

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

105. 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.

106. 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

107. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefits(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL of the ITAA 1936. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA – general tax avoidance provisions

108. 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).

109. The Oak Valley Truffle Project 2007 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 paragraph 23 of this Ruling that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

110. 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 truffles and hazelnuts. 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.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 97/11; TR 98/22;
TR 2000/8; TR 2002/6;
TR 2002/11; PR 2006/21;
PR 2006/122

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- horticulture
- management fees expenses
- non-commercial losses
- primary production
- primary production expenses
- primary production income
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- tax administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:

- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 25-25
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Div 40
- ITAA 1997 40-30
- ITAA 1997 40-515
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(2)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530
- ITAA 1997 40-545
- ITAA 1997 40-880
- ITAA 1997 Subdiv 61-J
- ITAA 1997 Div 70
- ITAA 1997 70-35
- ITAA 1997 Pt 3-1
- ITAA 1997 108-5
- ITAA 1997 110-25(2)
- ITAA 1997 Div 328
- ITAA 1997 328-285
- ITAA 1997 328-285(1)
- ITAA 1997 328-285(2)
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- IT(TP)A 1997 328-120
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- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- Corporations Act 2001

Case references:

- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

ATO references

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