



PR 1999/38 - Income tax: Old Mundulla Vineyard Project 1998

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Product Ruling

Income tax: Old Mundulla Vineyard Project 1998

Contents	Para
What this Product Ruling is about	1
Date of effect	9
Withdrawal	11
Arrangement	12
Ruling	45
Explanations	49
Detailed contents list	84

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 98/1 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Product Ruling is about

1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax law(s)’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Old Mundulla Vineyard Project, or just simply as ‘the Project’ or ‘the product’.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are sections 8-1, 42-15, 387-165 and Subdivision 387-C of the *Income Tax Assessment Act 1997* (‘ITAA 1997’), and sections 82KK and 82KL and Part IVA of the *Income Tax Assessment Act 1936* (‘ITAA 1936’).

Class of persons

3. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their terms expire), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as ‘Growers’.

4. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the

arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

5. The Ruling provides this specified class of persons with a binding ruling as to the tax consequences of this product. The Commissioner accepts no responsibility in relation to the commercial viability of this product and gives no assurance the prices charged for the product are reasonable, appropriate or represent industry norms. A financial (or other) adviser should be consulted for such information.

6. The Commissioner rules on the precise arrangement identified in the Ruling.

7. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 12 to 45) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

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Date of effect

9. This Ruling applies prospectively from 26 May 1999, 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 (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

10. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income

year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

11. This Product Ruling is withdrawn and ceases to have effect after 30 June 1999. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

12. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Prospectus issued by Blaxland Vineyards Ltd ('BVL') on 11 May 1998;
- **Project Deed** between BVL and Inteq Custodians Limited ('Inteq') and each several Grower, dated 1 May 1998;
- First Supplemental Deed between BVL and Inteq, dated 11 May 1998;
- **Management Agreement** (as amended on 5 May 1999) between BVL and Cardinal Financial Securities Limited (formerly Inteq) and each several Grower;
- **Grape Purchase Agreement** between Brian McGuigan Wines Limited ('BMW') and BVL and each several Grower and Inteq, dated 1 May 1998;
- Vineyard Management Agreement between BVL and BMW and Inteq, dated 1 May 1998;
- Administration Agreement between BVL and Vineyard Management Pty Ltd ('VMPL') and Inteq, dated 1 May 1998;
- Corporation Management Agreement between Community Corporation Inc ('CCI'), BVL, Andrew Paine Pty Ltd (APPL) and Inteq, undated; and

- Application dated 20 November 1998 and letters from BDO Nelson Parkhill Services (Vic) Pty Ltd dated 13, 22 and 27 April 1999.

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

13. The documents highlighted are those Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate (as defined in section 318 of the ITAA 1936) of a Grower, will be a party to, that are part of the arrangement to which this Ruling applies, except any agreements that come within paragraph 44 concerning the provision of finance. The effect of these agreements listed above is summarised as follows.

14. This arrangement is called the Old Mundulla Vineyard Project. Growers are invited by the Manager to develop collectively a large vineyard, of up to 297 hectares, on a site at Mundulla in South Australia, 35 kilometres north east of Padthaway and 15 kilometres south east of Bordertown. A Grower or an entity associated with each Grower, will have freehold title to the land through registered Community Title Lots (similar in concept to strata titles), with an independent representative monitoring the Vineyard Project on their behalf.

15. The Project will be limited to 99 individual participation interests, each relating to a parcel of land 3.0 hectares in size. The minimum subscription is 5 participation interests. The initial term of the Project will be the period to 30 June 2013 with mechanisms for Growers to extend the term of the Project thereafter.

16. Each lot will have approximately 2,025 vines per hectare planted on it. These will grow on trellising with 1.6 metre posts. The grape varietal mix will be determined by the Manager and is proposed to include Cabernet Sauvignon (40%), Shiraz (40%), Merlot (17%) and Petit Verdot (3%).

17. The Project is a prescribed interest vineyard managed by BVL. Participation in the Project involves two 'stapled' interests: Growers' Interests and Community Title Lots. The freehold title three hectare Lots are subject to the *Community Titles Act 1996* (SA). Growers may either own the Lot themselves or through an associated entity. The Manager is engaged to manage the vineyard on behalf of the Grower.

18. The Growers' Lots will be managed by BMWL. Approximately one half of the grapes will be purchased by BMWL with the balance sold by BMWL as the Growers' agent.

19. The Project does not involve guaranteed returns or non-recourse financing. Nor are there risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

20. The fees payable by a Grower in the first four years commencing during the year ended 30 June 1999 are:

	Year 1 1999	Year 2 2000	Year 3 2001	Year 4 2002
Trellis	13,000	432		
Irrigation	15,000			
Preplanting (vine establishment) costs	3,000			
Vines	5,978			
Roads and buildings		1,250		
Vineyard maintenance	39,847	16,561	16,723	19,063
Administration	25,000	1,000	1,000	2,926
Total vineyard costs	101,825	19,243	17,723	21,989
Land cost	31,160			
Net investment	132,985	19,243	17,723	21,989

21. Growers who invest during the year ended 30 June 1999 will pay the Year 1 fees after acceptance for services performed after that date. Growers will continue to pay Vineyard Maintenance and Administration costs during the term of the Project.

Project Deed

22. The Project Deed dated 1 May 1998 governs the rights, duties and obligations of the Manager, the Representative and participants as Growers, Lot Owners or both. Growers or their associated entity will be invited to purchase a 3 hectare Lot. Inteq was appointed as Representative under the Deed and agrees to act as representative of the participants in the Project with the capacity to review both the development and management of the vineyard over the period of approximately 15 years to 30 June 2013.

23. Growers will employ the services of BVL pursuant to the Management Agreement for the cultivation, maintenance and marketing of the viticultural enterprise on the Lot owned by them or their associated entity.

24. Under the Deed, each Grower appoints the Representative as agent and attorney for the purposes of executing the Management Agreement and the Grape Purchase Agreement ([cl 6](#)).

25. The Representative has the power to:
- execute agreements on behalf of the Grower (cl 6.1(a));
 - vary, cancel or replace any of the Project agreements or execute any documents (cls 6.1(b) and (c));
 - use the money in the Agency Account to discharge the Grower's obligations (cl 36);
 - receive and hold application moneys in the Agency Account (cl 35);
 - invest the application moneys in any 'authorised investment' (cl 10).
26. During the term of the Project, each Grower who is not also a Lot Owner is granted a grower's licence and *profit à prendre* over the Lot by its associated entity (cl 6.6).

First Supplemental Deed

27. The First Supplemental Deed dated 11 May 1998 between BVL and Inteq amended the Project Deed. Clause 5 of the Project Deed is amended to change the issue price and application price of each Lot to \$31,160.

Management Agreement

28. The Management Agreement between the Representative (Inteq), the Manager ('BVL') and each Grower sets out the role and obligations of the Manager to control the Project. BVL, in turn, has entered into subcontracts with BMWL and VMPL and has contracted with APPL to manage the vineyard.
29. Upon termination of the Management Agreement, BVL will, within 3 months after termination, at its own expense remove all employees, agents, equipment, plant vehicles and machinery from the Grower's or associated entity's Lots (cl 15).
30. BVL must establish the vineyard on the Lots for each Grower in accordance with the development plan. BVL must acquire vine rootlings for each Grower, and keep them separately identified as having been acquired on behalf of the Grower (cl 4.1).
31. The Vineyard Services to be provided by BVL are detailed at clause 4.3. These include, amongst other things:
- pruning;
 - irrigation and fertilisation;
 - soil management;

- vineyard maintenance;
- vermin and vegetation;
- insects and disease;
- spray diaries;
- destruction or abandonment of vines or grapes;
- management plan;
- restoration;
- incidentals.

32. Each Grower engages the Manager to harvest and deliver the grapes to the purchaser on behalf of each Grower complying with the Grape Purchase Agreement ([cl 4.4](#)).

33. A Grower may at any time terminate the Management Agreement if the Manager defaults in the performance of any obligation and the default is capable of remedy ([cl 14.1](#)).

34. All costs associated with providing the Vineyard Services shall be paid by the Manager out of the Management Fees and the Grower will have no further liability unless the costs exceed the Management Fees. The owner of the Lot will remain liable for the costs of ownership ([cl 9.11](#)).

Vineyard Management Agreement

35. The Vineyard Management Agreement dated 1 May 1998 provides for the engagement of BMWL as an independent contractor to carry out the Vineyard Services for the Vineyard Fee ([cl 3.1](#)).

36. BMWL:

- must establish a vineyard on each Lot and provide Vineyard Services to the Manager on substantially the same basis as the Manager is to provide them to the Growers under the Management Agreement ([cl 4.1](#));
- has similar reporting obligations as the Manager under the Management Agreement ([cl 12](#)) but makes no warranty about the quality and yield from any Lot ([cl 4.2](#));
- will assist the Manager in relation to its insurance obligations under the Management Agreement ([cl 7.1](#));
[and](#)
- must have sufficient rights of possession and occupation of the Lots to perform the Vineyard

Services and the Manager must ensure that no Grower interferes with that performance (cl 8.1).

Administration Agreement

37. Under the Administration Agreement dated 1 May 1998 between BVL, Inteq and VMPL, the Manager engages VMPL as an independent contractor to carry out certain administrative services during the term of the Project.

38. The Manager will pay VMPL administration fees (cl 5) to:

- assist BVL with the administration and supervision of matters under the Project Deed (cl 4);
- liaise with and monitor the performance of BMWL under the Vineyard Management Agreement (cl 4.1);
- liaise with the purchaser in relation to matters the subject of the Grape Purchase Agreement (cl 4.2); and
- liaise with Growers in relation to matters concerning the vineyard (cl 4.3).

Grape Purchase Agreement

39. The Manager, the Representative and each Grower have entered into a Grape Purchase Agreement with BMWL for the sale to BMWL, from vintage 2002 onwards, of the greater of 50% of each variety of grapes or 2,000 tonnes of grapes at market prices for the first 15 years of the Project (cls 3 and 4).

40. BMWL may act as agent for the Growers in selling the balance of the crop each year on a commission basis (cl 6).

Corporation Management Agreement

41. The Corporation Management Agreement is between CCI, BVI, APPL and Inteq. The Agreement provides for the engagement of APPL as an independent contractor to perform the Financial Services and Corporation Services on and subject to the terms of the Agreement.

42. Administration and management services on behalf of the Community Corporation are:

- receipt and holding of money;
- payment of money;
- preparation of accounts;

- collection of money;
- entering into contracts of insurance;
- maintaining and keeping records;
- issuing and signing notices;
- preparing minutes of meetings;
- providing information as required by the Act;
- investing money; and
- arranging for maintenance and repair of Common Property [\(cl 4.1\)](#).

43. Project services to be performed are:

- maintaining and keeping a register of Growers and Lot Owners;
- providing Growers and Lot Owners with tax return information;
- preparing CCL accounts; and
- assisting with financial management [\(cl 4.2\)](#).

Finance

44. Growers can fund their investment in the Project themselves, borrow from an independent lender, or borrow through an Australian bank organised by BVL. Finance arrangements organised directly by a Grower with independent lenders are outside the arrangement to which this Ruling applies. BVL has arranged for a credit facility to be offered by an Australian bank that has no interest in the Project. The loan will be on a full recourse basis. Other terms and conditions involved are:

- all loan terms will be of an arm's length nature;
- borrowers will remain fully liable for the balance of the loan outstanding at any time, and the lender will take full legal action against defaulting borrowers;
- none of the funds lent will be transferred back to the lender, or any associate, as part of any 'round robin', or equivalent transaction;
- the loan will not be a 'split-loan', of the type described in Taxation Ruling TR 98/22;
- no indemnity, or equivalent agreement, to reduce the borrower's liability applies;

PR 1999/38

- repayment of principal and payment of interest will not be linked to deriving income from the Project, and will be made regularly, commencing from or about, the time of the making of the loan.

Ruling

45. For a Grower who is also a Lot Owner and who invests in the Project by 30 June 1999 and utilises the services of BVL, the following deductions will be available for the years ended 30 June 1999 to 30 June 2002:

		Deductions available each year			
		Year 1	Year 2	Year 3	Year 4
Year ended		30/6/1999	30/6/2000	30/6/2001	30/6/2002
Fee type	ITAA 1997 section				
Irrigation	387-125 (see Note (i) below)	\$5,000	\$5,000	\$5,000	
Trellising	42-15 (see Note (ii) below)	[\$-]	\$1,746	\$1,746	\$1,746
Preplanting (vine establishment)	387-305 (see Note (iii) below)		\$625	\$750	\$750
Vines	387-305		\$1245	\$1,495	\$1,495
Roads and Buildings	Div 43 (see Note (iv) below)		\$13	\$25	\$25
Maintenance	8-1	\$39,847	\$16,561	\$16,723	\$19,063
Administration	8-1	\$25,000	\$1,000	\$1,000	\$2,926

Notes:

- (i) Deductibility under section 387-125 is calculated on the basis of one-third of the capital expenditure in the year in which the expenditure is incurred, and for each of the next 2 years of income.
- (ii) Deductibility under section 42-15 for depreciation, for the year ended 30 June 1999, will depend, for the purposes of either section 42-160, 'Diminishing value method', or section 42-165, 'Prime cost method', on the number of 'days owned', being the number of days in the income year in which the grower owned an interest in the trellising. BVL is to advise Growers of this for the year ended 30 June 1999. Deductions for the three succeeding years have been calculated, for illustrative purposes, on the basis of using the prime cost method at a rate of 13%, assuming that is the method that the Grower has chosen under section 42-25.

- (iii) Deductibility under section 387-305 is calculated on the basis of establishing grape vines for use in a primary production business by the owner. The capital cost may be written off over a four year period from the time of planting.
- (iv) A deduction is available under Division 43 of ITAA 1997 in respect of building costs at the rate of 2.5% per annum on a prime cost basis. A deduction will not be allowable in respect of capital works expenditure on the construction of buildings not completed in a construction expenditure area. Deductions shown are for illustrative purposes, calculated at the rate of 2.5% per annum on a prime cost basis for eligible works completed by 31 December 1999.

46. For Growers who are not Lot Owners, but have been granted a licence over a Lot by an associated entity, the costs of the vines and other 'establishment expenditure' will be deductible under section 387-165. These other costs include expenditure on preplanting and planting work. These Growers cannot claim deductions under section 387-305 as they are not the owners of the grape vines. The deductible amounts allowable under section 387-165 start in respect of the year that the grape vines, as horticultural plants, enter their first commercial season, and are calculated using the formula in section 387-185.

47. For a Grower who invests in the Project, any income received by them from the sale of grapes from their Lot will be assessable income to them under section 6-5.

Sections 82KZM, 82KK and 82KL and Part IVA

48. For a Grower who invests in the Project, the following provisions of the ITAA 1936 have application as indicated:

- the expenditure by Growers does not fall within the scope of section 82KZM;
- sections 82KK and 82KL do 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.

Explanations

Section 8-1

49. Consideration of whether the Maintenance and Administration fees are deductible under section 8-1 proceeds on the following basis:

- the outgoings 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 paragraph 8-1(b) if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that taxpayers contractually commits themselves 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 paragraph 8-1(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

50. An outgoing or a loss incurred in carrying on a business for the purpose of gaining or producing assessable income is deductible under the general deduction provision section 8-1, provided it is not expenditure or a loss of capital or of a capital, domestic or private nature. A business includes a 'primary production business', which is defined under subsection 995-1(1) to include a business of propagating and cultivating plants. Where there is a business, or a future business, of growing grapes for sale at a profit, the gross sale proceeds from the sale of grapes from the Project will constitute assessable income under section 6-5. 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. These operations will be the planting, tending, and maintaining of grape vines and the harvesting of the grapes.

Is the Grower in business?

51. Generally, a Grower will be carrying on a business of viticulture where:

- they have an identifiable interest in specific growing vines coupled with a right to harvest and sell the grapes resulting from those vines;
- the viticulture activities are carried out on their behalf; and

- the weight of the general indicators of a business, as developed by the Courts, points to them carrying on such a business.

52. By weighing up all of the attributes of the Project, it is accepted that Growers in the Project will be in a business of primary production from the date that 'business operations' are first commenced on their behalf. Business operations in this context mean such things as surveying of the land, installation of the trellising and irrigation items, and other preplanting work, all conducted as part of a co-ordinated and concerted plan to grow and harvest grapes for sale at a profit.

53. For this Project, investors either are Lot Owners or are Licence Holders through an associated entity. Each lot will have approximately 2,025 vines per hectare. This is consistent with the intention to carry on a business of growing grape vines.

54. Under the Management Agreements, Growers appoint BVL, as Manager, to provide services such as preplanting and planting of grape vines, the installation of trellising and irrigation, and all cultural operations necessary to develop a mature fruit bearing vine.

55. Growers have the right to use the land in question for viticulture purposes and to have BVL come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over BVL, as evidenced by the Agreements and supplemented by the Corporations Law, is sufficient. Under the general terms of the Project, Growers are entitled to receive regular progress reports on BVL's activities. Growers are able to terminate arrangements with BVL in certain instances, such as cases of default. The viticulture activities described in the Management Agreements are carried out on the Growers' behalf. Growers control their investment.

56. The general indicators of a business, as developed by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description in this Ruling for all these indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

57. Growers will engage the professional services of a Manager who holds itself out as having the appropriate credentials. There is a means to identify which vines Growers have an interest in. The services are based on accepted viticultural practices and are of the type ordinarily found in viticulture ventures that would commonly be said to be businesses.

PR 1999/38

58. Growers have a continuing interest in the vines from the time they are acquired until the termination of the Project. The viticulture 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. The Growers' viticulture activities will constitute the carrying on of a business.

Deductibility of expenses

59. The Maintenance and Administration fees payable in years one, two and three, associated with the viticulture activities, will relate to the gaining of income from this business and, hence, have a sufficient connection to the operations by which this income is to be gained. They will, thus, be deductible under the first limb of section 8-1, to the extent that they are not capital or of a capital nature (see further below). Further, no 'non-income producing' purpose in incurring the fees is identifiable from the arrangement. The fees, on the basis of the information provided, cannot be said to be grossly excessive. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply, except as set out below.

Expenditure of a capital nature

60. Any part of the expenditure of a Grower entering into the viticulture business 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. It is apparent from the Project's Agreements that certain payments made are attributable to the acquisition of capital assets. These include preplanting costs, the cost of establishing the vines, and the erection and establishment of such items as trellising and irrigation to support and water the vines. However, expenditures of this nature can fall for consideration under specific deduction provisions relevant to the carrying on of a business of primary production, and under the general depreciation provisions of the ITAA 1997.

61. The Manager, BVL, has identified the relevant expenditures that are of a capital nature. A Grower entering into the Project incurs and pays a separate amount to BVL for these capital items in Year 1 amounting to \$36,978 and \$1,682 in Year 2 (refer clause 9 of the Management Agreement). These amounts are detailed at paragraph 20 of this Ruling.

**Capital allowances for primary producers – Division 387;
Vine establishment - section 387-305, Subdivision 387-C**

62. The capital costs of establishing the vines are able to be written off under Division 387 of ITAA 1997. Participants who are Lot Owners are entitled to the deductions provided for by section 387-305. The capital cost of establishing grape vines may be written off by the owner over a four year period.

63. On the other hand, where a Grower is the holder of a Licence and a *profit à prendre* in relation to the land, the Grower cannot claim a deduction under section 387-305 on the basis that the ownership will vest in the associated entity. However, in these circumstances, Subdivision 387-C provides that the establishment costs are eligible for write-off over the effective life of the plants, commencing when they are first used for commercial horticulture. Under subsection 387-170(3), the definition of horticulture covers the cultivation of grape vines.

64. The Manager has estimated that the grape vines may be expected to have a useful life of 15 years. The write-off commences from the time the vines are used or held ready for use for the purpose of producing assessable income in a horticultural business (see sections 387-165 and 387-170). The write-off rate will be 13% per year, assuming an effective life of the plants of greater than 13 but less than 30 years (see section 387-185). The write-off deductions will, for a Grower who has been accepted into the Project by 30 June 1999 and whose primary production business has commenced, start in the third year of the Project, on the basis it is then the grapevines enter their first commercial season and, hence, begin to be used for the purpose of producing assessable income in a horticultural business.

65. Costs of establishing horticultural plants may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of surveying and ploughing. Expressly excluded is expenditure incurred on draining swamps or the clearing of land.

66. The Manager has identified that the relevant expenditure attributable to the establishment of the vines is \$8,978. This amount will be subject to the horticultural provisions and allowable as a deduction under Subdivision 387-C.

67. For a Grower entering into the Project by 30 June 1999, no deduction will be allowable for the years ended 30 June 1999 or 30 June 2000. A deduction will be available for the year ended 30 June 2001. This will be for the amount of \$1,167.

Alternative view

68. The applicant has indicated disagreement with the view that the grape vines do not commence to be used for the purpose of producing assessable income in a horticultural business until their first commercial season, and has submitted an alternative view that the

grape vines commence to be so used immediately after their establishment. The view is submitted by the applicant that the phrase 'or hold it ready for use' means the horticultural plant need not be producing assessable income at the time the deduction is first available.

Trellis – section 42-15

69. Growers accepted into the Project incur a number of expenses under the Management Agreement for items of plant that are to be used on their behalf in the operation of the vineyard business. Such expenditure includes that on trellising upon which the vines are attached. This is attached to the land as a fixture. This expenditure is also of a capital nature.

70. Generally speaking, if a taxpayer incurs expenditure of a capital nature on plant or equipment, used during the year of income for the purposes of producing assessable income, and it is expenditure to which section 42-15 applies, a deduction will be allowed for depreciation on the item under that section. Accordingly, a Grower who is a Lot Owner may claim a deduction for depreciation over the effective life of the trellis. Under clause 5 of the Management Agreement, the Grower, to the extent permitted by law, will own all plant, equipment and other property that is acquired by the Grower, or on its behalf, and which is installed on the Grower's Lot.

71. However, we accept in certain circumstances licence holders are entitled to claim depreciation where they are considered to be the owner of those improvements. In Taxation Ruling IT 175, we set out our views on this issue. Where a licensee is considered to own the improvements under a state law, as detailed in the Ruling, or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, we accept the licensee is entitled to claim depreciation for the fixture.

72. Under Taxation Ruling IT 2685, it has been estimated that the effective life of trellising is 20 years and that depreciation is therefore allowable on a prime cost basis at the rate of 13% per annum.

Irrigation – section 387-125

73. Expenditure on water facilities incurred primarily and principally for the purposes of conserving or conveying water for use in a primary production business conducted on land in Australia is deductible under section 387-125 in equal instalments over three years, commencing in the year the expenditure was incurred. Deductions will be allowable for the costs of installing irrigation equipment in the Old Mundulla Vineyard commencing from and including the year ended 30 June 1999.

Roads and buildings – Division 43

74. The costs of creating a road and erecting buildings are capital in nature. A deduction will be available under Division 43 in respect of building costs at the rate of 2.5% per annum on a prime cost basis.

Vineyard maintenance and administration charges

75. The vineyard maintenance and administration charges incurred by the Growers are deductible under section 8-1.

Section 82KZM

76. Under the Management Agreement, fees of \$101,825 per three hectare lot of 2,025 vines per hectare will be incurred on execution of that Agreement. In addition, management fees of \$19,243, \$17,723 and \$21,989 are payable in years two, three and four respectively. In each instance the fees are charged for providing services to a Grower only for the period of 12 months from the time they are incurred. The fees are expressly stated to be for a number of specified services. In effect, the Manager is promising to provide significantly more services, in terms of value, in respect of clause 4, in the first year of the Project, compared to years two and later years.

77. No explicit conclusion can be drawn from the arrangement's description, that the fees in the first four years have been inflated to result in reduced fees being payable for subsequent years. There is no evidence that might suggest the services covered by the fee could not be provided within 13 months of incurring the expenditure in question. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditures identified above in each of the financial years ended 30 June 1999 to 30 June 2002.

Sections 82KK and 82KL

78. These provisions allow the Commissioner to deny or defer deductions that have been incurred under certain tax avoidance schemes. Section 82KK deals with tax deferral arrangements. Section 82KL deals with certain expenditure recoupment schemes.

79. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'.

80. The specific anti-avoidance provisions of sections 82KK and 82KL should not apply to deny deductions to the Growers. Insufficient 'additional benefits' will be provided in respect of this

PR 1999/38

loan, to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

81. For Part IVA 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). The Old Mundulla Vineyard Project will be a 'scheme'. It will commence on the date the Prospectus issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the management fees allowable under section 8-1, and deductions allowable under Subdivisions 387-B, 387-C and 387-D, section 42-15 and Division 43, 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.

82. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the yearly sale of grapes or grape juice. Further, there are no features of the Project, for example, such as the management fees of being 'excessive', and uncommercial, and predominantly financed by a non-recourse loan, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Assessable income

83. Gross sale proceeds derived from the sale of grapes harvested from the Project will be assessable income of the Growers, under section 6-5, in the year in which a recoverable debt accrues to them. This will depend on the terms of the specific sale contracts entered into.

Detailed contents list

84. Below is a detailed contents list for this Ruling:

	Paragraph
What this Product Ruling is about	1
Tax Law(s)	2
Class of persons	3
Qualifications	5
Date of effect	9
Withdrawal	11

Arrangement	12
Project Deed	22
First Supplemental Deed	27
Management Agreement	28
Vineyard Management Agreement	35
Administration Agreement	37
Grape Purchase Agreement	39
Corporation Management Agreement	41
Finance	44
Ruling	45
Sections 82KZM, 82KK and 82KL and Part IVA	48
Explanations	49
Section 8-1	49
Is the Grower in business?	51
Deductibility of expenses	59
Expenditure of a capital nature	60
Capital allowances for primary producers - Division 387; Vine establishment – section 387-305, Subdivision 387-C	62
<i>Alternative view</i>	68
Trellis - section 42-15	69
Irrigation - section 387-125	73
Roads and buildings - Division 43	74
Vineyard maintenance and administration charges	75
Section 82KZM	76
Sections 82KK and 82KL	78
Part IVA	81
Assessable income	83

Commissioner of Taxation

26 May 1999

Previous draft:

No draft issued

Related Rulings/Determinations:

PR 98/1; TR 92/1; TR 92/20;
TR 97/11; TR 97/16; TD 93/34;
IT 175; IT 2685

Subject references:

- carrying on a business

- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration

PR 1999/38

- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:

- ITAA1936 82KK
- ITAA1936 82KL
- ITAA1936 82KZM
- ITAA1936 92
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1936 318
- ITAA1997 6-5
- ITAA1997 8-1

- ITAA1997 42-15
- ITAA1997 42-25
- ITAA1997 42-160
- ITAA1997 42-165
- ITAA1997 Div 43
- ITAA1997 Div 387
- ITAA1997 Subdiv 387-B
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- ITAA1997 Subdiv 387-D
- ITAA1997 387-125
- ITAA1997 387-165
- ITAA1997 387-170
- ITAA1997 387-185
- ITAA1997 387-305
- ITAA1997 995-1(1)

Case references:

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