



PR 2000/10 - Income tax: Coonawarra Wine-grape Project Investment

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 February 2001*



Product Ruling

Income tax: Coonawarra Wine-grape Project Investment

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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 1999/95 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.*

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. 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 investors 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, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO may be undertaking review activities in future years to confirm the arrangement has been implemented as described below and to ensure that participants in the arrangement 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 person(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 Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of person, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Coonawarra Wine-grape Project Investment, or just simply as 'the Project' or the 'product'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:

- section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 27-5 (ITAA 1997);
- section 27-30 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM (ITAA 1936);
- section 82KZMB (ITAA 1936);
- section 92 (ITAA 1936); and
- Part IVA (ITAA 1936).

3. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of those changes, especially those to do with 'tax shelters', could affect the tax laws dealt with in this Ruling. Some of the changes apply from the date of announcement and others are proposed to apply from nominated dates in the future.

4. Although this Ruling mentions certain of those announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally binding advice in respect of those changes cannot be given until the relevant law(s) are enacted.

5. However, if the changes become law the operation of that law will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded. If requested, when the relevant law(s) are enacted, the Commissioner will formalise the non-binding information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

Class of persons

6. 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 term expires), 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 'Farmers'.

7. 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

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

9. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 14 to 40) 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

11. This Ruling applies prospectively from 8 March 2000, 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).

12. 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 Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. 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, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

14. The arrangement that is the subject of this Ruling is described below. The description is based on the documents listed below and these documents, or relevant parts of them, as the case may be, form part of and are to be read with this description:

- Application for Product Ruling dated 16 April 1999;
- The Coonawarra Winegrape Project Prospectus dated 11/6/1999 ('the Prospectus') which includes **Loan**

Application and an **Equity Investment** in Coonawarra Property Holdings Limited (CPHL);

- Draft Prospectus received by ATO on 20 April 1999;
- Revised draft Prospectus received by the Australian Taxation Office ('the ATO') on 4 June 1999;
- First Supplementary Prospectus dated 11 June 1999;
- Draft copy of a Managed Investment Scheme **Constitution** between the Manager, Australian Hardwood Management Limited (AHML) and the landowner CPHL and the Farmer, which also incorporates a **Joint Venture Agreement** between AHML, CPHL and each Farmer received by the ATO on 20 April 1999;
- Revised draft **Joint Venture Agreement** between AHML, CPHL and each Farmer received by the ATO on 26 May 1999;
- Draft **Loan Deed** between the Lender, Rocky Castle Finance Pty Limited (RCFPL) and the Borrower received by the ATO on 20 April 1999;
- Revised draft **Loan Deed** between the Lender and the Borrower received by the ATO on 4 June 1999;
- Draft Deposit Agreement between the Contractor, Koonarra Management Pty Limited (KMPL) and the Lender received by the ATO on 26 May 1999;
- Draft Lease Agreement between CPHL and the Custodian, Australian Rural Group Limited (ARGL) as agent for AHML received by the ATO on 26 May 1999;
- Sub-Contract Agreement between the Manager and the Contractor;
- Correspondence dated 31 August, 8 and 20 September, 7 December and 8 December 1999 from the applicant's legal adviser;
- Correspondence dated 22 October 1999 from the Manager.

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

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15. The documents highlighted above are those that the Farmers enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal and whether or not legally enforceable, which a Farmer, or any associate of the Farmer, will be party to, other than those to which paragraphs 37-40 applies. The arrangement is summarised as follows:

16. The arrangement is called the 'Coonawarra Wine-grape Project Investment' and will be registered as a managed investment scheme under the Corporations Law.

Overview

Location	South Australia, north east of the township of Coonawarra. Sections 226, 227, 228 and 235 in the Hundred of Comaum.
Type of business each participant is carrying on	Viticulture, wine processing and production
Number of hectares under cultivation	180 hectares
Name used to describe the product	Coonawarra Winegrape Project Investment
Size of participation	0.2 hectares
Number of vines per hectare	1840
Number of vines per participation	368
The term of the investment	21 years
Initial cost	\$17,300 on settlement, \$5,309 one year after settlement and \$5,318 two years after settlement
Initial cost on a per hectare basis	\$139,635 for the first three years
Ongoing costs	From year three management fees of \$1,300 increased yearly by the greater of the CPI (All Groups) Adelaide or 3% and Lease Rent of \$318 increased yearly by the greater of the CPI (All Groups) Adelaide or 3%

Other aspects	No sales agreements are in place for the grapes and/or wine that is harvested / produced
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17. Farmers enter into a Joint Venture Agreement with AHML (the Manager), CPHL (the Landowner) and other Farmers whereby AHML will be engaged to manage the Joint Venture and the Farmers' interest in it until 30 June 2021.

18. Each farmer has a proportionate interest in the income of the scheme project. **The Joint Venture is a partnership for tax law purposes and the Joint Venture will prepare a partnership tax return.**

19. The Project aims to establish a vineyard of up to 180 hectares and has up to 900 interests in the Joint Venture on offer. The minimum subscription is set at 100 Joint Venture participations and a Farmer's minimum investment in the Project is the purchase of one 'Joint Venture Participation'.

20. The Prospectus will expire on the 11 June 2000 unless extended by authority of the ASIC. No investors will be accepted into the Project after 11 June 2000 or any extension.

21. Grape vines will be planted on the property which is part of a larger holding managed by the Vineyard Manager. Sections 226, 227 and 228 of the property are presently owned by Trevor Stanley Reschke and section 235 is owned by Trevor Reschke Nominees Pty Ltd. CPHL has an option to purchase this land from both owners and will be the landowner.

22. It is intended that CPHL will complete the purchase of the land as required to satisfy its obligations under the Constitution and the Joint Venture Agreement. CPHL will lease the Project land to ARG (Custodian) as agent for the Manager (AHML). The Manager will hold the interest in the land, being the lease, on behalf of the Joint Venture of Farmers to enable the vineyard to be planted out with grape vines.

23. The Manager will plant the Project's land, a total of 180 hectares, with 368 vines per 0.2 ha interest within the first 13 months of the date of acceptance of an investor's application.

Possible projected returns for Farmers are outlined on pages 10 to 13 of the Prospectus. These depend upon a range of assumptions made by the Manager. There are no sale agreements in place for the grapes and/or wine that will be harvested / produced under the arrangement.

Constitution and Joint Venture Agreement

24. In respect of the project, a Farmer has an interest in specific property comprising the managed investment scheme ("Scheme") property which is defined in the Constitution. There will be a Custodian of the Project for the Joint Venture Farmers. Farmers execute a power of attorney enabling AHML to act on their behalf as required.

25. Farmers do not have any right to withdraw from the Scheme nor do they have a right to require their interest in the Scheme to be bought by the Manager or any other person or to have their interest in the Scheme redeemed (Clause 11, Constitution). A Farmer's / Member's Scheme interest may be transferred provided such transfer is a transfer of the entire unencumbered interest in the Scheme (Clause 16, Constitution). AHML keeps a register of Farmers.

26. The Farmers will remain Scheme members until the Scheme is determined on 30 June 2021, unless it is wound up earlier (Clause 7, Constitution). The Farmers will each enter into a Joint Venture Agreement to carry out the Project as a Joint Venture and to appoint AHML to manage the Joint Venture.

27. Upon termination of the Joint Venture trellises will be valued at market value on the assumption they have been removed as tenants' fixtures. The Land Owner will pay this amount to the Manager on behalf of the Joint Venturers (clause 15.1).

Management Services

28. The services to be provided by AHML to the Joint Venture are specifically set out in clause 1.1 of the Joint Venture Agreement and include:

- (a) cultivating, fertilising and planting out the vineyard with rootstock in a healthy condition;
- (b) prune and/or train, string up, de-shoot and/or take other measures that may be necessary in accordance with good viticultural practice to properly manage the growth of the grape vines to and along the trellises and to optimise as far as is reasonably possible in the circumstances the quality of the grapes produced therefrom;
- (c) taking such reasonable measures as may be required to control the growth of weeds and other vegetable pests on the vineyard upon which the vines are growing;
- (d) taking all reasonable measures in accordance with the principles of good viticulture practice and to the extent

- reasonably possible to deter and eradicate any insect, bird or animal pests from the vineyard which may detract from the health and vigour of the grape vines or yield thereof;
- (e) taking representative soil samples from the vineyard from time to time and arranging to have those samples analysed by an accredited soil analysis laboratory and having regard to the results and recommendations of any soil analysis undertaken, supply suitable fertiliser and apply it to the vineyard in accordance with the principles of good viticulture practice and in such quantities as may be required to promote healthy plant growth and yield;
 - (f) replacing at the Farmers' expense any grape vines which die or become unproductive with juvenile grape vines of the same variety as those which die or have become unproductive;
 - (g) repairing and maintaining in a good condition all fences, trellises, accessways and other structural improvements and irrigation plant and equipment on the vineyard;
 - (h) arranging sales of the wine grapes and/or bottled wine from the vineyard including entering into a contract or contracts to supply grapes harvested from the vineyard or bulk wine produced therefrom;
 - (i) harvesting the wine grapes from the vineyard;
 - (j) effecting the insurances referred to in the Agreement;
 - (k) employing such staff and labour and engaging such contractors to assist the manager to carry out its obligations under the Agreement;
 - (l) carrying out the accounting, financial control and reporting needs and functions of the Joint Venture;
 - (m) keeping of proper books of account for the Joint Venture; and
 - (n) doing all other things that are necessary or incidental to the carrying out of the Project to produce a viable business of growing, marketing and sale of wine grapes and/or bulk wine.

29. The Vineyard Establishment Fee payable by each Farmer to the Manager is to cover the purchase of the cuttings or rootings and the costs of vine establishment, land care, trellising and irrigation

establishment being the amounts referred to in clause 7 of the Joint Venture Agreement.

30. The Manager is entitled to engage contractors and in this respect it will sub-contract all proposed vineyard establishment and maintenance functions to Koonara Management Pty Limited.

31. Clause 18.1 of the Constitution provides that gross income be paid by the Manager into the 'Scheme Bank Account'. There are no agreements for the allocation of product between Farmers and/or the pooling for sale of produce.

32. Members to the Constitution referred to as Farmers in the Joint Venture Agreement have the power to remove the Manager in accordance with the Constitution (clause 23.5 of the Constitution).

Other undertakings by the manager

33. The Manager has provided the ATO with the following undertakings:

- to contact the Joint Venture and to provide it with the correct date of commencement of the vines' first commercial season; and
- to contact the Joint Venture and provide it with the correct date of trellising installation, in the event that it differs from the estimated date of 1 November 1999, for purposes of calculating the depreciation deduction.

Fees

34. Farmers must pay the following subscription fees per Joint Venture interest:

	On Settlement	One Year After Settlement	2 Years After Settlement
Management fee	\$13,430	\$5,000	\$5,000
Lease Rent	\$300	\$309	\$318
Contribution fee			
Establishment fees	\$3570		
Total	\$17,300	\$5,309	\$5,318

35. Subsequent fees until 30 June 2021 will be as follows:

- **Management fees:** The annual fee for year 3 and subsequent years will be calculated on the basis of

\$1,300 for the 3rd year and then increased by the greater of the Consumer Price Index (All Groups) Adelaide or 3%, in accordance with the formula in clause 5.1 of the Joint Venture Agreement. Fees are payable until there is sufficient funds from income of the Joint Venture to enable management fees to be payable yearly in advance from those funds.

- **Lease Rent Contribution fees:** the fee for each year is equal to the fee of the previous year indexed by the Consumer Price Index (All Groups) Adelaide or 3%, in accordance with the formula in clause 6.1 of the Joint Venture Agreement.

36. The Goods and Services Tax will be applicable to services provided by the Manager to the Farmer on or after 1 July 2000. The Joint Venture Agreement states that the Goods and Services Tax is to be added to the amount of fees detailed above.

Finance

37. Farmers can fund their investment in the Project themselves, borrow from an independent lender or borrow through the finance option offered by RCFPL (“the Lender”).

38. This Ruling does not apply if a Farmer enters into a finance agreement that includes any of the following features:

- split loan features of the type described in Taxation Ruling TR 98/22;
- entities associated with the Project, other than RCFPL, are, or become, involved in provision of the finance;
- indemnity agreements, or equivalent collateral arrangements limiting the borrower’s risk;
- non-arms length terms and conditions;
- ‘additional benefits’, for the purposes of section 82KL are granted to the borrower, or the funding arrangement transforms the Project into a ‘scheme’ to which Part IVA may be applied;
- repayments of principal and payments of interest are limited to income derived from the Project;
- funds borrowed, in whole or in part, are not available for the conduct of the Project, but are transferred (by any means, and directly, or indirectly) back to the lender, or any associate; or

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

39. RCFPL will, if a loan option is taken, advance funds of \$8,000 on the Settlement Date, \$2,500 on the first and second anniversary of the Settlement Date, \$1,500 on the third anniversary of the Settlement Date and \$1,100 on the fourth anniversary of the Settlement Date, for each Joint Venture interest. Security is to be enforced over the Farmer's interest in the Project. An interest rate of 8.5% will be charged, payable yearly in advance for each Joint Venture interest.

40. The loan principal will be repayable by ten (10) annual repayments of \$1,560 from the net income of a Farmer's interest in the Joint Venture, commencing on 30 June in Year 5 of the Project until the loan is repaid. If net income is insufficient then the repayments will be met from the Farmers' own funds. The finance is provided as full recourse loans and the Lender will pursue legal action against borrowers to recover any outstanding obligations.

Ruling

GST

41. For a Farmer who invests in this Project, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Farmer is entitled or, in the case of section 27-5, a decreasing adjustment that a Farmer has.

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

Section 35-55 – Commissioner's discretion

41.1 For a Grower who is an individual and who entered the Project on or after 8 March 2000 and prior to any withdrawal of this Product Ruling the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income year ended 30 June 2001 (for Growers participating under the 'with finance option') or for the years ended 30 June 2001 to 30 June 2002 (for Growers participating under the 'without finance option') that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be carried on in a manner that is not materially different to the arrangement described in this Ruling.

41.2 This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies.

41.3 Where, either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

41.4 Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from such a perspective has not been made.

Allowable deductions

42. The Project will be a 'partnership' for the purposes of the definition of this term in section 995-1 of the ITAA 1997. The net income or loss of this partnership is calculated by deducting all its allowable deductions for a year of income from all its assessable income (section 90, ITAA 1936). However, no joint liability arises in respect of this partnership, in relation to expenditure on management fees, lease rental, horticultural plant establishment, trellising, landcare and irrigation work. The following tables set out the deductions for a Farmer, depending on whether or not they are a 'small business taxpayer'.

43. IMPORTANT: Paragraph 44 (relating to 'small business taxpayers') and paragraphs 45, 46 and 47 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Farmers are advised to carefully examine the information contained in paragraphs 51, 52 and 53 relating to proposed changes to the prepayment rules. Farmers who invest in the Project after 1pm, AEST, 11 November 1999 may be affected by these changes.

44. For a Farmer who is a 'small business taxpayer' and invests in the Project before 30 June 2000, the deductions shown in the Table

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below will be available for the years ended 30 June 2000 to 30 June 2002.

Fee type	ITAA 1997 section	Deductions for small business taxpayers only		
		Year 0	Year 1	Year 2
Management fee	8-1	\$10,760 see Note (i) below	\$5,000	\$5,000
Lease Rent Contribution Fee	8-1	\$548	\$309	\$318
Trellising	42-15	see Note (ii) below	\$131	\$197
Landcare	387-55	\$316		
Irrigation	387-125	\$1,065 - see Note (iii) below	\$1,065	\$1,065
Horticultural Plant expenditure	387-165	see Note (iv) below		\$125
Interest on RCFPL loan	8-1	As incurred	As incurred	As incurred

Notes

- (i) Legislative change for Farmers who are not small business taxpayers mean the full deduction will not be allowed in 2000. See paragraphs 45-47 and Example 1. Proposed legislative change for all Farmers applying to expenditure incurred after 11 November 99 means the full deduction will not be allowed in 2000. See paragraphs 51 to 53 and Example 2.
- (ii) For Farmers who are 'small business taxpayers' and who comply with the conditions in section 42-345, the deduction for depreciation of trellising is determined using the rates in section 42-125 and the formula in either subsection 42-160(1), 'diminishing value method', or subsection 42-165(1), 'prime cost method'. For the year ended 30 June 2000 the deduction allowed

will depend upon the number of 'days owned', being the number of days in the income year in which the Farmer owned an interest in the trellising. The Project Manager is to advise Farmers of this for the year ended 30 June 2000. The deductions available for 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 Farmer has chosen under section 42-25.

- (iii) A deduction under section 387-125 for capital expenditure for the irrigation system is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third for each of the next 2 years of income.
- (iv) A deduction under section 387-165 for expenditure on acquiring and planting the vines is calculated on the basis of the grapevines, as horticultural plants, entering their first commercial season in the year ended 30 June 2002 and a Farmer determining, under section 387-175, that they have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years. This results in a write-off rate of 13%.

45. For a Farmer who invests in the Project before 30 June 2000 who is **not a 'small business taxpayer'** and is carrying on a business, the deduction available in respect of the Management Fee and Lease Rent Contribution Fee is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5). (Example 1 at paragraph 112 illustrates the application of this method).

46. In calculating the deductions available, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 whose 'eligible service period' ends not more than 13 months after it is incurred by the taxpayer. The 'eligible service period' (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

Year 1: Expenditure incurred before 30 June 2000

Available deduction = A + B

Where :

Number of days of eligible service

$$A = \text{Expenditure} \times \frac{\text{period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

B = (Expenditure *less* A) x 80%

Year 2: Expenditure is incurred after 1 July 2000 and before 30 June 2001

Available deduction = A + B + C

Where :

Number of days of eligible service

$$A = \text{Expenditure} \times \frac{\text{period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

B = (Expenditure *less* A) x 60%

C = balance of the Year 1 expenditure not previously deducted

Year 3: Expenditure incurred after 1 July 2001 and before 30 June 2002

Available deduction = A + B + C

Where :

Number of days of eligible service

$$A = \text{Expenditure} \times \frac{\text{period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

B = (Expenditure *less* A) x 40%

C = balance of the Year 2 expenditure not previously deducted.

47. For a Farmer who invests in the Project before 30 June 2000 who is **not a 'small business taxpayer'** and is carrying on a business, the deductions available in respect of capital expenditure are shown in the Table below:

Fee type	ITAA 1997 section	Deductions for capital expenditure for taxpayers who are not small business taxpayers and are carrying on a business		
		Year 0	Year 1	Year 2
				30/6/2001
Trellising	42-15	see Note (v) below		
Landcare	387-55	\$316		
Irrigation	387-125	\$1,065 - see Note (iii) above	\$1,065	\$1,065
Preplanting and planting of Vines	387-165	see Note (iv) above		

Notes

- (v) For Farmers who are not 'small business taxpayers' the deduction for depreciation of trellising is determined using the formula in either subsection 42-160(3), 'Diminishing value method', or subsection 42-165(2A), 'Prime cost method'. Those formulae use 'effective life' to determine the deduction for depreciation. For the year ended 30 June 2000 the deduction will depend upon the number of 'days owned', being the number of days in the income year in which the Farmer owned an interest in the trellising. The Project Manager is to advise any affected Farmers of relevant details of their depreciation deductions for the year ended 30 June 2000. The deduction for succeeding years has been calculated, for illustrative purposes, on the assumption that the effective life of the trellising is 21 years. (that is, the length in years of the project).

Interest on RCFPL loan

48. Interest incurred on loans arranged through RCFPL, of the kind described in paragraphs 37 to 40 and subject of the documents described in paragraph 14, is deductible (section 8-1).

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

49. For a Farmer who invests in the Project the following provisions have application as indicated:

- expenditure by Farmers who are small business taxpayers is not within the scope of section 82KZM (but see paragraphs 51, 52 and 53);
- section 82 KZMB applies to expenditure by Farmers who are not small business taxpayers and are carrying on a business but also see paragraphs 51, 52 and 53);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling

Section 92

50. Under section 92 of the ITAA 1936, each Partner for each year of income in which their partnership exists can either deduct their individual interest in any partnership loss of that Partnership, or must include in their assessable income their individual interest in any net income of that Partnership regardless of whether that share has been distributed to them or not.

Proposed new laws

Proposed changes to prepayment rules

51. On 11 November 1999 the Government announced a number of changes to the deductibility of certain prepaid expenditure incurred in respect of 'tax shelter arrangements'. Provided the proposed changes are enacted as announced, the Project will be a 'tax shelter arrangement' and all Farmers, including 'small business taxpayers', who invest in the Project after 1pm, AEST, 11 November 1999 will be subject to these changes.

52. For these Farmers the amount of deduction available in respect of the Management Fee and the Lease Rent Contribution Fee is calculated using the formula shown below (see also Example 2 at paragraph 113). In the calculation, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 ITAA 1997 whose 'eligible service period' ends not more than 13 months after it is incurred by the taxpayer. The 'eligible service period' (defined in

subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

		Number of days the prepayment
Deduction = Expenditure	X	<u>covers in the expenditure</u>
		Total number of days of the eligible service period

53. The excess remaining after the application of this formula is deductible in the year that the services to which the excess relates are performed.

Note to promoters and advisers

54. **Product rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Australian Taxation Office suggests that promoters and advisers ensure that potential investors are fully informed of the announcement requiring prepayments in respect of ‘tax shelter’ arrangements to be deductible over the period services are provided. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.**

Explanations

Sections 27-5 and 27-30 – Goods and Services Tax

55. Section 27-30 operates to deny a deduction, that would be otherwise available under section 8-1, for the year ended 30 June 2000 to the extent that the loss or outgoing (incurred after 30 November 1999 and before 1 July 2000) includes an amount relating to an input tax credit to which a Farmer will be entitled after 1 July 2000.

56. Section 27-5 of the ITAA 1997, operates to deny a deduction, that would be otherwise available under section 8-1, to the extent that the loss or outgoing incurred (after 1 July 2000) includes an amount relating to an input tax credit to which a Farmer is entitled or a decreasing adjustment that a Farmer has.

Subdivision 960-Q – Small business taxpayers

57. In this product ruling the term ‘small business taxpayer’ is relevant for the purposes of certain prepaid expenditure and depreciation of trellising.

58. Whether a Farmer is a 'small business taxpayer' depends upon the individual circumstances of each Farmer and is beyond the scope of this product ruling. It is the individual responsibility of each Farmer to determine whether or not they are within the definition of a 'small business taxpayer'.

59. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than \$1,000,000 or their turnover recalculated under section 960-350 of the ITAA 1997 is less than \$1,000,000.

60. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The 'group turnover' is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345 of the ITAA 1997).

Section 8-1: Management and Lease Rent Contribution Fees

61. Consideration of whether the prepaid management and lease rent contribution fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have 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 a taxpayer merely 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 the second limb applies.

Is the joint venture carrying on a business?

62. Vineyard activities can constitute the carrying on of a business. 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 or manufacture of wine at a profit, the gross proceeds from the sale of grapes will constitute gross 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 for sale or the manufacture of wine.

63. The Joint Venture is considered to be carrying on a business of growing grapes for sale and producing wine where:

- the Farmers have a collective interest in the production and gross income of the business;
- the vineyard activities are carried out on the Farmer's behalf; and
- the weight of the general indicators of a business, as developed by the Courts, point to them carrying on a business.

64. Under the Joint Venture Agreement, Farmers appoint AHML as Manager of the Joint Venture, to provide services such as planting, cultivating, tending, pruning, fertilising, spraying, maintaining and otherwise caring for the wine grape vines. The Joint Venture Agreement gives Farmers in common, full right, title and interest in the wine grape vines and their produce and the right to have the wine grapes and/or wine produced therefrom sold for the Joint Venture Farmers' benefit. The Joint Venture Agreement does not specify an actual allocation of product according to each Farmer's interest. **The Joint Venture arrangement constitutes a partnership for income tax purposes** (see definition of 'partnership', section 995-1, ITAA 1997).

General indicators of business

65. 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. The independent Viticultural Report in the Prospectus considers the Project is feasible and commercially viable. Farmers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to cash flow projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Farmers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

66. Farmers will engage the professional services of a Manager, which holds itself and/or its delegates out as having the appropriate credentials. 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.

67. Farmers have a continuing interest in the vines in common from the time they are acquired until the end 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.

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

Apportionment of fees

69. The activities the Manager is required to undertake are listed in the Joint Venture Agreement (see summary at paragraphs 28 to 32). Some of these activities are of a capital nature. The Manager's breakdown of subscription fees in the table at paragraph 34 outlines how the Farmer's subscription monies will be spent. These monies, which principally consist of a management fee, will be spent on items that are of a revenue nature, while other expenditure is more properly classified as capital.

70. Under the Management Agreement the management fee is an undissected lump sum in return for which the Farmer obtains services of both a revenue and capital nature. *Ronpibon Tin v. Federal Commissioner of Taxation* (1949) 78 CLR 47; (1949) 8 ATD 431 provides authority for the apportionment of the management fee in determining deductibility under section 8-1.

71. The joint judgment of the High Court in *Ronpibon Tin* stated that subsection 51(1) of the ITAA 1936 'contemplates apportionment' and 'there are at least two kinds of expenditure which require apportionment'. One of the described kinds of apportionable expenditure is a 'single outlay or charge which serves both objects indifferently', those objects being previously described as 'expenditure in respect of things or services of which distinct and severable parts are devoted to gaining or producing assessable income and distinct or severable parts to some other cause' (CLR, at 59; ATD, at 437). The management fee paid by the Farmer is an example of such an expenditure.

72. The management fee paid by the Farmer is for activities that are of a revenue and capital nature and, in accordance with paragraph 8-1(2)(a), the management fee is not an allowable deduction to the extent it is a loss or outgoing of capital or of a capital nature.

73. For the purpose of determining the extent to which the management fee is capital or capital in nature, the projected expenditure components of the management fee have been examined and characterised as either revenue (e.g., vine training and pruning, grape harvesting), capital (e.g., vine purchase costs, irrigation equipment), indirect expenses (fund raising expenses, income tax) or profit. The following formula has then been applied to determine the percentage that indirect costs and profit bear to direct revenue and capital expenses:

$$\frac{\text{Total projected overheads (indirect expenses) plus profit}}{\text{Total projected direct expenses}} \times \frac{100}{1}$$

74. The resulting percentage is a 'mark-up' figure that is applied to all direct revenue and capital costs. By applying the mark-up figure to all direct costs, all indirect costs and profits will be absorbed in the costs that more directly advantage the investor, ensuring that the entire sum of prepaid management fees are referable to one advantage or another.

75. The revenue component of the management fee after the mark-up is the relevant deduction for management fees under section 8-1. The Lease Rent Contribution Fees are fully deductible under section 8-1 and have been marked up accordingly. Expenditures that are acceptable as being incurred for the purposes of section 42-15 and Subdivisions 387-A, 387-B and 387-C, are increased to account for the mark-up percentage based on the calculations described above. The resulting deductible amounts are shown in the table at paragraph 44.

Section 82KZM - prepaid expenditure for small business taxpayers

76. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure incurred by a 'small business taxpayer' that would otherwise be immediately deductible, in full, under section 8-1. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

77. Under the Management Agreement the initial Management Fee will be incurred upon execution of the Agreement. This fee is charged for providing services to a Farmers only for the period of 13 months from the date of execution of the Agreement. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years. The fee is expressly stated to be for a number of specified services. There is evidence this

fee is for services to be provided within 13 months of the fee being incurred.

78. Thus, for the purposes of this Ruling, it is accepted that no part of the initial Management Fee is for the Manager to do 'things' that are not to be wholly done within 13 months of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure for the Management Fee by Farmers who are 'small business taxpayers'.

79. Similar considerations apply to the Lease Fee which, under the Lease Agreement, is payable on or before 31 May each year for a period from the 1 June of that year to 31 May of the following year. Again, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure for the Lease Fee by Farmers who are 'small business taxpayers'.

Sections 82KZMA - 82KZMD: prepaid expenditure for taxpayers other than small business taxpayers

80. For a Farmer who is not a 'small business taxpayer' and is carrying on a business sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the expenditure year). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

81. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Farmers investing in the Project transitional treatment applies to prepayments initially incurred in the 1999-2000 income year. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service period ends more than 13 months after the date the expenditure was incurred, and does not apply to the Project.

82. The deduction available to Farmers for the Management Fee and the Lease Fee will be determined in accordance with the rules contained in section 82KZMB. Because the quantum of both the Management Fee and the Lease Rent Contribution Fee is lower in the second and subsequent years, the capping provisions contained in section 82KZMC will have no practical effect on the deduction available.

83. During the transitional period the amount of the deduction available to Farmers is determined using the formula in subsection

82KZMB(3) and the percentages shown in the table in subsection 82KZMB(5).

Proposed changes to prepayment rules

84. The changes announced by the Government to apply from 11 November 1999 but not yet enacted will affect all taxpayers that participate in a 'tax shelter arrangement' and prepay expenditure for up to 13 months. It is proposed that deductions otherwise allowable under section 8-1 of the ITAA 1997 be spread over the period to which the prepayment relates. Under the proposed changes, there will be no exemption for small business taxpayers and no transitional rules will apply.

85. A tax shelter arrangement is described as existing where:

- under the arrangement, the taxpayer's allowable deductions exceed the assessable income for that year; and
- all significant aspects of the arrangement during the income year are conducted by people (e.g.; a manager) other than the taxpayer; and
- either:
 - more than one taxpayer participates in the arrangement; or
 - the manager, or an associate of the manager, also manages similar arrangements on behalf of others.

86. The arrangement relating to the Project and described at paragraphs 14 to 40 of this product ruling is within the description of a 'tax shelter arrangement'. Therefore, the Management Fee and the Lease Rent Contribution Fee incurred by Farmers who invest in the Project after 11 November 1999 will be deductible over the period the services are provided. The formula for this apportionment is expected to be the same as that currently shown in section 82KZMD(2).

Section 8-1: interest deductibility

87. Some Farmers intend to finance the investment through a loan facility with RCFPL. The interest incurred will be in respect of a loan to finance the establishment of the vineyard, and its development in the first three years of the Project. These fees will, thus, also have a sufficient connection with the gaining of assessable income in later years. No capital, private or domestic component is identifiable in respect of them.

Section 42-15: trellising expenditure

88. Farmers will incur expenditure on trellising on which the vines are grown, to be used on the Farmer's behalf in the operation of the vineyard business.

89. Trellising is plant for the purposes of section 42-18. Under section 42-15 taxpayers can claim a deduction for depreciation on an item of plant used for the purposes of producing assessable income where they are the owners or quasi-owners of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, and absolutely, owned by the owner of the land.

90. However, it is accepted in certain circumstances that lessees are entitled to claim depreciation where they are considered to be the owners of those improvements. Taxation Ruling IT 175 sets out the ATO's views on this issue. Where lessees are considered to own the improvements under a state law or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the lessee is entitled to claim depreciation for the fixture. A deduction for depreciation is allowable on plant from the date it is installed and ready for use.

91. Farmers accepted into the Project enter into a Joint Venture Agreement to occupy certain land upon which they are entitled to grow vines to conduct a business of a vineyard. Under the Joint Venture Agreement, the Farmer has a right to remove the trellising at the end of the Project. The Farmer's expenditure attributable to the acquisition and installation of trellising on the land has been identified as \$1516 per participation.

92. Under section 42-15 Farmers are entitled to depreciation deductions for expenditure relating to the acquisition and installation of trellises on the land. The deduction commences at the date on which the trellising is installed and begins to be used for the purpose of producing assessable income. The Manager has given an undertaking to the ATO to advise Farmers of the date of installation. The deduction available, however, will depend on whether or not the Farmer is a 'small business taxpayer' as defined in section 960-335 and, if so, whether the Farmer complies with the conditions contained in section 42-345.

93. The depreciation deduction available to Farmers that are 'small business taxpayers' and who comply with the conditions contained in section 42-345 is calculated using the cost of the trellising and a rate of 13% prime cost or 20% diminishing value. These accelerated rates of depreciation are shown in section 42-125 and apply to plant with an effective life of between 13 and 30 years.

94. Farmers who are not 'small business taxpayers' will have entered the Project after 11:45 am, AEST, 21 September 1999, and will not be able to claim accelerated depreciation on plant to be used in the Project because of section 42-118. The deduction for such Farmers is calculated using the cost of the trellising and its effective life only. Subdivision 42-C provides the choice of methods available for determining the effective life of plant.

Subdivision 387-A: landcare expenditure

95. Capital expenditure incurred by a person carrying on a primary production business in respect of various measures primarily and principally for the prevention of land degradation qualifies for a 100% deduction in the year in which the expenditure is incurred, under Subdivision 387-A. The expenditure that qualifies includes the eradication of animal and vegetable pests and other measures, including fencing, to prevent soil erosion, salinity, and preserve natural vegetation (section 387-60).

96. In order for the expenditure to qualify as a deduction under section 387-55, a business must be being carried on at the time the expenditure was incurred. Under subsection 387-75(3) these deductions are to be disregarded when working out the net income or partnership loss of the Partnership under section 90 of the ITAA 1936. Each Partner claims a deduction as agreed between them or an amount equal to their proportionate interest in the Partnership.

97. The relevant expenditure attributable to eligible landcare measures for the purposes of sections 387-55 and 387-60 has been identified as \$316.

Subdivision 387-B: irrigation expenditure

98. Section 387-125 allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed by this Project would be covered by Subdivision 387-B.

99. Under subsection 387-150(3) these deductions are to be disregarded when working out the net income or partnership loss of the Partnership under section 90 of the ITAA 1936. Each Partner claims a deduction as agreed between them or an amount equal to their proportionate interest in the Partnership.

100. The expenditure identified as applicable to the conserving or conveying of water for the vineyards that meets the requirements of section 387-130 amounts to \$3,195 per participation.

Subdivision 387-C: horticultural plant expenditure

101. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. Under subsection 387-170(3), the definition of 'horticulture' includes the cultivation of grape vines. For the purpose of this Subdivision, a lessee or licensee of land carrying on a business of horticulture is treated as owning the plants growing on that land rather than the actual owner of the land.

102. Horticultural establishment expenditure may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or the clearing of land. The Partnership's cost of vine establishment has been identified as \$965 per participation.

103. The rate of the write-off will be 13% per year on a prime cost basis, assuming the effective life of the vines is greater than 13 but less than 30 years (section 387-185).

104. The write-off commences from the date the vines are used or held ready for use for the purpose of producing assessable income in a horticultural business (sections 387-165 and 387-170). The Manager anticipates the vines will enter their first commercial season and, hence, begin to be used for the purpose of producing assessable income in a horticultural business in the year ended 30 June 2002. The Partnership's cost of vine establishment will be eligible for write-off deductions at a rate of 13% from this date.

105. The Manager has given an undertaking to the ATO to advise Farmers of the actual date of commencement of the first commercial season if it differs from that anticipated. In this case, the deduction specified at the tables at paragraph 44 and 47 will need to be recalculated based on the actual date on which the first commercial season commences.

Section 82KL: recouped expenditure

106. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the

‘expected tax saving’ in relation to that expenditure equals or exceeds the ‘eligible relevant expenditure’.

107. ‘Additional benefit’ (see the definition of ‘additional benefit’ at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit that is additional to the benefit for which the expenditure is ostensibly incurred. The ‘expected tax saving’ is essentially the tax saved if a deduction is allowed for the relevant expenditure.

108. Section 82KL’s operation depends, among other things, on the identification of a certain quantum of ‘additional benefits’. Here, there may be a loan provided to the Farmer. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient ‘additional benefits’ will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA: general tax avoidance provisions

109. 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).

110. The Coonawarra Wine-grape Project Investment will be a ‘scheme’. The Farmers will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 44 and 47, 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.

111. Farmers 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 grapes. There are no facts that would suggest that Farmers 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 with each other at arm’s length, or, if any parties are not arm’s length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Example 1: Obligation to prepay expenditure arising on or after 21 September 1999 and before 11 November– applies to taxpayers who are not small business taxpayers and are carrying on a business:

112. Joseph Gardener has extensive business interests and his turnover for the 1999/2000 income year exceeds \$1 million. Therefore, he is not a small business taxpayer and is subject to the 21 September 1999 changes to the tax laws relating to prepaid expenditure. Joseph enters into a contract with Pinetree Pty Ltd to manage his one hectare interest in the No 2 Pine Plantation. Joseph's management contract is executed on 20 October 1999 for management services to be provided from 1 June 2000. Under the contract, the first five year's management fees, payable 12 months in advance on 1 June each year, are \$6,000 in the first year and \$1,200 for each of the following four years.

Joseph is unable to deduct the whole of his prepaid management fees in the years in which they are incurred. The fees are instead deductible over the eligible service period over which the management services will be provided. However, as the law currently stands, Joseph is able to take advantage of certain transitional rules that 'shade-in' the effect of the changes to the prepayment laws.

For 1999/2000 Joseph can claim a deduction of \$4,771 for expenditure incurred before 30 June 2000 on management fees. This amount is A + B where:

$$A = \text{Management fee} \times \frac{\text{Number of days of eligible service}}{\text{Period in the expenditure year}}$$

$$A = \$6,000 \times \frac{30}{365} = \$493$$

$$B = (\text{Management fee less A}) \times 80\%$$

$$B = (\$6,000 - \$493) \times 80\% = \$4,406$$

The balance of the \$6,000 management fees that were prepaid on 1 June 2000 (i.e. \$1,229) is carried forward and can be claimed as a deduction in the 2000/2001-income year. For 2000/2001, Joseph can claim a deduction of \$1989 for expenditure incurred after 1 July 2000 and before 30 June 2001 on management fees. This amounts is calculated as A + B + C where:

$$A = \$1,200 \times \frac{30}{365} = \$99$$

365

$$B = (\$1,200 - \$99) \times 60\% = \$661$$

$$C = \$1,229$$

Note: that the third component (Part C) is the amount carried forward from 1999/2000. As in the first year, the balance of the \$1,200 management fees prepaid on 1 June 2001 (i.e., \$440) is carried forward and can be claimed as a deduction in the 2001/2002-income year. It should also be noted that in certain circumstances, not present in most projects with product rulings, 'capping provisions' will apply in the second and subsequent transitional years. These are complex and are not explained in this example.

Similarly, For 2001/2002, Joseph can claim a deduction of \$980 for expenditure incurred after 1 July 2001 and before 30 June 2002 on management fees. This amounts is calculated as $A + B + C$ where

$$A = \$1,200 \times \frac{30}{365} = \$99$$

365

$$B = (\$1,200 - \$99) \times 40\% = \$441$$

$$C = \$440$$

Note: that the third component (Part C) is again the amount carried forward from 2000/2001. As in the first two years, the balance of the \$1,200 management fees prepaid on 1 June 2002 (i.e., \$660) is carried forward and can be claimed as a deduction in the 2002/2003-income year.

Example 2: Obligation arising on or after 11 November 1999 to prepay expenditure – applies to all taxpayers investing in 'tax shelter arrangements':

113. Assume the same facts as above except that the management agreement is executed after 11 November 1999. Assume also that the No 2 Pine Plantation is a 'tax shelter arrangement'. For the Management fee of \$6,000 incurred on 1 June 2000 for management services to be provided between that date and 31 May 2001, Joseph can claim a deduction for the 1999/2000 income year determined in the following way:

	X	$\frac{\text{Number of days of eligible service period}}{\text{Total number of days of the eligible service period}}$
Management fee		$\frac{\text{in the expenditure year}}{\text{Total number of days of the eligible service period}}$
\$6,000		$\times \frac{30}{365} = \493

365

In the following year Joseph can claim the balance of the \$6,000 prepayment (i.e., \$5,507) because that is the year in which the services are to be provided. The second and third year's management fees are calculated using the same method.

Detailed contents list

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Related Rulings/Determinations:

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
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 42-15
- ITAA 1997 42-18
- ITAA 1997 42-25
- ITAA 1997 42-118
- ITAA 1997 42-125
- ITAA 1997 42-160
- ITAA 1997 42-165
- ITAA 1997 42-345
- ITAA 1997 Subdiv 387-A
- ITAA 1997 387-55
- ITAA 1997 387-60

Legislative references:

- ITAA 1936 51(1)
- ITAA 1936 82KH(1)
- ITAA 1936 82KH(1F)(b)
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- ITAA 1936 82 KZL
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- ITAA 1936 92
- ITAA 1936 Pt IVA
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- ITAA 1936 177C
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- ITAA 1997 Subdiv 387-C
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- ITAA 1997 387-185
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Case references:

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ATO references:

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