PR 2000/116 - Income tax: Watermark Vineyard Project

Product Ruling
Income tax: Watermark Vineyard Project

Contents Para

Potential investors may wish to refer to the ATO's Internet site at **http://www.ato.gov.au** or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

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.*

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 will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the 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 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 Watermark Vineyard Project, or simply as 'the Project'.

Tax law(s)

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

- Part 2-25 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 6-5 (ITAA 1997);
- section 8-1 (ITAA 1997);
- section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- section 45-15 (ITAA 1997);
- Subdivision 387-B (ITAA 1997);
- Subdivision 387-C (ITAA 1997);
- Division 35 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936'); and
- section 82KZME (ITAA 1936);
- section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

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

Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the Ralph *Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled

Class of persons

7. 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 'Growers'.

8. 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

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

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 23) 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.

Date of effect

12. This Ruling applies prospectively from 13 December 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).

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

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. 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

15. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- application for a product ruling for the Watermark Vineyard Project, dated 8 September 2000;
- **Constitution** of Watermark Vineyard Project, dated 4 August 2000;
- Prospectus for Watermark Vineyard Project dated 1 September 2000;
- draft **Management** Agreement between Advin Management Ltd (the 'Responsible Entity' or 'Manager') and the Grower (the 'Management Agreement');
- draft **Agreement to Underlease** between IOOF Australia Trustees Ltd and the Grower as lessee, (the 'Agreement to Underlease');
- draft **Memorandum of Underlease** between IOOF Australia Trustees Ltd and the Grower, (the 'Underlease');
- draft Agreement to Lease between Watermark Vineyard Ltd (Lessor) and IOOF Australia Trustees Limited (Lessee);
- draft Memorandum of Lease between Watermark Vineyard Ltd (Lessor) and IOOF Australia Trustees Limited (Lessee);
- draft Grape Supply Agreement between Advin Management Ltd and Simeon Wines Ltd;
- Grape Supply Agreement between Advin Management Ltd and Andrew Garret Vineyard Estates Pty Ltd, dated 4 August 2000;

- Profit and Cost Sharing Agreement between Advin Management Ltd and Vinescape Management Services Pty Ltd, dated 20 August 2000;
- Consultancy Agreement between Advin Management Ltd and International Vintners Pty Ltd, dated 4 August 2000;
- Sub-contract of Management Services between Advin Management Ltd and Vinescape Management Services Pty Ltd, dated 4 August 2000;
- Water Supply Agreement between Alexandrina Water Pty Ltd and Advin Management Ltd, dated 4 August 2000;
- Administration Agreement between Advin Management Ltd and City Corporate Centre Pty Ltd, dated 4 August 2000;
- Watermark Vineyard Project Compliance Plan, dated 4 August 2000;
- Draft Balance Vineyard Lots Agreement between Watermark Vineyard Ltd and IOOF Australia Trustees Ltd and Vinescape Management Services Pty Ltd;
- Draft Option Agreements between Langhorne No. 1 Pty Ltd and Watermark Vineyard Ltd for Sections 341, 342 and 333;
- Draft Option Agreement between Mickies Lane Vineyard Pty Ltd and Watermark Vineyard Ltd for Lot 9;
- Draft Contract for Sale and Purchase of Land between Mickies Lane Vineyard Pty Ltd and Watermark Vineyard Ltd;
- Draft Blocks Agreement between Watermark Vineyard Limited and IOOF Australia Trustees Ltd and Advin Management Limited and Vinescape Management Services Pty Ltd;
- Draft Supplementary Prospectus to be dated 30 November 2000, and covering letter received on 27 November 2000;
- Correspondence on behalf of the applicant, dated 13 November 2000, 17 November 2000, and 23 November 2000 containing, among other things, draft

changes proposed for the Management Agreement and Agreement to Underlease; and

- Additional information provided by the applicant upon request.

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

16. The documents highlighted above are those that the Growers 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 Grower, or any associate of the Grower, will be a party to.

Overview

17. This arrangement is called the 'Watermark Vineyard Project'.

Location	Langhorne Creek, approximately 90 kilometres south east of Adelaide in South Australia
Type of business each participant is carrying on	Preparing, planting and growing vines and the growing, cultivating and harvesting of grapes on designated 0.2 hectare lots
Number of hectares to be put under cultivation	up to 280 hectares
Size of the Vineyard Lots	0.2 hectares
Average number of vines per hectare	2,100
Expected production	First harvest expected in the year ended 30 June 2004. Expected fruit yield starts at 7.5 and increases up to 17.5 tonnes/hectare
The term of investment in years	Approximately 20 years
Subscription amount per Vineyard Lot	10,374 in the first year
Initial share subscription, per Vineyard Lot	1,450 ordinary $1 shares in Watermark Vineyard Limited

18. This Project is to carry out a large scale planting of vines, for the production of grapes for a period of approximately 20 years.

19. Growers contract on the terms set out in the Management Agreement for the Manager to plant a 0.2 hectare vineyard on a specific allotment ("Vineyard Lot"), cultivate and manage the Vineyard Lot and harvest and sell grapes produced therefrom.

20. The right to occupy the land will be set out in a registrable underlease between the Growers and the Custodian as agent for the Manager. Pending acquisition of the land by Watermark Vineyard Limited the Growers and Custodian will enter into an Agreement to Underlease.

21. The minimum individual holding is one Vineyard Lot, being an allotment of 0.2 hectares of land. For each Vineyard Lot subscription, the Grower or his nominee must also subscribe for 1,450 shares in the land owning company, Watermark Vineyard Limited, at $1 per share.

22. Interests and shares will not be issued until minimum subscription is reached. The minimum subscription is 25 Vineyard Lots and their corresponding parcels of shares, by 29 March 2001, or as the Manager may determine. The Manager may accept subscriptions over the proposed 1,400 Lots, which would be developed on suitable adjacent land.

23. Watermark Vineyard Ltd will own the relevant land. It has Agreements and options to purchase the land, which are conditional among other things on the level of subscription. It will lease the land to IOOF Australia Trustees Ltd, the Custodian, which will in turn underlease specific 0.2 hectare lots of the land to individual Growers.

Agreements to Lease and Underlease

24. The Manager will, through IOOF as Custodian and agent, enter into a lease with Watermark Vineyard Limited in relation to Block 10 described in Certificate of Title Register Book Volume 5107 folio 649. The Lease is for 20 years and 1 day.

25. IOOF will grant an underlease over specific 0.2 hectare Vineyard Lots of the land to the Growers. Under the terms of the Underlease Agreement the Grower may only use the land for the permitted use of establishment and operation of a vineyard in accordance with the Constitution and the Management Agreement.

26. Each Grower has an interest in the vines on its Vineyard Lot by virtue of the underlease, although the ownership of the vines remains with the landowner. The Grower has full rights over the grapes produced from the leased area. At the expiration of the term the Grower will peaceably surrender and yield up to the Lessor the leased area and any fixtures, in good repair and condition.

27. Growers are required to pay an annual rent. For the year ended 30 June 2001 the rent is payable on application, and for subsequent years, it is payable quarterly in advance. For Growers who join the Project on or after 1 July 2001, the rent payable on application will be an amount equal to the sum of the instalments which would have been payable if the Grower had joined before 1 July 2001.

Management Agreement

28. Under the Management Agreement the Grower appoints the Manager to establish, cultivate, develop, manage and maintain the Grower's Vineyard Lot(s) for the duration of the term of the Project. This includes preparing the land, purchasing and planting the vines, installing trellising and irrigation, pruning, stringing up and de-shooting the vines, pest and weed control, providing water and generally managing the Vineyard Lots. The Manager will also harvest and endeavour to sell the grapes on behalf of the Growers.

29. The Growers are required to make payments under the Agreement in respect of the services. In the first 3 years, the payments will be management fees only, and in later years there will be harvest fees, insurance premiums and possibly additional costs as outlined in the Agreement. The costs of the establishment of the vines, trellising and irrigation are included in the management fees.

30. The Manager will arrange relevant insurance for Growers. The Manager will pay the insurance premiums on the Growers' behalf until 29 June 2003 and at the Growers' expense thereafter.

Other undertakings given by the Manager

31. The Manager has given an undertaking that for Growers who join the Project on or before 8 June 2001 all services to be provided in respect of the 2000/01 Management fees will be provided by 30 June 2001. Growers who apply to invest in the Project after 8 June 2001 will have their applications held over until after 30 June 2001, as the Manager is unable to complete the required services in less than three weeks.

32. The Manager will also notify Growers as to the following information to enable Growers to calculate relevant tax deductions:

- the date of commencement of the vines' first commercial season; and
- the date that the trellising is installed ready for use by the Grower.

Fees

33. Under the terms of the Agreement to Underlease and Management Agreement, a Grower will be liable to pay the rent and management fees. The amounts payable per Vineyard Lot in the first 3 years of the Project can be summarised as follows:

Expenses	**Year ended 30 June 2001**	**Year ended 30 June 2002**	**Year ended 30 June 2003**
Management Fee	10,534.70	5,790.40	1,852.40
Rent	325.60	325.60	325.60
Totals	10,860.30	6,116.00	2178.00

34. These fees are payable in advance as follows:

- Growers who invest on or before 31 December 2000 will pay $8,924.30 of the Year 1 fees on application and the balance of $1,936.00 on or before 31 December 2000. Fees for Year 2 and onwards are payable quarterly in advance with one quarter of the annual fees due on each of 30 June, 30 September, 31 December and 31 March, each year.

- Growers who invest from 31 December 2000 to 8 June 2001 pay the whole of the 2000/01 fees on application, and their quarterly payments also commence on 30 June 2001.

- Growers who invest after 30 June 2001 will pay $12,389.30 on application which includes the first quarterly payment for the 2001/02 year. Quarterly payments then commence on 30 September 2001.

35. The share subscription of $1,450 is also payable on application.

36. The ongoing management fees for the year ended 30 June 2004 and onwards will be $1984.40 adjusted for CPI increase, as defined in the Constitution, or 2.5%, whichever is the greater. Similarly, the rent for the year ended 30 June 2004 and onwards is based on the previous year's rent adjusted for CPI increase, as defined in the Constitution, or 2.5%, whichever is the greater. From the year ending 30 June 2004 and onwards there will also be additional payments in respect of insurance premiums, a harvest fee of 5% of the gross proceeds of sale, and possibly payments for reimbursement of certain costs of the Manager as outlined in clause 16 of the Constitution.

Derivation of income

37. The first harvest from the Project is expected in the year ending 30 June 2004. The Manager has executed a Grape Supply Agreement with Andrew Garrett Vineyard Estates Pty Ltd and Simeon Wines Ltd.

38. Under the Management Agreement the Manager (and ultimately Vinescape Management Services, pursuant to the Subcontract of the Management Services Agreement) is entitled to retain any grapes produced prior to 1 January 2003.

39. After that time the proceeds of sale of grapes shall be paid into a Gross Proceeds Account to be divided between the Growers in accordance with the Constitution.

40. Under the Constitution, the Manager will instruct the Custodian to distribute the sale proceeds to Growers within one month after all sale proceeds from each harvest are received by the Manager providing the amount exceeds $50,000 or other amount nominated by the Manager in the manner set out in Clause 8.3 of the Constitution.

Finance

41. Growers are expected to either fund their investment in the Project themselves or borrow from an independent lender.

42. This Ruling does not apply if a Grower enters into a finance Agreement that includes any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral Agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;

- lenders do not have the capacity under the loan Agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved, in the provision of finance to Growers for the Project.

Ruling

Assessable Income

43. A Grower's share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

44. Where a Grower has unsold grapes on hand at the end of the income year, the value of the grapes will need to be accounted for in accordance with the trading stock provisions contained in Part 2-25 of ITAA 1997.

Minimum subscription

45. A Grower will not incur the fees shown in the Tables below before the minimum subscription is reached and the Grower's application to join the Project is accepted. Under the Prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 25 interests is achieved. Tax deductions are not allowable until these requirements are met.

Apportionment of the Management Fees

46. The Management fees to be paid by the Growers include payment for a number of items which are capital in nature. These amounts are not deductible under section 8-1 and accordingly an apportionment of the fees is required. The following table outlines the components of the Management fee which are capital in nature:

Description	Value attributable to the year ended		**Total**
	30 June 2001*	30 June 2002*	
Vine purchase and planting	1221		**1221**
Irrigation	2021		**2021**
Trellising	926	583	**1509**
Total	**4168**	**583**	**4751**

*for Growers who enter the Project after 8 June 2001, all of the amounts will be attributable to the year ended 30 June 2002

Section 8-1 – Prepaid fees

47. Expenditure incurred by a Grower who participates in the Project is subject to the prepayment rules contained in sections 82KZME and 82KZMF. The initial fees are incurred in the same year in which the services are provided so there is no prepayment in the initial year. This will be the case whether the Grower joins the Project in the 2000/01 or 2001/02 financial years. However, after the initial period, subsequent years' fees are payable quarterly in advance, so that the first quarter's fees will generally be payable on the last day of the previous financial year. These constitute prepayments, however, because the service period to which they relate falls entirely in the following year of income, the deduction will be wholly allowable in the year to which the payment relates, i.e., the following year.

48. Subsection 82KZMF(1) dictates the amount and timing of deductions allowable each year, which must be determined using the formula as follows:

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

Where 'eligible service period' means, generally, the period over which the services are to be provided.

49. In effect, because there are no days of eligible service period in the year in which the prepayment is incurred, the whole of the fee will be deductible in the following year, which is the year to which it relates. Refer also to examples at paragraphs 132 and 133.

Deductions where a Grower is not registered nor required to be registered for GST

50. A Grower may claim the tax deductions outlined in the Tables below where the Grower:

- participates in the Project to carry on the business of growing grapes;
- incurs the fees shown in paragraph 33; and
- is not registered nor required to be registered for GST.

If the Grower joins the Project on or before 8 June 2001:

Fee Type	ITAA 1997 Section	Year 2001 deductions	Year 2002 deductions	Year 2003 deductions
Management Fee	8-1	$6,366.70– See Note (i) (below)	$5,207.40 – See Note (i) (below)	$1,852.40– See Note (i) (below)
Rent	8-1	$325.60 – See Note (ii) (below)	$325.60 – See Note (ii) (below)	$325.60 – See Note (ii) (below)
Establishment of the vines	387-165	Nil	Nil	See note (iii) below
Irrigation	387-125	$674 - see note (iv) below	$674 - see note (iv) below	$673 - see note (iv) below
Trellising	42-15	To be calculated - See note (v) below	To be calculated - See note (v) below	To be calculated - See note (v) below

If the Grower joins the Project after 8 June 2001

Fee Type	ITAA 1997 Section	Year 2001 deductions	Year 2002 deductions	Year 2003 deductions
Management Fee	8-1	Nil	$11,574.10 – See Note (i) (below)	$1,852.40– See Note (i) (below)
Rent	8-1	Nil	$651.20 – See Note (ii) (below)	$325.60 – See Note (ii) (below)
Establishment of the vines	387-165	Nil	Nil	Nil - see note (iii) below
Irrigation	387-125	Nil	$674 - see note (iv) below	$674 - see note (iv) below
Trellising	42-15	Nil	To be calculated - See note (v) below	To be calculated - See note (v) below

Notes:

(i) Where a Grower incurs the management fees as required by the Management Agreement those fees are deductible in full in the year to which they relate. Refer to explanation at paragraphs 47 to 49.

(ii) Amounts of less than $1,000 constitute 'excluded expenditure' under the prepayment provisions. Excluded expenditure is an exception to the prepayment rules and as such is deductible in full in the year in which it is incurred. Therefore, if a Grower incurs a proportion of the yearly rent in advance, a deduction may be claimed for that amount in the year that it is incurred. However, if a Grower acquires several interests in the Project and the quantum of prepaid rent is $1000 or more, then the deduction will be subject to apportionment.

(iii) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the grapevines for use in a horticultural business. The Grower's cost of vine establishment has been identified as $1221 per Vineyard Lot. The deduction is allowable when the vines, as horticultural plants, enter their first commercial season. If the grapevines 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 rate of 13% prime cost. The Project's Manager will inform Growers of when the grapevines enter their first commercial season, which is expected to be in the year ended 30 June 2004.

(iv) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.

(v) A Grower's cost of trellising has been identified as $1,509 per Vineyard Lot, of which $926 will be expended before 30 June 2001 for Growers who join the Project on or prior to 8 June 2001. The tax deduction for depreciation of trellising will depend upon whether or not the Grower is a 'small business taxpayer' (see paragraphs 118 to 121 below). A Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, can claim a deduction for depreciation 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'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising and the extent to which the trellising is installed ready for use during the year. The Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Depending upon the method the Grower elects to use, the rate for calculating the tax deduction will be 13% prime cost method or 20% diminishing value method. Note: The depreciation deductions for 'small business taxpayers' discussed above apply until the introduction of the Simplified Tax System on 1 July 2001 (see paragraphs 86 to 88). For a Grower who is NOT a 'small business taxpayer' or who is a 'small business taxpayer' who does not satisfy the conditions in section 42-345, the tax deductions 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'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising and the extent to which each is installed ready for use during the year. The formulae use 'effective life' rather than rate to determine the deduction for depreciation. The Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the initial year. A Grower who is NOT a 'small business taxpayer' has the option of allocating the trellising to a 'low value pool' and calculating the depreciation deduction under section 42-470 using the diminishing value method (see paragraphs 95 to 98 below).

Deductions where a Grower is registered or is required to be registered for GST

51. Where a Grower who is registered or is required to be registered for GST:

- participates in the Project to carry on the business of growing grapes;
- incurs the fees shown in paragraph 33; and
- is entitled to an input tax credit for the fees

then the tax deductions shown in the Tables above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 131.

Section 35-55 – Losses from non-commercial business activities

52. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001 or 30 June 2002 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 will decide for the income years ending 30 June 2001 to 30 June 2005 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

53. 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 (see paragraph 110 in the Explanations part of this Ruling, below).

54. 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.

Section 82KL

55. Section 82KL does not apply to deny the deductions otherwise allowable.

Part IVA

56. The relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained by any Grower under a tax law dealt with in this Ruling.

Cost of shares

57. Under section 8-1 of the ITAA 1997 no deduction is allowable to a Grower for the acquisition cost of the shares in Watermark Vineyard Limited. The cost is a capital outgoing and is excluded from deductibility by subsection 8-1(2).

Explanations

Section 8-1 ITAA 1997

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

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoing is not deductible under the second limb if it is 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. However, that does not preclude the application of the first limb in determining whether the outgoing in question would have a sufficient connection with activities to produce assessable income.

59. 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 provisions of section 8-1, provided it is not a loss of capital or expenditure of a capital, domestic or private nature. A business includes a primary production business, which is defined under sub-section 995-1(1) to include a business of propagating and cultivating plants. Where there is a business or future business of growing grapes for sale at a profit, the gross sale proceeds for the sales of the 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 planting, tending, and maintaining of grapevines and the harvesting of the grapes.

60. Under the Management Agreement, a Grower engages the Manager to grow and harvest grapes from the Grower's Vineyard Lot. The Manager may pool the grapes produced by the Project and use its reasonable endeavours to sell them. Under this Agreement, the Growers consent to the proceeds from such sales being paid into the Gross Proceeds Account to be divided between the Growers in accordance with the Constitution. The purpose for which the

Manager, on behalf of the Growers, utilises the grapes will be a determining factor as to whether the amounts incurred an any management fee will be allowable deductions.

61. This Ruling applies only to those Growers engaging the Manager to provide management services, including the harvesting and selling of the grapes, according to the terms of the Management Agreement.

Is the Grower carrying on a business?

62. Generally, a Grower will be carrying on a business of a grape grower where:

- the Grower has an identifiable interest in specific growing vines coupled with a right to harvest and sell the grapes produced;
- the viticulture activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business, as used by the Courts, point to the carrying on of a business.

63. Under the Agreement to Underlease, Growers have rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of a commercial grape grower. Under the Management Agreement, Growers appoint the Manager to grow and harvest the grapes from the Growers' Vineyard Lot. The Agreement gives Growers full right, title and interest in the grapes produced on their Vineyard Lot.

64. Under the Management Agreement, Growers appoint the Manager to provide services such as planting, tending, pruning, training, fertilising, replanting, spraying, maintaining and otherwise caring for the grapevines. The Manager will provide the services by engaging such contractors as are necessary including:

- Obtaining and planting healthy grapevine rootlings;
- Install irrigation equipment; and
- Spacing and trellising each grapevine rootling so that it may be harvested commercially.

65. The Manager is also responsible for the harvesting, marketing, and sale of the produce from the grapevines.

66. The Agreement to Lease provides the Growers with rights to use land to establish a vineyard. In addition the Growers have a legal interest in the land by virtue of the Underlease.

67. Growers have the right to use the land in question for horticultural purposes and to have the Manager come onto the land to carry out its obligations under the Underlease and Management Agreements. The Growers' degree of control over the Manager, as evidenced by the Agreements is sufficient. Under the Project, Growers are entitled to receive a yearly account for the proceeds of the sale of grapes, as well as regular reports of the activities. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default, neglect or non-performance.

General indicators of a business

68. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11 and TR 2000/8. Positive findings can be made from the arrangement's description for all the indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, that is, a 'profit' in cash terms that does not depend on its calculation, on the fees in question being allowed as a deduction.

69. Growers are engaging a Manager with the appropriate credentials. Each Grower will have a specific interest in an identifiable area denoted by Vineyard Lot number. The services rendered by the Manager are in line with accepted viticultural ventures that would commonly be said to be businesses.

70. Growers have a continuing interest in the vines designated on their Vineyard Lot from the time they are planted until the termination of the Underlease Agreement following the harvest of the grapes in autumn of 30 June 2020. The viticultural activities, and hence the fees associated with their procurement, are consistent with the commencement of regular activities that are permanent. The Growers viticultural activities will constitute the carrying on of a business.

71. The fees payable under the Management Agreement and Underlease will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which the income from the sale of the grapes is to be gained. They will be deductible under paragraph 8-1(1)(a). Further, no non-income producing purpose in incurring the fee is identifiable from the arrangement. The exclusions in subsection 8-1(2) do not apply except for the expenses relating to capital which are separately identified below.

Prepayment provisions: sections 82KZME – 82KZMF

72. The prepayment provisions of the ITAA operate to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1 of the ITAA 1997. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

73. Expenditure prepaid by Growers for management fees and rent meets the requirements of subsections 82KZME(1) and (2) and the expenditures are incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies to the expenditures, the amount and timing of tax deductions for those expenditures are determined under section 82KZMF.

74. In relation to the requirements of subsection 82KZME(1) and (2), the prepaid management and lease fees incurred by a Grower who participates in the Project:

- are otherwise deductible under section 8-1;
- have 'eligible service periods' (for each of the fees) that end not more than 13 months after the Grower incurs the expenditure; and
- are incurred in return for the doing of a thing under the agreement that is not wholly to be done within the expenditure year.

The 'eligible service period' (defined in subsections 82KZL(1)) means, generally, the period over which the services are to be provided.

75. In relation to an 'agreement' referred to in subsection 82KZME(3), the Project is an 'agreement' (this being a broad concept under subsection 82KZME(4)), where, during the term of this Product Ruling:

- the Grower's allowable deductions attributable to the Project for each expenditure year exceeds the Grower's assessable income from the Project (if any) for the expenditure year;
- the Grower does not have day-to-day control over the operation of the Project; and
- there is more than one Grower participating in the Project.

76. The prepaid management fees incurred by Growers do not fall within any of the 5 exceptions to section 82KZME and therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF overrides section 8-1 and apportions the management fees over the period that the services for which the prepayment is made are performed.

77. The prepaid rent, being amounts of less than $1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is not subject to section 82KZMF and is, therefore, deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of prepaid lease fees is $1,000 or more, then the deduction allowable for those amounts will also be subject to apportionment under section 82KZMF.

Prepayments where the eligible service period exceeds 13 months

78. Although not required under the arrangement, some Growers may choose to prepay some or all of their fees for periods longer than the agreements require. Specifically, this will occur when the 'eligible service period' relating to the prepaid amount ends more than 13 months after the Grower incurs the expenditure. Where the 'eligible service period' exceeds 13 months sections 82KZME and 82KZMF will not apply, as the requirement of paragraph 82KZME(1)(b) is not met.

79. Instead, for a Grower who is a 'small business taxpayer' (see paragraphs 118 to 121) subsection 82KZM(1) applies to apportion the expenditure and determine the amount and timing of the deductions. Alternatively, for a Grower who is not a 'small business taxpayer' subsection 82KZMD(2) applies to apportion the expenditure and determine the amount and timing of the deductions.

80. Both of these provisions, although slightly different in form, apportion deductible expenditure over the 'eligible service period' in the same way as the formula contained in paragraph 48 (above). However, expenditure, which is 'excluded expenditure', is an exception to both provisions (subparagraph 82KZM(1)(b)(ii) and subsection 82KZMA(4) respectively). A tax deduction for 'excluded expenditure' can be claimed in full in the year in which the expenditure is incurred.

Expenditure of a capital nature

81. Any part of the expenditure of a Grower entering into a horticultural business attributable to acquiring an asset or advantage of

an enduring kind, is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, the cost of establishing the vines and the costs of irrigation and trellising are considered to be capital in nature. The fees for these expenses are not deductible under section 8-1. However, this expenditure falls for consideration under the specific capital write-off provisions of the ITAA 1997.

Section 42-15: trellising expenditure

82. Growers entering into the Project incur expenditure on trellising upon which the vines are attached and are to be used on their behalf in the operation of the business. This is attached to the land as a fixture. This expenditure is of a capital nature.

83. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose or purposes of producing assessable income where they are the owner 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, absolutely owned by the owner of the land.

84. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. Income Tax Ruling IT 175 sets out the Australian Taxation Office's (ATO's) views on this issue. Where a lessee 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, the ATO accepts the lessee is entitled to claim depreciation for the fixture. Under the Underlease Agreement Growers are entitled to remove their trellising at or prior to the expiration of the lease.

85. Accordingly, Growers are entitled to depreciation deductions for expenditure relating to the acquisition and installation of trellises on the land. The timing of the deduction, however, will depend upon the date the investment is made, when the plant is installed ready for use and whether or not a Grower is a 'small business taxpayer' (see paragraphs 118 to 121).

86. For plant acquired or constructed after 11.45am by legal time in the Australian Capital Territory on 21 September 1999, accelerated rates of depreciation are no longer available except to some 'small business taxpayers'. The Government has announced that 'small business taxpayers' who meet the conditions in section 42-345 will have access to accelerated rates of depreciation until the introduction of the proposed Simplified Tax System on 1 July 2001.

87. The immediate deduction for items of plant costing $300 or less has been removed from 1 July 2000, except for 'small business

taxpayers'. The Government has announced that 'small business taxpayers' will be able to claim the immediate deduction until the introduction of the proposed Simplified Tax System.

88. The depreciation of trellising as explained in this Product Ruling is based on existing legislation and may be subject to change.

Depreciation deductions for Growers who are 'small business taxpayers'

89. The depreciation deduction available to a Grower who is a 'small business taxpayer' and who complies with the conditions contained in section 42-345 is calculated using the formula in either subsection 42-160(1) or subsection 42-165(1). The depreciation deduction depends on the cost of the trellising and the number of days the trellising was owned by the Grower during the income year. It also depends on the extent to which the trellising is installed ready for use during the year.

90. The deduction is calculated using 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. The Project Manager will advise Growers of the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

Depreciation deductions for Growers who are not 'small business taxpayers'

91. A Grower who is NOT a 'small business taxpayer' or is a 'small business taxpayer' who does not satisfy the conditions in section 42-345 will not be able to claim accelerated depreciation on plant used in the Project because of section 42-118. The depreciation deduction for trellising for such a Grower is calculated using the formula in either subsection 42-160(3) or subsection 42-165(2A).

92. The deduction depends on the cost of the plant, the number of days the plant was owned by the Grower during the income year and the 'effective life' of the plant. It also depends upon the extent to which the plant is installed ready for use during the year. The Project Manager will advise Growers of the date that the trellising are installed and begin to be used for the purpose of producing assessable income.

93. Subdivision 42-C provides the choice of methods for determining the 'effective life' of plant. Growers can either self-assess the effective life of plant or use the effective life specified by the Commissioner. In the schedule, the Commissioner has determined that the effective life of trellising is 20 years.

94. The Responsible Entity will advise Growers of the date the trellising is installed and ready to be used for the purpose of producing assessable income. Costs of acquisition and installation of trellises on the land will be eligible for depreciation deduction by the Growers, from that date.

Low value pool option

95. From 1 July 2000 the immediate 100% depreciation deduction for plant costing $300 or less has been replaced by a 'low value pool' arrangement for all taxpayers except 'small business taxpayers'.

96. Under subsection 42-455(1), a Grower who is not a 'small business taxpayer' can choose to allocate 'low cost plant' to a 'low value pool' in the year of acquisition. 'Low cost plant' is plant costing less than $1,000. Once the choice is made to allocate 'low cost plant' to the pool, <u>all</u> 'low cost plant' acquired in that income year and subsequent income years must be included in the pool (subsection 42-460(1)).

97. A 'low value pool' is depreciated using a diminishing value rate of 37.5%. However, low cost plant is depreciated at 18.75% in the year it is allocated to the pool, irrespective of the date it is allocated. The value of plant included in or disposed of from such a pool will be added to or subtracted from the value of the pool.

98. Where a Grower acquires more than one interest in the Project the cost of the trellising could exceed $1,000 and, therefore, the trellising may not qualify as 'low cost plant'. However, provided the Grower uses the diminishing value method to depreciate the trellising, the plant can be allocated to a 'low value pool' after it has been depreciated below $1,000 (paragraph 42-455(3)(b)).

Subdivision 387-B: irrigation expenditure

99. Subdivision 387-B 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 would be covered by this Subdivision.

100. The taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or licensee who is conducting a primary production business on land in Australia. Accordingly, a deduction would be available to the Growers for the cost of the irrigation system, with one third of the expenditure being

allowable in the year that it is incurred and one third in each of the next two years of income (subsection 387-125(2) ITAA 1997).

101. However, a deduction under section 387-125 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Grower can only choose a water facility tax offset where:

- had the Grower chosen a deduction instead of the tax offset, the Grower's taxable income for the income year would have been $20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Subdivision 387-C: horticultural expenditure

102. Subdivision 387-C allows capital expenditure on establishing horticultural plants for use in an horticulture business to be written off for tax purposes. For the purpose of this Subdivision, a lessee 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.

103. The write-off under Subdivision 387-C may commence on the first day of what is to be the vines' first commercial season. The Manager will advise the Growers of this event, which is expected to occur in 2003/04.

104. Establishment expenditure is limited to capital expenditure. The costs of establishing an horticultural plantation may include the costs of acquiring the plants or seeds, the cost of planting the plants or seeds and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or the initial clearing of the land.

105. Under this Subdivision, where the effective life of the plant is more than 3 years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period.

106. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the vines have an effective life in greater than 13 but less than 30 years. The write-off rate for horticultural plants with such an effective life is 13% (section 387-185).

Division 35 – Losses from non-commercial business activities

107. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law

partnership) from certain business activities will not be allowable in an income year unless:

- the 'Exception' in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

108. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

109. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

110. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than $40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

111. In broad terms, the objective tests require:

(a) at least $20,000 of assessable income in that year from the business activity (section 35-30);

(b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);

(c) at least $500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or

(d) at least $100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

112. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the

Project is unlikely to pass one of the objective tests until the income year ended 30 June 2006. Growers who acquire more than one interest in the Project may however, pass one of the tests in an earlier income year.

113. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

114. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) up to 30 June 2006.

115. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

- (i) the business activity has started to be carried on; and
- (ii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

116. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above, in the manner described in the Arrangement (see paragraphs 15 to 42), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

117. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the independent viticultural report from Scholefield Robinson Horticultural Service Pty Ltd, contained in the Prospectus;
- the binding Agreements with Andrew Garrett Vineyard Estates Pty Ltd and Simeon Wines Ltd to purchase the fruit produced in the vineyard; and
- other binding Agreements pertaining to the operation of the Project, provided with the application.

Small business taxpayers

118. In this Product Ruling the term 'small business taxpayer' is relevant for the purposes of certain prepaid expenditure and depreciation of trellising.

119. 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 is less than $1,000,000.

120. '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).

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

Interest deductibility

122. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

123. While the terms of any finance Agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those Agreements may require interest to be prepaid. Under the prepayment rules contained in sections 82KZME, 'Agreement' (defined in subsection 82KZME(4)) is a broad concept and will encompass activities such as a loan to finance participation in the Project and that loan is not described in the Arrangement or otherwise dealt with in the Product Ruling.

124. Therefore, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to determine any tax deduction using the formula in subsection 82KZMF(1). Where a prepayment is for a more than 13 months, any tax deduction must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same, or effectively the same as that shown above in paragraph 48 above.

Section 82KL

125. 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' and the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

126. '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.

127. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Insufficient 'additional benefits' will arise to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

128. For Part IVA to apply there must be a 'scheme' (section 177A of the ITAA 1936), a 'tax benefit' (section 177C), and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

129. The Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the tax deductions per leased area that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

130. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of the fruit from the vines. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at 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.

Examples

Example 1 – Entitlement to 'input tax credit'

131. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of $5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees however, is reduced by the amount of any 'input tax credit' to which she is entitled. The Project Manager provides Margaret with a 'tax invoice' showing its ABN and the 'price of the taxable supply' for management services as $5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

1/11 x $5,500 = $500

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is $5,000 ($5,500 *less* $500).

Example 2 – Prepaid expenditure and the apportionment of fees

132. Murray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are $5,000 in the first year and $1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

$$\text{Management fee} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

$$\$5{,}000 \times \frac{26}{365}$$

= **$356** (this is Murray's total tax deduction in 2001 for the Year 1 prepaid management fees of $5,000. It represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5{,}000 \times \frac{339}{365}$$

= **$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2002 income year).

$$\$1{,}200 \times \frac{26}{365}$$

= **$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2002 income year).

$4,643 + $85 = $4,728 (The sum of these two amounts is Murray's total tax deduction for management fees in 2002).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

Example 3 – Apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'

133. On 1 June 2001 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of $3,600 and first year lease fee of $500 on 15 June 2001.

Kevin, who is not registered nor required to be registered for GST calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

Management fee

Even though he paid the $3,600 in the 2001 income year, because there are no 'days of eligible service period' in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2001.

Lease fee

Because the $500 lease fee is less than $1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2001.

In the **2002 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\$3,600 \quad \text{X} \quad \frac{365}{365}$$

= **$3,600** (this represents the whole of the first year's management fee prepaid in the 2001 income year but not deductible until the 2002 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

Detailed contents list

134. Below is a detailed contents list for this Product Ruling:

Commissioner of Taxation
13 December 2000

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
PR 1999/95; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TR 98/22; TR 2000/8; IT 175; TD 93/34

Subject references:
- carrying on a business
- commencement of business
- primary production
- primary production expenses
- management fee expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance - schemes
- tax shelters

Legislative references:
- ITAA 1997 2-25
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(2)
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- 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)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Subdiv 42-C
- ITAA 1997 42-15
- ITAA 1997 42-118
- ITAA 1997 42-125
- ITAA 1997 42-160
- ITAA 1997 42-160(1)
- ITAA 1997 42-160(3)
- ITAA 1997 42-165
- ITAA 1997 42-165(1)
- ITAA 1997 42-165(2A)
- ITAA 1997 42-345
- ITAA 1997 42-455
- ITAA 1997 42-455(1)
- ITAA 1997 42-455(3)(b)
- ITAA 1997 42-460
- ITAA 1997 42-460(1)
- ITAA 1997 42-470
- ITAA 1997 45-15
- ITAA 1997 Subdiv 387-B
- ITAA 1997 Subdiv 387-C
- ITAA 1997 387-125
- ITAA 1997 387-125(2)
- ITAA 1997 387-165
- ITAA 1997 387-185
- ITAA 1997 388-55
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-350
- ITAA 1997 995
- ITAA 1997 995-1(1)

- ITAA 1997 Part 2-25
- ITAA 1936 82KH
- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZM(1)(b)(ii)
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(1)(b)
- ITAA 1936 82KZME(2) ITAA 1997 960-345
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1936 Part IVA

ATO references:
NO 2000/010789
BO
FOI number: I 1022327
ISSN: 1441-1172