PR 2000/117 - Income tax: Coal River Valley Premium Vineyard Project

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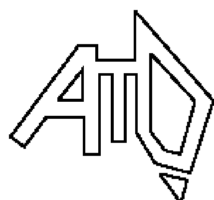

Australian Taxation Office

Product Ruling
Income tax: Coal River Valley Premium Vineyard Project

Contents Para

What this Product Ruling is about 1
Date of effect 12
Withdrawal 14
Arrangement 15
Ruling 37
Explanations 51
Example 124
Detailed contents list 125

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 Coal River Valley Premium Vineyard Project, or simply as 'the Project'.

Tax law(s)

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

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997')
- section 8-1 (ITAA 1997);
- section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 387-355 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZL (ITAA 1936);
- section 82KZM (ITAA 1936);
- sections 82KZMA to 82KZMD (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., remain 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. If the arrangement described in the Ruling is materially different from the arrangements that are actually carried out:

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- the Ruling will be withdrawn or modified.

11. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

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, this 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, 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

15. The arrangement that is the subject of this Ruling is described below. The capitalisation of a term indicates that the term is defined in the relevant document or agreement. This description incorporates the following documents:

- Product Ruling application dated 30 June 2000, received 6 July 2000;
- Prospectus for the Coal River Valley Premium Vineyard Project issued by the Responsible Entity, Coal River Valley Premium Vineyard Limited ('CRV'), dated 31 July 2000;
- Supplementary Prospectus for the Coal River Valley Premium Vineyard Project issued by CRV, dated 29 November 2000;
- **Final revised draft copy of Vineyard Management Agreement for the Coal River Valley Premium Vineyard Project between CRV ('Responsible Entity' and 'Manager') and the Grower, undated, received 5 December 2000;**
- **Draft copy of Constitution of the Coal River Valley Premium Vineyard Project between CRV and the Growers, undated, received 3 August 2000;**
- Agreement For Head Lease between Roslyn Estate Pty Ltd, CRV and Gordon Allen, dated 4 July 2000;
- Draft copy of Head Lease between Roslyn Estate Pty Ltd and CRV, undated, received 6 July 2000;
- **Final revised draft copy of Vineyard Lease between CRV and the Grower, undated, received 28 November 2000;**
- Draft copy of Compliance Plan for the Coal River Valley Premium Vineyard Project, undated, received 6 July 2000;
- Final revised draft copy of Principle Subcontractors Agreement between CRV and Coal River Valley Vineyard Management Services Pty Ltd, undated, received 13 November 2000;
- Vineyard Supervisors Agreement between the CRV and the Vineyard Supervisor, dated 4 July 2000;

- Draft copy of Custody Agreement between CRV and Sandhurst Trustees Ltd, undated, received 24 November 2000;
- Option Agreement For The Purchase of Real Property between the Vendor and Gordon Victor Allen, dated 30 September 2000:
- Option Agreement for Water Rights between the Grantor and Gordon Victor Allen, dated 19 January 2000:
- Facsimile and attachments to ATO from the applicant's representative, dated 24 August 2000;
- E-mail and attachments to ATO from the Solicitors to the Project, dated 29 August 2000;
- Letter and attachments to ATO from the applicant's representative, dated 1 September 2000;
- Facsimile and attachments to ATO from the applicant's representative, dated 4 September 2000;
- Facsimiles (2) and attachments to ATO from the applicant's representative, dated 16 November 2000;
- Facsimile and attachments to ATO from the applicant's representative, dated 27 November 2000;
- Facsimiles (2) and attachments to ATO from the applicant's representative, dated 28 November 2000;
- Facsimiles (2) and attachments to ATO from the applicant's representative, dated 29 November 2000;
- Facsimile and attachments to ATO from the applicant's representative, dated 5 December 2000.

Note: Certain information 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 are those the Growers enter into or become a party to. 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 party to, which are part of the arrangement to which this Ruling applies. The effect of these agreements is summarised as follows.

Overview

17. The arrangement is called the Coal River Valley Premium Vineyard Project.

Location	A 50 hectare site forming part of the property known as Roslyn near Campania in the Coal River Valley region in Tasmania
Type of business each participant is carrying on	Commercial growing of premium quality wine grapes and selling of the grapes and wine made from the grapes
Number of hectares under cultivation	The prospectus provides for 50 hectares to be planted.
Name used to describe the product	Coal River Valley Premium Vineyard Project
Size of each Vineyard Allotment	0.08 hectares
Number of vines per hectare	5,000
The term of the investment	Approximately 19 years – until 30 June 2019
Initial fees per Vineyard Allotment	$7,591.10
Ongoing annual Fees per Vineyard Allotment	For the Second and Third Financial Years, the rental fee payable is $116.60. For The Fourth Financial Year, the rental fee payable is $117.70. For the Fifth and subsequent Financial Years, the rental fee payable is the rental fee payable in the previous Financial Year increased by the greater of CPI or 4%. For the Second, Third and Fourth Financial Years, the management fee payable is $836. For the Fifth and subsequent Financial Years, the management fee payable is the total of instalments 1 & 2. Instalment 1 is the management fee payable in the previous Financial Year increased by the greater of CPI or 4%. Instalment 2 is any amount by which the Grower's proportion of Vineyard Operating Expenses incurred in the Financial Year exceeds the amount of Instalment 1.

	The Grower's Expenses notified to Growers by the Manager. The Grower's Proportion of Rates and Taxes and Service Charges in relation to the Vineyard land. Insurance.
Other costs	The Grower will pay an Incentive Fee equal to 20% of the amount by which the actual profit before tax for a financial year exceeds the projected profit before tax for that financial year as set out in pages 12 to 17 of the Prospectus.
Minimum subscription	200 Vineyard Allotments being 16 Hectares
Other Features	Applications for an Interest in the Project received between 1 April 2001 and 30 June 2001 will not be allocated with an interest until 1 July 2001.

18. In the prospectus dated July 2000 applications are invited to enter into the Project Agreements as part of the Coal River Valley Premium Vineyard Project. The offer made pursuant to the Prospectus and Supplementary Prospectus is conditional on the Manager receiving valid applications for 200 Vineyard Allotments by the end of 4 months after the date of the issue of the Supplementary Prospectus and the Head Lessor completing the purchase of the Project Land and the grant of the Head Lease in accordance with its obligations under the Agreement for Head Lease by the date on which minimum subscriptions are obtained ('Completion Date'). If these conditions are not met, the Manager will either withdraw this offer and return the Application Amount or extend the period of acceptance of offers and give written notice to the Applicant of the new date as extended and allow the Applicant one month in which to withdraw the Application by written notice to the Manager and request a refund of the Application Amount. This ruling does not apply unless the Project proceeds within these conditions.

19. Subject to the above requirements and availability, valid Applications received on or before 31 March 2001 will be allocated an Interest(s) in the Project. CRV, the Responsible Entity, can accept or refuse any Applications. Applications received between 1 April 2001 and 30 June 2001 will be dealt with in the following manner. Where an Application is received during this period, the Company will either return the Application and Application Amount to the Applicant or, provided all other conditions are met, issue an Interest to the Applicant on 1 July 2001 following the receipt of the Application.

20. Application for an Interest in the Project will be accepted up to 31 August 2001. No Applications will be accepted after this date.

21. The Custodian, Sandhurst Trustees, will hold all subscription monies until minimum subscription is reached. When minimum subscription is reached and the Vineyard Allotments are allocated to the applicants, the Custodian will distribute the subscription monies in accordance with the Custody Agreement and the Constitution. Applicants who are allocated interests in the Project are referred to as Growers and become parties to the Constitution.

22. Growers entering the arrangement will lease the land from the Responsible Entity pursuant to a Vineyard Lease. The Growers' Vineyard Allotment will form part of a larger area of land ('Project Land'). The Responsible Entity has in turn leased the Project Land from the Landowner under the Head Lease. Growers will also enter into a Management Agreement to have vines planted on their Vineyard Allotment for the purpose of providing grape harvests annually. The terms of the Project Agreements (i.e., the Vineyard Lease and Management Agreement) will allow returns for a period of approximately 16 years for Growers accepted into the Project in the year ended 30 June 2001 and approximately 15 years for Growers accepted into the Project in the year ended 30 June 2002, although it is not expected that returns will be generated until the fourth year.

23. Growers entering into the Project Agreements are required to make the following payment to the Manager per Vineyard Allotment:

- Vineyard Lease Rental - first Financial Year $116.60
- Management Fee - first Financial Year $7,474.50

TOTAL $7,591.10

24. Possible returns for a Grower accepted into the Project in the year ended 30 June 2001 are outlined on pages 14 to 17 of the Prospectus, with a forecasted IRR (pre-tax) of 14.6%. The projected returns are subject to risk and no assurance or guarantee is given for the returns.

Vineyard Lease Agreement and Management Agreement

25. Under the Vineyard Lease Agreement, each Grower enters into a Vineyard Lease in relation to each Vineyard Allotment of 0.08 hectares for a period of approximately 18 years for Growers accepted into the Project in the year ended 30 June 2001 and 17 years for Growers accepted into the Project in the year ended 30 June 2002. The period of the Grower's participation in the Project will be from the Commencement Date (being the date the Grower is accepted into the Project) and will terminate on 30 June 2019. In respect of each Vineyard Allotment, rental fees of $116.60 are payable in the First

Financial Year and form part of the Application Amount payable when a Grower makes an application pursuant to the Prospectus. For the Second to Third Financial Years, rental fees of $116.60 are payable at the beginning of each Financial Year. For the Fourth Financial Year, rental fees of $117.70 are payable at the beginning of the Financial Year. Subsequent rentals are increased by the Minimum Percentage Increase (being the greater of CPI or 4%) over the previous Financial Year's rental amount. The Manager expects that by the commencement of the 5th Financial Year of the Project Term, the return from the sale of the Crop will be sufficient to cover the annual Vineyard Lease Rental.

26. Growers will also enter into the Management Agreement with the Manager to establish the Vineyard Allotment and maintain that allotment. Management services will include and require the Manager to:

(i) attend to all works necessary to improve soil fertility and future crop yields, having regard to the soil types of the Vineyard Allotments;

(ii) attend to the construction and implementation of works necessary to control drainage and soil erosion;

(iii) select the variety of grapes to be planted and acquire rootlings on behalf of the Growers. The rootlings shall be the property of the Grower and the Manager shall ensure that they are adequately planted and maintained;

(iv) purchase and install an appropriate irrigation system in accordance with best viticultural practice for the Vineyard;

(v) supply and erect trellises in a good and workmanlike manner consistent with best viticultural practice;

(vi) prune the vines at least once per calendar year in accordance with best viticultural practice;

(vii) provide Vineyard Allotments with irrigation, fertilisation and nutrients in accordance with best viticultural practice;

(viii) use its best endeavours to minimise soil erosion and maintain quality in accordance with best viticultural practice;

(ix) use its best endeavours to maintain any buildings, sheds, fences, access roads on the Vineyard Allotment in accordance with the Lease;

(x) use its best endeavours to keep the Vineyard Allotments free from vermin, vegetation, insects and disease;

(xi) prepare accurate records of all fertilisers, nutrients and other chemicals applied to the Vineyard Allotments;

(xii) in the event that the Manager is unable to plant rootlings on the Grower's Vineyard Allotment prior to the agreed date, establish rootlings in a nursery and pay all fees in relation to their maintenance and storage; and

(xiii) do all other acts and things which the Grower may instruct or are necessary to manage and maintain the vines in conditions consistent with best viticultural practice.

27. For Growers who are allocated an interest(s) in the Project on or before 31 March 2001, the Vineyard Establishment Services will be completed on or before 30 April 2001. For Growers who are allocated an interest in the Project between 1 July 2001 and 31 August 2001, the Vineyard Establishment Services will be completed on or before 30 April 2002.

28. In respect of each Vineyard Allotment, management fees of $7,474.50 are payable in the First Financial Year and form part of the Application Amount payable when a Grower makes an application pursuant to the Prospectus. The Management Agreement indicates that an amount of $3,681.70 that forms part of the management fee in the First Financial Year is attributable to the acquisition of capital assets. For the Second to Fourth Financial Years, management fees of $836 are payable at the beginning of each Financial Year. For the Fifth and each subsequent Financial Year of the term, management fees are payable at the beginning of each Financial Year and are calculated on the Minimum Percentage Increase over the previous Financial Year's management fee ("first instalment"). However, an additional amount will be payable for that Financial Year ("second instalment") if the Grower's Proportion of the Vineyard Operating Expenses exceeds the first instalment. The second instalment, if any, is payable within 7 days of the Vineyard Operating Expenses Statement being given by the Manager.

Ownership and Transfer of Interests in the Project

29. The Growers can sell or transfer their Interest in the Project subject to the Constitution.

30. The Responsible Entity may be removed by an extraordinary resolution provided that the Growers also resolve to appoint a company to act as the new Responsible Entity of the Project.

31. The Grower will at all times during the term own all plant, equipment and other property which is acquired on its behalf for installation on the Vineyard Allotments (excluding anything used in connection with the Vineyard which is not a fixture and which belongs to the Manager or the Lessor) and the vines and the grapes.

Constitution

32. The Constitution is a deed constituting the Coal River Valley Premium Vineyard Project between CRV as the Responsible Entity and each Grower. Growers become bound by the Constitution on the acceptance by the Responsible Entity of the application.

Sale of the Crop

33. The Grower authorises the Manager to sell the grapes (the 'Crop') harvested from the Grower's Vineyard Allotment on the Grower's behalf. The Manager will sell half of the Crop on the 'spot' market at the prevailing market price and will engage contractors to process half of the Crop into wine which the Manager will sell to wholesalers at the highest price.

34. The Manager will pool the gross proceeds from the sale of the Crop. The Grower will be entitled to a pro-rata share of the proceeds of sale, calculated by dividing the proceeds of sale by the number of Vineyard Allotments held by all Growers.

Finance

35. Growers can fund their investment in the Project themselves, or borrow from an independent lender.

36. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL 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 payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; and
- entities associated with the Project, are involved, or become involved, in the provision of finance to Growers for the Project.

Ruling

Assessable Income

37. 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.

Minimum subscription

38. A Grower will not incur the fees shown in the Table(s) below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted (the date the investment is made). Under the prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 200 interests is achieved. Tax deductions are not allowable until these requirements are met.

Section 8-1

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

39. A Grower who is accepted into the Project on or before 31 March 2001 may claim tax deductions in the Table(s) below where the Grower:

- participates in the Project to carry on the business of growing grapes and the processing of grapes into bottled wine for sale;
- incurs the fees shown in paragraph 25 and 28; and

- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 30.06.2001	Year 2 30.06.2002	Year 3 30.06.2003
Management Fee	8-1	$3,792.80 – See Note (i) (below)	$836 – See Note (i) (below)	$836 – See Note (i) (below)
Lease Rental	8-1	$116.60 – See Note (i) (below)	$116.60 – See Note (i) (below)	$116.60 – See Note (i) (below)
Interest		See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)

Notes:

(i) Where a Grower incurs the management fees and the lease fees as required by the Management Agreement and the Lease Agreement, those fees are deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 107 to 114 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than $1,000, is an 'exception' to any prepayment rules that apply and is deductible in full in the year in which it is incurred.

(ii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraph 115 to 117 below as those rules may be applicable if interest is prepaid.

40. For a Grower who is accepted into the Project between 1 July 2001 and 31 August 2001, the deductions available to them for the year ended 30 June 2002 will be as detailed in paragraph 39 for Year 1, and for the year ended 30 June 2003 will be as detailed in paragraph 39 for Year 2, where the Grower:

- participates in the Project to carry on the business of growing grapes and the processing of grapes into bottled wine for sale;

- incurs the fees shown in paragraph 25 and 28; and
- is not registered nor required to be registered for GST.

Tax deductions for capital expenses

41. A Grower who is accepted into the Project on or before 31 March 2001 will also be entitled to the following tax deductions:

Fee type	ITAA 1997 section	Year 1 30.06.2001	Year 2 30.06.2002	Year 3 30.06.2003
Trellising	42-15	Must be calculated - See note (iii) below	Must be calculated - See note (iii) below	Must be calculated - See note (iii) below
Fencing & Netting	42-15	Must be calculated - See note (iii) below	Must be calculated - See note (iii) below	Must be calculated - See note (iii) below
Landcare operations	387-55	$308 - see notes (iv) and (vi) below		
Irrigation costs	387-125	$314.23 - see notes (v) and (vi) below	$314.23 - see notes (v) and (vi) below	$314.23 - see notes (v) and (vi) below
Establishment of horticultural plants	387-165	Nil - see note (vii) below	Nil	Nil
Power Infrastructure	387-355	$6.05 - see note (viii) below	$6.05 - see note (viii) below	$6.05 - see note (viii) below

Notes:

(iii) The tax deduction for depreciation of trellising, fencing and netting will depend upon whether or not the Grower is a 'small business taxpayer' (see paragraphs 70 to 72 below).

For a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the tax deduction for depreciation of trellising, fencing and netting 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'). 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, fencing and netting, and the extent to which each plant is installed ready for use during the year. For Growers accepted into the Project on or before 31 March 2001, the Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. For Growers accepted into the Project between 1 July 2001 and 31 August 2001, the Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2002. Depending upon the method the Grower elects to use, the rate for calculating the tax deduction for trellising will be 13% prime cost method or 20% diminishing value method. The rate for calculating the tax deduction for fencing will be 7% prime cost or 10% diminishing value. The rates for calculating the tax deduction for netting will depend upon the type of netting used. Growers will need to determine this from the Project manager.

Under section 42-167 a Grower who is a 'small business taxpayer' is also entitled to an immediate tax deduction for 100% of the cost of all plant the cost of which is $300 or less.

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 67 to 69).

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 trellising, fencing and netting 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, fencing and netting, 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. For Growers accepted into the Project on or before 31 March 2001, the Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. For Growers accepted into the Project

between 1 July 2001 and 31 August 2001, the Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2002. Note: This is only applicable to plant acquired after 21 September 1999 (see paragraphs 76 to 78).

A Grower who is NOT a 'small business taxpayer' has the option of allocating the trellising, fencing and netting to a 'low value pool' and calculating the depreciation deduction under section 42-470 using the diminishing value method (see paragraphs 79 to 83 below). Note: This choice is only available from 1 July 2000.

(iv) A deduction is allowable under section 387-55 for capital expenditure incurred for landcare operations. The deduction is allowed in the year that the expenditure is incurred.

(v) 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.

(vi) A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on landcare operations and/or facilities to conserve or convey water. This is an alternative to claiming deductions under sections 387-55 and 387-125.

(vii) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of grapevines for use in a horticultural business. The deduction is allowable when the grapevines, 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 fewer 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.

(viii) A deduction is allowable under section 387-355(2) for expenditure incurred in connecting power to land or upgrading such connections. A 10% deduction is

allowable in the year the expenditure is incurred and each of the next 9 years.

42. For a Grower who is accepted into the Project between 1 July 2001 and 31 August 2001, the deductions available to them for the year ended 30 June 2002 will be as detailed in paragraph 41 for Year 1, and for the year ended 30 June 2003 will be as detailed in paragraph 41 for Year 2.

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

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

- is accepted into the Project in either the year ended 30 June 2001 or the year ended 30 June 2002;
- to carry on the business of growing grapes and the processing of grapes into bottled wine for sale;
- incurs the fees shown in paragraph 25 and 28; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Table(s) above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 124.

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

44. For a Grower who is an individual and who is accepted into the Project during either the year ended 30 June 2001 or the year ended 30 June 2002, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project.

45. For a Grower who is an individual and is accepted into the Project during the year ended 30 June 2001, under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2004 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.

46. For a Grower who is an individual and is accepted into the Project during the year ended 30 June 2002, under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2002 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.

47. 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 98 in the Explanations part of this ruling, below).

48. 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.

49. 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 this perspective has not been made.

Sections 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF, 82KL and Part IVA

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

- expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 107 to 114);
- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 107 to 114);
- expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 107 to 114);
- section 82KL does not apply to deny the deductions otherwise allowable; and

- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 8-1

51. 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 outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer 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 has a sufficient connection with activities to produce assessable income.

Is the Grower carrying on a business?

52. A scheme comprising viticulture and the processing of grapes into bottled wine for sale can constitute the carrying on of a business. Where there is a business, or a future business, the Gross Sale Proceeds each year from grapes and bottled wine from vinelots comprising the Project will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the grapes and the processing of grapes into bottled wine each year from the vinelot. Generally, a Grower will be carrying on such a business where:

- the Grower has an identifiable interest in specific growing vines coupled with a right to harvest, process

and sell the grapes and the bottled wine produced each year from the vines;

- the above 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.

53. For this Project Growers have rights under the Lease Agreement in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing vines and the processing the grapes. Under the Management Agreement Growers engage the Project Managers to acquire vine seedlings, plant out the seedlings on the leased land, provide ongoing services to care and maintain the vines and to process the grapes into bottled wine for sale.

54. During the establishment period the Manager will provide the following services, by engaging contractors as are necessary to:

- prepare land ready for planting;
- obtain and plant healthy grape vine rootlings;
- install irrigation equipment; and
- space and trellis each grape vine rootling so that it may be harvested commercially.

55. The specific costs to the Grower of these services provided in the First Financial Year is $7,474.50 in management fees and $116.60 in lease rentals. In accordance with good viticultural practices, the Responsible Entity will see to pruning, vermin control, irrigation, fertilisation, and maintaining improvements and will otherwise maintain the Grower's vineyard lot in accordance with good viticultural practices. In return for these services the Responsible Entity will receive management fees, harvesting costs and reimbursement for vineyard operations from grape proceeds.

56. The Vineyard Lease and Management Agreements give Growers full right, title and interest in the grape harvest and the right to have the grapes and any bottled wine produced sold for their benefit.

57. Growers have the right to use the land in question in order to establish and maintain a vineyard and to subsequently harvest grapes for sale to the wine industry and to have the Project Manager come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are

entitled to receive regular progress reports on the Project Manager's activities. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect. The viticulture activities and the processing of grapes into bottled wine for sale described in the Management Agreement are carried out on the Growers' behalf. Growers are considered to have control of their operations.

58. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the 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 contained in the Prospectus that suggest the Project should return in the fifth year a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

59. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify which vines Growers have an interest in. These services are based on accepted practices of viticulture and the processing of grapes into bottled wine for sale and are of the type ordinarily found in such ventures that would commonly be said to be businesses.

60. Growers have a continuing interest in the vines from the time they are acquired until the cessation of the Project. The viticulture activities and the processing of grapes into bottled wine for sale, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' activities will constitute the carrying on of a business.

61. The lease fees and management fees associated with the viticulture activities and the processing of grapes into bottled wine for sale will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which income (from the regular sale of grapes and bottled wine) is to be gained from the business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Expenditure of a capital nature

62. Any part of the expenditure of a Grower entering into a viticultural business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature

and will not be an allowable deduction under section 8-1. The Project Management Agreement indicates that certain payments forming part of the management fee in respect of the First Financial Year are attributable to the acquisition of capital assets.

63. In this Project the amounts summarised in the Table below are considered to be capital in nature. However, some of this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

Project Landcare Works	$308
Road Construction	$44
Grapevines (including Grape Covers)	$484
Planting (including fertilisers)	$155.10
Trellising	$902
Fencing (Vermin)	$195.80
Building Infrastructure	$29.70
Irrigation	$942.70
Power Infrastructure	$60.50
Netting	$528
Wind breaks	$31.90
Total capital expenditure	**$3,681.70**

Section 42-15: depreciation of trellising, fencing and netting

64. Growers entering into the Project will incur in respect of each Vineyard Allotment an expense of $902 relating to the acquisition and installation of trellis, $195.80 in relation to fencing and $528 in relation to netting. 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 or quasi-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.

65. 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. Taxation Ruling IT 175 sets out the views of the Tax Office 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.

66. Under section 42-15, Growers in the Project are entitled to depreciation deductions for capital expenditure in relation to the acquisition and installation of trellises, fencing and netting on the land. The deduction available, 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 70 to 72).

67. 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.

68. 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.

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

Small business taxpayers

70. 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.

71. '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).

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

Depreciation deductions for Growers who are 'small business taxpayers'

73. The depreciation deduction for trellising, fencing and netting 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, fencing and netting and the number of days each plant was owned by the Grower during the income year. It also depends on the extent to which the plant is installed ready for use during the year.

74. The deduction for trellising is calculated using a rate of 13% prime cost or 20% diminishing value. The deduction for fencing is calculated using a rate of 7% prime cost or 10% 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 and 30 years or more, respectively. The rates used for the depreciation deduction for netting will depend upon the type of netting used. Growers will need to determine this from the Project manager. The Project manager will advise Growers of the date that the trellising, fencing and netting is installed and begins to be used for the purpose of producing assessable income.

75. However, under section 42-167, a Grower who acquires only one interest in the Project and who is a 'small business taxpayer' is entitled to a 100% depreciation deduction for expenditure on fencing, being items of plant with a cost of $300 or less.

Depreciation deductions for Growers who are not small business taxpayers

76. 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, fencing and netting for such a Grower is calculated using the formula in either subsection 42-160(3) or subsection 42-165(2A).

77. 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 trellising, fencing and netting are installed and begin to be used for the purpose of producing assessable income.

Determination of effective life

78. 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 the following effective lives: trellising - 20 years, fencing - 33 years, and, depending on the type of netting used, either 5 or 10 years.

Low value pool option

79. 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'

80. 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)).

81. 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.

82. Under the Management Agreement, for each interest acquired in the Project a Grower incurs expenditure of $902 for trellising, $195.80 for fencing and $528 for netting. A Grower, who is accepted into the Project on or before 31 March 2001, will first be entitled to claim a deduction for depreciation in the year ended 30 June 2001. A Grower who is accepted into the Project between 1 July 2001and 31 August 2001 will first be entitled to claim a deduction for depreciation in the year ended 30 June 2002. Therefore, a Grower who is not a 'small business taxpayer' will have the option of including trellising, fencing and netting in a 'low value pool'.

83. Where a Grower acquires more than one interest in the Project, the cost of the trellising, fencing or netting could exceed $1,000 and, therefore, the trellising, fencing and netting could not qualify as 'low cost plant. However, provided the Grower uses the diminishing value method to depreciate the trellising, fencing or netting, 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-A - Expenditure for landcare operations

84. The relevant expenditure attributable to eligible landcare measures in respect of each Vineyard Allotment totals $308. Section 387-55 allows a taxpayer a deduction for capital expenditure incurred on a landcare operation for land used to carry on a primary production business. Growers need not own the land to qualify for the deduction, so long as it is used by them to carry on a primary production business.

85. 'Landcare operation for land' includes an operation primarily and principally for the purposes of eradicating or exterminating from the land animals that are pests or eradicating, exterminating or destroying plant growth detrimental to the land or preventing or fighting land degradation. It also includes constructing surface or sub surface drainage works on the land if the construction is primarily and principally for the purpose of controlling salinity or assisting in drainage control.

86. Under the Management Agreement a Grower incurs expenditure to control drainage, soil erosion, degradation and salinity and to keep the Vineyard Allotments free from Vermin, Vegitation, insects and disease. A Grower in the Project is accepted as carrying on a business of primary production and these expenses will be deductible under section 387-55 in the year they are incurred.

87. However, a deduction under section 387-55 is denied where the Grower is entitled to claim a landcare tax offset under section 388-55 and chooses to do so. A Grower can only choose a landcare 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-B – Irrigation expenditure

88. The Responsible Entity, CRV, has identified that for each Vineyard Allotment the expenditure applicable to the conserving or conveying of water for the vineyards is $942.70. 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 would be covered by this Subdivision.

89. As 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, a deduction would be available to a Grower in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

90. 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 - Vines and horticultural provisions

91. The Responsible Entity, CRV, has identified that for each Vineyard Allotment the expenditure incurred in establishing horticultural plants is $639.10. Section 387-165 allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. A lessee or licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land (section 387-210).

92. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant, such as the grapevines in this Project, with an effective life of 13 to 30 years, that rate is 13%.

Subdivision 387-E – Expenditure on mains electricity connection

93. The Responsible Entity, CRV, has identified that for each Vineyard Allotment the expenditure applicable to connecting power to land is $60.50. Section 387-355 allows a deduction where capital expenditure is incurred in connecting power to land where the person incurring the expenditure has an interest in the land, is carrying on a business on the land and intends to use some or all of the electricity

supplied as a result of the expenditure on the business of the land for the purpose of producing assessable income.

94. The write-off commences in the income year in which the expenditure is incurred and continues over the next nine income years. A deduction of 10% is allowed in each year.

Division 35 - Losses from non-commercial business activities

95. 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.

96. 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.

97. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that the loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity, or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

98. 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.

99. 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).

100. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions.

101. Information provided with the application for this Product Ruling indicates that a Grower accepted into the Project in the year ended 30 June 2001 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 2005. A Grower accepted into the Project in the year ended 30 June 2002 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.

102. Therefore, prior to this time in each case, 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.

103. 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(s) 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) until the year ended 30 June 2004 (for a Grower accepted into the Project in the year ended 30 June 2001) or 30 June 2005 (for a Grower accepted into the Project in the year ended 30 June 2002).

104. 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.

105. 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 (see paragraph 44 to 46), in the manner described in the Arrangement (see paragraphs 15 to 36), 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.

106. 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 report of the independent agricultural expert included in the prospectus and additional evidence provided with the application by the Responsible Entity; and
- independent, objective, and generally available information relating to the viticulture industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD and 82KZME – 82KZMF

107. The prepayments 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. 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.

108. In this Project, the Management Fee of $7,47.50 and a Lease Fee of $116.60 per Vinelot will be incurred on execution of the Management Agreement and the Lease Agreement. The Management Fee and the Lease Fee are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreements. In particular, the Management Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Management Fee has been inflated to result in reduced fees being payable for subsequent years.

109. There is also no evidence that might suggest the management services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for

the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the agreements as set out in paragraph 25 and 28, then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

Growers who choose to pay fees for a period in excess of that required by the Project's agreements

110. Although not required under either the Management Agreement or the Lease Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 109 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

111. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Lease Fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means generally, the period over which the services are to be provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and, where the 'eligible service period' exceeds 13 months, whether the Grower is a 'small business taxpayer'.

112. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

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

In the formula, the 'eligible service period' means, generally, the period to which the services are to be provided.

113. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Grower is a 'small business taxpayer' or section 82KZMD if the Grower is not a 'small business taxpayer'. For a 'small business

taxpayer' (see paragraphs 70 to 72), the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same, or effectively the same, as that shown in paragraph 112 above, concerning section 82KZMF.

114. A prepaid management fee and/or a prepaid lease fee of less than $1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(7) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than $1,000 is 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 a prepaid management fee or a prepaid lease fee is $1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Interest deductibility

115. 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.

116. 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 includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

117. 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 use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. Where a prepayment is for more than 13 months, any tax deduction that may be allowable 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 112 above.

Section 82KL - recouped expenditure

118. 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'.

119. '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.

120. 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 Grower. 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

121. 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).

122. The Coal River Valley Premium Vineyard Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 39 to 43 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

123. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the grapes and the processing of grapes into bottled wine for sale. 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.

Example

Example 1 – Entitlement to 'input tax credit'

124. 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).

Detailed contents list

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

	Paragraph
What this Product Ruling is about	**1**
Tax law(s)	2
Goods and Services Tax	3
Business Tax Reform	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
Date of effect	**12**
Withdrawal	**14**
Arrangement	**15**
Overview	17

Vineyard Lease Agreement and Management Agreement 25
Ownership and Transfer of Interests in the Project 29
Constitution 32
Sale of the Crop 33
Finance 35
Ruling **37**
Assessable income 37
Minimum subscription 38
Section 8-1 39
Deductions where a Grower is not registered nor required to be registered for GST 39
Tax deductions for capital expenses 41
Deductions where a Grower is registered or is required to be registered for GST 43
Section 35-55 – Losses from non-commercial business activities 44
Sections 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF, 82KL and Part IVA 50
Explanations **51**
Section 8-1 51
Is the Grower carrying on a business? 52
Expenditure of a capital nature 62
Section 42-15: depreciation of trellising, fencing and netting 64
Small business taxpayers 70
Depreciation deductions for Growers who are 'small business taxpayers' 73
Depreciation deductions for Growers who are not 'small business taxpayers' 76
Determination of effective life 78
Low value pool option 79
Subdivision 387-A – Expenditure for landcare operations 84
Subdivision 387-B – Irrigation expenditure 88
Subdivision 387-C – Vines and horticulture provisions 91
Subdivision 387-E – Expenditure on mains electricity connection 93
Division 35 – Losses from non-commercial business activities 95
Prepayments provisions – section 82KZM, 82KZMA –

82KZMD and 82KZME – 82KZMF 107

Growers who choose to pay fees for a period in excess of that required by the Project's agreements 110

Interest deductibility 115

Section 82KL – recouped expenditure 118

Part IVA – general tax avoidance provisions 121

Example **124**

Example 1 – Entitlement to 'input tax credit' 124

Detailed contents list **125**

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

Subject references:
- carrying on a business
- commencement of a business
- interest expenses
- harvesting expenses
- management fees
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- tax benefits
- viticultural expenses

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- ITAA 1997 27-5
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- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
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- ITAA 1997 35-40
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- ITAA 1997 35-55(1)
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- ITAA 1997 42-15
- ITAA 1997 42-118
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