

# ***PR 2000/17 - Income tax: Saint Magnus Vineyard Project***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *26 March 2001*



## Product Ruling

### Income tax: Saint Magnus Vineyard Project

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#### *Preamble*

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Previous Rulings**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

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

### No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

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

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

Potential investors should be aware that the ATO 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 desired in those future years.

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.

## **Terms of Use of this Product Ruling**

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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**

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling the arrangement is sometimes referred to as the Saint Magnus Vineyard Project, or just 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 27-5 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KK (ITAA 1936);
- section 82KJ (ITAA 1936);
- Part IVA (ITAA 1936).

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

4. Although this Ruling mentions certain of those announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally

binding advice in respect of those changes cannot be given until the relevant laws(s) are enacted.

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

### **Class of persons**

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

7. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangements prior to its completion, or who otherwise do not intend to derive assessable income from it.

### **Qualifications**

8. If the arrangements described in the Ruling are 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 arrangements ruled upon; and
- the Ruling will be withdrawn or modified.

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### **Date of effect**

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10. This Ruling applies prospectively from 15 March 2000, the date this Ruling is made. However, the Ruling does not apply to

taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

11. 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**

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12. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangements during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangements prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangements or in the persons' involvement in the arrangements.

## **Arrangement**

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13. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, 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:

### **Property Trust**

- Product Ruling application dated 15 December 1999;
- Draft Prospectus for the St Magnus Vineyard Project;
- Agency Agreement – Custodian (for the Property Trust) between Blaxland Vineyards Limited ('BVL', 'the Manager' or 'the Responsible Entity') and Cardinal Financial Securities Limited (the 'Custodian');
- Property Trust Compliance Plan for the Responsible Entity;

- Property Trust Constitution, the parties to which are the Landowners (collectively) and BVL;

### **Project**

- Agency Agreement – Custodian (for the Vineyard Project) between BVL and the Custodian;
- **Vineyard Project Constitution**, the parties to which are the Growers (collectively) and BVL;
- Vineyard Project Compliance Plan for the Responsibility Entity;
- **Allotment Agreement** between the Custodian and each Grower;
- **Management Agreement** between BVL and each Grower;
- Contract for the Establishment and/or Maintenance of a Vineyard, the parties to which are BVL and Nepenthe Viticulture Pty Ltd;
- **Contract for the Sale and Purchase of Wine Grapes** between BVL, Nepenthe Wines Pty Ltd and each several grower.

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

14. The documents highlighted are those Growers enter into or become party to. For the purpose 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 party to. The effect of these agreements is summarised as follows.

### **Overview**

15. The arrangement is called the Saint Magnus Vineyard Project. The arrangement that is the subject of this Ruling is described below. There is a dual offer made under the prospectus. Interests will be divided into both Growers Interests and LandOwner Units. Growers will thus own and operate the vineyard and own the Project property through a trust structure. Each parcel of Units will be an allocated and identifiable allotment. Grower's Interests and LandOwner units are stapled securities and cannot be sold separately. However, the Units

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can be owned by an associated entity of the Grower such as a superannuation fund, trust or spouse.

Location	The vineyard site is located approximately one kilometre north of Birdwood in the Adelaide Hills, about 44 kilometres north-east of Adelaide
type of business each participant is carrying on	Each individual Grower will be in the business of wine grape growing, harvesting and processing.
Number of hectares under cultivation	The prospectus offers for 96.8 hectares to be developed
name used to describe the product	Saint Magnus Vineyard Project
size of the leased area	0.4 hectares
Number of vines per hectare	1800
Expected production	Tonnage per allotment of 0.4 hectares is estimated to rise to 4.75 tonnes per grower's interest in 2006 when the vineyard will be fully mature. Tonnages from year to year will vary due to seasonal variations
the term of the investment	15 years
initial cost	\$13,700 for applications lodged before 1 June 2000 including \$7,400 for one parcel of Land Owner units
Initial cost on a per hectare basis	\$34,250
Ongoing costs	<p>\$10,070 by 31 August 2000, \$1,465 by 1 May 2001, \$2,415 by 31 August 2001, \$3,610 by 30 June 2002.</p> <p>Ongoing rent of \$265 per year, plus CPI, from Yr 4 onwards.</p> <p>Ongoing annual management fees of:</p> <ul style="list-style-type: none"> <li>(i) anticipated maintenance, management, harvesting and processing costs for the next 12 months;</li> <li>(ii) 6% of gross sale proceeds.</li> </ul>

16. Growers entering the Project will occupy, under licence, land owned by Saint Magnus Vineyard Property Trust, known as Saint Magnus Vineyard, located at Birdwood in South Australia. At the same time Growers, or their associates, will enter the Property Trust. The Custodian will license the land to each grower by the way of the Allotment Agreement, to conduct grape-growing activities on the land.

17. There are 242 Allotments of 0.4 hectares on offer. The total land area for this project is 96.8 hectares. By 30 June of the financial year of execution of the Allotment and Management Agreements, grapevines will be planted on each allotment. The Manager as Responsible Entity will operate the project.

18. Growers will engage BVL to perform services including the establishment and maintenance of the Vineyard and the annual harvesting and selling of the grapes produced. BVL will engage Nepenthe Viticulture Pty Ltd to professionally manage the Vineyard and harvest the produce of the Vineyard for the life of the project.

19. BVL and the Growers will enter into a Grape Sale and Purchase Agreement to sell the produce from the Vineyard to Nepenthe Wines Pty Ltd.

#### **Agency Agreement – Custodian (Vineyard Project)**

20. Blaxland Vineyards Limited (BVL) has appointed Cardinal Financial Securities Limited (the “Custodian”) to act as its agent within the scope of the agreement. The role of the Custodian is to hold the Project Property as agent for BVL. The agreement does not create a trustee or partnership relationship (cl 3).

21. The Custodian must not give a charge, mortgage or any other encumbrance over any of the Property (cl 5.4).

#### **Constitution (Vineyard Project)**

22. Clause 11.1 states the Project is to be known as the St Magnus Vineyard Project and its purpose is to invite the public to become proprietors of their own business venture of establishing, maintaining, harvesting and selling wine grapes (cl 11.4).

23. Clause 2 prescribes the amounts, which Growers must pay in order to participate in the Project. There are no withdrawal rights under the Project (cl. 10).

24. A Grower has the right to assign their Interest only in the circumstances set out in clause 18 of the Constitution and on the terms and conditions of the Allotment Agreement and Management

Agreement. Growers are able to remove the Responsible Entity by taking action under the Corporations Law.

25. Each Grower is vested with the following assets:

- the Vines on the Grower's Allotment (cl 16.3(a)(i));
- the Vine System on the Grower's Allotment (cl 16.3(a)(ii));
- the Grower's Interest (cl 16.3(a)(iii));
- the Grapes Attributable to the Grower's Allotment (cl 16.3 (a)(iv)); and
- the Processed Products Attributable to the Grower (cl 16.3(a)(v)).

### **Compliance Plan (Vineyard Project)**

26. The objective of the Compliance Plan is to ensure the interests of the Growers are protected. The Compliance Plan provides that the Responsible Entity will act in the interests of Growers in preference to its own interest (cl 1.1 (e)(iii)).

27. The Responsible Entity must ensure that the Constitution and the Compliance Plan meet the relevant requirements of the Corporations Law (cl 11.1(b)).

28. The Responsible Entity must ensure that all property of the Project is clearly identified and held separately from any other property of the Responsible Entity or other managed investment schemes (cl 3). All Project property will be held by the Custodian (cl 2.1).

29. The Compliance Plan outlines the various reports and reconciliations which will be provided to each Grower by the Manager.

### **Allotment Agreement**

30. Pursuant to clause 2.1 of the Allotment Agreement, the Manager grants each Grower a license to:

- use and occupy the Grower's Allotment for the purpose only of developing, planting, growing, maintaining and harvesting the Vines; and;
- use in common with all other Growers the viticultural infrastructure on the Land required for the Project.

31. A fee of \$80 in Year 1, \$202.50 in Year 2 and \$225.50 in Year 3 increased for CPI ('All Groups') in subsequent years is payable to the Responsible Entity for this licence (cl 7).

32. The Grower's rights and obligations are set out in clause 5 and the Land Owner's (as agent for the Responsible Entity) obligations are set out in clause 6.

### **Management Agreement**

33. Pursuant to the Management Agreement, BVL is engaged to manage the allotment. The fees payable to BVL in return for its services are set out in clause 5. Growers enter into the Agreement until 30 June 2015. BVL is entitled to delegate all or any of the functions to be performed by it pursuant to the Management Agreement (cl 8.1).

34. BVL is to establish the Grower's Allotment with Vines by 30 June of the financial year in which a Grower's application is accepted (clause 4.2). The Vineyard Services to be provided by the Manager are detailed at clause 4.3. These include among other things:

- ongoing management of the Vineyard;
- establishment of vines;
- harvesting the grapes produced; and
- marketing the grapes produced.

35. The Manager will pool for sale all produce of each Grower's business with that of each other Grower and will market and sell all such produce (cl 4.6). The proceeds of the pooled sales will be paid to the Custodian for crediting to the account of each Grower on a proportional basis (clause 4.6(b) of the Management Agreement and clause 16.2(a) of the Constitution). Where the produce from a Grower's Allotment is of sufficiently reduced quality or quantity, that Grower's share of the pooled sale proceeds may be reduced (cl 4.6(c) of the Management Agreement and clause 25.1(c) of the Constitution). The Manager is entitled to a fee for each processed tonne of grape attributable to the Grower's Allotment (cl 5.3).

36. Income of the Project is to be held on behalf of the Growers by the Custodian and to be applied in payment of the Growers' obligations under the Management Agreement. Any net income remaining after the payment of these fees is to be distributed to Growers after the final payment is received for each sale of produce (clause 25.3(d) of the Constitution).

37. The Grower may terminate the Management Agreement in certain instances, including where the Manager defaults in the performance of its duties (cl.10.1(d)(i)).

38. All costs and expenses incurred by the Manager in carrying out its duties are to be borne by it and the Grower has no further obligation to make any payment, save under clause 5.7 of the Management Agreement (cl 5.6).

39. There will be a Grape Sale Agreement entered into with Nepenthe Wines Limited as the purchaser of 75% of the grapes harvested.

40. The Management Agreement and Project Constitution will bind a participant who enters into the St Magnus Vineyard Project and utilises the services of BVL. These documents detail, among other things, the fees and charges for which an investor is liable. Once a Grower's application has been accepted, the Manager will be responsible for erecting trellis and irrigation and planting vines on each allotment prior to 30 June of the financial year in which an application is accepted (cl 4.1). The Manager will advise Growers when certain 'business operations' have been commenced on their behalf, for example, when their vines have been planted.

## **Vineyard Management Agreement**

41. Pursuant to its right to delegate any functions required of it, BVL has contracted with Nepenthe Viticulture Pty Limited to undertake the obligations under the Management Agreement to establish the Vineyard and undertake all necessary viticultural work in future years. A Vineyard Management Agreement exists between the Manager and Nepenthe detailing those services to be undertaken by Nepenthe in each year. Nepenthe is specifically required to acquire rootlings for the Growers in the Project (cl 3.1 Schedule 3) and install the Irrigation System (cl 3.1 schedule 4).

42. Nepenthe is required to undertake all preplanting activities, planting vines, irrigation and maintenance of the Vineyard and other necessary operations over the life of the Project (cl.3.1 Schedule 4) Nepenthe is required to harvest the grapes on behalf of the Growers (cl 3.1Schedule 4B).

**Contract for the Sale and Purchase of Wine Grapes (Grape Sale Agreement)**

43. Pursuant to clause 3.1 of the Grape Sale Agreement, Nepenthe Wines Pty Ltd shall purchase, in each Vintage Year, 75% of the grapes grown on the property. Nepenthe shall process the balance into wine on behalf of the Growers at a cost of \$500 per tonne of grape processed.

44. Clause 4 states that the grapes shall be sold to Nepenthe at the Grape Price, for each Category of Grape, agreed by Nepenthe and BVL by 31 December of each year.

45. The proceeds of the sale are to be paid to the Custodian as agent for BVL. Clause 5 sets out the payment schedule.

**Fees*****Years 1 to 3 payments:***

46. The fees payable by a Grower in the Project in the first three years for one allotment are:

	<b>Year 1 One payment</b>	<b>Year 2 Two Payments</b>	<b>Year 3 Two Payments</b>
Allotment Licence Fee	80	235	193
Installation of Irrigation	1,500	611	-
Supply & Planting of Rootlings	-	704	-
Supply & Erection of Trellis	-	2,377	-
Pre-Planting Activities	300	308	-
Maintenance of Allotment	1,850	5,600	1,741
Management & Administration	2,570	1,650	356
Roads & Buildings	-	50	125
<b>Total</b>	<b>6,300</b>	<b>11,535</b>	<b>2,415</b>

47. The Year 1 Maintenance of Allotment and Management and Administration fees are only for work to be done up until 30 June 2000, for those Growers accepted into the Project up until 31 May 2000. Acceptance of Applications received between 1 June 2000 and 30 June 2000 will be deferred until 1 July 2000. The term of the Project will be for 15 years from 30 June 2000, at which time Growers will vote to decide on the future of the vineyard. The Project can be renewed or the vineyard sold.

48. The Goods and Services Tax will be applicable to services provided by the Grower and any Manager on or after 1 July 2000.

## Finance

49. Growers must fund their investment in the Project themselves. None of the arrangement entities or any associated entities will be involved with the financing of the investments by Growers.

## Other details

50. This ruling does not apply if a Grower enters into a finance agreement that includes any of the following features:

- split loan features of the type described in Taxation Ruling TR 98/22;
- entities associated with the Project become involved in the provision of finance;
- indemnity arrangements, or equivalent collateral arrangements, limiting the borrowers risk;
- non-arms length terms and conditions;
- ‘additional benefits’, for the purposes of the section 82KL, are granted to the borrower, or the funding arrangement transforms the project into a ‘scheme’ to which Part IVA may be applied;
- repayments of principle and payments of interest are linked to deriving income from the Project ;
- funds borrowed, in whole or in part, are not available for the conduct of the Project, but are transferred (by any means, and directly or indirectly) back to the lender, or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

51. A prospectus for this Project will be lodged with the Australian Securities and Investment Commission.

52. Should a Grower default in payment of any money due to the Responsible Entity the Responsible Entity may terminate the arrangement with the Grower and under the Constitution of the Project the Responsible Entity has the right to carry out the Grower’s responsibilities under the Allotment and Management Agreements.

53. All Application monies are paid to the Custodian and are available for use by the Responsible Entity only after the Application

has been accepted. Any Application monies received will be refunded if the Application is refused.

## **Ruling**

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### **Goods and Services Tax**

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

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

#### **Section 35-55 – Commissioner’s discretion**

54.1. For a Grower who is an individual and who entered the Project on or after 15 March 2000 and prior to any withdrawal of this Product Ruling, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2003 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be, carried on in a manner that is not materially different to the arrangement described in this Ruling.

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

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

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

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

investment. An assessment of the Project or the product from such a perspective has not been made.

### **Allowable deductions**

55. For a Grower who invests in the Project by 1 June 2000, who incurs the fees set out in paragraph 46, the following deductions will be available for the years ended 30 June 2000 to 30 June 2002:

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
	<b>30/6/2000</b>	<b>30/6/2001</b>	<b>30/6/2002</b>
Management & Administration of Allotment	2,570	1,325	681
Supply and Erection or Trellis	-	231	309
Installation of Irrigation System	500	704	704
Maintenance of Growers Allotment	1,850	5,250	2,091
Land Rental	80	203	226
<b>Total</b>	<b>5,000</b>	<b>7,713</b>	<b>4,011</b>

### **Deductions available for Growers who invest after 30 June 2000**

56. For a Grower who invests in the Project after 30 June 2000, who incurs the fees set out in paragraph 46, the above deductions will be available for the years ended 30 June 2001 to 30 June 2003 on the basis that Year 1 (above) becomes the year ended 30 June 2001.

### **Supply and Erection of Trellis**

57. The costs of purchasing and erecting trellis is capital in nature. For a Grower who is a 'small business taxpayer', where the conditions in section 42-345 are met, a deduction is allowable under s 42-15 of the ITAA 1997 at the rate of 20% per annum diminishing value or 13% per annum prime cost, commencing from the time the trellis is first used. For Growers who enter the Project before 1 June 2000 it is likely the first deduction will be in the financial year ended 30 June 2001. Deductions for two succeeding years have been calculated, for illustrative purposes, on the basis of using the prime cost method under section 42-25. The Manager will advise details of the exact amounts to be claimed.

### **Installation of Irrigation expenses**

58. Growers incur a liability to pay irrigation expenses of \$1,500 upon entering the Project and \$611 payable by 31 August 2000.

Expenses incurred on irrigation are deductible to the Grower in the year incurred and in the next two years at the rate of 33.3% under section 387-125 of the ITAA 1997.

### **Pre-Planting Activities/Supply and Planting of Rootlings**

59. The costs of purchasing and planting vines are capital in nature. A deduction is allowable under Subdivision 387-C of the ITAA 1997 at the rate of 13% per annum, commencing from the time the vines commence their first commercial season. For Growers who enter the Project before 1 June 2000 it is likely the first commercial season will be in the financial year ended 30 June 2003.

### **Assessable Income**

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

### **Sections 82KJ, 82KK, 82KL and Part IVA;**

61. For a Grower who invests in the Project the following provisions have application as indicated:

- sections 82KK, 82KJ and 82KL do not apply to deny the deduction otherwise allowable; and
- the relevant provisions of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

## **Explanations**

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### **Sections 27-5 - Goods and Services Tax**

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

### **Subdivision 960-Q - Small business taxpayers**

63. In this product ruling the term 'small business taxpayer' is relevant for the purposes of the discussion relating to depreciation of trellising.

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

65. 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 that year is less than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

66. '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).

## Section 8-1

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

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under paragraph 8-1(1)(b) if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that taxpayers contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

68. An outgoing or a loss incurred in carrying on a business for the purpose of gaining or producing assessable income is deductible under the general deduction provision section 8-1, provided it is not expenditure or a loss of capital or of a capital, domestic or private nature. A business includes a 'primary production business', which is defined under subsection 995-1(1) to include a business of propagating and cultivating plants. Where there is a business, or a future business, of growing grapes for sale at a profit, the gross sale

proceeds from the sale of grapes from the Project will constitute assessable income under section 6-5. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, and maintaining of grapevines and the harvesting of the grapes.

### **Is the Grower in business?**

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

- they have an identifiable interest in specific growing vines coupled with a right to harvest and sell the grapes resulting from those vines;
- the viticulture activities are carried out on their behalf; and
- the weight of the general indicators of a business, as developed by the Courts, points to them carrying on such a business.

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

71. Each lot will have approximately 1800 vines per hectare. This is consistent with the intention to carry on a business of growing grapevines.

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

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

The viticulture activities described in the Management Agreements are carried out on the Growers' behalf. Growers control their investment.

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

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

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

### **Section 8-1: Deductibility of expenses**

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

### **Expenditure of a capital nature**

78. Any part of the expenditure of a Grower entering into the viticulture business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. It is

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

79. The Manager, BVL, has identified the relevant expenditures that are of a capital nature. These amounts are detailed at paragraph 46 of this Ruling.

### **Vineyard management and administration charges**

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

### **Section 42-15: depreciation of trellising**

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

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

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

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

85. The deduction available, however, will depend on whether or not a Grower is a 'small business taxpayer' as defined in section 960-335 and, if so, whether the Grower complies with the conditions contained in section 42-345.

86. 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 cost of the trellising and a rate of 13% prime cost or 20% diminishing value. These accelerated rates of depreciation are shown in section 42-125 and apply to plant with an effective life of between 13 and 30 years.

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

## **Irrigation - section 387-125**

88. Expenditure on water facilities incurred primarily and principally for the purposes of conserving or conveying water for use in a primary production business conducted on land in Australia is deductible under section 387-125 in equal instalments over three years, commencing in the year the expenditure was incurred. Deductions will be allowable for the costs of installing irrigation equipment in the Saint Magnus Vineyard commencing from and including the year ended 30 June 2000.

## **Maintenance of Grower's Allotment**

89. Maintenance fees are deductible under section 8-1 of the ITAA97.

## **Part IVA**

90. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C), and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Saint Magnus Vineyard Project will be a 'scheme'. It will commence on the date the Prospectus issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the

deduction for the management fees allowable under section 8-1, and deductions allowable under Subdivisions 387-B, 387-C and section 42-15, 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.

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

### **Sections 82KJ; Section 82KK, and section 82KL**

92. These provisions allow the Commissioner of Taxation to deny or defer deductions, which have been incurred under certain tax avoidance schemes. Section 82KJ deals with certain prepaid outgoings being used to defray the capital cost of the acquisition of property. Section 82KK deals with tax deferral arrangements and section 82KL deals with certain expenditure recoupment schemes.

93. For the purposes of this Ruling, no Grower is an 'associate' of the Manager, or any other party involved with carrying on the Project.

94. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL.

95. The specific anti-avoidance provisions contained in sections 82KJ, 82KK, and 82KL do apply to deny deductions to Growers.

### **Assessable income**

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

## **Detailed contents list**

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### **Commissioner of Taxation**

15 March 2000

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<i>Previous draft:</i>	- ITAA 1936 82KL(1)
Not previously issued in draft form	- ITAA 1936 Pt IVA
	- ITAA 1936 177A
<i>Related Rulings/Determinations:</i>	- ITAA 1936 177C
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1936 177D
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1997 6-5
IT 175; IT 2685; PR 1999/95	- ITAA 1997 8-1
	- ITAA 1997 8-1(b)
<i>Subject references:</i>	- ITAA 1997 8-1(1)(a)
- carrying on a business	- ITAA 1997 27-5
- commencement of business	- ITAA 1997 27-30
- fee expenses	- ITAA 1997 Div 35
- interest expenses	- ITAA 1997 35-10
- management fees expenses	- ITAA 1997 35-10(4)
- producing assessable income	- ITAA 1997 35-30
- product rulings	- ITAA 1997 35-35
- public rulings	- ITAA 1997 35-40
- schemes and shams	- ITAA 1997 35-45
- taxation administration	- ITAA 1997 35-55
- tax avoidance	- ITAA 1997 35-55(1)
	- ITAA 1997 35-55(1)(b)
<i>Legislative references:</i>	- ITAA 1997 42-15
- ITAA 1936 82KJ	- ITAA 1997 42-25
- ITAA 1936 82KK	- ITAA 1997 42-118
- ITAA 1936 82KL	- ITAA 1997 42-125

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- ITAA 1997 42-345
  - ITAA 1997 Subdiv 42-C
  - ITAA 1997 42-345
  - ITAA 1997 Subdiv 387-A
  - ITAA 1997 387-55
  - ITAA 1997 Subdiv 387-B
  - ITAA 1997 387-125
  - ITAA 1997 Subdiv 387-C
  - ITAA 1997 387-165
  - ITAA 1997 Subdiv 960-Q
  - ITAA 1997 960-335
  - ITAA 1997 960-340
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