



PR 2000/21 - Income tax: Stoneham Estate Vineyard Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 April 2000*



Product Ruling

Income tax: Stoneham Estate Vineyard Project

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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**, **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 derived in those future years.

Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

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

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA1997');
 - section 8-1 (ITAA 1997);
 - section 27-5 (ITAA 1997);
 - section 27-30 (ITAA 1997);
 - section 42-15 (ITAA 1997);
 - section 387-125 (ITAA 1997);
 - section 387-165 (ITAA 1997);
 - Part 2-25 (ITAA 1997);
 - Part 3-1 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZM (ITAA 1936);
 - section 82KZMA (ITAA 1936);
 - section 82KZMB (ITAA 1936);
 - section 82KZMC (ITAA 1936);
 - section 82KZMD (ITAA 1936); and
 - Part IVA (ITAA 1936).

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

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

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

Class of persons

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

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

Qualifications

8. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

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

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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

10. This Ruling applies prospectively from 22 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, the Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

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 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 change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

13. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, 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:

- Application for Product Ruling Stoneham Estate Management Ltd dated 17 September 1999;

- **Draft Stoneham Estate Management Limited Prospectus**, issued by Stoneham Estate Management Limited, dated 7/3/2000;
- **Licence and Management Agreement** between Stoneham Estate Management Limited (the Manager) and the Grower, received 7/3/2000;
- **Stoneham Growers' MIS Constitution** between the Manager, Stoneham Estate Management Limited (SEML) and the Growers of the Stoneham Growers' MIS dated 15 October 1999;
- Stoneham Growers' MIS Compliance Plan for Stoneham Estate Management Limited as the Responsible Entity, undated;
- Contract for Sale of Land by Offer and Acceptance between Redcolt Pty Ltd and Jindong Land Holdings Ltd as tenants in common in equal shares and Woodzone Nominees Pty Ltd dated 5 November 1999;
- Contract for Sale of Land by Offer and Acceptance between Woodzone Nominees Pty Ltd and the current owners of the Land dated 3 March 1999;
- Draft Agreement to Lease between Redcolt Pty Ltd and Jindong Land Holdings Ltd (Lessors) and Stoneham Estate Management Limited (Lessee) received 7 March 2000;
- Annexure "A" Lease between Redcolt Pty Ltd and Jindong Land Holdings Ltd (Lessors) and Stoneham Estate Management Limited (Lessee), received 7 March 2000;
- Option Deed between Jindong Land Holdings Ltd (Grantor) and Redcolt Pty Ltd (Grantee) undated;
- Preliminary Technical Management Agreement between Dawnsun Investments Pty Ltd and MMKS Pty Ltd (Consultants) and Mark Hansford Babidge (Nominee) undated;
- Technical Management Agreement between Stoneham Estate Management Limited and MMKS Pty Ltd (Consultants) and Mark Hansford Babidge (Nominee) undated;
- Stoneham Growers' MIS Custodian Agreement between Stoneham Estate Management Limited and Charters Securities Ltd undated;

- Management Agreement between Stoneham Estate Management Limited (“Company”) and Dawnsun Investments Pty Ltd as Trustee for the Dawnsun Management Unit Trust (“Manager”), received 7 March 2000;
- Management Services Agreement between Stoneham Estate Management Limited (“Company”) and Anthony David Fitzgerald undated; and
- Additional correspondence received from the applicant dated 23 December 1999, 28 January 2000, 3 February 2000, 14 February 2000, 11 February 2000.

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. 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. This arrangement is called “Stoneham Estate Vineyard Project”.

Location	20 kilometres South West of Busselton in Western Australia
Type of business each participant is carrying on (a clear description)	Planting, propagating, cultivating and developing Vines on the Grower’s Area.
Number of hectares under cultivation	165 Hectares
Names used to describe the product	Stoneham Estate Vineyard Project
Size of the leased area, plot etc	0.1 hectares
Number of vines per hectare	1660 vines per hectare
Expected production	Will come into production in the year ended 30 June 2003. Production will progressively increase, reaching a maximum of 14.04 tons per hectare in the year ended 30 June 2006.
The term of investment in years	20
Initial cost	\$3,460
Initial cost per hectare	\$34,600

16. The Project is to carry out a large scale planting of grapevines upon land which is to be held by the Manager and located 20 kilometres South West of Busselton, in Western Australia. The Project is for a period of twenty years. Growers enter into the Project, whereby the Manager provides a licence to the Grower to use and occupy an area for cultivating and harvesting wine grapes for sale. The Growers pay for the roads, buildings, irrigation and trellising system that will be installed on their licensed area. Growers contract with the Manager for the establishment and management of the vineyard and harvesting of their grapes. Unless the Grower has elected to take possession of their grapes, the manager will sell the grapes on behalf of the Grower.

17. The establishment of the Project is subject to a minimum subscription of six hundred licensed areas. This ruling does not apply if minimum subscription requirement is not achieved.

18. The minimum individual holding is one licensed area of 0.1 hectare. Overall, it is proposed that 165 hectares will be planted. The 1650 licensed areas that this represents will be allocated in accordance with the vineyard development plan. Once the Grower's Licensed Area has been allocated it will be identified on the Vineyard Row Register and noted on the Register of Applications. A copy of the Vineyard development Plan will be sent to the Grower, showing the Grower's allocated Licensed Area or Areas, when the Licence and Management Agreement has been executed. Approximately 166 vines per licensed area (1,660 vines per hectare) will be planted in the first 13 months following execution of the Licence and Management Agreement.

19. Possible projected returns for Growers are outlined in the Draft Prospectus. The projected returns depend on a range of assumptions and the Manager does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Project. Based on the information supplied in the Draft Prospectus, a grower could expect to achieve a before tax internal rate of return of 13.2%. Growers will execute a Power of Attorney enabling Stoneham Estate Management Limited to act on their behalf as required when they make an application for Licensed Areas.

20. Each Grower must also subscribe for a minimum of one thousand three hundred and forty two shares in Jindong Land Holdings Limited at \$1 per share. Shareholders may not hold more than 5% of the shares on issue in Jindong Land Holdings Limited.

Constitution

21. The Stoneham Growers' MIS Constitution is between the Project Manager and each several Grower. It sets out the terms and conditions under which the Project Manager agrees to act for the Growers and to manage the Project. The Licence and Management Agreement is annexed to the Constitution and will be executed on behalf of a Grower following them signing the Application Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

Licence and Management Agreement

22. The Licence and Management Agreement sets out the roles and obligations of the parties to the agreement. It is entered into between the Manager and the Grower for each Grower's Area. The term of the agreement is until 30 June 2020. Under the agreement the Manager grants a licence to the Grower and the Grower appoints the Manager to manage, maintain and harvest the vines on the Grower's Area.

23. Under the terms of the Licence and Management Agreement the Grower agrees not to:

- use or permit any other person to use the area for any purpose other than that of commercial horticulture and the Project;
- install or remove any trees, earth, minerals, Fixtures or Vines from the Grower's Area without the consent of the Manager;
- do anything which would invalidate or increase the premiums of any insurance policies in respect of the Grower's Area; and
- cause nor permit anything on the Grower's Area that will cause a nuisance, disturbance, obstruction or damage.

24. In return, the Grower has the right to pass over the Grower's Area at any time and the Grower will at all times have full right, title and interest to the Grower's vines, fixtures and any grapes produced from the vines from the Grower's Area. If Growers wish to remove vines or fixtures from the Grower's Area, they must make a request in writing for the Manager to arrange removal of the vines and fixtures. The cost of removal of the vines and fixtures and repairs to any neighbouring areas are to be borne by the requesting Grower.

25. Growers do not have a right of exclusive occupation of the Grower's Area. At the expiration of the term of the Licence and

Management Agreement, the Vines and Fixtures and any improvements remaining on the Grower's Area shall vest in the Joint Lessors and no compensation will be payable to the Grower or the Manager.

26. The Grower appoints the Manager to plant, develop, manage and maintain the vines on the Grower's Area and to harvest the grape produce from the Grower's Area. The Manager accepts the appointment upon the terms and conditions in the Draft Licence and Management Agreement and undertakes to provide the Services on behalf of the Grower. The manager is responsible for the day to day running of the Project including, but not limited to the provision of the following services:

- Conduct the Grower's Project in a commercial manner in keeping with accepted wine industry standards including maintenance of the trickle irrigation systems, maintenance of suitable trellising systems and cultivate, prune, fertilise, spray and otherwise tend to the vines on the Grower's Area;
- Control vermin, diseases, animals, insects, pests, thistles, bracken, other noxious plants and weeds;
- Upon the first commercially harvestable crop of grapes being grown upon the Grower's Area, annually harvest or arrange for the harvesting of grapes grown on the Grower's Area ;
- Sales, marketing and advertising services in relation to the grapes harvested from the Grower's Area, unless the Grower elects to collect and market the produce personally; and
- Negotiating and implementing long-term arrangements for the sale of the Grower's grapes on the growers behalf, for the best possible commercial price.

27. Unless a Grower elects to collect and market the produce personally, the Manager is authorised to enter into a contract as agent for the Grower to collect and market the produce from their Grower's Areas. The Manager will harvest and sell the grapes on the Growers' behalf, for the best possible commercial price.

28. If it is determined that obtaining frost damage insurance for the project is commercially feasible the Manager will obtain such insurance. The Manager will pay insurance premiums at its own expense for the term of the Project.

29. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or

express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

Fees

30. The Growers will make the following payments per licensed area for the first three years, commencing during the year ended 30 June 2000:

	Year 1	Year 2	Year 3
Management Fee	2,969	2,628	1,000
Irrigation	97	817	
Rootlings	73	197	
Trellising		717	
Roads and Buildings	111	116	
Licence Fee	210	221	232
Shares in Property Co.	1,342		
Total	4,802	4,696	1,232

(Note: All figures shown are exclusive of GST)

31. Commencing on 31 July 2000 until 30 June 2003 all management fees and payments for irrigation, trellising and rootlings will be payable quarterly as stipulated in the Licence and Management Agreement. For the remainder of the term, the Management Fee for each year will be payable in advance on 1 July of that year. Growers who invest prior to 1 June 2000 will pay the Year 1 fees which will include payment for certain services which will be completed prior to 30 June 2000. Growers who invest on or after 1 June 2000 will pay the Year 1 fees which will include payment for certain services, some of which may be performed after 30 June 2000.

32. Growers who invest after 30 June 2000 will pay:

- the Year 1 fees; and
- the quarterly Management Fees and amounts payable for irrigation, trellising, rootlings, roads and buildings as stipulated in the Licence and Management Agreement from 1 July to the date of investment.

33. The Manager will only provide services following the execution of the Licence and Management Agreement.

34. Commencing on 1 July 2002 Licence and Management Fees will be payable from gross project income. If gross project income is not sufficient to pay the fees for the year, the fees will be deducted from gross project income in any subsequent year or years. The Manager may provide or secure finance for any shortfall or require a grower by notice in writing, subject to approval in general meeting, to make additional contributions to make up the shortfall. In the event that outstanding Licence and Management Fees are not recouped from gross project income within two years the Manager will commence debt recovery proceedings against the Grower.

35. Where actual net income exceeds projected net income in any year, a Profit Incentive of 25% is to be paid to the Manager, provided that actual net income exceeded the projected net income in the previous year.

36. Where Gross Project Income exceeds the total amount of grape produce from the Project multiplied by the average location price per tonne for wine grapes in the Margaret River Region for the Year as published by the Western Australian Department of Agriculture, a Continuity of Supply Bonus of 18% is to be paid to the Manager.

37. The Application Monies will be banked into a trust account held by Charters Securities Pty Ltd, which act as custodian. The Licence Fees and the Management Fees received for Year 1 will only be released by Charters Securities Pty Ltd following receipt of written evidence of:

- Minimum subscription being achieved;
- Each Grower entering into a Licence and Management Agreement;
- The Lessor of the land entering into a binding contract to purchase the land on which the Project will be located and lodgement of the necessary transfers of title and certificates of title for registration of the land in the name of the Lessor; and
- The Manager and the Lessor having entered into a binding agreement to lease the Project Land.

Agreement to Lease/Lease

38. The Agreement to Lease and the Lease are between Jindong Land Holdings Ltd and Redcolt Pty Ltd (Joint Lessors) and Stoneham Estate Management Ltd (Lessee). The Agreement provides for the Lease of the "Project Land" being:

- a) Portion of Sussex Location 3117 being the whole of the land contained in Certificate of Title Volume 1160 Folio 322;
- b) Portion of Sussex Location 3120 being the whole of the land contained in Certificate of Title Volume 1137 Folio 53; and
- c) Portion of each of Sussex Locations 3114 and 3118 in Certificate of Title Volume 2166 Folio 191.

39. The leasing of the land is subject to the satisfaction of the conditions precedent. The conditions precedent are:

- The Lessors becoming entitled to be registered as the registered proprietor of the “Project Land”;
- The Lessors receiving the consent of the Western Australian Planning Commission to the Lease (if required); and
- The Prospectus obtaining the Minimum Subscription on or before the closing date of the Prospectus.

40. The Lease terminates on 30 June 2020. Upon termination the Manager and any Grower cease to have any interest in the “Project Land” and any improvements remaining on the land on the date of termination vest in and become the property of the Lessors.

Preliminary Technical Management Agreement

41. This Agreement is between Dawnsun Investments Pty Ltd and MMKS Pty Ltd (Consultants) and Mark Hansford Babidge (Nominee). The Agreement commences on 1 December 1999 and expires on 30 June 2000. The Agreement provides for the Consultant to be engaged to provide the Services under the Agreement. The Consultant employs the Nominee to provide the services under the Agreement.

Technical Management Agreement

42. This Agreement is between Stoneham Estate Management Limited and MMKS Pty Ltd (the Consultant) and Mark Hansford Babidge (the Nominee). The Agreement commences on 1 July 2000 and expires on 30 June 2003. The Agreement provides for the Consultant to be engaged to provide the Services under the Agreement. The Consultant employs the Nominee to provide the services under the Agreement.

Finance

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

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

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

45. Other than the arrangement referred to in paragraph 34 of this Ruling, there is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance to the Grower for any purpose associated with the Project.

Ruling**Goods and Services Tax**

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

Allowable deductions

47. For a Grower who invests in the Project, the deduction available for the prepaid Management Fee or the prepaid Licence Fee will depend upon the date that the investment is made and, in some cases, whether or not they are 'small business taxpayers'.

IMPORTANT: Paragraphs 48 to 52 (relating to 'small business taxpayers') and paragraphs 53 to 60 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Growers are advised to carefully examine the information contained in paragraphs 66 and 68 relating to proposed changes to the prepayment rules. Growers who invest in the Project after 1pm, AEST, 11 November 1999 may be affected by these changes.

Growers who are small business taxpayers

48. For a Grower who invests in the project and is a small business taxpayer the following deductions will be available in the year in which they are incurred:

- licence fees paid by the Grower in relation to the licensed area will be an allowable deduction in the year incurred (section 8-1 of the ITAA 1997);
- management fees paid for the services outlined in the Licence and Management Agreement will be allowable deductions to the Grower in the year incurred (section 8-1 of the ITAA 1997);
- expenditure incurred on irrigation will constitute an allowable deduction to the Grower under section 387-125. A deduction for capital expenditure for the irrigation system is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and on third in each of the next two years;
- for a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the deduction for depreciation of trellising is determined using the rates in section 42-125 and the formula in either subsection 42-160(1), 'diminishing value method', or subsection 42-165(1), 'prime cost method'. For Year 2 the deduction allowed will depend upon the number of 'days owned', being the number of days in

the income year in which the Grower owned an interest in the trellising; and

- A deduction under section 387-165 for expenditure on acquiring and planting the vines will be calculated on the basis of the grapevines, as horticultural plants, entering their first commercial season and a Grower determining, under section 387-175, that they have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years. This results in a write-off rate of 13%.

49. A deduction for roads and buildings will not be allowed to a Grower who invests in the Stoneham Estate Vineyard Project.

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

51. Legislative change means that the full deduction for management and licence fees may not be allowed in the year ended 30 June 2000 to Growers who are not 'small business taxpayers'. See paragraphs 53 to 60, 62 and Example 1.

52. The following is an estimate of deductions available to a Grower, who is a **'small business taxpayer'**, over the first three years of the investment where:

(a) the Grower invests prior to 30 June 2000:

Expenses	Legislation ITAA 1997	Refer Note	Year 1	Year 2	Year 3
			30/6/2000	30/6/2001	30/6/2002
Management Fee	8-1	(i)	2,969	2,628	1,000
Irrigation	387-125		33	305	304
Rootlings	387-165	(ii)			
Trellising	42-15	(iii)		70	93
Roads and Buildings	8-1(2)			0	0
Licence Fee	8-1	(i)	210	221	232
Profit Incentive	8-1				
Continuity of Supply Bonus	8-1				
Total			3,212	3,224	1,629

(Note: All figures shown are exclusive of GST)

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(b) the Grower invests after 30 June 2000:

Expenses	Legislation ITAA 1997	Refer Note	Year 1	Year 2	Year 3
			30/6/2000	30/6/2001	30/6/2002
Management Fee	8-1			5,597	1,000
Irrigation	387-125			305	305
Rootlings	387-165	(ii)			
Trellising	42-15	(iii)		70	93
Roads and Buildings	8-1(2)			0	0
Licence Fee	8-1			431	232
Profit Incentive	8-1				
Continuity of Supply Bonus	8-1				
Total				6,403	1,630

(Note: All figures shown are exclusive of GST)

- (i) Proposed legislative change applying to expenditure incurred after 1:00pm AEST 11 November 1999 means that the full deduction will not be allowed to Growers who invest on or after 1 June 2000. See the non binding advice in paragraphs 67 and 68 and Example 2.
- (ii) The Manager will advise the Growers of the years in which a deduction will be allowable.
- (iii) Trellising is to be installed in September of Year 2. The Manager is to advise Growers of the number of days in which the Growers owned an interest in the trellising.

The deductions available in Years 2 and 3 have been calculated on the basis of using the prime cost method at a rate of 13%, assuming that is the method that the Grower has chosen under section 42-25.

If the Grower elects to use the diminishing value method the rate for calculating the deduction will be 20%. The deduction available in Years 2 and 3 are estimated to be:

Expenses	Legislation ITAA 1997	Year 1	Year 2	Year 3
Trellising	42-15		108	122

Growers who are not small business taxpayers who invest before 30 June 2000

53. For a Grower who invests in the project before 30 June 2000 who is **not a 'small business taxpayer'** and is carrying on a business but is not a small business taxpayer, the deduction available in respect of the Management Fee and Licence Fee is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5). (Example 1 at paragraph 127 illustrates the application of this method).

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

55. For a Grower who is not a small business taxpayer who invests before 30 June 2000 deduction will be available as follows:

For the year ended 30 June 2000

- expenditure on irrigation in the same manner as taxpayers who are small business taxpayers (section 387-125 of the ITAA 1997);
- depreciation of trellising as per paragraphs 59 and 60;
- expenditure on acquiring and planting the vines in the same manner as taxpayers who are small business taxpayers (section 387-165 of the ITAA 1997);
- The Licence Fee (section 8-1 of the ITAA 1997); and
- The Management Fee eligible to be claimed as a deduction is determined using the following formula:

Available deduction = A + B

Where:

Number of days of eligible service

period in the expenditure year

$$A = \$2,969 \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

service period

$$B = (\$2,969 \text{ less } A) \times 80\%$$

For the year ended 30 June 2001

- expenditure on irrigation in the same manner as taxpayers who are small business taxpayers (section 387-125 of the ITAA 1997);
- depreciation of trellising as per paragraphs 59 and 60;
- expenditure on acquiring and planting the vines in the same manner as taxpayers who are small business taxpayers (section 387-165 of the ITAA 1997);
- the Licence Fee (section 8-1 of the ITAA 1997); and
- the Management Fee eligible to be claimed as a deduction is determined using the following formula:

Available deduction = \$5,597 + A

Where:

A = balance of the Year 1 expenditure not previously deducted

For the year ended 30 June 2002

- expenditure on irrigation in the same manner as taxpayers who are small business taxpayers (section 387-125 of the ITAA 1997);
- depreciation of trellising as per paragraphs 59 and 60;
- expenditure on acquiring and planting the vines in the same manner as taxpayers who are small business taxpayers (section 387-165 of the ITAA 1997);
- the Licence Fee (section 8-1 of the ITAA 1997); and
- the Management Fee (section 8-1 of the ITAA 1997).

Growers who are not small business taxpayers who invest after 30 June 2000

56. For a Grower who is **not a 'small business taxpayer'** and is carrying on a business, who invests in the Project after 30 June 2000, the deduction available in respect of the Management fee is determined under sections 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5).

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

58. For a Grower who is not a small business taxpayer who invests after 30 June 2000 deductions will be available as follows:

- expenditure on irrigation in the same manner as taxpayers who are small business taxpayers (section 387-125 of the ITAA 1997);
- depreciation of trellising as per paragraphs 59 and 60;
- expenditure on acquiring and planting the vines in the same manner as taxpayers who are small business taxpayers (section 387-165 of the ITAA 1997);
- the Licence Fee incurred (section 8-1 of the ITAA 1997); and
- the Management Fee eligible to be claimed as a deduction is determined using the following formula:

number of days of eligible service period in
the expenditure year

Expenditure x

Total number of days the eligible service
period

The availability of a deduction under the transitional arrangements is limited by the operation of subsections 82KZMB(7) and 82KZMC(1) – where this is the first year of a Grower's involvement with this Project they limit the deduction under the transitional provisions to nil.

Deduction for depreciation for Growers who are not small business taxpayers

59. For a Grower who is not a small business taxpayer the deduction for depreciation of trellising is determined using the formulas in either subsection 42-160(3), 'Diminishing value method', or 42-65(2A), 'Prime cost method'. The formulas use 'effective life' to determine the deduction for depreciated.

60. The following is an estimate of deductions available for trellising to a Grower, who is **not a 'small business taxpayer'** and is carrying on a business, over the first three years of a Grower's investment:

Expenses	Legislation ITAA 1997	Refer Note	Year 1	Year 2	Year 3
Trellising	42-15	(iv)		27	36

(Note: All figures shown are exclusive of GST)

- (iv) For Year 2 the deduction will depend 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. The Manager is to advise any affected Growers of relevant details of their depreciation deductions for Year 2. The deduction for Years 2 and 3 has been calculated using the prime cost method on the assumption that the effective life of the trellising is 20 years – (that is, the length in years of the project), using the 'Prime cost method'. If the diminishing value method is chosen the deductions available in Years 2 and 3 will be:

If the Grower elects to use the diminishing value method the rate for calculating the deduction will be 7.5%. The deduction available in Years 2 and 3 are estimated to be:

Expenses	Legislation	Year 1	Year 2	Year 3
	ITAA 1997			
Trellising	42-15		41	51

Assessable Income

61. For a Grower who invests in the Project, any income received from the sale of Grapes from the Grower's Area will be assessable income under section 6-5.

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

62. For a Grower, who is a small business taxpayer, the following provisions have application as indicated:

- Where a Grower invests in the Project before 1 June 2000, the expenditure for Management Fees does not fall within the scope of section 82KZM;
- Where a Grower invests in the Project on or after 1 June 2000, the expenditure for Management Fees does not fall within the scope of section **82KZM (but see paragraph 66, 67 and 68)**.

63. For a Grower, who is not a small business taxpayer and who is carrying on a business, the following provisions have application as indicated:

- Where a Grower invest in the Project before 1 June 2000, the expenditure for Management Fees does not fall within the scope of section 82KZMB as the services will be provided by 30 June 2000; and

- Where Growers invest in the Project on or after 1 June 2000, the expenditure for Management Fees falls within the scope of section 82KZMB as the services to be provided in respect of the Year 1 fee will not be completed within the same year of income as the expenditure in question is incurred (**but also see paragraphs 67 and 68**).

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

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

Proposed new laws

Proposed changes to prepayment rules

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

67. For these Growers, the amount of deduction available in respect of the Management Fee is calculated using the formula shown below (see also Example 2 at paragraph 128). In the calculation, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 ITAA 1997 whose 'eligible service period' ends not more than 13 months after it is incurred by the taxpayer. The 'eligible service period' (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

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

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

Note to promoters and advisers -

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

Explanations**Sections 27-5 and 27-30**

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

70. Section 27-5 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 a Grower has.

Section 960-Q: Small business taxpayers

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

72. Whether or not a Grower is a 'small business taxpayer' depends upon the individual circumstances of each Grower. It is the responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

73. 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.

74. '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: licence and management fees

75. It is appropriate, as a starting point, to consider whether licence and management fees are deductible under paragraph 8-1(1)(a). This consideration proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoing is not deductible under paragraph 8-1(1)(b) if it is incurred when the business has not commenced; and
- where 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 paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoing in question would have a sufficient connection with activities to produce assessable income of the taxpayer.

76. A vineyard project can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from grapes from the scheme will constitute 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 vines.

77. Generally, a Grower will be carrying on a business of a vineyard where:

- the Grower has an identifiable interest in specific grape vines coupled with a right to harvest and sell the grapes produced;
- the vineyard 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.

78. Under the Licence and Management Agreement, Growers have rights in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of a commercial vineyard. Under the Licence and Management Agreement, Growers appoint Stoneham Estate Management Limited, as Manager, to provide services such as planting. The agreement gives Growers full right, title and interest in the grapes produced and the right to have the grapes sold for their benefit.

79. Under the Agreement, Growers appoint the Manager to provide services such as preplanting and planting of grape vines (which are owned and paid for by the licensee), the installation of trellising and irrigation, and all operations necessary to develop and maintain a mature fruit bearing vine. The Manager is also responsible for harvesting and selling the grapes.

80. The Licence and Management Agreement gives Growers an identifiable interest in specific vines and a legal interest in the land by virtue of a licence. Growers have the right personally to market the produce attributed to their licensed area or they can elect to use the Manager, Stoneham Estate Management Limited, to market the produce for them.

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

82. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

83. Growers will engage the professional services of a Manager with appropriate credentials. The services are based on accepted viticulture practices and are of the type ordinarily found in viticulture practices activities.

84. Growers have a continuing interest in the vines from the time they are acquired until they reach the end of the most productive period of their life. There is a means to identify which vines Growers have an interest in. The vineyard 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' vineyard activities will constitute the carrying on of a business.

85. The management fees and licence fees associated with the vineyard activities will relate to the gaining of income from this business and, hence, have a sufficient connection to the operations by which this income (from the sale of grape produce) is to be gained from this 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. No capital component is identifiable. The tests of deductibility under paragraph 8-1(1)(a) are met. The exclusions of subsection 8-1(2) do not apply.

86. Licence and management fees are pre-paid. Taxation Ruling TR 94/25 states that the facts in *Coles Myer Finance Ltd v. Federal Commissioner of Taxation* (1993) 176 CLR 640; 93 ATC 4124; (1993) 25 ATR 95 were fundamentally different from those of a pre-payment and that the decision did not affect the deductibility of pre-paid expenses. The licence and management fees will be incurred in the year of payment.

Expenditure of a capital nature

87. Any part of the expenditure of a Grower entering into a horticultural 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. In this Project, the costs of irrigation, trellising, rootlings and construction of roads and buildings are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, expenditure of this nature can fall for consideration under specific capital write-off provisions of the ITAA 1997.

Section 42-15: trellising expenditure

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

89. 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.

90. It is, however, accepted in certain circumstances that a licensee is entitled to claim depreciation where they are considered to be the owner of those improvements. Income Tax Ruling IT 175 sets out the Australian Taxation Office's (ATO's) views on this issue. Where a 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, the ATO accepts the licensee is entitled to claim depreciation for the fixture.

91. Under section 42-15 Growers are entitled to depreciation deductions for expenditure of \$717, relating to the acquisition and installation of trellises on the land. 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.

92. 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.

93. Growers who are not 'small business taxpayers' will have entered the Project after 11:45am, AEST, 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.

94. A Grower accepted into the Project enters into a licence for a right to occupy certain land upon which they are entitled to grow grapes to conduct a viticulture business. Subject to the terms and conditions of the Licence and Management Agreement, they have a right to remove the vines and fixtures within their Grower's Area.

95. The Manager will advise Growers the date the trellising is installed and begins to be used for the purpose of producing assessable income. Therefore, the cost that relates to the acquisition and installation of trellises on the land will be eligible for depreciation deduction by the Growers, who are small business taxpayers, under section 42-125, at a rate of 13% prime cost or 20% diminishing value from this date. Growers, who are not small business taxpayers, will be eligible for a depreciation deduction under subsections 42-160(3) or 42-165(2A), at a rate of 5% prime cost or 7.5% diminishing value from this date.

Subdivision 387-B: irrigation expenditure

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

97. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant or lessee, a deduction would be available to the Growers in the Project at a rate of 33.3% per annum for the cost of the irrigation system.

Section 387-165: horticulture expenditure

98. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. Costs of establishing horticultural plants may include the cost of acquiring the plants; the cost of establishing the plants; and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or clearing land. Under subsection 387-170(3), the definition of 'horticulture' includes the cultivation of grapevines. For the purpose of this Subdivision, a lessee or licensee of land carrying on a business of horticulture is treated as owning the plants growing on that land rather than the actual owner of the land.

99. The write-off commences from the time the vines are used or held ready for use for the purpose of producing assessable income in commercial horticulture. The write-off deductions will commence when the vines enter their first commercial season. Where the vines are planted in or about September 2000, it is projected that these vines will become commercially productive after a period of 2.5 years. The Manager will advise the Grower of this event.

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

101. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the vines will have an effective life in excess of 13 years. The write-off rate for horticultural plants with an effective life of 13 to 30 years is 13%.

Section 82KZM: prepaid expenditure for small business taxpayers

102. Section 82KZM operates 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. The section affects the deductibility of prepaid expenses where the taxpayer is a small business taxpayer or where the expenditure is not incurred in carrying on a business. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not to be wholly done within 13 months after the day on which the expenditure is incurred.

103. Under the Licence and Management Agreement a management fee of \$2,969 per holding will be incurred on execution of the Agreement. This fee is charged for the provision of Year 1 services to a Grower. The services will be provided within 13 months after the execution of the relevant agreement. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years. The fee is expressly stated to be for a number of specified services. There is no evidence to suggest the services covered by the fee could not be provided within 13 months of the expenditure being incurred.

104. Thus, for the purposes of this Ruling, it is accepted that no part of the Year 1 management fee of \$2,969 is for the Manager to do 'things' that are not to be done wholly within 13 months of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure by Growers, who are small business taxpayers.

105. Subparagraph 82KZM (b)(ii) excludes expenditure of less than \$1,000 from the scope of section 82KZM. The Licence Fee, payable on application for Year 1 and on or before 30 June for each subsequent year is less than \$1,000. Again, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the Licence Fee by Growers who are 'small business taxpayers'.

82KZMA to 82KZMD: prepaid expenditure for non-small business taxpayers

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

107. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Growers investing in the Project on or after 1 June 2000, transitional treatment applies to expenditure incurred in the 1999-2000 income year. Section 82KZMD governs the deductibility of prepaid expenditure where the eligible service period ends more than 13 months after the date the expenditure was incurred, and does not apply to the Project.

108. The deduction available to Growers for the Management Fee and the Licence Fee will be determined in accordance with the rules contained in section 82KZMB.

109. During the transitional period the amount of the deduction available to Growers is determined using the formula in subsection 82KZMB(3) and the percentages shown in the table in subsection 82KZMB(5).

110. An amount of expenditure that is less than \$1,000 is fully deductible in the year incurred (subsection 82KZMA (4) ITAA 1936).

111. Under the Licence and Management Agreement the management fee of \$2,969 will be incurred on execution of that agreement. The management fee is charged for the provision of Year 1 services to a grower. Where the Grower invests prior to 1 June 2000 the services will be provided by 30 June 2000.

112. Where the Grower invests prior to 1 June 2000 there is no evidence to suggest the 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 Year 1 fee is for the Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. The basic preconditions for the operation of sections 82KZMB and 82KZMC are not satisfied; therefore they will not apply to the expenditure by the Growers who are not small business taxpayers.

113. Where the Grower invests on or after 1 June 2000 there is evidence to suggest the services to be provided in respect of the Year 1 fee could not be completed 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 a part of the initial fee is for the Manager doing 'things' that are not to be wholly done within the year of income in which the fee is incurred. On this basis, the basic preconditions for the operation of sections 82KZMB and 82KZMC are satisfied. The provisions will apply to the management fees for Year 1 for a grower who is not a small business taxpayer and who invests in the project between 1 June 2000 and 30 June 2000.

Proposed changes to prepayment rules

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

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

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

116. The arrangement relating to the Project and described at paragraph 13 to 45 of this product ruling is within the description of a 'tax shelter arrangement'. Therefore, the Management Fee and the Lease Fee incurred by Growers who invest in the Project after 11 November 1999 will be deductible over the period the services are provided. The formula for calculating the deductible amount is expected to be the same as that currently shown in subsection 82KZMD(2).

Section 82KL

117. 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'.

118. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received 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.

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

Part IVA: general anti-avoidance provision

120. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into or carrying out the scheme to enable the relevant taxpayer to obtain a tax benefit in connection with the scheme (section 177D).

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

122. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of the grapes from the vines. Further, there are no features of the Project, such as the payment of excessive management fees and non-recourse loan financing by any entity associated with the Project, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude, that it would attract the operation of Part IVA. No ruling is given on the application of Part IVA to financing arrangements entered into between investors and other financiers in respect of lending arrangements to invest in the Project.

Section 6-5: assessable income

123. Gross sale proceeds derived from the sale of grapes harvested from the Project will be assessable income of the Growers, under section 6-5.

124. Once harvested, a Grower's grapes will, in most circumstances, be trading stock of the Grower. As a consequence, if

grapes are on hand at the end of the income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of the ITAA 1997. In Income Tax Ruling IT 2001, it is accepted that costs associated with the establishment of a vineyard do not form part of the trading stock ultimately produced by the vineyard.

Part 3-1: capital gains tax

125. To enter the Project, each grower or an associate will subscribe for 1,342 ordinary \$1 shares in respect of each 0.1 Licensed Area participation interest of the Grower. Unless any shares in the Lessor are trading stock of the Grower or otherwise assessable on revenue account to the Grower, a capital gain or loss will arise on the sale of those shares.

126. In the event that the Lessor is liquidated at the conclusion of the Project, further taxation considerations arise for the Grower holding shares in the Lessor. Any distribution made to a Grower on liquidation of the Lessor would be deemed to be a dividend to the Grower, to the extent of the undistributed profits of the Lessor. This dividend would be assessable as a normal dividend and may have franking credits attached. Further, a capital gain or loss could arise, based on the difference between the Grower's indexed cost base and the amount distributed in accordance with the provisions of Part 3-1 of the ITAA 1997.

Examples

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

Joseph Gardener has been in business for a number of years and has calculated his average turnover for the 1999/2000 income year to be greater than \$1 million. Therefore, he is not a small business taxpayer and is subject to the 21 September 1999 changes to the tax laws relating to prepaid expenditure. Joseph enters into a contract with Pinetree Pty Ltd to manage his one hectare interest in the No 2 Pine Plantation. Joseph's management contract is executed on 20 October 1999 for management services to be provided from 1 June 2000 to 31 May 2001. Under the contract, the first five year's management fees, payable in advance on 1 June each year for services to be provided for the following 12 months, are \$6,000 in the first year and \$1,200 for each of the following four years. Joseph is unable to deduct the whole of his prepaid management fees in the years in

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

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

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

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

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

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

The balance of the \$6,000 management fees that were prepaid on 1 June 2000 (i.e. \$1,101) is carried forward and can be claimed as a deduction in the 2000/2001-income year.

For 2000/2001, Joseph can claim a deduction of \$1,861 for expenditure incurred after 1 July 2000 and before 30 June 2001 on management fees. This amount is calculated as A + B + C where:

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

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

$$C = \$1,101$$

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

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

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

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

$$C = \$440$$

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

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

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

	Number of days of eligible service period in the expenditure year
Management fee X	<hr/>
	Total number of days of the eligible service period
\$6,000 X $\frac{30}{365}$	

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

Detailed contents list

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Commissioner of Taxation

22 March 2000

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Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
 TR 94/25; TR 98/22; TR 97/11;
 TR 97/16; TD 93/34; IT 175; IT 2001

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- primary production
- primary production expenses

- producing assessable income
- product rulings
- public rulings
- schemes and shams
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- tax avoidance
- tax benefits under tax avoidance schemes
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