



PR 2000/28 - Income tax: Margaret River Watershed Project No.1

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 This document has changed over time. This is a consolidated version of the ruling which was published on *29 March 2000*



Product Ruling

Income tax: Margaret River Watershed Project No.1

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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**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

No guarantee of commercial success

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

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

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

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

Potential investors should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Margaret River Watershed Project No.1, 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 42-125 (ITAA 1997);
 - section 387-55 (ITAA 1997);
 - section 387-125 (ITAA 1997);
 - section 387-165 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZM and 82KZMB - KZMD (ITAA 1936); and
 - Part IVA (ITAA 1936).

Class of persons

3. 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'.

4. 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

5. 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

7. This Ruling applies prospectively from 29 March 2000, the date the 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).

8. 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

9. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

10. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Application for Product Ruling dated 17 January 2000;
- The Margaret River Watershed Project No.1 Draft Prospectus, undated;
- **Constitution for the Margaret River Watershed Project No.1 between Primary Securities Ltd [the ‘Responsible Entity’], Primary Securities Ltd [‘the Bare Trustee’] and the Grower, undated;**
- **Marketing and Management Agreement between Watershed Marketing and Management Pty Ltd [the Manager], Primary Securities Ltd [the ‘Responsible Entity’], Primary Securities Ltd [‘the Bare Trustee’] and the Grower, undated;**
- **Lease between Watershed Land Ltd [Owner], Primary Securities Ltd [the ‘Responsible Entity’], and the Grower, undated;**
- Compliance Plan for the Margaret River Watershed Project No.1, undated and;
- Wine Production Agreement between Watershed Marketing and Management Pty Ltd [the Manager], Watershed Wines Ltd [the Winery] and Gillard Turner & O’Brien Pty Ltd trading as Custodian & Funds Management Services (the Custodian).

Note: certain information received from Watershed Marketing and Management Pty Ltd has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

11. The documents highlighted are those the 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 a party to, with the exception of finance agreements to which paragraphs 34 and 35 apply. The effect of these agreements is summarised as follows.

Overview

12. These arrangements are called the Margaret River Watershed Project No.1.

Location	South West Region of Western Australia, South of Margaret River.
Type of business each participant is carrying on	A commercial viticulture and wine production business for a period of 18 years.
Number of hectares under cultivation	80 hectares
Name used to describe the product	Margaret River Watershed Project No.1
Size of each Vinelot	0.05 hectares
Number of vines per hectare	1,600
Expected production	300 cubic metres / hectare
The term of the investment in years	18 years
Initial cost	\$4,220
Initial cost per hectare	\$84,400
Ongoing costs	Annual Management Fees and Rent

13. Growers applying under the Prospectus enter into a Marketing and Management Agreement and a Lease. Watershed Land Ltd agrees to lease to a Grower an identifiable area of land called a 'Vinelot' until the Project is terminated on 30 June 2018. Each Vinelot is 0.05 hectares in size.

14. The Project Land is situated in the South West Region of Western Australia, approximately 5kms south of Margaret River. Watershed Land Ltd owns the land.

15. Watershed Land Ltd will lease the Vinelot to the Grower for the purpose of Cultivating Vines and Harvesting Grapes.

16. The Draft Prospectus states that there is a minimum subscription and no applications will be accepted unless there are applications for at least 1000 Vinelots. Each investor may subscribe for a minimum of one Vinelot. The Manager will plant approximately 83 vines per Vinelot (1660 per hectare) during the period up to 30

June 2001 following the execution of the Marketing and Management Agreement and Lease (cl 3.2 of Constitution).

17. Possible projected returns for Growers are outlined on page 18 of the Draft Prospectus. The projected returns are subject to the inherent risks of primary production and the commercial risks of a long term venture. Watershed Marketing and Management Pty Ltd has outlined these risks in the Draft Prospectus. Based on the example set out on page 18 of the Draft Prospectus, a Grower could expect to achieve an after tax internal rate of return of 10.92% per Vinelot. Growers will execute a Power of Attorney enabling the Responsible Entity, Primary Securities Ltd, to act on their behalf as required when they make an application for a Vinelot.

Constitution

18. The Constitution for the project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Responsible Entity will keep a register of Growers. A Grower is entitled to assign their Grower's Interest in certain circumstances. The Lease and Marketing and Management Agreement will be executed on behalf of a Grower following them signing the Application and the Power of Attorney Form in the Prospectus. Growers are bound by the Constitution and the Marketing and Management Agreement by virtue of their participation in the Project.

Compliance Plan

19. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Law. Its purpose is to ensure that the Responsible Entity meets its obligations as the Responsible Entity of the Project and that the rights of the Growers are protected.

Interest in Land

20. A lease is granted by the Land Owner, Watershed Land Ltd, to the Growers under the terms of the Lease (cl.2.1). Growers are granted an interest in land in the form of a lease to use their Vinelots for the purpose of cultivating vines and harvesting grapes for commercial grape production (Recital C). Growers must pay rent to the Lessor of an amount of \$320 per Vinelot per annum commencing on 30 June 2001, payable in arrears. This fee will be indexed annually from year 3. The term of a Grower's lease is from the Commencement Date until 30 June 2018.

Marketing and Management Agreement

21. Each Grower enters into a Marketing and Management Agreement with the Manager. The termination of the project is the date on which all wine has been sold, proceeds from the sale of wine have been paid, and all accounts and reports have been given in relation thereto (cl.3). Growers contract with the Manager to plant, manage, maintain and harvest grapes from the vines. Growers pay a Management Fee of \$8,130 in Year One, \$4,400 in Year Two, \$4,160 in Year Three and an amount annually thereafter which is the Grower's proportion of the Manager's actual costs for performing the services under this agreement.

22. The Manager will carry out the following services under this agreement:

- prepare and cultivate the Vinelots in a proper and skilful manner pursuant to the Marketing and Management Plan;
- take any necessary steps to prevent or combat land degradation in relation to the Vinelots;
- purchase and plant rootlings and vines in a healthy condition;
- tend to the rootlings and vines according to the principles of good husbandry, including applying fertiliser;
- maintain and/or upgrade fences to prevent the entry of kangaroos and vermin, soil degradation and protect the placement of vines;
- keep the vines in good and substantial repair and condition and conduct activities on them in a commercial manner in keeping with accepted viticulture industry standards; and
- do such things as may reasonably be required to eradicate, exterminate and keep the Vinelots and the land free from disease, vermin, noxious weeds, rabbits, kangaroos, insect pests and all other pests.

23. The Manager will harvest (cl 7) each season (except for the initial growing seasons) as and when deemed appropriate in keeping with sound viticultural practice, to produce the best results for the Grower. The Manager will be responsible for paying for the cost of annual insurance on the Vinelots (cl. 12).

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Fees

24. The total fee payable in the first year under the Marketing and Management Agreement for the Project is \$9,250 per Vinelot. This fee includes the Management Fee which is payable in two instalments.

The first instalment of \$3,100 is payable on 1 July 2000 and the second instalment of \$5,030 is payable on 30 June 2001. The balance of the fee is made up of fees for rootlings expenses of \$110, irrigation costs of \$300, landcare expenses of \$180 and trellising expenses of \$530 which are all payable on 1 July 2000 (schedule to the Marketing and Management Agreement). These services will be performed during the period 1 July 2000 to 30 June 2001.

25. A Management Fee of \$4,400 is payable for services to be carried out in the period commencing 1 July 2001 until 30 June 2002 and is payable on 30 June 2002.

26. A Management Fee of \$4,160 is payable for services to be carried out in the period commencing 1 July 2002 until 30 June 2003 and is payable on 30 June 2003.

27. For the years from 1 July 2003 to 30 June 2018, Management Fees are payable by the Grower each year for the Grower's proportion of the actual cost to the Manager of performing the services under the Marketing and Management Agreement for the relevant financial year.

28. Rent of \$320 per year, indexed annually, is payable by the Grower.

29. The Viticulturist Consultant has reported at pages 34 - 39 of the Draft Prospectus that with appropriate establishment procedures and sound management, this project can achieve its aims and objectives as outlined in the Prospectus.

30. The Subscription Monies will be held in the Trust Account by the Bare Trustee formed under the Project's Constitution (cl 6.1(a)).

Planting

31. During the period up to 30 June 2002 the Manager will be responsible for planting rootlings and vines on the leased area. After 30 June 2002, the Manager will tend to the rootlings and vines according to the principles of good husbandry. The services to be provided by the Manager over the term of the project are outlined in the Marketing and Management Agreement (cl 5).

32. The Manager will be responsible for the harvesting of the grapes, and/or purchase of the grapes and delivery of the grapes to the winery and for production of wine from those grapes and storage of the wine. The harvest will take place each season (except for the

initial growing seasons) as and when deemed appropriate by the Manager in keeping with sound viticultural practice to produce the best results for the Grower.

33. The receipts from the sale of wine will be paid into the Trust Account held by the Bare Trustee in the name of the Custodian. Receipts received by the Bare Trustee are to be distributed in the following order of priority:

- to the Responsible Entity for any outstanding fees and expenses payable by the Grower to the Responsible Entity under the Constitution;
- to the Manager for any outstanding fees, costs or interest owing by the Grower to the Manager under the Marketing and Management Agreement;
- to the Owner for any outstanding rent or other fees, costs, interest or expenses owing by the Grower to the Owner under the Lease; and then
- to the Grower provided that if the aggregate sum to be distributed is less than \$1,000, then, at the discretion of the Responsible Entity, distribution to Growers may be postponed. (cl 12 of Constitution).

Finance

34. All Growers are required to fund their investment in the Project themselves or borrow from an independent lender.

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

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

- transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Goods and Services Tax

36. 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 deductions allowable by any GST input tax credit to which a Grower is entitled or, in the case of section 27-5, a decreasing adjustment that a Grower has.

Section 8-1

37. For a Grower who invests in the Project by 30 June 2001, the following deductions will be available for the years ended 30 June 2001 to 30 June 2003:

Deductions available each year

Fee Type	ITAA 1997 Section	Year 1 30/6/2001	Year 2 30/6/2002	Year 3 30/6/2003
Management Fee	8-1	\$8,130	\$4,400	\$4,160
Lease Fee	8-1	\$ 320	\$ 320	\$ 320 (indexed)
Rootlings	387-165	Nil see note (i) below	Nil	Nil
Irrigation	387-125	\$100 see note (ii) below	\$100	\$100
Landcare	387-55	\$180	Nil	Nil
Trellising	42-15	see note (iii) below	\$ 69	\$ 69

(Note: All figures shown are exclusive of GST)

- A deduction under section 387-165 for expenditure on acquiring and planting the vines is calculated on the basis of the grapevines, as horticultural plants, entering

their first commercial season in the year ended 30 June 2004 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%.

- (ii) A deduction under section 387-125 for capital expenditure for the irrigation system is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.
- (iii) For Growers who are 'small business taxpayers' and who comply with the conditions in section 42-345, the deduction for depreciation of trellising is determined using the rates in section 42-125 and the formula in either subsection 42-160(1), 'diminishing value method', or subsection 42-165(1), 'prime cost method'. For the year ended 30 June 2001, the deduction allowed will depend on 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 Growers of this for the year ended 30 June 2001. The deductions available for succeeding years have been calculated 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%.

38. For a Grower who invests in the Project before 30 June 2001 who is **not a 'small business taxpayer'** and is carrying on a business, the deductions available in respect of capital expenditure are shown in the Table below:

Expenses	ITAA 1997 Section	Refer Note	Year 1	Year 2	Year 3
			30/6/2001	30/6/2002	30/6/2003
Trellising	42-15	(iv)	See note (iv) below	\$ 29	\$ 29
Irrigation	387-125	(ii)	\$100	\$100	\$100
Rootlings	387-165	(i)	Nil	Nil	Nil
Landcare	387-55		\$180	Nil	Nil
Total			\$309	\$129	\$129

(Note: All figures shown are exclusive of GST)

Notes:

- (iv) For Growers who are not 'small business taxpayers' the deduction for depreciation of trellising is determined using the formula in either subsection 42-160(3), 'Diminishing value method', or subsection 42-165(2A), 'Prime cost method'. Those formulae use 'effective life' to determine the deduction for depreciation. For the year ended 30 June 2001, the deduction allowed will depend on the number of 'day 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 Growers of this for the year ended 30 June 2001. The deduction for each year has been calculated using the prime cost method on the assumption that the effective life of the trellising is 18 years – (that is, the length in years of the project).

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

39. For a Grower who invests in the Project the following provisions of the ITAA 1936 have applications as indicated:

- (i) the expenditure by Growers does not fall within the scope of section 82KZM;
- (ii) the expenditure by Growers does not fall within the scope of sections 82KZMB-82KZMD;
- (iii) section 82KL does not apply to deny the deductions otherwise allowable; and
- (iv) the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Section 6-5 ITAA 1997: assessable income

40. Gross sale proceeds derived from the sale of wine from the project will be assessable income of the Growers under section 6-5 of ITAA 1997.

41. Once harvested, a Grower's grapes will be trading stock of the Grower, as will any bottled wine. As a consequence, if grapes or grape juice or bottled wine 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 ITAA 1997.

42. Each Grower will be notified by Watershed Marketing and Management Pty Ltd of the respective amounts to be brought to

account in proportion to their total holding in the Project, in accordance with Part 2-25 and Taxation Ruling IT 2001.

Explanations

Sections 27-5 and 27-30 ITAA 1997 - Goods and Services Tax

43. Section 27-30 of the ITAA 1997 operates to deny a deduction that would be otherwise available under section 8-1 for the year ended 30 June 2000 to the extent that the loss or outgoing (incurred after 30 November 1999 and before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled after 1 July 2000.

44. 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 Grower has.

Subdivision 960-Q ITAA 1997 - Small business taxpayers

45. In this product ruling the term 'small business taxpayer' is relevant for the purposes of the depreciation of trellising.

46. 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'.

47. 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.

48. '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 ITAA 1997

49. It is appropriate, as a starting point, to consider whether the lease 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.

50. 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 gross assessable income under section 6-5 of the ITAA 1997. 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.

51. Generally, a Grower will be carrying on a vineyard business 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.

52. Under the Lease, Growers have rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of a commercial vineyard. Under the Marketing and Management Agreement, Growers appoint Watershed Marketing and Management Pty Ltd, as Manager, to carry out viticulture farming in accordance with the agreement. The agreements give Growers full right, title and interest in the grapes produced and the right to have the wine sold for their benefit.

53. Under the Lease and the Marketing and Management Agreement, Growers appoint the Manager to provide services such as purchasing and planting rootlings and vines in a healthy condition on the Vinelots, installing trellising and irrigation, and tending to the rootlings and vines according to the principles of good husbandry. The Manager is also responsible for harvesting and selling the grapes. The specific cost of these services provided in the initial period is \$9,250.

54. The Lease gives Growers an identifiable interest in specific vines and a legal interest in the land by virtue of a lease. Growers elect to use the Manager, Watershed Marketing and Management Pty Ltd, to market the produce for them.

55. Growers have the right to use the land in question for the cultivation of vines and harvesting of grapes and to have the Manager enter the land to carry out its obligations under the Marketing and Management 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 neglect, failure to satisfy any substantial duty or the Manager going into liquidation. The activities described in the Marketing and Management Agreement are carried out on the Growers' behalf.

56. 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.

57. 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 activities.

58. 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.

59. The management fees and lease 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 the business. They will, thus, be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. 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.

Expenditure of a capital nature

60. 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 landcare operations 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 ITAA 1997: trellising expenditure

61. 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. The trellising is attached to the land as a fixture. This expenditure is of a capital nature.

62. 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.

63. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. Income Tax Ruling IT 175 sets out the Australian Taxation Office's (ATO's) views on this issue. Where a lessee is considered to own the improvements under a state law, as detailed in the Ruling, or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the lessee is entitled to claim depreciation for the fixture.

64. Under section 42-15 Growers are entitled to depreciation deductions for expenditure of \$530, 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.

65. 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.

66. 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.

67. A Grower accepted into the Project enters into a lease 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 Lease, they have a right to remove all grapes, vegetation other than vines, plant, equipment, implements and any other items they may have brought onto the Vinelot.

68. The Manager will advise Growers of 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 5.5% prime cost or 8.3% diminishing value from this date.

Subdivision 387-B ITAA 1997: irrigation expenditure

69. 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.

70. 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 ITAA 1997: horticulture expenditure

71. 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.

72. 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.

73. 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.

74. 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 387-55 ITAA 1997: Landcare Expenses

75. Section 387-55 allows a deduction for capital expenditure that is incurred on a landcare operation for land in Australia that is being used for carrying on a business of primary production or rural land in Australia that is used for carrying on a business for the purpose of producing assessable income from the use of that land.

76. 'Landcare Operation' for land includes an operation primarily and principally for the purposes of eradicating or exterminating from the land animals that are pests or eradicating, exterminating or destroying plant growth detrimental to the land. It also includes constructing surface or subsurface drainage works on the land if the

construction is primarily and principally for the purpose of controlling salinity or assisting in drainage control.

77. Under the Marketing and Management Agreement, the grower incurs expenditure to eradicate, exterminate and keep the Vinelots and the land free from disease, vermin, noxious weeds, rabbits, kangaroos, insect pests and all other pests. The Growers are accepted as carrying on businesses of primary production and these expenses will be deductible under section 387-55 of the ITAA 1997 in the year they are incurred.

Section 82KZM ITAA 1936

78. 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 of the ITAA 1997. The section applies to certain expenditure incurred under an agreement in return for doing of a thing under the agreement that is not wholly done within the same year of income as the execution of the relevant agreement.

79. Under the Lease and Management Agreement and Management Agreement, fees of \$3,100 per Vinelot will be incurred on the execution of that Agreement. The fee is charged for providing services to a Grower by 30 June of the year of execution of the Agreement. The fee is expressly stated to be for a number of specified services. 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.

80. There is also no evidence that might suggest the services covered by the fee could not be provided in the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Project Manager doing 'things' that are not to be wholly done within the year of income 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 incurred by the Grower. New sections 82KZMB, 82KZMC and 82KZMD also have no application to this Project since the services to be provided in respect of the initial fee are completed in the same year of income as the expenditure is incurred (see paragraph 82KZMA(3)(c)).

Section 82KL ITAA 1936

81. The operation of section 82KZL depends, among other things, on the identification of a certain quantum of 'additional benefits'. In the project, insufficient 'additional benefits' will be provided to

trigger the application of section 82KZL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA ITAA 1936

82. 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 Project will be a ‘scheme’, commencing when the Prospectus is issued. The Growers will obtain an initial ‘tax benefit’ from entering into the scheme, in the form of the deduction for the initial fee, allowable under section 8-1, that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

83. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the trees. The Independent Forester’s Report contained in the Prospectus states that the Project should achieve its financial objective if the forestry regimes set out in the report are followed, good marketing arrangements are put in place and the international economy and climatic factors (especially annual rainfall) are favourable. There are no features of 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.

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29 March 2000

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ATO references:

NO 99/16090-0

BO

FOI number: I 102464

ISSN: 1441-1172