PR 2000/54 - Income tax: Rosedale Vines Project

Product Ruling
Income tax: Rosedale Vines Project

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **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 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 Rosedale Vines Project, or just simply as 'the Project'.

Tax law(s)

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

- section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 27-5 (ITAA 1997);
- section 27-30 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM (ITAA 1936);
- sections 82KZMA to 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 laws 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 become 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. The Commissioner rules on the precise arrangement identified in the Ruling.

9. 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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Date of effect

11. This Ruling applies prospectively from 10 May 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 TR92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect on 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 material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Product Ruling application dated 12 April 2000;
- Prospectus for the Rosedale Vines Project issued by Barossa Vines Ltd ("BVL") dated 26 April 2000;
- **Management Agreement for the Rosedale Vines Project between Barossa Vines Ltd ("Responsible Entity") and the Grower;**
- Vineyard Maintenance Agreement for the Rosedale Vines Project between the Responsible Entity and Vines Management Limited ("Vineyard Manager");
- **Constitution of the Rosedale Vines Project between the Responsible Entity, and the Growers;**
- **Three separate licence agreements for the Rosedale Vines Project, for the periods, Commencement Date to 30 June 2005, 1 July 2005 to 30 June 2010 and 1 July 2010 to 30 June 2015 respectively, between the Responsible Entity and the Grower;**

- Memorandum of Lease between Rosedale Vines Ltd ("Landholder") and the Responsible Entity;
- Compliance Plan for the Rosedale Vines Project;

Note: Certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

15. 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 party to, which are part of the arrangement to which this Ruling applies, other than any finance agreement to which paragraph 39 refers. The effect of these agreements is summarised below:

Overview

16. The arrangement is called the Rosedale Vines Project.

Location	1.5 kilometres west of the township of Greenock in the Barossa Valley region of South Australia
Type of business each participant is carrying on	Commercial growing and sale of premium quality wine grapes
Number of hectares under cultivation	The prospectus provides for 70 hectares to be planted.
Name used to describe the product	Rosedale Vines Project
Size of the leased area	0.10 hectares
Number of vines per hectare	185
Expected production	10 tonnes per hectare
The term of the investment	15 years
Initial cost	$8,600
Initial cost on a per hectare basis	$86,000
Ongoing costs	Maintenance fee of $400 in the second year and Management fee of 7.5% of grape sale proceeds for subsequent years.

Other costs	Growers will be charged for the cost of all insurances as well as harvest costs and vineyard operation costs estimated at $60 and $541 per lot per annum respectively.
Minimum subscription	50 Lots

17. In the prospectus dated in April 2000 applications are invited from people wishing to enter into the Management and Licence Agreement as part of the Rosedale Vines Project. Acceptance of a Grower into the Project will not occur until applications equating to 50 Lots have been received. This ruling does not apply unless minimum subscription is reached by 30 June 2000.

18. Growers entering the agreement will licence the land from the Responsible Entity who have entered into a lease with Rosedale Vines Ltd. Growers will enter into Licence Agreements and a Management Agreement to have vines planted on their licensed lot for the purpose of providing grape harvests annually. The term of the licences will allow returns for a period of fifteen years. The Growers have a discretion to appoint Contractors to perform work on the lot instead of the Manager.

19. For each lot a Grower subscribes to a 'B' Class Share in the capital of the Landholder.$1 of the subscription price is payable on application with the balance payable on 1 July 2005. This share is regarded as stapled.

20. The Growers entering into the Licence Agreements are required to make the following payments to the Landholder:

(i) A fee of $300 a year indexed to the CPI increase (All Groups Index for Adelaide) until year fifteen.

21. The Growers entering into the Management Agreement with BVL for services including the establishment of the vineyard, maintenance, annual harvesting and marketing, pays BVL the following:

(i) A fee of $1,252 comprised of $573 for acquisition and installation of trellising, $464 for acquisition of irrigation equipment and $215 for pre-planting and for planting work.

(ii) An initial management fee of $7,048 for other services to be provided by 30 June 2001.

(iii) A fee of $400 in the second year for operating costs in the licensed lot.

(iv) Further ongoing fees that are estimated as, harvest costs of $60 per lot, vineyard operation costs estimated at $541 and management fees of 7.5% of the grape

proceeds, these costs commencing in the 2001 financial year.

22. The Goods and Services Tax will be applicable to services provided by the Responsible Entity and any Manager after 1 July 2000. The Goods and Services Tax is to be added to the amount of fees detailed above.

23. Possible returns are outlined on page 11 of the Prospectus. The projected returns are subject to risk and no assurance or guarantee is given for the returns. Based on the example set out on page 11 of the Prospectus a Grower will derive an average return of 9%.

Management and Licence Agreements

24. Under the Management and Licence Agreements, Growers enter into licences for one or more lots and contract with BVL to establish the vineyard lot and maintain that lot. Subsequent to this the ongoing costs and fees are to be paid from the proceeds of grape harvests. Growers are not entitled to assign their Licence and Management Agreements except as stipulated on pages 7 and 8 of the Prospectus. The grapes will always remain the property of the Grower and the Grower is not obliged to engage any person, firm or corporation recommended for the performance of work on the Grower's vineyard lot.

Share Ownership

25. A Grower must subscribe for one 'B' Class Share in the capital of the Landholder. The $2,500 payable is payable as to $1 on application, with the balance payable on 1 July 2005.

26. BVL have indicated in the Prospectus that shareholders could reasonably expect dividend returns commencing after the Project terminates at midnight on 30 June 2015.

Licence Agreement

27. Pursuant to the Constitution and the Lease, the Licensor (BVL) has entered into a lease over the whole of the land and is the registered Lessee.

28. Growers entering into the Licence Agreements pay licence fees pursuant to Item 6 of Schedule 1 of these agreements. Growers licence a portion of land in order to establish and maintain a vineyard and to subsequently harvest grapes for sale to the wine industry.

29. The Growers can sell or transfer their Share, Licence Agreement and Management Agreement but must transfer their

interest in all three together. Each Grower will have a licence over an identifiable area of land. Each Grower is advised of the exact location of their lot. Each Grower in their absolute discretion may appoint any competent contractor.

Constitution

30. The Constitution is a deed constituting the Rosedale Vines Trust between Barossa Vines Ltd as the Responsible Entity and each Grower. Growers become bound by the Constitution on the acceptance by the Responsible Entity of the application.

Management Agreement

31. Growers who use the services of BVL the Responsible Entity will enter into the Management Agreement that is summarised at page 38-41 of the Prospectus.

32. Growers enter into this agreement until the year ended 30 June 2015 or subject to clauses 17 and 18 if termination occurs at an earlier date. Clauses 8.5 and 8.6 of the Licence Agreements allow the Grower a right to remove the trellising should they desire to do so.

33. The Responsible Entity is to establish the Growers vineyard by the end of the first year.

34. The management services to be provided by BVL are detailed at clause 5 and clause 6 of the Management Agreement which is summarised in the Prospectus. These services include preparing the vineyard lot, planting healthy grapevine rootlings, installing the appropriate irrigation equipment, ensuring the vineyard lot is maintained in accordance with good viticultural practices.

35. BVL will pool for sale the gross proceeds of grapes. The Grower will be entitled to a pro-rata share of the proceeds of sale, calculated by dividing the proceeds of sale by the number of lots held by all Growers.

36. The income of the Project is to be held by the Custodian of the project, IOOF, and to be applied to reimburse harvesting and vineyard operation costs. Any net income remaining after payment of these fees is to be distributed to the Growers. BVL have contracted with Vines Management Pty Ltd who will enter into a Vineyard Management Agreement with the Responsible Entity. Under this agreement the vineyard manager will provide and co-ordinate all services of an agricultural nature relating directly to the propagation and supply of the rootlings. The preparation of land for planting, the planting and ongoing care and maintenance of vines and other services have been described more fully in the Vineyard Management

Agreement. This entity will report directly to the Responsible Entity. If in any year the sale of produce is insufficient to meet the annual charges, Growers are liable to pay the shortfall.

37. The Responsible Entity is negotiating to execute a Grape Supply Agreement with a major wine producer in the Barossa Valley which will see all grapes sold to this wine producer.

Planting

38. During the Establishment Period, BVL will be responsible for planting vines of the appropriate variety on the Grower's lot. From this point onwards the Responsible Entity will maintain the vines in accordance with sound viticultural practices. In each year the Responsible Entity will determine when it is appropriate to harvest the grapes. The Responsible Entity will provide the Grower with a report of the harvest of the grapes and certain other matters as discussed at Clause 6 of the Management Agreement.

Finance

39. Growers are required to make their own arrangements to finance the application fees, licence fees and share acquisition. In addition, this Ruling does not apply if a Grower enters into a loan arrangement with 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, or become involved, in the provision of finance to Growers for the Project;
- there are indemnity arrangements, or equivalent collateral agreements, in relation to the loan, designed to limit the borrower's risk;
- 'additional benefits' are granted to a borrower, for the purposes 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-arms length;
- repayments of principal and interest are linked to 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 are transferred (by any means, and whether directly or

indirectly) back to the lender, or any associate of the lender; and

- 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

40. For a Grower that 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

41. 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 taxpyaers'.

IMPORTANT: Paragraph 42 (relating to 'small business taxpayers') and paragraphs 44 to 47 (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 49 and 50 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

42. For a Grower who is a **'small business taxpayer'** and invests in the Project before 30 June 2000, the deductions shown in the Table below will be available for the years ended 30 June 2000 to 30 June 2002.

Year Ended		**Year 1 30/6/2000**	**Year 2 30/6/2001**	**Year 3 30/6/2002**
		$	**$**	**$**
Fee Type	**ITAA 1997 Section**			
Management Fee	8-1	7,048 (see note	400	

		(i) below)		
Occupancy Fee	8-1	300		
Preplanting & Planting	387-165			28 (see note (iv) below)
Trellising	42-15	(see note (ii) below)	74	74
Irrigation	387-125 (see note (iii) below)	155	155	154

Notes

(i) Legislative change for Growers who are not 'Small Business Taxpayers' means the full deduction will not be allowed in 2000. See paragraphs 44 to 46 and Example 1 (paragraph 101). Proposed legislative change for all Growers applying to expenditure incurred after 1.00pm, AEST, 11 November 1999 means the full deduction will not be allowed in 2000. See non binding advice in paragraphs 49 and 50 and Example 2 (paragraph 102).

(ii) 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 2000 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. The Responsible Entity is to advise Growers of this for the year ended 30 June 2000. The deductions available for succeeding years have been calculated for illustrative purposes 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.

(iii) 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.

(iv) 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 2002 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%

43. Growers who enter the Project subsequent to 30 June 2000 are entitled to those deductions detailed in paragraph 42 for 'Year 1' for the 2000/2001 income year, whilst in Year 2 such Growers will be entitled to the those deductions detailed in paragraph 42 for 'Year 2', for the 2001/2002 income year.

Growers who are not small business taxpayers

44. 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, the deduction available in respect of the Management Fee and Lease 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 101 illustrates the application of this method).

45. 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.

Year 1: Expenditure incurred on or before 30 June 2000

Available deduction = A + B

Where:

$$A = \text{Expenditure} \times \frac{\text{Number of days of eligible Service period in the expenditure year.}}{\text{Total number of days of the eligible services period}}$$

B = (Expenditure *less* A) x 80%

Year 2: Expenditure is incurred on or after 1 July 2000 and on or before 30 June 2001

Available deduction = A + B + C

Where:

A = Expenditure X (Number of days of eligible service period in the expenditure year. / Total number of days of the eligible services period)

B = (Expenditure *less* A) x 60%

C = balance of the Year 1 expenditure not previously deducted

Year 3: Expenditure incurred on or after 1 July 2001 and on or before 30 June 2002

Available deduction = A + B + C

Where:

A = Expenditure X (Number of days of eligible service period in the expenditure year. / Total number of days of the eligible services period)

B = (Expenditure *less* A) x 40%

C = balance of the Year 2 expenditure not previously deducted.

Note: Growers affected by section 82KZMB will need to be advised by BVL about when their 'eligible service period' begins and ends, in order to perform the calculations described above.

46. 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, the deductions available in respect of capital expenditure are shown in the Table below:

Fee Type	**ITAA 1997 Section**	**Deductions for capital expenditure for taxpayers and are carrying on a business**		
		Year 1	**Year 2**	**Year 3**
		30/6/2000	**30/6/2001**	**30/6/2002**
Trellising	42-15	See note (v) below	$74	$74
Irrigation	387-125	$155 – see note (iii) above	$155	$154

Preplanting and planting of Vines	387-165	See Note (iv) above		

Notes

(v) 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 2000 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 Responsible Entity is to advise any affected Growers of relevant details of their depreciation deductions for the year ended 30 June 2000. The deduction for succeeding years has been calculated, for illustrative purposes, on the assumption that the effective life of the trellising is 15 years – (that is, the length in years of the project).

47. Growers who enter the Project subsequent to 30 June 2000, **who are not 'small business taxpayers'**, are entitled to those deductions detailed in paragraph 42 for 'Year 1' for the 2000/2001 income year, whilst in 'Year 2' such Growers will be entitled to those deductions detailed in paragraph 42 for 'Year 2', for the 2001/2002 income year.

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

Section 35-55 – Commissioner's discretion

47.1 For a Grower who is an individual and who entered the Project on or after 10 May 2000 and prior to any withdrawal of this Product Ruling, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2002 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be, carried on in a manner that is not materially different to the arrangement described in this Ruling.

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

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or

- the 'Exception' in subsection 35-10(4) applies.

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

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

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

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

- expenditure by Growers who are small business taxpayers is not within the scope of section 82KZM **(but see paragraphs 49 and 50);**
- section 82KZMB applies to expenditure by Growers who are not small business taxpayers and are carrying on a business (**but also see paragraphs 49 and 50**);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Proposed new laws

Proposed changes to prepayment rules

49. [Omitted]

50. [Omitted]

Note to promoters and advisers

51. [Omitted]

Explanations

Sections 27-5 and 27-30 – Goods and Services Tax

52. 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 on or before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled on or after 1 July 2000.

53. 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 (on or 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 – Small business taxpayers

54. In this product ruling the term 'small business taxpayer' is relevant for the purposes of certain prepaid expenditure and the depreciation of trellising.

55. 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'.

56. 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.

57. '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 Fess

58. Consideration of whether licence and management fees are deductible under section 8-1 begins with paragraph 8-1(1)(a) on the following basis:

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

59. A viticultural scheme can constitute the carrying on of a business. Where there is a business or a future business, gross sale proceeds from the sale of grapes from the scheme will constitute gross assessable income in their own right. The generation of business income from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be planting, tending, maintaining and harvesting the grapes.

60. Generally an investor will be carrying on a business of viticulture where:

- the investor has an identifiable interest in specific growing vines;
- coupled with a right to harvest and sell grapes;
- the viticultural activities are carried out on behalf of the Grower by the Manager; 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.

61. For this project, the Growers have, under the Licence and Management Agreements, rights in the form of a licence over an identifiable area of land consistent with the intention to carry on the business of viticulture. Under the Management Agreement Growers appoint the Responsible Entity as Manager. The Manager in the establishment period (12 months from date of entrance to the arrangement) will provide the following services, by engaging contractors as are necessary to:

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

62. The specific costs to the Grower of these services provided in the first twelve months is $8,300. In accordance with good viticultural practices the Responsible Entity will see to pruning, vermin control, irrigation, fertilisation, maintaining improvements and otherwise maintain the Growers vineyard lot in accordance with good viticultural practices. In return for these services the Responsible Entity will receive management fees, harvesting costs and reimbursement for vineyard operations from grape proceeds.

63. The Licence and Management Agreements gives Growers full right, title and interest in the grape harvest and the right to have the grapes sold for their benefit.

64. Growers will use the land in order to establish and maintain a vineyard and to subsequently harvest grapes for sale to the wine industry. They will appoint BVL to perform the obligations and duties as imposed on the Manager under the Agreement.

65. The Growers degree of control over BVL as evidenced by the Agreements, and supplemented by the Corporations Law, is sufficient. Under the project Growers are entitled to receive regular reports on BVL's activities. Growers can terminate arrangements with BVL in certain instances, such as where the Manager has failed to perform duties and fundamental obligations under the Agreement.

66. The general indicators of the business, as used by the courts are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangements description for all the indicators discussed in that Ruling. The viticultural report indicates that the site is suitable for vine planting and the directors have indicated, subject to market conditions, that Growers will earn assessable income from the project. Projections contained in the prospectus suggest that the project should return a before tax profit to Growers after the first three years.

67. Growers will engage the professional services of a Manager with the appropriate credentials. Each Grower will have a specific interest in an identifiable area denoted by lot number. The services rendered by the Manager are in line with good viticultural practices and are of the type ordinarily found in viticultural ventures that would commonly be said to be businesses.

68. Growers have a continuing interest in the vines designated on their lot from their planting until the termination of the third licence

agreement on 30 June 2015. The viticultural activities, and hence the fees associated with their procurement, are consistent with the commencement of regular activities that are permanent. The Growers viticultural activities will constitute the carrying on of a business.

69. The fees associated with the viticultural activities will relate to the gaining of income from this business and hence, have a sufficient connection to the operations by which this income (sale of grapes), is to be gained. They will thus be deductible under the first limb of section 8-1. Further, no non-income producing purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. No capital component of the Grower is identifiable from the arrangement apart from those identified. The tests of deductibility under the first limb of section 8-1 are accordingly met. The exclusions of section 8-1 do not apply.

Section 82KZM: Prepaid expenditure for small business taxpayers

70. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure incurred by a 'small business taxpayer' that would otherwise be immediately deductible, in full, under section 8-1. 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 wholly to be done within 13 months after the day on which the expenditure is incurred.

71. Under the Management Agreement, the initial Management Fee will be incurred upon execution of the Agreement. This fee is charged for providing services to Growers for a period of 12 months from the date of execution of the 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 evidence this fee is for services to be provided within 12 months of the fee being incurred.

72. Thus, for the purposes of this Ruling, it is accepted that no part of the initial Management Fee is for the Manager to do 'things' that are not to be wholly done 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 for the Management Fee by Growers who are 'small business taxpayers'.

73. Similar considerations apply to the Licence Fee which, under the Licence Agreement, is payable on or before 31 May each year for a period from the 1 June of that year to 31 May of the following year. Again, the basic precondition for the operation of section 82KZM is

not satisfied and it will not apply to the expenditure for the Licence Fee by Growers who are 'small business taxpayers'.

Sections 82KZMA – 82KZMD – Prepaid expenditure for taxpayers other than small business taxpayers.

74. 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.

75. 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, transitional treatment applies to prepayments initially incurred in the 1999-2000 income year. Section 82KZMD governs the deductibility of prepayment 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.

76. 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. Because the quantum of both the Management Fee and the Licence Fee is lower in the second and subsequent years, the capping provisions contained in section 82KZMC will have no practical effect on the deduction available.

77. 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).

Proposed changes to prepayment rules

78. [Omitted]

79. [Omitted]

80. [Omitted]

Expenditure of a capital nature

81. Any part of the expenditure of a Grower entering into a viticulture business that is attributable to acquiring an asset that

provides an enduring benefit is generally capital in nature. The documentation indicates that certain payments are attributable to the acquisition of capital assets. These capital costs are set out at Clause 15 of the Management Agreement. The costs include preplanting and planting, installation of trellising and irrigation to the Growers lot.

Section 42-15

82. Growers entering into the Project will incur an expense with respect to trellising. Trellising is an item of plant. Where an item of plant is affixed to the land at common law it becomes part of the land and is legally owned by the owner of the land.

83. However, in certain circumstances where a Licensee has a right to remove a fixture or is entitled to compensation for the value of a fixture it is accepted, pursuant to Taxation Ruling IT 175, that the Licensee is entitled to claim depreciation for the fixture.

84. A Grower that is accepted into the Project enters into legally binding agreements that confer on the Licensee, pursuant to clause 8.5 and 8.6 of the Licence Agreement, a right to remove the trellising and receive compensation for its market value.

85. Under section 42-15 Growers are entitled to depreciation deductions for expenditure of $573, 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.

86. The depreciation deduction available to a Grower who is a 'small business taxpayer' and who complies with the conditions contained in section 42-345 is calculated using the cost of the trellising and a rate of 13% prime cost or 20% diminishing value. These accelerated rates of depreciation are shown in section 42-125 and apply to plant with an effective life of between 13 and 30 years.

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

Subdivision 387-B

88. Capital expenditure incurred by a Grower carrying on a viticultural business in the construction, acquisition and installation of

plant, equipment and structural improvements to be used primarily and principally for the purpose of conserving or conveying water for use in such a business qualifies for a write off over a three year period. Subdivision 387-B of the ITAA 1997 requires no pro-rating of this particular expense. The requirements of this section are that the taxpayer claiming the deduction is carrying on a business of primary production and therefore a Growers expenditure will commence upon the signing of the agreements, at the time the expenditure is incurred. The Responsible Entity, BVL, has identified that the expenditure applicable to the conserving or conveying of water for the vineyards is $464. For a Grower entering into the Project prior to 30 June 2000 they will be entitled to a deduction under Section 387-125 of $155.

Subdivision 387-C

89. Subdivision 387-C of the ITAA 97 allows capital expenditure incurred in establishing horticultural plants to be written off where the plants are used in a business of horticulture.

90. The write off commences from the time the vines are used or held ready for use for the purpose of producing assessable income in the horticulture business. The write off rate will be 13% per year, assuming an effective life of a plant of less than 30 years. Deductions will, for a Grower accepted into the Project by 30 June 2000, commence in the third year of the Project as it is then that the grapevines enter their first commercial season.

91. Costs of establishing horticultural plants, as indicated in the Prospectus, include the cost of acquiring the plants and establishing the plants and preparing the land ready for planting.

92. The Responsible Entity BVL has identified that the relevant expenditure attributable to these establishment costs is $215.

93. A deduction will be available for the year ended 30 June 2002 of $28.

Section 82KL

94. 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’.

95. ‘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.

96. 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 of ITAA 1997.

Part IVA

97. 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).

98. The Rosedale Vines project will be a "scheme". The Growers will obtain a tax benefit from entering into the scheme, in the form of a tax deduction per lot, 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 for the dominant purpose of obtaining this tax benefit.

99. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the annual harvesting of grapes. Further, there are no features of the project, for example, such as the Licence and Management fees being excessive and uncommercial, predominantly financed by non recourse loan and resulting in insufficient real money coming into the Manager's hands, that might suggest the project was so tax driven and so designed to produce a tax deduction for a certain magnitude that will attract the operation of Part IVA.

Interest Deductibility

100. Growers may finance their investment through a loan facility. Deductibility of the interest incurred under section 8-1 depends on the same reasoning as that applied to the Licence and Management fee as set out in paragraphs 57-68 above. The interest incurred will be in respect of a loan to finance the viticultural operations that will continue to be directly connected with the gaining of business income of the Project. These interest amounts will thus also have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of these interest

amounts and these amounts will be deductible to the Grower under section 8-1.

Examples

101. **Example 1: Obligation to prepay expenditure arising on or after 11.45am AEST 21 September 1999 and before1pm AEST 11 November – applies to taxpayers who are not small business taxpayers and are carrying on a business:**

Joseph Gardener has extensive business interests and his turnover for the 1999/2000 income year exceeds $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. Under the contract, the first five year's management fees, payable 12 months in advance on 1 June each year, 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 $4,899 for expenditure incurred on or 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 = (Management fee *less* A) X 80%

= ($6,000 - $493) X 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 on or after 1 July 2000 and on or before 30 June

2001 on management fees. This amount is calculated as A + B + C where:

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

B = (\$1,200 - \$99) X 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 X $\frac{30}{365}$ = \$99

B = (\$1,200 - \$99) X 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.

102. **Example 2: Obligation arising after 1pm AEST 11 November 1999 to prepay expenditure – applies to all taxpayers investing in 'tax shelter arrangements':**

Assume the same fact 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:

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

service period

$6,000 X 30 = $493
365

In the following year Joseph can claim the balance of the $6,000 prepayment (i.e., $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

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

Commissioner of Taxation
10 May 2000

Previous draft:
Not previously issued in draft form.

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

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

Legislative references:
- ITAA 1997 8-1
- ITAA 1997 27-5
- ITAA 1997 27-30
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 42-15
- ITAA 1997 42-118
- ITAA 1997 42-125
- ITAA 1997 42-160
- ITAA 1997 42-165
- ITAA 1997 42-345
- ITAA 1997 387-55
- ITAA 1997 387-125
- ITAA 1997 387-165
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
- ITAA 1936 82KH
- ITAA 1936 82KL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 PIVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- TAA 1953 Pt IVAAA
- Copyright Act 1968

ATO references:
NO 2000/6401
BO
FOI number: I 102674
ISSN: 1441-1172