

# ***PR 2000/85 - Income tax: James Estate Vineyard Project***

⚠ This cover sheet is provided for information only. It does not form part of *PR 2000/85 - Income tax: James Estate Vineyard Project*

⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *28 June 2000*



# Product Ruling

## Income tax: James Estate Vineyard Project

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### *Preamble*

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

### **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.

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.

## **What this Product Ruling is about**

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1. This Ruling sets out the Commissioner's opinion on the way in which the "tax 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 James Estate Vineyards Project, or "the Project" or the "product".

### **Tax law(s)**

2. The tax law(s) dealt with in this ruling are;
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - section 8-1 of the ITAA 1997;
  - section 25-25 of the ITAA 1997;
  - section 35-10 of the ITAA 1997;
  - section 35-30 of the ITAA 1997;
  - section 35-35 of the ITAA 1997;
  - section 35-40 of the ITAA 1997;
  - section 35-45 of the ITAA 1997;
  - section 35-55 of the ITAA 1997;
  - section 42-15 of the ITAA 1997;
  - section 70-35 of the ITAA 1997;
  - section 110-25 of the ITAA 1997;
  - section 387-125 of the ITAA 1997;
  - section 387-185 of the ITAA 1997;
  - section 960-Q of the ITAA 1997;
  - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
  - section 82KZM of the ITAA 1936; and
  - Part IVA of the ITAA 1936.

### **Class of persons**

3. The class of persons (referred to below as 'Growers') to whom this Ruling applies is those who enter into the project described below. These persons will have a purpose of staying in the project 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.

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. The Commissioner rules on the precise arrangement identified in the Ruling.

6. The class of persons defined in the Ruling may rely on its contents, provided the arrangement is carried out in accordance with details described in the Ruling.

7. 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.

**Note:** Without limiting the generality of the term, a material difference may arise in relation to a variation in the facts of the arrangement described in the Ruling. It may also arise in circumstances where the person otherwise included in the class of persons enters into the arrangement as described, but also enters into transactions or arrangements (including financing arrangements) that, when viewed as a whole with the arrangement described in the Ruling, will produce a different taxation consequence for the arrangement. This might include, for example, where the Grower borrows to enter into the arrangement by way of a limited or non-recourse loan and the overall consequence might be that the arrangement is one that would have attracted the application of a tax avoidance provision.

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## Date of effect

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9. This Ruling applies prospectively from 1 July 2000. 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 this Ruling.

10. 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 pursuant to Taxation Determination TD 93/34.

## Withdrawal

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11. 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

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12. The project that is the subject of this product ruling application is described below. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Draft Prospectus prepared for the James Estate Vineyard Project;
- Draft copy of the Constitution, including the **Licence and Management Agreement** at schedule 3, prepared for the James Estate Vineyard Project, undated between the Cardinal Financial Securities Limited as the Responsible Entity and each Grower;
- Draft copy of Lease Agreement between Cardinal Financial Securities Limited and Sundara Pty. Ltd ('the Lease Agreement');

- Draft copy of Vineyard Development and Management Agreement between Cardinal Financial Securities Limited and James Estate Vineyard Management Pty Limited (undated) ('the Management Agreement');
- Draft copy of Grape Purchasing Agreement between each Grower and James Estate Wines Pty. Ltd (undated); and
- Draft copy of the Compliance Plan for James Estate Vineyard 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.**

13. The document highlighted is that which the Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate (in this Ruling "associate" has the meaning as defined in section 318 of the ITAA 1936) of a Grower, will be a party to, which are part of the arrangement to which this Ruling applies, except agreements that come within paragraph 35 below, concerning the provision of finance. The effect of the agreements listed above is summarised as follows.

### Overview

14. The arrangement is called the James Estate Vineyard Project.

Location	The Project will lease land from Sundara Pty Ltd at Baerami, approximately 10 kms west of Denman, NSW.
type of business each participant is carrying on	Commercial growing and sale of premium quality wine grapes.
number of hectares under cultivation	This prospectus provides for 81 hectares to be planted.
name used to describe the product	James Estate Vineyard Project
size of the area under licence per interest	0.25 hectare
expected production	12.35 tonnes per hectare
the term of the investment	15 years

initial cost per licensed area	\$14,000
initial cost on a per hectare basis	\$56,000
ongoing costs per licensed area	\$463 Management fee \$247 Licence fee Both fees will be indexed by CPI from year 3 onwards.
minimum subscription	200 Growers interests

15. This arrangement is called the James Estate Vineyards Project. The Responsible Entity, Cardinal Financial Securities Limited (CFSL), proposes to offer 324 identifiable licensed areas of 0.25 hectare to Growers.

16. Growers in the James Estate Vineyard Project will be licensed an area of 81 hectares from CSFL. The 81 hectares are subdivided into 324 individually identifiable licensed areas of 0.25 hectare, and CSFL will contract with James Estate Vineyard Management Pty Ltd to plant and establish the new vineyard, install all necessary trellising and irrigation, provide ongoing management of the vineyard once established, and harvest the crop for the term of the licence.

### **Licence, vineyard development, management agreement & grape sale agreement**

17. CFSL will lease identifiable leased areas of 0.25 hectare from Sundara Pty Ltd. ('Lessor') for a term of 15 years.

18. CFSL as Lessee is obliged to provide to the Growers individually identifiable licensed areas of 0.25 hectare with attaching water rights. The Lease Agreement is conditional upon the CFSL entering into the Vineyard Development and Management Agreement.

19. CFSL will contract James Estate Vineyard Management Pty Ltd to:

- establish and develop the vineyard;
- maintain and supervise all viticultural activities on the vineyard plots; and
- harvest and transport the grapes from the vineyard to the winery.

20. CSFL will contract James Estate Wines Pty Ltd to acquire all grapes harvested at market prices for Upper Hunter Valley winegrape of similar quality. The market price will be agreed between the

Responsible Entity & James Estate. Where the market price cannot be agreed by the parties, it will be determined by an independent expert appointed by the Australian Wine Research Institute.

21. CFSL is the Responsible Entity for the Project and will manage Grower's interests in the Lease, Vineyard Development & Management Agreement and the Grape Sale Agreement.

22. The Growers will make the following payments per Licensed Area for the periods 1 July 2000 to 30 June 2001 and 1 July 2001 to 30 June 2002 being the first and second years respectively of operation:

- (i) a management fee of \$463 payable by each investor to James Estate Management Pty Limited for the management of the vineyard;
- (ii) a licence rental of \$247 payable to Sundara Pty. Ltd for Licence of the Grower's Licensed Area of the vineyard;

Management fees and license rentals may be CPI indexed from Year 3 onwards.

### **The Constitution - management conditions**

23. There is a Management Agreement for this Project under which CFSL is to provide management services to the Growers. Further, the Constitution is intended to set out in full the legal relationships between a Grower and CFSL, on acceptance of the Grower into the Project.

24. The Grower enters into a management arrangement with CFSL for the period to 30 June in the 15th year following the commencement of the lease of the Vineyard Lot. CFSL is responsible for the establishment of a vineyard on their behalf, the ongoing maintenance of those vines, the harvesting of grapes from those vines, and the marketing and selling of the grapes.

25. CFSL may subcontract some or all of its obligations under this arrangement to another party, and proposes to contract with James Estate Vineyard Management Services Pty Ltd in this regard.

26. CFSL will be responsible for maintaining records of the activities carried out on behalf of the Grower. The Grower may inspect these records at any time. CFSL is to supply the following reports to each Grower at least once a year:

- the state of health of the grapevines;
- the expected crop levels;
- previous crop yield;
- revenue generated; and

- expenses incurred.

27. A Grower may terminate their agreement with CFSL in certain situations:

- where CFSL commits a breach of any of its obligations and the default is not remedied within 10 Business Days of receiving notice of the breach; and
- where, in accordance with the Corporations Law, a motion is passed by at least 50% of the total number of votes to do so.

28. Any trellises affixed to the land on behalf of a Grower will remain the property of the Grower and the Constitution grants the Grower the right to remove these trellises at the end of the Project.

29. Each Grower's name will be entered in a Growers' Register. Each Grower's name will be matched with a "uniquely identified" Vineyard Lot of 0.25 hectare, and they will be advised of the exact location.

### **Fees payable and work to be performed**

30. Application fees payable by each Grower in respect of the first Issue (the first allocation of Grapevines) are:

- (i) \$1,590 per 0.25 hectare which comprise of project establishment and prospectus costs; and
- (ii) \$12,410 per 0.25 hectare, which is comprised as follows:
  - \$609 for land preparation and headworks;
  - \$162 for soil survey and analysis;
  - \$6 for marking out vineyard;
  - \$327 for ripping and deep fertilising;
  - \$2,184 for the purchase of grapevine rootlings;
  - \$167 for planting the Grapevines;
  - \$611 for the purchase of vinecovers;
  - \$432 for the provision of vine training services;
  - \$2,313 for the purchase and installation of trellising;
  - \$193 for building infrastructure and fencing;
  - \$1,803 for Irrigation works, including the purchase and installation of irrigation, bores, pumps, frost control and other similar irrigation.

All of this expenditure is limited to activities set out in Subdivision 387-B;

- \$3,603 for general farm operations and maintenance of the Vineyard Lot. This particular amount is payable by 1 July 2000. \$1,696 covers the period 1 July 2000 to 30 June 2001 and \$1,907 covers the period 1 July 2001 to 30 June 2002.

31. After the initial application fees of \$14,000 have been applied in the above manner, fees payable in subsequent years are to be met, in the first instance, from the Grower's proceeds from sale of grapes. However, to the extent that the annual management fee of \$463 and/or licence fee of \$247 cannot be discharged in this manner, Growers will continue to be liable personally for any balance owing.

32. Liability for the \$14,000 payable on application does not become a presently existing liability until such time as a Grower completes and lodges their application and the minimum subscription for the Project is achieved.

33. Training expenditure of 3 instalments being \$576 is payable in November 2000, January 2001 and July 2001. The liability for training expenditure arises subsequent to training services being provided.

34. 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.

### **Finance**

35. Growers are required to make their own arrangements to finance the application fees and the Licence and Management fees. 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.

### **Derivation of income**

36. Growers appoint CFSL to be their exclusive agent to market and sell the grapes produced.

37. CFSL may, at its discretion, mix all or some of the grapes from each Grower's managed vineyard lots for subsequent sale. CFSL may also reject and dispose of any grapes which it deems unsuitable for the production of wine.

38. Growers will be entitled to the proceeds from the sale of the grapes without reference to type, quality or volume. However, sale proceeds will be derived by each Grower based on the number of lots licensed by each grower. Possible projected returns for Growers are provided in the draft Prospectus. They depend on a range of assumptions and CFSL does not give any assurance or guarantee whatsoever in respect of the future success of, or financial returns associated with entering into the Constitution and associated agreements.

## **Ruling**

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### **Section 6-5**

39. Growers deriving gross proceeds from the sale of grapes must include these proceeds in their assessable income for the relevant year, under section 6-5 of the ITAA 1936.

**Goods and Services Tax**

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

**Section 70-35**

41. Growers who have harvested grapes on hand at the end of any income year will be holding trading stock of a business carried on by them. The excess of the value of this trading stock at the end of any income year over the value of trading stock at the start of that income year must be included in their assessable income under section 70-35.

**Allowable deductions**

42. For a Grower who invests in the Project before 30 June 2001, the deductions shown in the Table below will be available for the years ended 30 June 2001 to 30 June 2003.

<b>Year Ended</b>		<b>Year 1 30/6/2001</b>	<b>Year 2 30/6/2002</b>	<b>Year 3 30/6/2003</b>
		<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Fee Type</b>	<b>ITAA 1997 Section</b>			
Licence Rental Fees	8-1	247	247	247
Management Fees	8-1	463	463	463
Vine Training	8-1	288	144	
Operational Expenses	8-1	1696	1907	
Trellising	42-15 (see note (i) below)	423	378	302
Irrigation	387-125 (see note (ii) below)	601	601	601
Vines & Planting	387-185 (see note (iii) below)		528	528

**Notes:**

- (i) 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 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 2001. The deductions available have been calculated for illustrative purposes on the basis of using the 'diminishing value method' at a rate of 20%, assuming that is the method that the Grower has chosen under section 42-25 and assuming the trellising is installed on or before 1 August 2000.
- (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) A deduction under section 387-185 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 387-185, 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. 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:

Fee Type	ITAA 1997 Section	Deductions for capital expenditure for taxpayers and are carrying on a business		
		Year 1	Year 2	Year 3
		30/6/2001	30/6/2002	30/6/2003
		\$	\$	\$
Trellising	42-15 see note (iv) below	211	210	189
Irrigation	387-125 see note (ii) above	601	601	601
Pre-planting and planting of Vines	387-185 see note (iii) above		528	528

**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 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. For illustrative purposes, it has been assumed that the trellising will be installed by 1 August 2000 and that the Grower has paid application monies and been accepted into the Project on 1 August 2000, the ‘diminishing value method’ has been adopted and the effective life of the trellising is 15 years. The Responsible Entity is to advise any affected Growers of relevant details of their depreciation deductions for the year ended 30 June 2001.

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

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

- expenditure by Growers for ‘Operational Expenses’ is within the scope of section 82KZM;
- 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**

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### **Losses from non-commercial business activities**

45. Provisions introduced into Parliament, but not yet enacted, will mean that in some circumstances, losses arising from a business activity will not be allowed as deductions in the year that they arise. These provisions will only apply from 1 July 2000 to individual taxpayers (including individual taxpayers in general law partnerships) carrying on a business activity. They will not apply however, to an individual with a loss from a primary production business activity where their non primary production assessable income for the income year (excluding any net capital gain) is less than \$40,000 (proposed subsection 35-10(4)).

46. Under proposed subsection 35-10(2), where an individual taxpayer's business activity does not meet one of the objective tests set out in proposed sections 35-30, 35-35, 35-40 and 35-45 then, unless the Commissioner exercises the discretion in proposed section 35-55, a loss arising in an income year from the taxpayer's business activity cannot be claimed as a deduction in that year. A loss, in this context, refers generally to the excess of a taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

47. The Project's agreements, its (draft) prospectus, and its cash flow projections, show that Growers are expected to incur losses relating to interests in the Project during the Project's early years and, that none of the objective tests are expected to be met in those years. However, provided that a Grower's business activity under the Project is carried on during the income years specified below in the manner described in the Arrangement, the Commissioner will exercise his discretion under proposed paragraph 35-55(1)(b).

48. In accordance with the decision to exercise the discretion during this period, and subject only to the above condition relating to the Arrangement (discussed below at paragraphs 99 and 100), Growers can deduct losses arising from interests they hold in the Project in the years that such losses arise.

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## **Explanations**

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### **Section 6-5 - assessable income**

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

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

50. 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.

51. 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.

### **Section 70-35 - trading stock**

52. Once harvested, a Grower's grapes will be trading stock of the Grower. As a consequence, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of the ITAA 1997.

53. Each Grower will be notified by James Estate 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.

### **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**

58. Consideration is required to determine whether license and management fees are deductible under paragraph 8-1(1)(a). This consideration proceeds on the following basis:

- (i) the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- (ii) the outgoing is not deductible under paragraph 8-1(1)(b) if it is incurred when the business has not commenced; and
- (iii) 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.

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

60. Generally, a Grower will be carrying on a wine grape growing business where:

- (i) the Grower has an identifiable interest in specific grape vines coupled with a right to harvest and sell the wine grapes produced;

- (ii) the business activities are carried out on the Grower's behalf; and
- (iii) 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. Under the Licence Agreement, Growers have rights in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of a commercial vineyard. Under the Constitution or Management Agreement, Growers appoint the Manager to provide services such as maintaining the vines, harvesting the grapes. The Constitution, Licence agreement and Management agreement gives Growers full right, title and interest in the grapes produced and the right to have the grapes sold for their benefit. Growers are considered to have control of their investment.

62. The Constitution gives Growers an interest in the grapes grown on their behalf and the right to have those grapes sold for their benefit. The Project documentation contemplates that Growers will have an ongoing interest in the growing crops. The crops belong to the Growers in the sense that they have an interest in the land on which they are growing and a profit a prendre in respect of the produce, which confers an equitable interest in the crops upon the Grower.

63. The Licence Agreement gives Growers an identifiable interest in specific vines and a legal interest in the land by virtue of a Licence. Growers have the right to use the land in question for grape growing purposes and to have the Manager come onto the land to carry out its obligations under the Management agreement. The Growers' degree of control over the Manager, as evidenced by the Management Agreement and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Manager's activities. Growers are able to terminate arrangements with the Manager in certain instances, such as substantial breach of obligations or insolvency.

64. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. The Independent Horticultural report considers that the Project is realistic and commercially viable. 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, ie., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

65. Growers will engage the professional services of a Manager with appropriate credentials. There is a means to identify which vines Growers have an interest in. The services are based on accepted

viticultural and processing practices and are of the type ordinarily found in grape growing activities that would commonly be said to be businesses.

66. The management fees and rent associated with the growing of wine grapes will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which this income, is to be gained from this business. They will thus be deductible under the first paragraph 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.

67. Rental in relation to the Licensed Area is a recurrent expense not of a capital nature. The expense is incurred in producing assessable income and represents a necessary expense of the Grower's viticulture business. Therefore, rent payable under the Licence Agreement should be deductible under section 8-1 of the ITAA 1997.

68. On the basis of the details contained in the Management Agreement, we believe that the management fees represent a recurring expense not of a capital nature. The expense is incurred in producing assessable income and represents a necessary expense of the Grower's viticulture business. Therefore, management fees payable under the Management Agreement should be deductible under section 8-1 of the ITAA 1997.

69. The operational expenses are incurred in relation to services provided during the period ended 30 June 2001. A Grower who invests in the Project will obtain deductions for the operational expenses for services provided during the year ended 30 June 2001.

70. Vine training expenditure of 3 instalments being \$144 is payable in November 2000, January 2001 and July 2001. The liability for training expenditure arises subsequent to training services being provided. Of this expenditure, \$288 is deductible during the period ended 30 June 2001 whilst the remaining instalment of \$144 is deductible during the period ended 30 June 2002.

### **Section 82KZM - prepaid expenditure for small business taxpayers**

71. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure incurred by a Grower 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.

72. Under the Licence and Management Agreement, the 'operational expenses' will be incurred upon execution of the Agreement. This fee is charged for providing services to Growers for a period of more than 13 months from the date of execution of the Agreement. The fee is expressly stated to be for specified services. There is evidence that this fee is for services to be provided more than 13 months after the fee is incurred.

73. Thus, for the purposes of this Ruling, the 'operational expenses' are 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 satisfied and it will apply to the expenditure for the 'operational expenses' by the Growers.

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

74. 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. The costs include pre-planting and planting, installation of trellising and irrigation to the Growers lot.

#### **Section 42-15**

75. 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.

76. 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.

77. A Grower accepted into the Project pays an amount that entitles them to an undivided beneficial interest in land upon which they are entitled to grow vines to conduct a business of viticulture. Trellising used in the viticultural business will thus belong to the Grower.

78. Under section 42-15 Growers are entitled to depreciation deductions for expenditure of \$2,313, 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.

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79. 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.

80. 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. Subsection 42-160(3) advises that the 'non-small business taxpayer' may calculate depreciation deductions using the following formula for the Diminishing Value Method:

$$\begin{array}{rcccl} \text{Opening} & & \text{X} & \text{days owned} & \text{X} & 150\% \\ \text{Undeducted cost} & & & \underline{365} & & \underline{\text{Plant's} \\ \text{effective life} \\ \text{(in years)}} \end{array}$$

Subsection 42-165(2A) advises that the 'non-small business taxpayer' may calculate depreciation deductions using the following formula for the Prime Cost Method:

$$\begin{array}{rcccl} \text{Cost} & & \text{X} & \text{days owned} & \text{X} & 100\% \\ & & & \underline{365} & & \underline{\text{Plant's} \\ \text{effective life} \\ \text{(in years)}} \end{array}$$

For this Ruling, the effective life of the trellising used for the Project will be 15 years, being the life of the Project.

**Subdivision 387-B**

81. 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 requirement of this section are that the taxpayer claiming the deduction is carrying on a business of primary production. Growers' expenditure will be incurred upon the

acceptance of their application and the achievement of minimum subscription for the Project. The Responsible Entity, CFSL, has identified that the expenditure applicable to the conserving or conveying of water for the vineyards is \$1,803. A Grower entering into the Project prior to 30 June 2001 will be entitled to a deduction under Section 387-125 of \$601.

### **Subdivision 387-C**

82. 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 and where the Grower does not hold sufficient additional interests over and above that of a mere lessee or licensee so as to be deemed an owner for subdivision 387-D.

83. 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 may, for a Grower accepted into the Project by 30 June 2001, commence in the second year of the Project as it is then that the grapevines may enter their first commercial season. CFSL is to advise the Grower of this fact for the year ended 30 June 2001.

84. 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.

85. The Responsible Entity CFSL has identified that the relevant expenditure attributable to these establishment costs is \$4,066.

86. A deduction will be available for the year ended 30 June 2002 of \$528.

### **Section 82KL**

87. 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'.

88. '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.

89. 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**

90. For Part IVA to apply there must be:

- a scheme (section 177A);
- a tax benefit (section 177C); and
- a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

91. The James Estate Vineyard 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.

92. 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 Rental 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 it will attract the operation of Part IVA.

#### **Interest deductibility**

93. 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 Rental and Management fee as set out in paragraphs 58-70 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.

**Proposed changes to losses from non-commercial business activities**

94. Under the rule in proposed subsection 35-10(2), a deduction for losses incurred by individuals (including individuals in general law partnerships) from certain business activities will not be allowable in an income year unless:

- one of four statutory objective tests is met; or
- the Commissioner exercises a discretion to allow the losses.

95. In broad terms, the statutory tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

96. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities of a similar kind. And, under subsection 35-10(4), there is an 'Exception' to the general rule in section 35-55(2) where the losses are from primary production business activities and the individual taxpayer has other assessable income for the income year of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of taxpayers they are beyond the scope of this Product Ruling and are not considered further.

97. Information provided with the application for this Product Ruling indicates that investors in the Project are unlikely to pass one of the statutory tests until the income year ended 30 June 2003 and therefore, unless the Commissioner exercises a discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer the loss from the business activity to a future year.

98. The discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for individual investors who acquire interests in the Project, the

Commissioner has determined that it would be unreasonable not to exercise the discretion in paragraph 35-55(1)(b).

99. The discretion in paragraph 35-55(1)(b) may be exercised where:

- (i) the business activity has started to be carried on; and
- (ii) there is an objective expectation that the business activity of an individual taxpayer with an interest in the Project will either pass one of the statutory tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

100. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above in the manner described in the Arrangement, the Commissioner's discretion will not have been exercised as one of the key conditions in paragraph 35-55(1)(b) will not have been met.

101. In deciding to exercise his discretion the Commissioner has relied upon:

- the report of the independent viticulturist, provided by the Responsible Entity in the Prospectus, and additional expert evidence provided with the application by the Responsible Entity;
- the binding Grape contract(s) with James Estate Wines Pty limited, winemaker for the sale of the grapes, setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the grapes are grown;
- independent, objective and generally available information relating to the viticulture industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity; and
- expert opinion independently obtained by the Commissioner that specifically relates to the Project.

## **Detailed contents list**

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**Commissioner of Taxation**

 28 June 2000
 

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<i>Previous draft:</i>	- ITAA 1936 82KL(1)
Not previously issued in draft form	- ITAA 1936 82KZM
	- ITAA 1936 82KZMA
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZMA (b) (ii)
PR 1999/95; TR 92/1; TR 92/20;	- ITAA 1936 82KZMA(4)
TR 94/25; TR 98/22; TR 97/11;	- ITAA 1936 82KZMB
TR 97/16; TD 93/34; IT 175; IT 2001	- ITAA 1936 82KZMB(2)
	- ITAA 1936 82KZMB(3)
	- ITAA 1936 82KZMB(5)
<i>Subject references:</i>	- ITAA 1936 82KZMB(7)
- carrying on a business	- ITAA 1936 82KZMC
- commencement of business	- ITAA 1936 82KZMC(1)
- fee expenses	- ITAA 1936 82KZMC(3)
- interest expenses	- ITAA 1936 82KZMD
- management fees expenses	- ITAA 1936 82KZMD (2)
- primary production	- ITAA 1936 Pt IIIAA
- primary production expenses	- ITAA 1936 Pt IVA
- producing assessable income	- ITAA 1936 177A
- product rulings	- ITAA 1936 177C
- public rulings	- ITAA 1936 177D
- schemes and shams	- ITAA 1997 6-5
- taxation administration	- ITAA 1997 8-1
- tax avoidance	- ITAA 1997 8-1(1)(a)
- tax benefits under tax avoidance schemes	- ITAA 1997 8-1(1)(b)
- tax shelters	- ITAA 1997 8-1(2)
- tax shelters project	- ITAA 1997 27-5
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	- ITAA 1997 42-15
<i>Legislative references:</i>	- ITAA 1997 42-25
- ITAA 1936 82KH(1)	- ITAA 1997 Subdiv 42-C
- ITAA 1936 82KH(1F)(b)	- ITAA 1997 42-118
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  - ITAA 1997 42-160(3)
  - ITAA 1997 42-165(1)
  - ITAA 1997 42-165(2A)
  - ITAA 1997 Subdiv 42-K
  - ITAA 1997 42-345
  - ITAA 1997 70-35
  - ITAA 1997 Pt 2-25
  - ITAA 1997 Pt 3-1
  - ITAA1997 Subdiv 387-B
  - ITAA 1997 387-125
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- ITAA 1997 387-165
  - ITAA 1997 387-170(3)
  - ITAA 1997 387-175
  - ITAA 1997 387-185
  - ITAA 1997 Subdiv 960-Q
  - ITAA 1997 960-335
  - ITAA 1997 960-340
  - ITAA 1997 960-345
  - ITAA 1997 960-350

ATO references:

NO T2000/008312

BO

FOI number: I 1021301

ISSN: 1441-1172