



PR 2000/89 - Income tax: Settlement 22 Managed Investment Scheme

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 This document has changed over time. This is a consolidated version of the ruling which was published on *12 July 2000*



Product Ruling

Income tax: Settlement 22 Managed Investment Scheme

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Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Settlement 22 Managed Investment Scheme, or just simply as 'the Project'.

Tax law(s)

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

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 8-1 (ITAA 1997);
- section 27-5 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 42-125 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- Part 2-25 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM and 82KZMB - 82KZMD (ITAA 1936); and
- Part IVA (ITAA 1936).

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

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

5. However, if the changes become law, the operation of that law will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded. If requested, when the relevant

law(s) are enacted, the Commissioner will formalise the non-binding information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

6. This Ruling does not deal with the application of the Goods and Services Tax (GST).

Class of persons

7. 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'.

8. 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

9. The Commissioner rules on the precise arrangement identified in this Ruling. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

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

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Date of effect

11. This Ruling applies prospectively from 12 July 2000, the date the Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute

agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

13. 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

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

- Application for Product Ruling dated 14 January 2000;
- The Settlement 22 Managed Investment Scheme Draft Prospectus, undated;
- Draft Lease and Licence Agreement between Settlement 22 Estate Ltd (the Lessor) and Settlement 22 Management Ltd (the Lessee), undated;
- **Draft Constitution for the Settlement 22 Managed Investment Scheme between Settlement 22 Management Ltd (the 'Responsible Entity') and the members of the Managed Investment Scheme (the 'Members'), undated;**
- **Draft Lease and Management Agreement between Settlement 22 Management Ltd (the 'Manager'), Settlement 22 Estate Ltd (the 'Lessor') and the Member (the 'Grower'), undated;**

- Draft Compliance Plan for the Settlement 22 Managed Investment Scheme, undated and;
- Additional information provided by the applicant on request.

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

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 a party to, with the exception of finance agreements to which paragraphs 36 and 37 apply. The effect of these agreements is summarised as follows.

Overview

16. These arrangements are called the Settlement 22 Managed Investment Scheme Project.

Location	Rosa Brook region, about 15 km east of Margaret River in Western Australia.
Type of business each participant is carrying on	A commercial viticulture, wine production and marketing business
Number of hectares under cultivation	113 hectares
Name used to describe the product	Settlement 22 Managed Investment Scheme
Size of each Vineyard Allotment	0.05 hectares
Expected production	9-10 tonnes of grapes per hectare by the year 2006
The term of the investment in years	Approx 16 years
Initial cost	\$13,915 over 3 years, of which \$6,084.10 payable in the first year
Initial cost per hectare	\$121,682 in the 1 st year
Ongoing costs	Annual Fees and Rent

(NOTE: Figures shown include GST)

17. The Project allows members to participate in the ownership and/or operation of a fully integrated wine production and marketing business. This will comprise a vineyard and winery located in the

Rosa Brook region in the South West of Western Australia. Settlement 22 Estate Ltd will be the land owning company which will also own the winery complex and the brandnames and trademarks. Settlement 22 Management Ltd will manage the operations of the Managed Investment Scheme.

18. Investors applying under the Prospectus have a choice of investing in the Managed Investment Scheme so as to become Growers, and/or buying shares in the land owning company, Settlement 22 Estate Ltd. An investor can choose to invest in either or both. The minimum holding is one Vineyard Allotment or a parcel of 2,035 shares in Settlement 22 Estate Ltd. The cost of participation is \$13,915 over the first 3 years per Vineyard Allotment and/or \$3663 per parcel of 2,035 shares.

19. Investors who invest in the Managed Investment Scheme enter into a Lease and Management Agreement with the Manager, Settlement 22 Management Ltd, and the Lessor, Settlement 22 Estate Ltd. Under this Agreement, the Lessor agrees to lease to a Grower an identifiable area of land called a 'Vineyard Allotment' on which the Grower will grow grapes by engaging the Manager to undertake a range of services. Each Vineyard Allotment is 0.05 hectares in size. The Grower will also undertake wine production and marketing activities through the Manager.

20. The Prospectus seeks a minimum subscription of 768 Vineyard Allotments and 1,670,625 shares in the property owning company. If the minimum subscription is not attained by 31 January 2001 there will not be any allotments of Vineyard Allotments or shares and all application monies will be refunded. A total of 2,260 Vineyard Allotments and 4,600,000 shares are offered for subscription. However, oversubscriptions of up to 2 million shares may be accepted by the property owning company.

21. For applications received up to 31 January 2001, the Responsible Entity will execute Agreements and perform all services as required on or before 30 June 2001.

Constitution

22. The Constitution for the project establishes a managed investment scheme to be administered by Settlement 22 Management Ltd for the benefit of the members. It sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Lease and Management Agreement will be executed on behalf of a Grower following signing of the Application and the Power of Attorney Form in the Prospectus. Growers are bound by the Constitution and the Lease and Management Agreement by virtue of their participation in the Project.

Compliance Plan

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

Lease and Management Agreement

24. Each Grower enters into a Lease and Management Agreement with the Manager and the Lessor. The term of the agreement is to 30 June 2016, or the later completion of the final harvest of the Grape Produce.

25. A lease is granted by Settlement 22 Estate Ltd to the Grower to use the Vineyard Allotment for the purpose of carrying on a long term viticulture project. The Grower must pay rent to the Lessor. The rent payable in the first three years is fixed, and in the fourth and following years will be an indexed amount, calculated by reference to the previous year's rent and adjusted by an inflation factor, as provided in the Agreement.

26. Under the terms of the Lease and Management Agreement each Grower also engages the Manager to undertake a number of services on behalf of the Grower in relation to the growing of grapes, producing wines and marketing activities. These include:

- administration and management, including supervising activities, maintaining records, preparing plans, budgets and reports.
- viticultural services, including preparing, establishing and cultivating the Vineyard Allotments, caring for the vines, harvesting and delivering the grape produce, constructing trellising and an irrigation system, keeping the Vineyard Allotments free from weeds, vermin, and pests, fire prevention and control, and so on.
- purchasing grapes to supplement the grape produce from the Vineyard Allotments in order to meet expected wine sales targets.
- processing the Grape Produce into wine in accordance with good commercial and wine-making practice.
- bottling, packaging and storage.
- marketing in accordance with the marketing strategy referred to in the Prospectus.

- distribution and sale of the wine in accordance with strategies referred to in the Prospectus. The Manager will endeavour to sell any Grape Produce and wine on hand at the termination date up to 36 months after that date and then distribute it in specie to Growers.
- arranging for insurance of the Grape Produce and wine.

27. In consideration for those services the Grower pays an Annual Fee. This fee is fixed in the first three years and in the fourth and following years will be calculated by reference to the Grower's proportion of the Manager's actual costs of performing the services.

28. Other than in the first year when fees are payable on application, the annual fees will be payable on or before the beginning of the financial year to which the services relate, ie, on or before 1 July. From the fourth year and onwards, an Estimated Annual Fee will be payable on 1 July of the relevant financial year, calculated as provided in the Agreement. The Manager will calculate the actual Annual Fee after the end of that financial year and there will be a balancing amount credited to or payable by the Grower.

29. The Manager may at its discretion apply against any payments due from the Grower the whole or any part of the Grower's Proportional Interest in any Gross Proceeds from the previous year.

Fees

30. The Growers will make the following payments per Vineyard Allotment for the first three years, commencing during the year ended 30 June 2001:

	Year 1	Year 2	Year 3
Annual Fee	5,903.18	5,168.45	2,284.16
Rent	180.92	186.35	191.94
Total	6,084.10	5,354.80	2,476.10

(Note: Figures shown include GST)

31. The Annual Fees payable in the first two years include some capital costs as follows:

Expenditure	Year 1	Year 2
Trellising	82.50	550.00
Water – dams, irrigation and roaded catchments	842.60	207.90
Vines and planting	-	154.00
Pre-planting, fertilising and soil amelioration	52.80	-
Soil and site preparation including ripping	51.70	-
Initial establishment costs	75.90	48.40

Totals	1105.50	960.30
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(Note: Figures shown include GST)

32. For the years ending 1 June 2004 to 30 June 2016, Annual Fees are payable by the Grower each year for the Grower's proportion of the actual cost to the Manager of performing the services under the Lease and Management Agreement for the relevant financial year, adjusted for the inflation as provided in the Agreement.

33. Rent payments payable in the years ending 1 June 2004 to 30 June 2016 will be calculated by reference to the previous year's rent and adjusted for inflation. The inflation adjustment is undertaken by multiplying the rent by the Inflation Adjustment Factor for that year, which is calculated by dividing the CPI [Consumer Price Index Perth (All Groups)] last published before the date at which the adjustment factor is to be ascertained, by the CPI last published as close as possible to one year prior to that date.

34. The Manager will take out public risk insurance at its own cost and will use its best endeavours to obtain insurance on behalf of the Grower, and at the Grower's expense, in relation to the vineyard infrastructure, vines and growing crops.

35. Where, after 30 June 2004, the Responsible Entity sells at least 90,000 cases of wine per year, an incentive fee per case of wine sold by the Responsible Entity will be payable by the Growers.

Finance

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

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

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;

- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Goods and Services Tax

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

Allowable deductions

39. For a Grower who invests in the Project, the deductions available will depend upon the date that the investment is made and whether or not they are 'small business taxpayers'.

40. The following will be allowable deductions:

- rent paid by the Grower in relation to the Vineyard Allotment (section 8-1 of the ITAA 1997);
- annual fees paid for the services outlined in the Management Agreement, to the extent that they are not of a capital nature (section 8-1 of the ITAA 1997);
- insurance premiums to cover the Vineyard Allotment (section 8-1 of the ITAA 1997);
- a capital write-off for the costs of acquiring and planting the vines, including specified pre-planting and site and soil preparation expenses (section 387-165);
- a capital write-off for the cost of establishing the irrigation system (section 387-125);
- depreciation for the trellising (section 42-15).

41. For a Grower who invests in the Project by 31 January 2001, the following is an estimate of the deductions available for the years ended 30 June 2001 to 30 June 2003:

Expenses	ITAA 1997 Section	Refer Note	Year 1 30/6/2001	Year 2 30/6/2002	Year 3 30/6/2003
Annual Fee	8-1		4797.68	4208.15	2284.16
Rent	8-1		180.92	186.35	191.94
Vines and planting	387-165	(i)	-	10.78	10.78
Pre-planting and soil/site preparation	387-165	(i)	7.31	7.31	7.31
Irrigation	387-125	(ii)	280.86	350.16	350.16
Trellising	42-15	(iii)	up to 10.72	up to 82.22	82.22
Totals			5277.49	4844.97	2926.57

(Note: All figures shown include GST – lesser amounts will be deductible for registered Growers - as described in paragraph 38 above)

- (i) A deduction under section 387-165 for expenditure on the soil preparation, etc, and the acquisition and planting of 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 30 years. This results in a write-off rate of 7%. The Manager will advise Growers of the date that the write-off can commence.
- (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. A further deduction of \$69.30 will be available in the fourth year.
- (iii) For Growers who are ‘small business taxpayers’ and who comply with the conditions in section 42-345, the deduction for depreciation of trellising is determined using the rates in section 42-125 and the formula in either subsection 42-160(1), ‘diminishing value method’, or subsection 42-165(1), ‘prime cost method’. For the year ended 30 June 2001, the deduction allowed

will depend on the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising. The Manager is to advise Growers of this for the years ended 30 June 2001 and 30 June 2002. The deductions shown above have been calculated using the prime cost method at a rate of 13%, assuming that is the method that the Grower has chosen under section 42-25. If the Grower elects to use the diminishing value method the rate for calculating the deduction will be 20%.

42. For a Grower who is **not a 'small business taxpayer'** and is carrying on a business, the deductions available in respect of depreciation of trellising is determined using the formula in either subsection 42-160(3), 'Diminishing value method', or subsection 42-165(2A), 'Prime cost method'. Those formulae use 'effective life' to determine the deduction for depreciation. For the year ended 30 June 2001, the deduction allowed will depend on the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising. The Manager is to advise Growers of this for the year ended 30 June 2001. The deduction for each year can be calculated on the assumption that the effective life of the trellising is 15 years.

43. Any insurance premiums paid by the Grower in a year of income in respect of insurance cover for that year of income will be deductible in that year. Premiums which are prepaid to any extent may require apportionment over different periods subject to the relevant prepayment rules.

Non deductible expenses

44. The 'initial establishment costs' in relation to activities that are capital in nature and are not deductible to the Grower.

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

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

- (i) the expenditure by Growers does not fall within the scope of section 82KZM;
- (ii) the expenditure by Growers does not fall within the scope of sections 82KZMB-82KZMD;
- (iii) section 82KL does not apply to deny the deductions otherwise allowable; and

- (iv) the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Assessable income

46. Gross sale proceeds derived from sales from the Project will be assessable income of the Growers under section 6-5 of ITAA 1997.

47. Once harvested, a Grower's grapes will be trading stock of the Grower, as will any purchased grapes, grape juice or bottled wine. As a consequence, if grapes, grape juice or bottled wine are on hand at the end of the income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of ITAA 1997.

48. Each Grower will be notified by the Manager 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.

49. Any wine distributed to the Grower in specie after the end of the Project will also be assessable income.

Proposed new laws**Losses from non-commercial activities**

50. 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)).

51. 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.

52. 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).

53. In accordance with the decision to exercise the discretion during this period, and subject only to the above condition relating to the Arrangement, Growers can deduct losses arising from interests they hold in the Project in the years that such losses arise.

Explanations

Sections 27-5 ITAA 1997 - Goods and Services Tax

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

Subdivision 960-Q ITAA 1997 - Small business taxpayers

55. In this Product Ruling the term 'small business taxpayer' is relevant for the purposes of depreciation of trellising.

56. 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'.

57. 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.

58. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

Section 8-1 ITAA 1997

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

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

60. A vineyard and winery project can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from grape produce and wine from the scheme will constitute gross assessable income under section 6-5 of the ITAA 1997. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the vines, and the production and marketing of grape produce and wines.

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

- the Grower has an identifiable interest in specific grape vines coupled with a right to harvest and sell the grapes produced;
- the vineyard activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business, as used by the Courts, point to the carrying on of a business.

62. Under the Lease, Growers have rights in the form of a lease over an identifiable area of land consistent with the intention to carry

on a business of a commercial vineyard. Under the Lease and Management Agreement, Growers appoint Settlement 22 Management Ltd, as Manager, to carry out viticulture farming in accordance with the Agreement. The Agreement gives the Grower full right, title and interest in the grapes and wine produced and the right to have the wine sold for their benefit.

63. Under the Lease and Management Agreement, Growers appoint the Manager to provide services such as purchasing and planting rootlings and vines in a healthy condition on the Vineyard Allotments, installing trellising and irrigation, and tending to the rootlings and vines according to the principles of good husbandry. The Manager is also responsible for harvesting the grapes and producing wine from them. The Manager will market the wine as outlined in the Prospectus, and sell it on behalf of the Growers, including to itself, or to its special-purpose subsidiary, for re-sale in its hospitality activities.

64. The Lease gives Growers an identifiable interest in specific vines and a legal interest in the land by virtue of a lease over the Vineyard Allotment. Growers use the Manager to harvest the produce for them, unless they make an election, within 6 months of entering into the Agreement, that they wish to harvest and take delivery of the grapes grown on their Vineyard Allotment.

65. Growers have the right to use the land in question for the cultivation of vines and harvesting of grapes and to have the Manager enter the land to carry out its obligations under the Lease and Management Agreement. The Growers' degree of control over the Manager, as evidenced by the Agreement and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Manager's activities. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of neglect, failure to satisfy any substantial duty or the Manager going into liquidation. The activities described in the Lease and Management Agreement are carried out on the Growers' behalf.

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

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

68. Growers have a continuing interest in the vines from the time they are acquired until the end of the Project in 2016. There is a means to identify which vines Growers have an interest in. The vineyard activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' vineyard activities will constitute the carrying on of a business.

69. The annual fees and rent associated with the vineyard and wine-making activities will relate to the gaining of income from this business and, hence, have a sufficient connection to the operations by which this income (from the sale of wine) is to be gained from the business. They will, thus, be deductible under the first limb of section 8-1 to the extent that they are not of a capital nature. Any fees that relate to services performed prior to the execution of the Agreement will be capital in nature, but this will not apply to Agreements entered into prior to 31 January 2001. Also included in the annual fees in the first two years are certain specified capital expenses which are discussed below.

Expenditure of a capital nature

70. Any part of the expenditure of a Grower entering into a horticultural business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, the costs of irrigation, trellising, pre-planting expenses, acquisition and planting of vine rootlings, and the initial establishment costs are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, some of this expenditure falls for consideration under specific capital write-off provisions of the ITAA 1997.

Section 42-15 ITAA 1997: trellising expenditure

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

72. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose or purposes of producing assessable income where they are the owner of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, absolutely owned by the owner of the land.

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

74. Under section 42-15 Growers are entitled to depreciation deductions for expenditure of \$632.50 (inclusive of GST), 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.

75. 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.

76. Growers who are not 'small business taxpayers' will have entered the Project after 11:45am, AEST, 21 September 1999, and will not be able to claim accelerated depreciation on plant used in the Project because of section 42-118. The deduction for such Growers is calculated using the cost of the trellising and its effective life only. Subdivision 42-C provides the choice of methods available for determining the effective life of plant.

77. A Grower accepted into the Project enters into a lease for a right to occupy certain land upon which they are entitled to grow grapes to conduct a viticulture business. Subject to the terms and conditions of the Lease, they have a right to remove all grapes, vegetation other than vines, plant, equipment, implements and any other items they may have brought onto the Vineyard Allotment.

78. The Manager will advise Growers of the date the trellising is installed and begins to be used for the purpose of producing assessable income. Therefore, the cost that relates to the acquisition and installation of trellises on the land will be eligible for depreciation deduction by the Growers, who are small business taxpayers, under section 42-125, at a rate of 13% prime cost or 20% diminishing value from this date. Growers, who are not small business taxpayers, will be eligible for a depreciation deduction under subsections 42-160(3) or 42-165(2A), based on an effective life of 15 years.

Subdivision 387-B ITAA 1997: irrigation expenditure

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

80. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant or lessee, a deduction would be available to the Growers in the Project for the cost of the irrigation system, in the amount of one third in the year that the expenditure is incurred and one third in each of the next two years of income.

Section 387-165 ITAA 1997: horticulture expenditure

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

82. The write-off commences from the time the vines are used or held ready for use for the purpose of producing assessable income in commercial horticulture. The write-off deductions will commence when the vines enter their first commercial season. It is projected that these vines will become commercially productive in the second year. The Manager will advise the Grower of this event.

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

84. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the vines will have an effective life in excess of 30 years. The write-off rate for horticultural plants with an effective life of 30 years or more is 7%.

Section 82KZM ITAA 1936

85. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full under section 8-1 of the ITAA 1997.

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

86. Under the Lease and Management Agreement, Annual Fees will be incurred on the execution of that Agreement. The fee is charged for providing services to a Grower by 30 June of the year of execution of the Agreement. The fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years.

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

Section 82KL ITAA 1936

88. The operation of section 82KZL depends, among other things, on the identification of a certain quantum of 'additional benefits'. In the project, insufficient 'additional benefits' will be provided to trigger the application of section 82KZL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA ITAA 1936

89. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C), and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Project will be a 'scheme', commencing when the Prospectus is issued. The Growers will obtain an initial 'tax benefit' from entering into the scheme, in the form of the deduction for the initial fee, allowable under section 8-1, that would not have been obtained but for

the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

90. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the Project. The Independent Viticultural Report contained in the Prospectus states that the Project should achieve its production targets provided that all stages of the development are completed in a timely manner and that current best practice is employed in the management of the vines. There are no features of the Project that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that it would attract the operation of Part IVA.

Assessable Income

91. All sales made from the Grape produce and wine produced will be ordinary income of the Grower under the general provisions of section 6-5 of ITAA 1997.

92. Once harvested, a Grower's grapes will be trading stock of the Grower. Products from those grapes such as grape juice or bottled wine will also constitute trading stock. As a consequence, any grapes, grape juice or bottled wine on hand at the end of the income year will need to be accounted for in accordance with the trading stock provisions in Part 2-25 of ITAA 1997, and included in assessable income. Where items such as grapes or grape juice are purchased during the year and held for use in wine-making, these will also constitute trading stock.

93. Each Grower will be notified by the Manager 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.

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:

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- (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 35-10(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 2007 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 independent viticultural report included in the Prospectus provided with the application by the Responsible Entity.

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Commissioner of Taxation

12 July 2000

<i>Previous draft:</i>	- ITAA 1997 42-15
Not previously issued in draft form.	- ITAA 1997 42-25
	- ITAA 1997 42-118
<i>Related Rulings/Determinations:</i>	- ITAA 1997 42-125
PR 1999/95; TR 92/1; TR 92/20;	- ITAA 1997 42-160
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1997 42-165
TD 93/34; IT 175; IT 2001	- ITAA 1997 42-345
	- ITAA 1997 387-125
<i>Subject references:</i>	- ITAA 1997 387-165
- carrying on a business	- ITAA 1997 387-170
- commencement of business	- ITAA 1997 387-175
- primary production	- ITAA 1997 387-185
- primary production expenses	- ITAA 1997 960-335
- management fee expenses	- ITAA 1997 960-340
- producing assessable income	- ITAA 1997 960-345
- product rulings	- ITAA 1997 960-350
- public rulings	- ITAA 1997 Part 2-25
- schemes and shams	- ITAA 1936 82KL
- taxation administration	- ITAA 1936 82KZM
- tax avoidance	- ITAA 1936 82KZMB
- tax benefits under tax	- ITAA 1936 82KZMC
avoidance schemes	- ITAA 1936 82KZMD
- tax shelters	- ITAA 1936 177A
	- ITAA 1936 177C
<i>Legislative references:</i>	- ITAA 1936 177D
- ITAA 1997 6-5	- ITAA 1936 Part IVA
- ITAA 1997 8-1	
- ITAA 1997 27-5	

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