PR 2001/144 - Income tax: Magpie Ridge Vineyards Project - Stage 1

Product Ruling
Income tax: Magpie Ridge Vineyards Project – Stage 1

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Potential participants 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. 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 participants 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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants 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, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Magpie Ridge Vineyards Project – Stage 1 or simply as 'the Project'.

Tax laws

2. The tax laws dealt with in this Ruling are:

- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Part 2-25 (ITAA 1997);
- Division 328 (ITAA 1997);
- Section 44 of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KL (ITAA 1936);
- Section 82KZL (ITAA 1936);
- Section 82KZME (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the Ralph *Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified 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. In this Ruling, each of these persons, referred to as 'Growers', will have accepted an offer made under section 708 of the *Corporations Act 2001*.

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 the Ruling. 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. The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 14 November 2001, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. 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 arrangement specified below. 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 person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 13 August 2001;
- Information Memorandum for Magpie Ridge Vineyards Project - Stage 1 prepared and issued by Norfolk Ridge

Vineyards Ltd ('the Responsible Entity'), dated 18 September 2001;

- **Amended Constitution for Magpie Ridge Vineyards Project between Norfolk Ridge Vineyards Ltd ('the Responsible Entity') and N.R. Properties Ltd ('the Lessor'), dated 1 August 2001;**
- **Lease and Management Agreement – Stage 1 between Norfolk Ridge Vineyards Ltd ('the Responsible Entity'), N.R. Properties Ltd ('the Lessor') and the Grower, dated 1 August 2001;**
- Compliance Plan for Magpie Ridge Vineyards Project adopted by Norfolk Ridge Vineyards Ltd as the Responsible Entity, dated 14 March 2001; and
- Additional correspondence dated 2 August 2001, 13 August 2001, 6 September 2001, 18 September 2001, 3 October 2001, 8 October 2001 and 16 October 2001.

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

15. The documents highlighted are those that Growers enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows.

16. In accordance with the above documents, a Grower who participates in the arrangement must have accepted an offer that was made under section 708 of the *Corporations Act 2001*. This Ruling does not apply unless the Grower:

- has accepted a 'personal offer' under subsections 708(1)-(7) of the *Corporations Act 2001*; or
- is a 'sophisticated investor' for the purposes of subsections 708(8)-(9) of the *Corporations Act 2001*; or
- has accepted an offer made by a licensed dealer where the offer meets the requirements of sub-section 708(10) of the *Corporations Act 2001*; or
- is a 'professional investor' for the purposes of paragraphs (a), (b) or (h) of subsection 708(11) of the *Corporations Act 2001*.

17. Each of these categories is explained in paragraphs 72 to 79 in the Explanations area of this Product Ruling.

Overview

18. The arrangement is called the Magpie Ridge Vineyards Project - Stage 1.

Location	South West Region of Western Australia, near Mt Barker.
Type of business each participant is carrying on	Commercial growing and harvesting of grapevines for the sale of grape produce.
Number of hectares offered for cultivation	The Information Memorandum provides for up to 6.4 hectares to be planted.
Possible total subscription	40 Leased Areas
Size of each Leased Area	0.16 hectares
Minimum allocation	1 Leased Area
Number of Vines established per hectare	1,666 vines per hectare
Expected Production	13 tonnes per hectare
The term of the Project	15 years
Initial Cost	$11,000
Initial costs per hectare	$68,750
Ongoing costs	Annual management fees. Rent. Annual insurance premiums. Cost of harvesting produce. Responsible Entity Bonus.
Other costs	Purchase shares in the Lessor at a cost of $1,000.

19. The Project is to carry out a planting of grapevines upon land that is held by the Lessor. The Project is for a period of 15 years.

20. A Lease and Management Agreement will be entered into between Norfolk Ridge Vineyards Ltd (as the Responsible Entity), N.R. Properties Ltd (as the Lessor) and the Grower. This Agreement is set out in the Schedule to the Amended Constitution. The Agreement provides for the lease of a property located 10 kilometres West of Mt Barker, in Western Australia. The property is situated at

Plantagenet Location 6116 on the corner of Muir Highway and Denmark/Mt Barker Road.

21. The Lease and Management Agreement gives a Grower a Lease from the Lessor over an identifiable area of land called a Leased Area until the Project is terminated pursuant to the provisions of the agreement or on 31 December 2016, which ever happens first.

22. The Grower appoints the Responsible Entity as the manager of the Grower's commercial viticulture project that is to be conducted on their Leased Area. The Responsible Entity will plan, develop, manage and maintain the vines on the Leased Area and be responsible for the harvesting, marketing and sale of the grape produce from the Leased Area. Growers may elect, at any time prior to 31 December 2001, to collect and market their grape produce by giving written notice to the Responsible Entity (clause 17) or the Responsible Entity will sell the grape produce on behalf of the Non-Electing Growers for the highest practicable price (clause 18).

23. Under the Information Memorandum, the Responsible Entity proposes to offer a maximum of 40 Leased Areas. There is no minimum subscription for the Project. The minimum individual holding is one Leased Area, being an allotment of 0.16 hectares of land, which will be planted with a minimum of 267 vines during the period up to 31 December 2001 following the execution of the Lease and Management Agreement. Leased Areas are allocated by the Responsible Entity who shall maintain an up to date register of Growers, identifying the Leased Areas held by Growers. Applications will be accepted until 30 November 2001.

24. Possible projected returns for Growers are outlined at pages 11 and 12 of the Information Memorandum. The Responsible Entity does not guarantee the success of the vineyard. Growers will be exposed to the usual business risks and agricultural risks inherent in primary production due to matters beyond the control of the Responsible Entity such as adverse weather conditions, insect attacks and variable market conditions. The projected returns are subject to the inherent risks of the long term nature of the venture. The Responsible Entity and the Lessor have outlined these risks in the Information Memorandum.

25. Growers will execute a Power of Attorney enabling the Responsible Entity to act on their behalf as required when they make an application for a Leased Area.

26. Each Grower or the Grower's nominee must also subscribe for 10,000 shares in the Lessor.

Amended Constitution

27. The relevant Amended Constitution establishes the Project and operates as a deed binding on all of the Growers of the Project and the Responsible Entity. The Amended Constitution sets out the terms and conditions under which Norfolk Ridge Vineyards Ltd agrees to act as Responsible Entity and thereby manage the Project. The Lease and Management Agreement is annexed to the Amended Constitution and will be executed on behalf of a Grower following them signing the Application and a Power of Attorney Form in the Information Memorandum. Growers are bound by the Amended Constitution by virtue of their participation in the Project. Pursuant to clause 20 of the Amended Constitution, the Responsible Entity will keep a register of Growers. Growers may assign their interest only in certain circumstances as set out in clause 24 of the Lease and Management Agreement.

Lease and Management Agreement

28. The Lease and Management Agreement sets out the roles and obligations of the parties to the agreement. The agreement is entered into between Norfolk Ridge Vineyards Ltd, N.R. Properties Ltd and the Grower. Under the terms of the agreement the Grower may only use the land for the purpose of commercial viticulture and the Project (clause 5.2). Under the agreement the Lessor grants a Lease to the Grower and the Grower appoints the Responsible Entity to plan, develop, manage and maintain the vines on the Leased Area and be responsible for the harvesting, marketing and sale of the grape produce from the Leased Area.

29. The Grower's participation in the Project commences on the date the Grower's Lease and Management Agreement is executed by the Responsible Entity and a Leased Area is allocated to the Grower. The Lease and Management Agreement may be executed following the acceptance of a Grower's Application for Leased Area(s). The Responsible Entity will not accept a Grower's Application for Leased Area(s) unless, amongst other things, the applicant has paid the minimum instalment of the project subscription moneys, as specified in the Information Memorandum. The minimum instalment required under the Information Memorandum is $3,300 per Leased Area applied for. The Project is terminated on the date on which the last of the Growers has been advised that the grape produce of the 2015/2016 crop from each Leased Area which is leased by the Grower has been harvested and that the relevant Lease and Management Agreement has been terminated but, in any event, no later than 31 December 2016.

30. Growers participating in the Project are granted an interest in the land by the Lessor in the form of a lease to use their Leased Area for the purpose of conducting a long-term viticulture business.

31. Growers must pay rent to the Lessor being an amount as specified in clause 4 of the Lease and Management Agreement.

32. Under the terms of the Lease and Management Agreement, amongst other things, the Grower must not:

- use or permit any other person to use the area for any purpose other than that of commercial viticulture and the Project;
- do anything which would vitiate the insurance policies or increase the premiums of any insurance policies in respect of the Leased Area;
- do or permit to be done on the Leased Area anything that will cause a nuisance, disturbance, obstruction or damage; and
- install or remove any vines, earth, gravels, stones, sand or minerals, or any fixtures from the Leased Area without the written consent of the Lessor. The Grower will be permitted at their cost, to remove the trellising at the end or the Project subject to certain conditions.

33. In return, the Grower has the right to conduct a commercial viticulture project on the Leased Area and peaceably possess and enjoy the Leased Area during the term of the Agreement.

34. The Lease and Management Agreement provides that each Grower appoints the Responsible Entity to perform services under the agreement. The services to be performed are specified in Item 9 of the Schedule. The Responsible Entity will supervise and manage all viticultural activities to be carried out on the Leased Area on behalf of the Grower including, but not limited to, the provision of the following services:

- plant suitable callused cuttings or vine rootlings on the leased area;
- establish and maintain a trickle irrigation system;
- erect and maintain suitable trellising systems;
- cultivate, tend, train, prune, fertilise, spray, and otherwise care for the vines as and when required;
- establish and keep in good repair access laneways;
- use all reasonable measures to keep the leased area free from vermin, noxious weeds, pests and diseases;
- replace any vines that fail to establish or that die during the first three years of the project; and

- harvest the produce grown on the Leased Area each year and despatch them for sale.

35. The Responsible Entity will plant the callused cuttings or vine rootlings not later than 31 December 2001.

36. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

Fees

37. Under the terms of the Lease and Management Agreement, a Grower will make the following payments per Leased Area:

- **Application Moneys** are payable by each Grower in two instalments. Application Moneys include fees for services that are to be provided by the Responsible Entity in the period from the Commencement Date to 30 June 2002. The Application Moneys are made up of:
- **First instalment** of $3,300, payable on application. This amount includes the Management fee of $1,540, Rent of $330, trellising costs of $1,210 and grapevine establishment and planting costs of $220; and
- **Second instalment** of $8,700, payable on application or by 31 March 2002. This amount is made up of the cost of Irrigation of $1,375, the balance of the Management fees of $6,325 and a fee of $1,000 for the purchase of shares in the Lessor.
- **Annual Management Fees** of $1,925 are payable in relation to the years ended 30 June 2003 to 30 June 2006. In subsequent years the Annual Management Fees will be the amount payable in the preceding year increased by the greater of 3% of the percentage increase in the CPI between the March quarter in the year of payment and the March quarter in the immediately preceding year. These Management Fees are payable by 31 October in the relevant year.
- Following the year ended 30 June 2006 a Grower may elect to pay a **Deferred Annual Management Fee** equivalent to 50% of the Annual Management Fee and in consideration pay an **Additional bonus** to the Responsible Entity equivalent to 50% of the value of grape produce received each year in excess of the

projected total returns per Leased Area set out in the Information Memorandum.

- **Rent** of $330 is payable in relation to the years ended 30 June 2003 to 30 June 2006. In subsequent years the Rent fee will be the amount for the immediately preceding year, increased by the greater of 3% or the percentage increase in the CPI between the March quarter in the year of payment and the March quarter in the immediately preceding year.
- **Responsible Entity bonus** equivalent to 50% of the value of grape produce received each year in excess of the projected total returns per Leased Area set out in the Information Memorandum.
- Additional **insurance** cover requested by the Grower.
- **Cost of harvesting** produce that is in excess of the yields projected in the Information Memorandum.

Vineyard Establishment

38. For Growers whose Lease and Management Agreements are executed on or before 30 November 2001 all initial development services required to establish the plantation are to be completed by 30 June 2002. The Responsible Entity will not accept any application for Leased Areas after 30 November 2001.

39. The Responsible Entity will not undertake any work on a Leased Area prior to the Leased Area being allocated to a Grower.

Harvesting

40. For the term of the agreement, the Grower will have full right, title and interest in the grape produce from the Leased Area and the right to have the grape produce from the Leased Area sold for their benefit (clause 8.3). Unless the Grower elects to take possession of their harvested grape produce, the Responsible Entity will arrange the marketing and sale of the grape produce.

41. The Responsible Entity will be responsible for the harvesting of the grape produce grown on the vineyard. The Responsible Entity will harvest the grape produce in each year that there is a commercially harvestable grape crop. Until such time as 90% of the Leased Areas subscribed for in a calendar year are in full production the Responsible Entity will harvest the grape produce from all Leased Areas subscribed for in different calendar years separately. In addition, the Responsible Entity will keep separate records in respect of grape produce from Leased Areas subscribed for in different

calendar years. The proceeds from the sale of produce from the previously mentioned Leased Areas will be paid into separate Produce Funds. At the time the Responsible Entity obtains a certificate from an independent viticulturist stating that 90% of the Leased Areas subscribed for in a calendar year are in full production the Responsible entity will establish one Produce Fund for all leased areas.

42. Growers will share in the gross sale proceeds on a proportionate basis following the payment of any outstanding annual contributions and any interest payable in relation to those contributions, and where applicable, the Responsible Entity's bonus, the Responsible Entity's Additional bonus and any other amounts due and payable by the relevant Grower (clause 19).

43. If a Grower is an Electing Grower (clause 17), the Responsible Entity will advise the Grower of the time and place at which the collectable produce will be available for collection, of the amount of annual contribution and of the estimated amount of the Responsible Entity's bonus. The amounts due must be paid at least 1 week prior to collection of the grape produce (subclause 17.2.2). After the sale of the grape produce the Responsible Entity will ascertain the actual amount of Responsible Entity's bonus and notify the Grower of any amount payable or refundable.

Finance

44. Growers can fund their involvement in the Project themselves, or borrow from an independent lender.

45. This Ruling does not apply if a finance arrangement entered into by the Grower 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;

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

46. This Ruling applies only to Growers who are accepted to participate in the Project on or before 30 November 2001 and who have executed a Lease and Management Agreement on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

The Simplified Tax System ('STS')

Division 328

47. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

48. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'

Assessable Income

Section 6-5

49. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

50. The Grower recognises ordinary income from carrying on the business of viticulture at the time that income is derived.

Shares

51. Shares in NR Properties Ltd are CGT assets (section 108-5) and the amount paid by a 'Grower' to acquire those assets is an outgoing of capital and is not allowable as a deduction. The amount paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)).

52. Dividends paid out of profits by NR Properties Ltd are included in the assessable income of shareholders under subsection 44(1) of the ITAA 1936.

Trading stock

Section 70-35

53. A Grower who is not an 'STS taxpayer' may, in some years, hold grape produce that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Grower must include the amount of that excess in assessable income.

54. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Grower may claim the amount of that excess as an allowable deduction.

Deductions for Management fees, Rent, Insurance Premiums and Interest

Section 8-1

55. A Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1	$7,865 – See Notes (i) & (ii) (below)	$1,925 – See Notes (i) & (ii) (below)	$1,925 – See Note (i) & (ii) (below)
Rent	8-1	$330 – See Notes (i) & (ii) (below)	$330 – See Notes (i) & (ii) (below)	$330 – See Notes (i) & (ii) (below)
Insurance Premiums	8-1	As incurred See Note (i)& (ii) (below)	As incurred See Note (i)& (ii) (below)	As incurred See Note (i)& (ii) (below)
Interest		See Note (iii) (below)	See Note (iii) (below)	See Note (iii) (below)

Notes:

(i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 137.

(ii) The Management fees, the Rent and, where the Grower has requested that the Responsible Entity arrange insurance of the Leased Area, the insurance premiums as detailed in the Lease and Management Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 110 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

(iii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers is outside the scope of this Ruling. However all Growers who finance their participation in the Project should read the discussion of the prepayment rules in paragraphs 104 to 118 (below) as those rules may be applicable if interest

is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Deductions for capital expenditure

Division 40

56. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to trellising, a 'water facility' (the irrigation system) and grapevines. All deductions shown in the following Table are determined under Division 40.

Fee type	ITAA 1997 section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Trellising	40-25	Must be calculated - See Notes (iv) and (v) below	Must be calculated - See Notes (iv) and (v) below	Must be calculated - See Notes (iv) and (v) below
Water facility (the irrigation system)	40-515	$458.33- see Notes (iv) & (vi) below	$458.33 - see Notes (iv) & (vi) below	$458.33- see Notes (iv) & (vi) below
Establishment of horticultural plants (grapevines)	40-515	Nil - see Notes (iv) & (vii) below	Nil - see Notes (iv) & (vii) below	Nil - see Notes (iv) & (vii) below

Notes:

(iv) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 137.

(v) Trellising is a 'depreciating asset'. Each Grower's interest in the trellising is a 'depreciating asset'. The 'cost' of the asset is the amount paid by each Grower. The decline in value of the asset is calculated using the formula in either subsection 40-70(1) ('diminishing value method') or subsection 40-75(1) ('prime cost method'). Both formulas rely on the 'effective life' of the trellising.

Growers can either self-assess the 'effective life' (section 40-105) or use the Commissioner's determination of 'effective life' (section 40-100). The Commissioner has determined that trellising has an 'effective life' of 20 years. Trellising will be installed and first used during the year ended 30 June 2002. The Responsible Entity will advise Growers when that occurs to enable Growers to calculate the deduction for the decline in value.

(vi) The irrigation system is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

(vii) As grapevines are affixed to land which the Grower does not own, they are not owned by the Grower, the conditions in subsection 40-525(3) cannot be met, and the grapevines are not eligible for the 4 year write-off under section 40-550. However, grapevines are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the grapevines enter their first commercial season.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5

57. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

58. The Grower recognises ordinary income from carrying on the business of viticulture at the time the income is received (paragraph 328-105(1)(a)).

Shares

59. Shares in NR Properties Ltd are CGT assets (section 108-5) and the amount paid by a 'Grower' to acquire those assets is an outgoing of capital and is not allowable as a deduction. The amount paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)).

60. Dividends paid out of profits by NR Properties Ltd are included in the assessable income of shareholders under subsection 44(1) of the ITAA 1936.

Trading stock

Section 328-285

61. A Grower who is an 'STS taxpayer' may, in some years, hold grape produce that will constitute trading stock on hand. Where, for such a Grower, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than $5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

62. Alternatively, a Grower who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

Deductions for Management fees, Rent, Insurance Premiums and Interest

Section 8-1 and section 328-105

63. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1 & 328-105	$7,865 – See Notes (viii), (ix) & (x) (below)	$1,925 – See Notes (viii), (ix) & (x) (below)	$1,925 – See Notes (viii), (xi) & (x) (below)
Rent	8-1 & 328-105	$330 – See Notes (viii), (ix) & (x) (below)	$330 – See Notes (viii), (ix) & (x) (below)	$330 – See Notes (viii), (ix) & (x) (below)
Insurance Premiums	8-1 & 328-105	Amount advised by the Responsible Entity– See Notes (viii), (ix) & (x) (below)	Amount advised by the Responsible Entity– See Notes (viii), (ix) & (x) (below)	Amount advised by the Responsible Entity– See Notes (viii), (ix) & (x) (below)
Interest		See Note (xi) (below)	See Note (xi) (below)	See Note (ix) (below)

Notes:

(viii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 137.

(ix) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

(x) Where a Member who is an 'STS taxpayer', pays the Management fees, the Rent and the insurance premiums in the relevant income years shown in the Lease and Management Agreement, those fees are deductible in full in the year that they are paid. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules

of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 110, unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

(xi) The deductibility or otherwise of interest arising from loan agreements entered into with financiers is outside the scope of this Ruling. However all Growers who finance their participation in the Project should read the discussion of the prepayment rules in paragraph 104 to 118 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Deductions for capital expenditure

Subdivision 328-D and Subdivision 40-F

64. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to trellising, a 'water facility' (the irrigation system) and grapevines. Deductions relating to the 'cost' of trellising must be determined under Division 328. An 'STS taxpayer' may claim deductions in relation to the 'water facility' under Subdivision 40-F. If the 'water facility' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328. Deductions for the grapevines must be determined under Subdivision 40-F.

65. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on the irrigation system (as a 'water facility') under Subdivision 40-F and not under Division 328. If the expenditure on the irrigation system has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Notes (xiv) below.

66. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than $1000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the

income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

Fee type	ITAA 1997 section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Trellising	328-185 & 328-190	$181.50 - See Notes (xii) & (xiii) below	$308.55 - See Notes (xii & (xiii) below	$215.99 - See Notes (xii) & (xiii) below
Water facility (the irrigation system)	40-515	$458.33 - see Notes (xii) & (xiv) below	$458.33 - see Notes (xii) & (xiv) below	$458.33 - see Notes (xii) & (xiv) below
Establishment of horticultural plants (grapevines)	40-515	Nil - see Notes (xii) & (xv) below	Nil - see Notes (xii) & (xv) below	Nil - see Notes (xii) & (xv) below

Notes:

(xii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 137.

(xiii) Trellising is a 'depreciating asset'. Each Grower's interest in the trellising is a 'depreciating asset' which can be allocated to a 'general STS pool'. The 'cost' of the asset is the amount paid by each Grower. The tax deduction allowable is determined in the year ended 30 June 2002 by multiplying the 'cost' of the interest by half the 'general STS pool rate, i.e., by 15%. Each Grower's interest in the trellising is allocated to their 'general STS pool' at the end of the year ended 30 June 2002 and that part of the 'cost' not deducted in the first year is added to the pool balance. In subsequent years, the full pool rate of 30% will apply.

(xiv) The irrigation system is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost'

apportionable to that deemed 'depreciating asset' is less than $1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2002 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

(xv) As grapevines are affixed to land which the Grower does not own, they are not owned by the Grower, the conditions in subsection 40-525(3) cannot be met, and the grapevines are not eligible for the 4 year write-off under section 40-550. However, grapevines are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530(2)). The Responsible Entity will inform Growers of when the grapevines enter their first commercial season.

Tax outcomes that apply to all Growers

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

Section 35-55 – Commissioner's discretion

67. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2006 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'exception' in subsection 35-10(4) applies (see paragraph 89 in the Explanations part of this ruling, below).

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

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

Sections 82KZME – 82KZMF, 82KL, and Part IVA

71. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Lease Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by a Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs 104 to 118);
- 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.

Explanations

Section 708 of the *Corporations Act 2001*

72. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by the Grower under one of four categories in subsections 708(1)-(11) of the *Corporations Act 2001*. These provisions set out situations where a prospectus or similar disclosure document is not required.

73. Under subsections 708(1)-(7) a Grower may participate in the project by accepting a 'personal offer' for an interest in the project . Offers under these provisions cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than $2 million dollars.

74. An offer will be a personal offer where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 708(2)).

75. Offers made under other exclusions in section 708 (see below) are not counted for the purposes of the 20 investors limit.

76. Alternatively, a Grower who is a 'sophisticated investor' may accept an offer for interests in the project under subsections 708(8)-(10). Under subsection 708(8), an investor in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will be a 'sophisticated investor' where :

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least $500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for

interests in the project of the same class that are held by the person add up to at least $500,000; or

- it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made that the person to whom the offer is made:

  (i) has net assets of at least $2.5 million; or

  (ii) has a gross income for each of the last 2 financial years of at least $250,000 a year.

77. A Grower may also participate in the project where the offer is made by a licensed dealer under subsection 708(10). Under this provision the dealer must be satisfied that the person to whom the offer is made has previous experience in investing which allows them to assess the merits of the offer, the value of the interests in the project, the risks involved in accepting the offer, their own information needs and the adequacy of the information provided.

78. The licensed dealer must provide a written statement of reasons for being so satisfied. Where a Grower is accepted into the project under this provision he or she must sign an acknowledgment that they did not receive a prospectus in relation to the offer.

79. Under subsection 708(11) an offer may be made to and accepted by a person who is considered to be a professional investor. Growers who participate in the project under this provision will be, at the time the offer is made:

- a person who is a licensed or exempt dealer and who is acting as a principal;
- a person who is a licensed or exempt investment adviser and who is acting as a principal; or
- a person who controls at least $10 million for the purposes of investment in securities.

Is the Grower carrying on a business?

80. For the amounts set out in the Tables above to constitute allowable deductions the Grower's viticulture activities as a participant in the Magpie Ridge Vineyards Project – Stage 1 must amount to the carrying on of a business of primary production. These viticulture activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

81. For schemes such as that of the Magpie Ridge Vineyards Project – Stage 1, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out,

these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929.

82. Generally, a Grower will be carrying on a business of viticulture, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's grapevines are established;
- the Grower has a right to harvest and sell the grape produce each year from those grapevines;
- the viticulture activities are carried out on the Grower's behalf;
- the viticulture activities of the Grower are typical of those associated with a viticulture business; and
- the weight and influence of general indicators point to the carrying on of a business.

83. In this Project, each Grower enters into a Lease and Management Agreement.

84. Under the Lease and Management Agreement each individual Grower will have rights over a specific and identifiable area of land. The Lease and Management Agreement provides the Grower with an ongoing interest in the specific grapevines from the Leased Area for the term of the Project. Under the lease the Grower must use the land in question for the purpose of carrying out viticultural activities and for no other purpose. The lease allows the Responsible Entity to come onto the land to carry out its obligations under the Lease and Management Agreement.

85. Under the Lease and Management Agreement the Responsible Entity is engaged by the Grower to establish and maintain a Leased Area on the Grower's identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Leased Area on the Grower's behalf.

86. In establishing the Leased Area, the Grower engages the Responsible Entity to purchase and install trellising and water facilities (e.g., irrigation) and to acquire and plant vine rootlings on the Grower's Leased Area. During the term of the Project, these assets will be used wholly to carry out the Grower's viticulture activities. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the grape produce grown on the Grower's Leased Area.

87. 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 Project's description for all the indicators.

88. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of its grape produce that will return a before-tax profit, i.e., a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

89. The pooling of grape produce grown on the Grower's Leased Area with the grape produce of other Growers is consistent with general viticulture practices. Each Grower's proportionate share of the sale proceeds of the pooled grape produce will reflect the proportion of the grape produce contributed from their Leased Area.

90. The Responsible Entity's services and the installation of assets on the Grower's behalf are also consistent with general viticulture practices. The assets are of the type ordinarily used in carrying on a business of viticulture. While the size of a Leased Area is relatively small, it is of a size and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

91. The Grower's degree of control over the Responsible Entity as evidenced by the Lease and Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's Leased Area and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as cases of default or neglect.

92. The viticulture 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. For the purposes of this Ruling, the Growers' viticulture activities in the Magpie Ridge Vineyards Project – Stage 1 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

93. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

94. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS

will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of management fees, rent and insurance premiums

Section 8-1

95. Consideration of whether the initial Management fees and Rent are deductible under section 8-1 begins with the first limb of the section. This view 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 outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer is contractually committed 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 the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

96. The Management fees and Rent associated with the viticulture activities will relate to the gaining of income from the Grower's business of viticulture (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of grape produce) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the Management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Possible application of prepayment provisions

97. Under the Lease and Management Agreement neither the Management fees nor the Rent are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

98. However, where a Grower chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 104 to 118) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

Timing of deductions

99. In the absence of any application of the prepayment provisions, the timing of deductions for the Management fees or the Rent will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

100. If the Grower is not an 'STS taxpayer', the Management fees and the Rent are deductible in the year in which they are incurred.

101. If the Grower is an 'STS taxpayer' the Management fees and the Rent are deductible in the income year in which they are paid, or are paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Interest deductibility

Section 8-1

102. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

103. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 104 to 118).

Prepayment provisions

Sections 82KZL to 82KZMF

104. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

105. For this Project only section 82KZL (an interpretative provision) and sections 82KZME and 82KZMF are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

106. Where the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

107. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either :

(a) there is more than one participant in the agreement in the same capacity as the taxpayer; or

(b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

108. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

109. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than $1,000. Such expenditure is immediately deductible.

110. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

111. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Application of the prepayment provisions to this Project

112. In this Project, an initial Management fee of $7,865 and an initial Rent of $330 per Leased Area will be incurred on execution of the Lease and Management Agreement. The Management fee and the Rent are charged for providing management services or leasing land to a Grower by 30 June of the year of execution of the Agreement. Under the Agreement, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

113. In particular, the Management fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the initial management fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

114. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial Management fee, and the fees for subsequent years, is for the Responsible Entity doing 'things' that are not to be wholly done within the expenditure year. Under the Lease and Management Agreement, Rent is payable annually in advance for the lease of the land during the expenditure year.

115. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraph 37, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

Growers who <u>choose</u> to pay fees for a period in excess of that required by the Project's agreements

116. Although not required under the Lease and Management Agreement, a Grower participating in the Project may **<u>choose</u>** to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 115 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

117. For these Growers, the amount and timing of deductions for any relevant prepaid Management Fees, prepaid Rent, or prepaid interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

118. However, as noted above, prepaid fees of less than $1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

Expenditure of a capital nature

Division 40 and Division 328

119. Any part of the expenditure of a Grower 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, expenditure attributable to trellising, water facilities, and the establishment of the grapevines is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

120. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

121. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 56 and 66 (above) in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

122. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual from certain business activities will not be allowable in an income year unless:

- the 'Exception' in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

123. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

124. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity, or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

125. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a 'primary production business' activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than $40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

126. In broad terms, the objective 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).

127. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of one Leased Area in the Project is unlikely to have their activity pass one of the objective tests until the income year ended 30 June 2009. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

128. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

129. The first arm of 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, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

(i) the business activity has started to be carried on;

(ii) because of its nature, it has not satisfied one of the objective tests; and

(iii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

130. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Leased Area in the Project is expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2007. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2006. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

131. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 67), in the manner described in the Arrangement (see paragraphs 14 to 45). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

132. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent viticulturist and additional expert evidence provided with the application by the Responsible Entity;
- correspondence regarding the sale of the grape produce 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 industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity ;
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project;

Section 82KL - recouped expenditure

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

Part IVA - general tax avoidance provisions

134. 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).

135. The Magpie Ridge Vineyards Project – Stage 1 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 53 to 66 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

136. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of their grape produce. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Entitlement to GST input tax credits

137. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in

the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2002 to 30/6/2002	$4 400*
Carrying out of upgrade of power for your vineyard as quoted	$2 200*
Total due and payable by 1 January 2002 (includes GST of $600)	$6 600

*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

1/11 x $4400 = $400.

Hence her outgoing for the management fee is effectively $4400 *less* $400, or $4000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

1/11 x $2200 = $200.

Hence her outgoing for the power upgrade is effectively $2200 *less* $200, or $2000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as $4000 (not $4400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as $200 (one tenth of $2000 only, not one tenth of $2200).

Detailed contents list

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

Commissioner of Taxation
14 November 2001

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 94/13; TR 97/11; TR 97/16; PR 1999/95; PR 1999/27; TR 92/1; TR 92/20; TD 93/34; TR 98/22

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- horticulture
- irrigation expenses
- management fees expenses
- primary production
- primary production expenses
- primary production income
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- tax administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:

- ITAA 1997 Part 2-25
- ITAA 1997 Part 3-1
- ITAA 1997 Div 328
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(1)(b)
- ITAA 1997 8-1(2)(a)
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-25
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 995-1
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- ITAA 1936 44
- ITAA 1936 82KH(1)
- ITAA 1936 82KH(1F)(b)
- ITAA 1936 82KL
- ITAA 1936 82KL(1)
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZMA
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Part III
- ITAA 1936 Part IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- TAA 1953 Part IVAAA
- Corporations Act 2001 708
- Copy right Act 1968

Case references:

- FCT v. Lau 84 ATC 4929

ATO references:
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