



PR 2001/83 - Income tax: Beechworth Winegrape Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *13 June 2001*



Product Ruling

Income tax: Beechworth Winegrape Project

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications sections**), **Date of effect**, **Withdrawal**, **Previous Ruling**, **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 in future years to confirm the arrangement has been implemented as described below and to ensure that participants in the arrangement include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

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

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

What this Product Ruling is about

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 Beechworth Winegrape Project, 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 17-5 (ITAA 1997)
 - Division 27 (ITAA 1997);
 - section 35-55 (ITAA 1997);
 - section 42-15 (ITAA 1997);
 - section 387-55 (ITAA 1997);
 - section 387-125 (ITAA 1997);
 - section 387-165 (ITAA 1997);
 - section 388-55 (ITAA 1997);
 - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZM (ITAA 1936);
 - sections 82KZMB - 82KZMD (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 Farmer) 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.

Business Tax Reform

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 laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing 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 investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

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 'Farmers'.

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.

10. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:

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

11. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, Ausinfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

12. This Ruling applies prospectively from 13 June 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).

13. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely upon 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

14. This Product Ruling is withdrawn and ceases to have effect on 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 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 the withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Previous Ruling

15. This Ruling replaces Product Ruling PR 2000/59, which is withdrawn on and from the date this Ruling is made. Product Ruling PR 2000/59 will continue to apply to investors who entered into the Project on or before 30 June 2000.

Arrangement

16. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents or parts of documents lodged with the Tax Office:

- Prospectus prepared for Beechworth Vineyard Project and Indigo Wine Company Limited dated 21 August 2000 ('current Prospectus');
- Draft copy of a Managed Investment Scheme **Constitution** between BVL Management Limited ('BVL M') and Beechworth Vineyards Limited ('BVL') and the Farmer, which also incorporates a **Joint Venture Agreement** between BVL M, BVL and each Farmer in the Joint Venture;
- Draft copy of **Equity Investment** in Indigo Wine Company Limited ('IWC'), included in the Draft Prospectus;
- Draft copy of **Loan Application**, Principal and Interest Loan, included in the Draft Prospectus;
- Draft copy of **Loan Deed** between BVL Management Limited and the Borrower; and
- Facsimile transmission from the Applicant's representative dated 13 April 2000 and letters and attachments from BVL M dated 7 December 2000 and 19 April 2001.

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.

17. The documents highlighted are those Farmers enter into or become a party to. 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, to which the Farmer, or an associate of the Farmer, will be a party to. The effect of these agreements may be summarised as follows.

Overview of the Project

18. This arrangement is called the Beechworth Winegrape Project and is registered as a Managed Investment Scheme under the Corporations Law. The salient features of the Project are shown in the table below.

Location	The Land, known as “Big Valley”, is situated approximately 10 kilometres west of the town of Beechworth in North East Victoria.
Type of business each participant is carrying on	Commercial viticulture for eventual sale of winegrapes and bottled wines.
Number of hectares under cultivation	The Project aims to establish a vineyard of up to 140 hectares. Part of this had already been established under an earlier offer. The current Prospectus is an offer for the balance of approximately 110.6 hectares.
Product Name	Beechworth Winegrape Project
Size of each interest or participation	0.2 hectare Under the current Prospectus this equates to a total of 553 participations.
Vines planted per hectare	1,700
Term	20 years
Initial cost per participation (see paragraph 27)	\$6,985
Initial cost per hectare	\$34,925
Ongoing Costs	Annual management fee and lease rent contribution fee

The project land

19. The project land is owned by BVL and is leased to Australian Rural Group Limited (‘the Custodian’) for the term of the Project. The current Prospectus states that BVL is a wholly owned subsidiary of IWC. Farmers have the option to subscribe for an equity stake in IWC.

20. BVLM ('the Manager') holds the interest in the land, being the lease, on behalf of the Joint Venture of Farmers, to enable the vineyard to be planted out with grapevines.

The Constitution

21. In respect of the Project, a Farmer has an interest in specific property comprising the Managed Investment Scheme ('Scheme') property which is defined in the Constitution. There will be a Custodian of the Project for the Joint Venture Farmers as required by law. Farmers execute a power of attorney enabling BVLM to act on their behalf as required.

22. Farmers do not have any right to withdraw from the Scheme nor do they have a right to require their interest in the Scheme to be bought by the Manager or any other person or to have their interest in the Scheme redeemed (Clause 11, Constitution). A Farmer's / Member's Scheme interest may be transferred, provided such transfer is a transfer of the entire unencumbered interest in the Scheme (Clause 16, Constitution). BVLM keeps a register of Farmers.

The Joint Venture Agreement

23. The Farmers will each enter into a Joint Venture Agreement to carry out the Project as a Joint Venture and to appoint BVLM to manage the Joint Venture. The Project, as defined in the Joint Venture Agreement, is essentially the business of acquiring, planting, growing and cultivating grapevines to produce wine grapes and the harvesting, marketing and sale of the wine grapes and sharing in the profits from the sale of wine produced therefrom.

24. The services to be provided by BVLM to the Joint Venture are specifically set out in the Joint Venture Agreement and they include:

- cultivating, fertilising and planting out the vineyard with rootstock in a healthy condition;
- carrying out field grafting, if required;
- applying water to the vineyard in order to maintain the grapevines on the vineyard in a healthy condition;
- pruning and/or training, stringing up, de-shooting and/or taking other measures that may be necessary in accordance with good viticultural practice to manage properly the growth of the grapevines to and along the trellises and to optimise as far as is reasonably possible in the circumstances the quality of the grapes produced therefrom;

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- taking such reasonable measures as may be required to control the growth of weeds and other vegetable pests on the vineyard upon which the vines are growing;
- taking all reasonable measures in accordance with the principles of good viticultural practice and to the extent reasonably possible to deter and eradicate any insect, bird or animal pests from the vineyard that may detract from the health and vigour of the grapevines or yield thereof;
- taking representative soil samples from the vineyard from time to time and arranging to have those samples analysed by an accredited soil analysis laboratory and, having regard to the results and recommendations of any soil analysis undertaken, supply suitable fertiliser and apply it to the vineyard in accordance with the principles of good viticultural practice and in such quantities as may be required to promote healthy plant growth and yield;
- replacing any grapevines that die or become unproductive with juvenile grapevines of the same variety as those that die or have become unproductive;
- repairing and maintaining in a good condition all fences, trellises, accessways and other structural improvements and irrigation plant and equipment on the vineyard;
- arranging sales of the wine grapes and/or bulk wine from the vineyard, including entering into a contract or contracts to supply grapes harvested from the vineyard or bulk wine produced therefrom;
- harvesting the wine grapes from the vineyard at or about the time instructed by the buyers of the grapes or as estimated by the Manager as being the appropriate time for harvesting the same;
- effecting the insurances referred to in the Agreement;
- employing such staff and labour as are necessary for the aforesaid purposes;
- carrying out the accounting, financial control and reporting needs and functions of the Joint Venture;
- keeping proper books of account for the Joint Venture and preparation and filing of income tax returns; and
- doing all other things necessary or incidental to the carrying out of the Project to produce a viable business

of growing, marketing and sale of wine grapes and/or bulk wine.

25. The Vineyard Establishment fee payable by each Farmer to the Manager is to meet the costs of the following acquisition and/or works:

- acquisition of suitable wine grape rootstock and the carrying out of field grafting, if required, to establish the vineyard and the planting out of the rootstock in the ground;
- the provision of trellising for the training of the grapevines;
- the provision of land care in respect of the vineyard;
- the establishment of dams required for irrigating the vineyard;
- the establishment of irrigation works other than dams (as mentioned above) for irrigating the vineyard; and
- the preparation of the land so that it is suitable for the planting out of the wine grape rootstock.

26. The Manager will subcontract all proposed services and work.

Project fees

27. Fees and contributions payable for the first four years per participation are shown in the table below.

Fee type	Year 1	Year 2	Year 3	Year 4
	30/06/2001	30/06/2002	30/06/2003	30/06/2004
Management fee - see Note (i)	\$3,300.00	\$3,300.00	\$2,750.00	\$2,750.00
Lease rent contribution fee - see Note (ii)	\$137.50	\$137.50	\$137.50	\$137.50
Vineyard establishment fee to be applied as follows - see Note (iii):				
Rootstock purchase	\$841.50	\$841.50		
Land care expenses	\$110.00	\$110.00		
Land preparation	\$192.50	\$192.50		
Dam establishment	\$396.00	\$396.00		
Irrigation est.	\$1,045.00	\$1,045.00		
Trellising	\$880.00	\$880.00		
Vine establishment	\$82.50	\$82.50		
Total	\$6,985.00	\$6,985.00	\$2,887.50	\$2,887.50

Notes:

- (i) Management fee for year 1 will be payable on the day the Manager accepts the application from the Farmer ('Settlement Date'). Management fees for subsequent years are payable on each respective year's anniversary of the Settlement Date. The fee is payable in advance for services to be provided by the Manager for the period of twelve (12) months from the date of payment.

The amount of management fees in years subsequent to the fourth year will be the year 4 amount increased by the Consumer Price Index (All Groups) Melbourne, or 3%, whichever is the greater, in each subsequent year, until there are sufficient funds from income of the Joint Venture to enable management fees to be payable yearly in advance from those funds.

- (ii) The lease rent contribution fee is payable 12 months in advance the first payment being payable on the Settlement Date and on each anniversary thereafter. From Years 5 onwards, the previous year's Lease Rent Contribution fee will be increased by the Consumer Price Index (All Groups) Melbourne, or 3%, whichever is the greater, for each interest in the Joint Venture.
- (iii) Year 1 vineyard establishment fee is payable on settlement date, and Year 2, on the first anniversary of the settlement date. It is contemplated that the fee for year 1 will be applied for the establishment of 0.1 hectare within 13 months of the settlement date and the fee for year 2 will be applied for the establishment of 0.1 hectare within 13 months of the first anniversary of the settlement date.

28. In the event that the Gross Income of the Joint Venture is insufficient in any year to meet payment of the relevant management fees and Lease Rent Contribution fees, the shortfall will be met by the Joint Venture Farmers and not from Gross Income of future years.

Finance

29. Farmers can fund their investment in the Project themselves, or borrow from an independent lender.

30. A finance option is offered by BVL Management Limited ('the Lender') to fund a Farmer's fees and expenses associated with the Joint Venture Project. The Lender will, if a loan option is taken,

advance funds of \$2,000 on the Settlement Date, \$2,000 on the first anniversary of the Settlement Date and \$1,400 on the second and third anniversaries of the Settlement Date, for each Joint Venture interest. Security is to be enforced over the Farmer's interest in the Project, i.e., the Farmer's interest in the Joint Venture including the rights obtained as a result of the various Agreements entered into and payments made.

31. An interest rate will be charged of 8% payable yearly in advance. The loans will be repayable by monthly repayments of \$150 until the loan is repaid in full. The first repayment is required to be made on the first day of the month following the date of settlement of the loan. The finance is provided as full recourse loans and the Lender will pursue legal action against outstanding borrowers.

32. This Ruling does not apply if a Farmer 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;
- 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 other than the Lender, are involved or become involved, in the provision of finance to Farmers for the Project.

Ruling

Assessable income

33. A Farmer's share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

Section 8-1

34. Expenditure incurred by a Farmer who participates in this Project that is otherwise deductible under section 8-1 falls within subsections 82KZME(9), (10) and (11). Such expenditure is an exception ('Exception 5') to the prepayment rules contained in sections 82KZME and 82KZMF. Therefore, the amount and timing of tax deductions for such expenditure is determined under section 82KZM where the Farmer is a 'small business taxpayer' (see paragraphs 72 to 74), or under sections 82KZMA - 82KZMD where the Farmer is NOT a 'small business taxpayer'.

Deductions where a Farmer is not registered nor required to be registered for GST

Tax deductions for a Farmer who is a 'small business taxpayer'

35. A Farmer may claim the tax deductions referred to in the table below where the Farmer:

- is a 'small business taxpayer';
- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 27; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 30 June 2001	Year 2 30 June 2002	Year 3 30 June 2003	Year 4 30 June 2004
Management Fees	8-1	\$3,300 – see Note (i) below	\$3,300 – see Note (i) below	\$2,750 – see Note (i) below	\$2,750 – see Note (i) below
Lease rent contribution fee	8-1	\$137.50 – see Note (i) below	\$137.50 – see Note (i) below	\$137.50 – see Note (i) below	\$137.50 – see Note (i) below
Interest	8-1	As incurred – see Note (ii) below	As incurred – see Note (ii) below	As incurred – see Note (ii) below	As incurred – see Note (ii) below

Notes:

- (i) Where a Farmer who is a ‘small business taxpayer’ incurs the Management and Lease rent contribution fees as required by the Joint Venture Agreement those fees are deductible in full in the year incurred. However, if a Farmer **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done within 13 months of the fees being incurred, then the prepayments rules in section 82KZM 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 59 unless the expenditure is ‘excluded expenditure’. ‘Excluded expenditure’, being expenditure of less than \$1,000, is an ‘exception’ to the prepayments rules and is deductible in full in the year in which it is incurred.
- (ii) For a Farmer who is a ‘small business taxpayer’, interest incurred using the finance option offered by the Lender is deductible in full in the year in which it is incurred.

The deductibility or otherwise of interest arising from agreements that Farmers enter into with financiers other than the Lender is outside the scope of this Ruling. However, Farmers who are ‘small business taxpayers’ and who finance their participation in the Project other than with the Lender should read carefully the discussion of the prepayments rules in paragraph 58 to 59 below as those rules may be applicable if interest is prepaid for a period exceeding 13 months.

Tax deductions for a Farmer who is NOT a ‘small business taxpayer’

36. A Farmer may claim the tax deductions referred to in the table below where the Farmer:

- is NOT a ‘small business taxpayer’;
- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 27; and
- is not registered nor required to be registered for GST.

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Fee Type	ITAA 1997 Section	Year 1 30 June 2001	Year 2 30 June 2002	Year 3 30 June 2003	Year 4 30 June 2004
Management Fees	8-1	Amount must be calculated – see Notes (iii) & (vi) below	Amount must be calculated – see Notes (iii) & (vi) below	Amount must be calculated – see Notes (iii) & (vi) below	Amount must be calculated – see Notes (iii) & (vi) below
Lease rent contribution fee	8-1	\$137.50 – see Notes (iv) & (vi) below	\$137.50 – see Notes (iv) & (vi) below	\$137.50 – see Notes (iv) & (vi) below	\$137.50 – see Notes (iv) & (vi) below
Interest	8-1	As incurred - see Notes (v) & (vi) below	As incurred - see Notes (v) & (vi) below	As incurred - see Notes (v) & (vi) below	As incurred - see Notes (v) & (vi) below

Notes:

- (iii) A Farmer who is NOT a ‘small business taxpayer’ cannot claim the prepaid Management Fees in full in the years in which the fees are incurred. The tax deduction in each year must be calculated using the formula in subsection 82KZMB(3) (shown below). This formula apportions the tax deduction in each ‘expenditure year’ (i.e., the year that the fees are incurred) using the number of days in the ‘eligible service period’. The ‘eligible service period’ means, generally, the period over which the management services are to be provided.

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

Because of the operation of the capping provisions in section 82KZMC, there is no additional deductible amount available in the ‘expenditure year’ from the table in subsection 82KZMB(5). Instead, the balance of the Management Fee incurred each year is determined under subsection 82KZMC(4) and the formula in subsection 82KZMC(5). These provisions apportion the balance of the prepaid Management Fee incurred each year over the years in which the management services are to be provided (See Example 2 at paragraph 115).

The Manager must provide the Farmer with the number of days of 'eligible service period' for the income year ended 30 June 2001 (i.e., the first 'expenditure year'). This figure is necessary to calculate the Farmer's tax deduction for both the income year ended 30 June 2001 and the other income years over which the management services will be provided.

- (iv) The Lease rent contribution fee, being an amount of less than \$1,000 each year, constitutes 'excluded expenditure' and is deductible in full in the year in which it is incurred. However, if a Farmer who is NOT a 'small business taxpayer' acquires more than one interest, the quantum of the Lease rent contribution fee may be \$1,000 or more. Where this occurs, the Farmer must determine the tax deduction that is allowable by using the method shown above for the Management Fee (see Note (iii)).
- (v) A Farmer who is NOT a 'small business taxpayer' and who finances participation in the Project using the finance option offered by the Lender (described in paragraphs 30 to 31 above) is required to prepay interest. The Farmer must therefore determine the tax deduction that is allowable by using the method shown above for the Management Fee (see Note (iii)) unless the expenditure is 'excluded expenditure'.

The deductibility or otherwise of interest arising from agreements entered into with financiers other than the Lender is outside the scope of this Ruling. However, all Farmers who finance their participation in the Project other than with the Lender should read carefully the discussion of the prepayments rules in paragraph 60 to 66 below as those rules may be applicable if interest is prepaid.

- (vi) A Farmer, who chooses to prepay the Management Fee, and/or the Lease rent contribution fee for a period exceeding 13 months should read carefully the information shown in paragraph 66 below. The tax deductions for prepaid fees with an 'eligible service period' exceeding 13 months must be determined using the formula shown in paragraph 66 unless the expenditure is 'excluded expenditure'.

PR 2001/83**Tax deductions for capital expenses**

37. A Farmer who participates in the Project will also be entitled to the following tax deductions.

Fee type	ITAA 1997 section	Year 1 30 June 2001	Year 2 30 June 2002	Year 3 30 June 2003	Year 4 30 June 2004
Trellising	42-15	Amount must be calculated - see Note (vii) below	Amount must be calculated - see Note (vii) below	Amount must be calculated - see Note (vii) below	Amount must be calculated - see Note (vii) below
Landcare	387-55	\$110 - see Notes (viii) & (x) below	\$110 - see Notes (viii) & (x) below		
Dam and Irrigation establishment	387-125	\$481 - see Notes (ix) & (x) below	\$962 - see Notes (ix) & (x) below	\$962 - see Notes (ix) & (x) below	\$477 - see Notes (ix) & (x) below
Rootstock, land preparation and vine establishment	387-165	Nil - see Note (xi) below	Nil - see Note (xi) below	Nil - see Note (xi) below	Nil - see Note (xi) below

Notes:

- (vii) The tax deduction for depreciation of trellising will depend upon whether or not the Farmer is a 'small business taxpayer' (see paragraphs 72 to 74 below).

For a Farmer who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the tax 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'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Farmer owned an interest in the trellising and the extent to which the trellising is installed ready for use during the year. The Manager is to advise Farmers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001.

Depending upon the method the Farmer elects to use, the rate for calculating the tax deduction will be 13% prime cost method or 20% diminishing value method.

Note: The depreciation deductions for 'small business taxpayers' discussed above apply until the introduction of the Simplified Tax System on 1 July 2001 (see paragraphs 79 to 81).

For a Farmer who is NOT a 'small business taxpayer' or who is a 'small business taxpayer' who does not satisfy the conditions in section 42-345, the tax deductions for depreciation of trellising is determined using the formula in either subsection 42-160(3) ('diminishing value method') or subsection 42-165(2A) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Farmer owned an interest in the trellising and the extent to which the trellising is installed ready for use during the year. The formulae use 'effective life' rather than specific rates to determine the deduction for depreciation. The Manager is to advise Farmers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Note: this is only applicable to plant acquired after 21 September 1999 (see paragraphs 84 to 86).

In certain circumstances, a Farmer who is NOT a 'small business taxpayer' is able to allocate plant to a 'low value pool' (see paragraphs 87 to 90 below). Note: This choice is only available from 1 July 2000.

- (viii) A deduction is allowable under section 387-55 for capital expenditure incurred for Landcare operations. The deduction is allowed in the year that the expenditure is incurred.
- (ix) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction 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.
- (x) A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on Landcare operations and/or facilities to conserve or convey water. This is an alternative to claiming deductions under sections 387-55 and 387-125.

- (xi) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the grapevines for use in a horticultural business. The deduction is allowable when the grapevines, as horticultural plants, enter their first commercial season. If the grapevines have an 'effective life' for the purposes of section 387-185 of greater than '13 but fewer than 30 years', this results in a write-off rate of rate of 13% prime cost. Information provided in the current Prospectus indicates that the first commercial season of the grapevines commences, for year 1 planting, 1 July 2004 and, for year 2 planting, 1 July 2005.

Deductions where a Farmer is registered or required to be registered for GST

38. Where a Farmer who is registered or required to be registered for GST:

- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 27; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the tables in paragraphs 35 to 37 above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 114.

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

39. For a Farmer who is an individual and who enters the Project during the year ended 30 June 2001 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 2001 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.

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

- a Farmer'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 102 in the Explanations part of this Ruling, below).

41. Where, either the Farmer’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 Farmer will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any ‘loss’ from that activity, to a later year. Instead, this ‘loss’ can be offset against other assessable income for the year in which it arises.

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

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

43. For a Farmer who participates in the Project and incurs expenditure in accordance with the Joint Venture Agreement, the following provisions of the ITAA 1936 have application as indicated:

- the expenditure by a Farmer who is a ‘small business taxpayer’ does not fall within the scope of section 82KZM (but see paragraphs 58 to 59);
- section 82KZMB applies to expenditure by a Farmer who is not a ‘small business taxpayer’ (but see paragraphs 66);
- 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

44. It is appropriate, as a starting point, to consider whether the management fee and lease rent contribution fee payable under the Joint Venture Agreement are deductible under paragraph 8-1(1)(a). This consideration proceeds on the following basis:

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

45. The growing of wine grapevines can constitute the carrying on of a 'primary production business', which is defined in section 995-1 to include a business of propagating and cultivating plants. Where there is a business, or a future business, the gross sale proceeds from the sale of the wine grapes and/or wine produced from the grapes and/or profit sharing in wine production profits will constitute gross assessable income. 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 and maintaining of the grapevines and harvesting the produce.

46. Under the Joint Venture Agreement, Farmers in this Project have rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing wine grapevines to produce wine grapes and/or wine produced from the grapes for commercial exploitation. Under the Joint Venture Agreement, Farmers appoint BVLM, as Manager of the Joint Venture, to provide services such as planting, carrying out field grafting if required, cultivating, tending, pruning, fertilising, spraying, maintaining and otherwise caring for the wine grapevines. Farmers control their investment in the Joint Venture.

47. The Joint Venture Agreement gives Farmers full right, title and interest in the wine grapevines and their produce and the right to have the wine grapes and/or wine produced from the grapes sold for the Joint Venture Farmers' benefit.

48. The Joint Venture Farmers have the right to use the land for the growing of wine grapevines for producing wine grapes. They will appoint BVLM to perform the obligations and duties as imposed on

the Manager under the Joint Venture Agreement. The Farmers' degree of control over BVLM, as evidenced by the Constitution of the Project being a Managed Investment Scheme which also incorporates the Joint Venture Agreement, and supplemented by the Corporations Law, is sufficient.

49. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators discussed in that Ruling. Farmers who participate in this Project intend to derive assessable income from the Joint Venture Project. This intention is related to projections in the current Prospectus that suggest the Joint Venture Project should return a 'before tax' profit to the Farmers, i.e., a 'profit' in cash terms, that does not depend on its calculation on the fees in question being allowed as a deduction.

50. Farmers will engage the professional services of a Manager who holds itself out as having the appropriate credentials. The Manager will subcontract certain works and services as appropriate. These services are based on accepted commercial agricultural/viticultural practices and are of the type ordinarily found in ventures that would commonly be said to be businesses.

51. Farmers have a continuing interest in the Project from the time they enter into the Joint Venture. The 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 Farmers' activities of conducting in joint venture the growing of wine grapevines for producing wine grapes and/or wine produced from the grapes for commercial sale and/or profit sharing in wine production profits will constitute the carrying on of a business.

52. The management and Lease Rent Contribution fees associated with the aforementioned 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 grapes and/or wines) is to be gained from the business. Those fees will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fees is identifiable from the arrangement. No capital component is identifiable. The tests of deductibility under both the first and second limbs of section 8-1 are met.

Sections 82KZME and 82KZMF and Exception 5

53. Unless one of the statutory exceptions applies, where the requirements of section 82KZME are met, section 82KZMF operates to set the amount and timing of deductions for expenditure that a taxpayer incurs in a year of income. Effectively, these provisions

apportion the allowable tax deductions over the period during which the prepaid benefits will be provided.

54. This Product Ruling is issued in response to an application received by the Commissioner on or before 1pm (by legal time in the Australian Capital Territory) on 11 November 1999. Therefore, the Project is an arrangement to which Exception 5 (subsections 82KZME(9), (10) and (11)) applies. Because Exception 5 applies, sections 82KZME and 82KZMF do not apply to set the amount and timing of expenditure incurred by Farmers who participate in the Project. Expenditure incurred by a Farmers for the doing of a thing not to be wholly done within the expenditure year will, therefore, be determined under section 82KZM (for a 'small business taxpayer') or sections 82KZMA – 82KZMD (for a taxpayer who is NOT a 'small business taxpayer').

Section 82KZM - prepaid expenditure for 'small business taxpayers'

55. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure incurred by a 'small business taxpayer' that would otherwise be immediately deductible, in full, under section 8-1. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly to be done within 13 months after the day on which the expenditure is incurred.

56. Under the Joint Venture Agreement, fees totalling \$3,437.50 per Joint Venture interest will be incurred upon execution of the Agreement comprising management fees of \$3,300 and lease rent contribution fees of \$137.50. These fees are payable for providing services to Farmers within 13 months from the date of execution of the Joint Venture Agreement. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description that the fees have been inflated to result in reduced fees being payable for subsequent years. The fees are expressly stated to be for a number of specified services. There is evidence these fees are for services to be provided within 13 months of the fee being incurred.

57. Thus, for the purposes of this Ruling, it is accepted that no part of the initial management fee of \$3,300 and the Lease Contribution Fee of \$137.50 is for the doing of 'things' that are not to be wholly done within 13 months of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure of \$3,437.50 by Farmers who are 'small business taxpayers'.

58. Although not required by the Joint Venture Agreement, some Farmers who are 'small business taxpayers' may choose to prepay

fees for periods longer than that required by the Agreements. Where a prepayment is incurred and the 'eligible service period' is greater than 13 months then, contrary to the conclusion reached above, unless the expenditure is 'excluded expenditure', section 82KZM will apply. 'Excluded expenditure' being expenditure of less than \$1,000 (subsection 82KZL(1)) is an exception to section 82KZM.

59. Where the 'eligible service period' exceeds 13 months the formula in paragraph 82KZM(1)(c) (shown below) is used to apportion the tax deduction over the period that the benefits relating to the prepaid fees are provided.

$$\frac{\text{Period in year}}{\text{Eligible service period}}$$

Where:

Period in year is the number of days in the whole or the part of the eligible service period in the year of income;

Eligible service period is the number of days in the eligible service period.

Sections 82KZMA to 82KZMD - Farmers who are NOT 'small business taxpayers'

60. For a Farmer who is NOT a 'small business taxpayer', sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the 'expenditure year'). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

61. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period for things to be done wholly within 13 months. For Farmers investing in the Project, transitional treatment applies to prepayments initially incurred in the year ended 30 June 2001. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service period ends more than 13 months after the date the expenditure was occurred.

62. Under the Joint Venture Agreement, the Management Fee is for services to be wholly done within 13 months of the fee being incurred. Therefore, the tax deduction available to a Farmer for the Management Fee of \$3,300 will be determined in accordance with the rules contained in section 82KZMB and 82KZMC. The amount of the deduction available to Farmers in the 'expenditure year' (that is, the

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year ended 30 June 2001) is determined using the formula in subsection 82KZMB(3) and the table in subsection 82KZMB(5).

63. However, section 82KZMB is subject to the capping provisions in section 82KZMC. For Farmers who participate in the Project and incur the Management Fee in the year ended 30 June 2001, the 'later year amount' for the purposes of the table in subsection 82KZMB(5) is nil. Therefore, for the year ended 30 June 2001, the tax deduction for a Farmer who is NOT a 'small business taxpayer' will be the amount determined using the formula in section 82KZMB(3) only. The balance of the tax deduction is then determined under subsection 82KZMC(4) using the formula in subsection 82KZMC(5). For Farmers in this Project, the balance of the 13 month 'eligible service period' is in the year ended 30 June 2002, therefore the balance of the Management Fee is deductible in that year. Example 2 at paragraph 115 demonstrates the application of these provisions.

64. A Farmer who is NOT a 'small business taxpayer' also incurs expenditure on lease rent contribution fee. The fee of \$137.50 per interest is incurred on or before the 30 June each year for a lease over the land for the following 12 months. The lease rent contribution fee constitutes 'excluded expenditure' for a Farmer who acquires one interest in the Project. 'Excluded expenditure' being expenditure of less than \$1,000 (subsection 82KZL(1)) is an exception to sections 82KZMB and 82KZMC. The Lease Fees are therefore deductible in full in the year in which a Farmer who is NOT a 'small business taxpayer' incurs them.

65. However, if a Farmer who is NOT a 'small business taxpayer' acquires more than one interest in the Project, the quantum of the lease rent contribution fee may be \$1,000 or more. Where this occurs, like the Management Fee discussed above, the amount and timing of the deduction allowable for the lease rent contribution fee must be determined under sections 82KZMB and 82KZMC.

66. Although not required by the Joint Venture Agreement, some Farmers who are NOT 'small business taxpayers' may choose to prepay fees for periods longer than that required by the Agreements. Where a prepayment is made and the 'eligible service period' is greater than 13 months then section 82KZMB and 82KZMC do not apply. Instead, unless the expenditure is 'excluded expenditure', section 82KZMD will apply to apportion the tax deduction over the period that the benefits relating to the prepaid fees are provided. The relevant formula contained in subsection 82KZMD(2) is:

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

Interest deductibility*(i) Farmers who use the Lender as the finance provider*

67. Farmers may finance their participation in the Project through a finance option offered by the Lender (see paragraphs 30 to 31 above). Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of management and lease rent contribution fees.

68. The interest incurred for the year ended 30 June 2001 and in subsequent years of income will be in respect of a loan to finance the Project business operations of viticulture and is, therefore, directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

69. Under the Loan Agreement the loan interest is payable annually in advance, the first payment being on the Settlement Date and, subsequently, on each anniversary of the Settlement Date. Because Exception 5 applies, sections 82KZME and 82KZMF do not apply to set the amount and timing of expenditure incurred by Farmers who participate in the Project. Expenditure incurred by a Farmer for the doing of a thing not to be wholly done within the expenditure year will, therefore, be determined under section 82KZM (for a 'small business taxpayer') or sections 82KZMA – 82KZMD (for a taxpayer who is NOT a 'small business taxpayer') – see discussion above of these provisions.

(ii) Farmers who DO NOT use the Lender as the finance provider

70. The deductibility of interest incurred by Farmers who finance their participation in the Project through a loan facility with a bank or financier other than the Lender 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.

71. While the terms of any finance agreement entered into between relevant Farmers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid, relevant Farmers will be required to determine any tax deduction under section 82KZM (for a Farmer who is 'small business taxpayer'), or sections 82KZMA - 82KZMD (for a Farmer who is not a 'small business taxpayer') – see discussion above of these provisions.

Subdivision 960-Q - small business taxpayers

72. 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.

73. '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).

74. Whether a Farmer is a 'small business taxpayer' depends upon the circumstances of each Farmer and is beyond the scope of this Product Ruling. It is the responsibility of each Farmer to determine whether or not they are within the definition of a 'small business taxpayer'.

Expenditure of a capital nature

75. Any part of the expenditure of a Farmer entering into a viticultural 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 expenditure for trellising, Landcare operations, irrigation and establishing grapevines are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, these expenditure fall for consideration under specific write-off provisions of the ITAA 1997.

Section 42-15 - depreciation of trellising

76. Each of the two Vineyard Establishment Fees payable by a Farmer includes an amount of \$880 on account of trellising costs to be incurred in the first and second years of the Project. These costs are considered to be capital expenditure on plant and equipment used during the year of income for the purposes of producing assessable income when the trellising is installed ready for such use, or so used.

77. Trellising is attached to the land as a fixture. However, in the case of the Farmers being Joint Venturers, they are lessees who are considered to be owners of the trellising. This is based on Taxation Ruling IT 175 and the fact that the Farmers, as Joint Venturers, are entitled to be compensated for the trellising at the end of the term of the Joint Venture. The Farmers, as Joint Venturers, are treated as owners and, accordingly, depreciation is allowable on plant comprising trellising from the date it is installed and ready for use.

78. Under section 42-15 Farmers in the Project are entitled to depreciation deductions for capital expenditure in relation to the acquisition and installation of trellises on the land. The deduction available, however, will depend upon the date the investment is made, when the plant is installed ready for use and whether or not the taxpayer is a 'small business taxpayer' (see paragraphs 72 to 74).

79. For plant acquired or constructed after 11:45am by legal time in the Australian Capital Territory on 21 September 1999, accelerated rates of depreciation are no longer available except to some 'small business taxpayers'. The Government has announced that 'small business taxpayers' who meet the conditions in section 42-345 will have access to accelerated rates of depreciation until the introduction of the proposed Simplified Tax System on 1 July 2001.

80. The immediate deduction for items of plant costing \$300 or less has been removed from 1 July 2000, except for 'small business taxpayers'. The Government has announced that 'small business taxpayers' will be able to claim the immediate deduction until the introduction of the proposed Simplified Tax System.

81. The depreciation of trellising as explained in this Product Ruling is based on existing legislation and may be subject to change.

Depreciation deductions for Farmers who are 'small business taxpayers'

82. The depreciation deduction for **trellising** available to a Farmer who is a 'small business taxpayer' and who complies with the conditions contained in section 42-345 is calculated using the formula in either subsection 42-160(1) or subsection 42-165(1). The depreciation deduction depends on the cost of the trellising and the number of days the trellising was owned by the Farmer during the income year. It also depends on the extent to which the trellising is installed ready for use during the year.

83. The deduction is calculated using 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. The Manager will advise Farmers of the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

Depreciation deductions for Farmers who are NOT 'small business taxpayers'

84. A Farmer who is NOT a 'small business taxpayer' or is a 'small business taxpayer' who does not satisfy the conditions in section 42-345 will not be able to claim accelerated depreciation on

plant used in the Project because of section 42-118. The depreciation deduction for trellising for such a Farmer is calculated using the formula in either subsection 42-160(3) or subsection 42-165(2A).

85. The deduction depends on the cost of the plant, the number of days the plant was owned by the Farmer during the income year and the 'effective life' of the plant. It also depends upon the extent to which the plant is installed ready for use during the year. The Manager will advise Farmers of the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

Determination of effective life

86. Subdivision 42-C provides the choice of methods for determining the 'effective life' of plant. Farmers can either self-assess the effective life of plant or use the effective life specified by the Commissioner. In the schedule, the Commissioner has determined that the effective life of trellising is 20 years.

Low value pool option

87. From 1 July 2000 the immediate 100% depreciation deduction for plant costing \$300 or less has been replaced by a 'low value pool' arrangement for all taxpayers except 'small business taxpayers'.

88. Under subsection 42-455(1), a Farmer who is not a 'small business taxpayer' can choose to allocate 'low cost plant' to a 'low value pool' in the year of acquisition. 'Low cost plant' is plant costing less than \$1,000. Once the choice is made to allocate 'low cost plant' to the pool, all 'low cost plant' acquired in that income year and subsequent income years must be included in the pool (subsection 42-460(1)).

89. A 'low value pool' is depreciated using a diminishing value rate of 37.5%. However, low cost plant is depreciated at 18.75% in the year it is allocated to the pool, irrespective of the date it is allocated. The value of plant included in or disposed from such a pool will be added to or subtracted from the value of the pool.

90. Under the Joint Venture Agreement, a Farmer incurs expenditure of \$880 in each of the first and second year. As the cost of trellising in each year is less than \$1,000 it will qualify as 'low cost plant'.

Subdivision 387-A - expenditure for Landcare operations

91. Each of the two Vineyard Establishment Fees payable by a Farmer includes an amount of \$110 on account of Landcare costs to be incurred in both the first and second years of the Project. This is

considered to be capital expenditure incurred at a particular time on a 'Landcare operation' for the prescribed purposes as set out in section 387-55. Landcare operations, as relevant to the Project, include, among other things, constructing surface or sub-surface drainage works on the land primarily and principally for controlling salinity or assisting in drainage control and/or an operation primarily and principally for the purpose of preventing land degradation and/or eradicating weeds and other pests and/or other erosion control measures.

92. In order to qualify for a deduction under section 387-55, a business must be carried on at the time the expenditure is incurred. It is considered that a business has commenced at the time the expenditure is incurred. It is accepted that the execution of the Joint Venture Agreement is sufficient to constitute the commencement of a business. The business is considered to have commenced at the time the management fees were incurred by the Joint Venture Farmers. Further, it is considered the land care cost of \$100 in the first and second year is primarily and principally for the purpose of assisting in drainage control and/or preventing land degradation and the eradication of weeds and other pests. Accordingly, the expenditure is deductible to a Joint Venture Farmer under section 387-55 in the year of income in which it is incurred.

93. However, a deduction under section 387-55 is denied where the Farmer is entitled to claim a Landcare tax offset under section 388-55 and chooses to do so. A Farmer can only choose a Landcare tax offset where:

- had the Farmer chosen a deduction instead of the tax offset, the Farmer's taxable income for the income year would have been \$20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Subdivision 387-B – irrigation expenditure

94. Each of the two Vineyard Establishment Fees payable by a Farmer includes an amount of \$1,441 on account of Dam Establishment (\$396) and Irrigation Establishment costs (\$1,045) to be incurred in both the first and second years of the Project. These costs are considered to be capital expenditure incurred on the construction, manufacture, installation or acquisition of a 'water facility', primarily and principally for the purpose of conveying water for use in a primary production business, as set out in section 387-125. Examples of a water facility include a dam, tank, bore, irrigation channel (or similar improvement), pipe and pump. Under section

387-125 there is no requirement that the taxpayer actually own the 'water facility'.

95. The growing of wine grapevines to produce wine grapes for commercial exploitation is considered to be a primary production business, provided the taxpayer is actually carrying on a business. The Joint Venture Farmers of the Project satisfy the requirements of section 387-125. Accordingly, the dam and irrigation costs totalling \$1,310 in each of the first and second years of the Project, are deductible in equal amounts over three (3) years of income, commencing in the year of income the Farmer incurs that expenditure.

96. However, a deduction under section 387-125 is denied where the Farmer is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Farmer can only choose a water facility tax offset where:

- had the Farmer chosen a deduction instead of the tax offset, the Farmer's taxable income for the income year would have been \$20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Subdivision 387-C - vines and horticultural provisions

97. Section 387-165 allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. A lessee or licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land (section 387-210).

98. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant, such as the grapevines in this Project, with an effective life of 13 to 30 years, that rate is 13%.

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

99. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law partnership) 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.

100. 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.

101. 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.

102. 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 Farmers who participate in the Project, they are beyond the scope of this Product Ruling and are not considered further.

103. 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).

104. A Farmer who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the Product Ruling Application indicates that a Farmer who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests. Farmers who acquire more

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than one interest in the Project may, however, pass one of the tests in an earlier income year.

105. Therefore, 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 Farmer's participation in the Project.

106. 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, for an individual Farmer who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the income years ending 30 June 2001 to 30 June 2006.

107. 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; and
- (ii) 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.

108. This Product Ruling is issued on a prospective basis (i.e., before an individual Farmer's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 39), in the manner described in the Arrangement (see paragraphs 16 to 32), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

109. 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 independent viticulture and supplementary reports included in the current Prospectus; and
- the binding Grape Supply Contract between the Manager and the grapes Purchaser for the sale of the grapes setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the grapes are grown.

Section 82KL

110. 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

111. 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).

112. This Project will be a 'scheme'. A Farmer will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed in the tables at paragraphs 35 to 37 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.

113. Farmers 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 the grapes. There are no facts that would suggest that Farmers 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 with each other at arm's length or, if any parties are not 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.

Examples

Example 1 – entitlement to 'input tax credit'

114. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of \$5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees however, is reduced by the amount of any 'input tax credit' to which she is entitled. The Project Manager provides Margaret with a 'tax invoice' showing its ABN and the price of the taxable supply for management services as \$5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 less \$500).

Example 2 - tax deductions for prepaid expenditure where Exception 5 applies and the Farmer is NOT a 'small business taxpayer'

115. Joseph decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The ABC Pineforest Project lodged an application for a Product Ruling on 20 October 1999 and the Ruling was issued by the Tax Office on 8 January 2000. Accordingly, Exception 5 applies to taxpayers who are accepted into the Project and incur prepaid expenditure under the arrangement.

The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months. Thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Joseph provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Joseph that the minimum subscription has been reached and the Project will go ahead. Joseph's agreements are duly executed and management services start to be provided on that date.

Joseph has extensive business interests and his average turnover for the 2000/2001 income year exceeds \$1 million. Therefore, he is not a 'small business taxpayer' and must calculate his tax deductions under the prepayment rules in sections 82KZMA-82KZMD.

Joseph, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

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

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Joseph's total tax deduction in 2001 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Joseph will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Joseph in the 2002 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Joseph in the 2002 income year).

\$4,643 + \$85 = \$4,728 (The sum of these two amounts is Joseph's total tax deduction for management fees in 2002).

Joseph continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

Detailed contents list

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	- ITAA 1997 Div 27
<i>Related Rulings/Determinations:</i>	- ITAA 1997 Div 35
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