


PR 2002/29 - Income tax: Padthaway Braithwaite Estate Vineyard Project (Lease of Community Lot)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *27 March 2002*



Product Ruling

Income tax: Padthaway Braithwaite Estate Vineyard Project (Lease of Community Lot)

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Preamble

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

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.

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.

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 Padthaway Braithwaite Estate Vineyard Project (Lease of Community Lot), or simply as 'the Project'.

Tax laws

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);
 - Division 35 (ITAA 1997);
 - Division 40 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('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 those persons 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 agreement until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, each of these persons, referred to as 'Growers', will be wholesale clients for the purpose of the Corporations Act 2001 or will have accepted an offer which qualifies as a small scale offer for the purpose 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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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

11. This Ruling applies prospectively from 27 March 2002, 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 described below. This description incorporates the following documents or parts of documents lodged with the Tax Office:

- Application for a Product Ruling dated 3 December 2001;
- Draft Padthaway Braithwaite Estate Vineyard Information Memorandum dated November 2001;

- Information Memorandum – Additional Materials 2002;
- **Pro forma Grower Accession Agreement between PAWK Pty Ltd ('Developer'), Australasian Agribusiness Services Pty Ltd ('Project Manager'), the Community Corporation for the Padthaway Braithwaite Estate ('Community Corporation') and the Grower, undated;**
- **Project Management Agreement between the Developer, the Project Manager and the Growers, dated 30 January 2002;**
- **Vineyard Management Agreement between the Project Manager, the Developer, Tomina Pty Ltd trading as Padthaway Management Services ('Vineyard Manager') and Growers, dated 30 January 2002;**
- **Draft Contract for the Sale of Land between the Developer as vendor and the Grower (or nominee) as Purchaser;**
- **Draft Memorandum of Mortgage with a Grower as Mortgagor and the Developer and the Project Manager as Mortgagees;**
- **Draft Memorandum of Lease between the Developer as Lessor and the Grower as Lessee;**
- **Development Contract between the Developer, the Project Manager and Growers, dated 30 January 2002;**
- Community Scheme Description executed by the Developer;
- Community Scheme By-Laws executed by the Developer;
- The Constitution of the Project Manager;
- The Constitution of Vineyard Manager;
- The Constitution of the Developer; and
- Correspondence including e-mails dated 30 January 2002, 11 February 2002 and 25 February 2002.

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. In accordance with the above documents, a Grower who participates in the arrangement must be a wholesale client or have accepted an offer that is a small scale offering . **This Ruling does not apply unless:**

- the Grower is a wholesale client as defined in section 761G of the Corporations Act 2001; or
- not being a retail client, the Grower has accepted a ‘personal offer’ of a small scale offering for the purpose of the Corporations Act 2001.

16. Each of these categories is explained in paragraphs 87 to 93 in the Explanations area of this Product Ruling. The documents highlighted are those Growers 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 Grower, or an associate of the Grower, will be a party. The effect of these agreements may be summarised as follows.

Overview

17. The arrangement is called the Padthaway Braithwaite Estate Vineyard Project and is summarised as follows.

Location	Padthaway in South Australia
Type of business each participant is carrying on	Commercial growing and cultivation of premium quality cool climate wine grapes
Name used to describe the Project	Padthaway Braithwaite Estate Vineyard Project
Number of hectares under cultivation	57.6
Number of Community Lots	16
Size of each Community Lot	3.389 hectares
Minimum subscription	4 Community Lots
Number of vines per hectare	1,818
Nature of the investment	Freehold title over land or alternatively leasehold interest at the option of the Grower. This Product Ruling only applies to Growers who lease a Community Lot.

Project Term	Just over 5 years if a Grower commenced before 30 June 2002 (see paragraph 26).
Initial cost per Community Lot (see paragraph 52)	<ul style="list-style-type: none"> • \$164,047 for a purchased lot • \$120,422 for a leased lot
Initial cost per hectare	<ul style="list-style-type: none"> • \$45,569 for a purchased lot • \$33,451 for a leased lot

The Project Land

18. The Project Land has a total area of approximately 57.62 hectares and is situated off the Riddoch Highway, approximately 5 km north of Padthaway and 52 km north of the regional centre of Naracoorte in South Australia. The Project Land has been purchased by the Developer and will be subdivided under a Community Scheme which is regulated by the *Community Titles Act 1996 (South Australia)* ('the Act').

19. The subdivision will consist of 16 Community Lots, each of approximately 3.389 hectares and a 3.5 hectares Common Property. The Project Land is presently contained in the Hundred of Parsons being Allotment 20 on Deposited Plan 58001 and part of the land comprised in Certificate of Title Register Book Volume 5481 Folio 847. The Developer will transfer the Water Licence to the Community Corporation.

20. 'Community Scheme' documents have been executed by the Developer in compliance with the Act. These documents include the Community Plan, Community Scheme Description, By-laws and Development Contract.

21. Under the Development Contract, the Developer shall establish and develop the Vineyard on the Community Lots and Common Property in accordance with statutory requirements and this contract (cl 4). The Project Manager, on behalf of the Developer, must establish the following on the Project Land for use and with permission of all Growers:

- an access road to the Vineyard and each community lot through the Common Property;
- headlands over designated portions of the Common Property;
- the provision of electricity to the Common Property;

- a water bore and pump or pumps on designated portions of the Common Property and the Community Lots; and
- an integrated irrigation system over designated portions of the Common Property and the Community Lots (cl 5).

Interest in land

22. Growers will hold either a freehold or a leasehold interest in the land. Growers, whether holding a freehold or leasehold title to the land, will only use the Project Land for the purpose of viticulture and the development and operation of a vineyard for the production of wine grapes and associated purposes.

23. The Developer through the Project Manager will commence the development of the Project once a minimum of not less than four (4) contiguous Community Lots, being Lots 1 to 4 or more, are either sold or leased by the Developer. Further development of the Project may proceed in stages, if necessary. The development of a particular stage will only proceed if a minimum of not less than four (4) contiguous Community Lots adjacent to lots of a preceding stage are either sold or leased.

24. A Grower who chooses to purchase a Community Lot will enter into a Contract for the Sale and Purchase of Land with the Developer. This Contract is subject to Special Conditions. Under the Act the owner of a Community Lot owns all of the improvements on that lot and the common property is vested in the owners of the Community lots as tenants in common. The purchase price is \$45,000 per Community Lot with 20% deposit payable on the execution of this Contract or on expiration of the cooling-off period and the balance on settlement.

Project Agreements

25. A Grower participating in the Project enters into a Grower Accession Agreement and becomes a party to the Project Management Agreement and Vineyard Management Agreement. The Memorandum of Lease will be an agreement in respect of a Grower who leases a Community Lot. In this Ruling, these agreements are collectively referred to as the Project Agreements.

26. A Grower will become a party to the Project Management Agreement and Vineyard Management Agreement upon payment of the balance of the first year fees. Both agreements will terminate on 30 June 2007. While it is not contemplated that the Project Management Agreement will be extended, the term of the Project

Management Agreement can be extended if the parties agree in writing. With regard to the Vineyard Management Agreement, the Community Corporation may, on behalf of Growers, extend this agreement for a further term of 5 years.

Grower Accession Agreement

27. By execution of the Grower Accession Agreement the Developer, the Project Manager and other Growers accept the Grower as a participant in the Project and the Grower agrees to own or occupy a Community Lot, becomes a party to the Project Management Agreement and Vineyard Management Agreement and agrees to pay its Grower Share of Project Expenditure as set out in this agreement (cl 2).

28. Where a Grower is the owner of Community Lots, that Grower will execute and deliver to the Project Manager a Grower Mortgage as security for the payment of any outstanding Grower Share of Project Expenditure and be a member of the Community Corporation in respect of those Community Lots (cls 3.3 & 5.1).

29. Where a Grower leases Community Lots, that Grower will be bound by the terms and conditions of the Memorandum of Lease. The Developer agrees to appoint the Grower as the Developer's proxy at meetings of Community Corporation and to vote at the direction of the Grower at any general meetings of the Community Corporation (cls 3.4 & 5.2).

30. The initial Project Development Plan prepared by the Project Manager for the establishment and development of the Vineyard over the first five Years of the Project, including the first three years to first harvest, (assuming the Completion Date in respect of the first Grower is on or before 1 April 2002) is set out in Schedule 6. The Project Development Plan will be reviewed and varied (if necessary) each Year by the Project Manager in accordance with the Project Management Agreement (cl 4.2).

31. Under the Initial Project Development Plan set out in Schedule 6, the following works will be carried-out in the year ended 30 June 2002:

- land preparation, ripping, cultivate and re-level;
- install water bore and pump;
- install trellis posts;
- install mains irrigation system and laterals;
- mound soils along planting rows;
- spray for weed control;

- install end assemblies of the trellis system; and
- install trellis wires.

32. The Initial Project Development Plan also provides that the selection and planting of vine rootlings will take place between August and September 2002.

33. Fees payable by Growers in the Project are set-out in Schedule 8 and detailed in paragraphs 52 to 54 of this Ruling.

Project Management Agreement

34. The Project Management Agreement sets out, among other things, the Project Manager's duties to the Developer and each Grower. This agreement also provides the grounds for early termination and the consequences of such early termination (cl 18). A Grower's interests can only be transferred upon satisfaction of certain conditions (cl 13.1).

35. The Project Manager must during the Project Term, by itself or through reputable contractors, at the cost of each Grower in proportion to their Grower Share:

- design, plan, budget, manage and supervise the establishment, development and initial harvests of the Vineyard on the Project Land for the Community Corporation and the Growers in accordance with the Project Development Plan, Project Budget and Community Scheme;
- supply to the Growers the Project Management Services set out in Part B of Schedule 1 in accordance with the Project Development Plan and Project Budget;
- supervise the Vineyard Manager on behalf of Growers as set out in this agreement and the Vineyard Management Agreement;
- invest contributions by Growers only in Authorised Investments; and
- ensure that the Project Assets are developed and used for the Project (cl 2.3).

36. The Project Management Services that are set out in Part B of Schedule 1 are as follows:

- obtain the Project Development Consent;
- manage and supervise the development and initial operation of the Vineyard;

- carry out for the Growers the on-going requirements of the Development Contract;
- collect Project Expenditure from Growers in good time;
- annually research and revise the Project Development Plan and Project Budget;
- develop annual activities schedule and budget with Vineyard Manager/contractors;
- supervising Vineyard establishment and the Vineyard Manager;
- carry out the statutory obligations of the Developer;
- initiate technical reports and liaise with independent advisers;
- monitor and report performance under the Project Development Plan and to Budget;
- arrange for regular meetings of Growers and the Community Corporation;
- authorise and pay Project accounts;
- maintain the Register of Growers and monitor transfers of Project Interests;
- manage the Community Corporation;
- invest surplus contributions by Growers in Authorised Investments;
- comply with South Australian industry standard viticultural practice;
- comply with all applicable laws and Project licences;
- initiating technical reports and liaising with independent advisers;
- general provide advice and assistance to Growers in relation to all aspects of general management of the Growers Vineyard development; and
- act honestly and in good faith towards the Growers.

37. The Project Manager will also provide progress reports to Growers at regular intervals of not more than 6 months and other reports that may be requested by Growers from time to time, provide a copy of the viticultural report provided under the Vineyard Management Agreement within 1 month of receipt (cl 9) and take out any insurance required including public liability insurance not less

than \$10 million and if available, professional indemnity insurance (cl 12).

38. The agreement also provides for the opening and operation of a bank account in the name of the Padthaway Braithwaite Estate. This account is referred to in the agreement as the Project Master Account. The signatories of this account will be one person nominated by the Project Manager and one person nominated by the Community Corporation who must sign jointly for all withdrawals from the account, except for payments authorised under a firm Project Budget, in which case the Project Manager may sign and make withdrawals solely (cls 7.1 & 7.2). Amount due and payable by a Grower as Grower Share of the Project Expenditures must be deposited into this Account (cl 7.4). A Grower will be required to pay interest on the amount unpaid by the due date (cl 8.1). Any monies received by the Project Manager or any other person in relation to the Project, other than Deposit Monies, must be held on trust for the Growers and deposited into the Project Master Account within 5 Business Days of receipt by the Project Manager (cl 7.5). Deposit Monies means an amount of 20% of total Project Expenditure paid or payable by an intending Grower when tendering a signed Application Form to the Project Manager to secure acquisition of the intended interest in the Project (cl 1.1).

Vineyard Management Agreement

39. Through the Vineyard Management Agreement, the Vineyard Manager is appointed and accepts this appointment to provide Vineyard Management Services for the Community Lots and the Common Property (cls 2.1 & 2.2). This agreement also provides the grounds for early termination and the consequences of such early termination (cl 15).

40. Clause 2.4 of the Vineyard Management Agreement stipulates the duties of the Vineyard Manager. The Vineyard Manager will also carry out the following:

- replant any vines which fail to strike in the first Year;
- generally maintain the Vineyard including control of weeds, suckers, vermin or other pests which may impede the growth of the vines;
- maintain and repair all fences, access roads, irrigation systems and trellising on and around the Vineyard;
- apply water and fertiliser to the Vineyard in such form and in such quantities necessary to maintain satisfactory vine growth and grape yields;

- arrange harvesting of grapes from the Vineyard;
- market and sell all grapes produced from the Vineyard; and
- provide advice and assistance to the Grower generally in relation to all aspects of general management of and good viticultural practice on the Vineyard and of the grapevines thereon.

41. The agreement also provides for the opening and operation of a bank account in the name of the Padthaway Braithwaite Estate. This account is referred to in the agreement as the Project Operating Account. The signatories of this account will be one person nominated by the Project Manager and one person nominated by the Vineyard Manager (cls 7.1 & 7.2). Any monies received by the Vineyard Manager for the account of Growers in relation to the Project must be held on trust for the Growers and deposited into the Project Master Account within 5 Business Days of receipt by the Project Manager (cl 7.5).

42. The Vineyard Manager will provide progress reports to the Project Manager at regular intervals of not more than 3 months and other reports that may be requested by the Project Manager from time to time. The Vineyard Manager must, at least once every 12 months, cause the Vineyard to be inspected by a person with viticultural expertise who must report in writing to the Project Manager the results of the inspection within one month of the date of such inspection (cl 6).

Memorandum of Lease

43. A Grower who chooses to lease a Community Lot will enter into a Memorandum of Lease with the Developer. The lease will be for an initial term of 10 years with an option for the Grower to renew for 5 years (cl 5.5). The Grower lessee will have the option to purchase the leased land in a 30 day period expiring 30 days before the end of the 5th and 10th years of the lease at 60% of the independently assessed market value of the leased Community Lot at the time the option is exercised. At the expiration of the lease term of 10 years, if the Grower has not exercised the option to purchase, the Developer may elect to purchase the vineyard improvements on the leased land from the Grower at the existing written down value or \$10,000, whichever is the higher (cl 5.6).

44. The agreement also provides that at the end or sooner of the termination of the Term or any extension thereof, all grapevines planted on the Leased Premises and all improvements made to the Leased Premises by the Lessee and all produce of the vines on the

Leased Premises not then harvested become the absolute property of the Lessor provided that the Lessor must, at the expiration of the Term or any extension thereof, pay for any improvements comprising trellising, irrigation equipment and piping and sheds on the Leased Premises a sum equal to the greater of \$10,000.00 or the tax written down value of those items, such amount to be paid to the Lessee within 180 days of termination of the lease (cl 5.12).

45. At all times during the Term the Grower will:

- own all plant, equipment and other property installed or placed on the Leased Premises by or on behalf of the Lessee;
- own all vine rootlings planted on the Leased Premises; and
- have the right to own, harvest and take away all grapes and other produce produced on the Leased Premises (cl 5.1).

46. Annual rent of \$5,500 per Community Lot is payable annually in advance, the first payment of rent being made on the commencement date of this lease pro rata to end of the following June. Subsequent annual rent are payable annually on the first day of July in each year. The annual rent will be reviewed annually in accordance with clause 2.3.

Planting and Harvesting

47. The Initial Project Development Plan contemplates that planting of vine rootlings will take place between the period August and September 2002. The Vineyard Manager will plant vines on the Growers' Community Lots. It is expected that the overall mix of varieties on the Project will be Chardonnay (25%) Cabernet Sauvignon (25%) Merlot (25%) and Shiraz (25%).

48. Growers will have an entitlement to a pro-rata share of the grape sale proceeds from the Project which will be pooled according to the maturity of the vineyard developed on each Community Lot. This pooling means that a Grower will not be able to specify the grape type to be planted on his/her Community Lot nor receive the proceeds of sale from the grapes produced solely on those lots. This will enable all Growers to benefit from the full variety mix intended to be planted and reduce the impact of any yield or variability that may occur across the vineyard from year to year.

49. To allow for phase-in of vines maturing, until full production capacity (expected to be after year 4) grapes harvested from Community Lots will be pooled with those produced from the vines planted in the same year and sold separately. Thereafter all grapes

from the vineyard of whatever variety harvested will be pooled with all grapes harvested from the Community Lots at full production capacity and marketed on behalf of all Growers.

50. An annual recommendation will be made to Growers on the preferred sales strategy for each forthcoming vintage. The strategy will be one or more of the following:

- sales of grapes on the annual spot market;
- pre-sell grapes by contract to major wine producers; and
- crush grapes and sell as bulk wine to local or export markets.

51. To date no contracts for the sale of grapes have been entered into. The Vineyard Manager may in its absolute discretion, negotiate and, with the approval of the Project Manager and the Growers (represented by the Community Corporation), enter into one or more long term contracts on behalf of Growers for the sale of grapes from the Project. In negotiating the terms of sale on behalf of the Growers with the buyer or buyers of Produce, including juice or wine, the Vineyard Manager must, as a term of the sale, require buyers to pay the purchase price payable into the Project Master Account for the credit of the Growers.

Project Fees

52. The table below shows the fees payable by a Grower per Community Lot in accordance with Schedule 8 of the Grower Accession Agreement.

	30 June 2002	30 June 2003	30 June 2004
Land cost (purchase)	\$45,000		
Land cost (lease)	\$1,375	\$5,500	\$5,500
Access roads/headlands	\$1,719		
Building	\$1,375		
Irrigation	\$21,038		
Vine establishment	\$22,482	\$2,200	
Trellising	\$20,625	\$6,875	
Project feasibility	\$18,632		

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Project Management fee	\$27,913	\$14,163	\$6,875
Vineyard Management fee	\$2,258	\$4,657	\$4,657
Operating Costs	\$3,005	\$16,895	\$24,795
Total (purchased lots)	\$164,047	\$44,790	\$36,327
Total (leased lots)	\$120,422	\$50,290	\$41,827

Notes:

- (a) The fees for 30 June 2002 is firm while the fees for subsequent years are provisional and will be updated each year by the Project Manager;
- (b) The lease, Project Management and Vineyard Management fees are subject to CPI variation;
- (c) The lease fee for the year ended 30 June 2002 is calculated pro rata based on an annual rent of \$5,500. The lease amount shown for the year ended 30 June 2002 assumes that the lease commences on 1 April 2002.

53. On application, Growers will pay 20% of the total fees for the year ended 30 June 2002 as Deposit Monies and the balance will be payable on or before 30 June 2002. For subsequent years, the following fees are payable as follows:

- Annual Rent (lease fee) – on 1 July each year;
- Project Management fee – on or before 1 July each year;
- Operating costs – on 1 July each year; and
- Vineyard Management fee – quarterly in advance beginning 1 July each year and calculated at the rate of \$344 per quarter per Plantable Hectare.

54. The Grower must also reimburse the Project Manager for any expenditures incurred in excess of the Project Budget for any particular year (cl 7.6, Grower Accession Agreement).

Finance

55. Growers can fund their investment in the Project themselves or borrow from an independent lender.

56. This Ruling does not apply if the 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

57. This Ruling applies only to Growers who become lessees of Community Lots and are accepted to participate in the Project:

- in the year ended 30 June 2002 and have executed a Grower Accession Agreement and become parties to the Project Management Agreement and Vineyard Management Agreement ('2002 Growers'); and/or
- in the year ended 30 June 2003 and have executed a Grower Accession Agreement and become parties to the Project Management Agreement and Vineyard Management Agreement ('2003 Growers').

58. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

59. For 2002 Growers, a reference in the following paragraphs to the first Financial Year is a reference to the income year ended 30 June 2002.

60. For 2003 Growers, a reference in the following paragraphs to the first Financial Year is a reference to the income year ended 30 June 2003.

Minimum subscription

61. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the Information Memorandum, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 4 Community Lots is achieved.

The Simplified Tax System ('STS')

Division 328

62. 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

63. 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.

Prepaid fees

64. For a Grower who is accepted into the Project between 1 April and 30 June of the first Financial Year, the services contemplated under the Project Agreements to be provided for that Financial Year may not be completed on or before 30 June of that Financial Year.

65. Where these services are not completed by 30 June of the first Financial Year, the fees incurred by a Grower in consideration for these services will be subject to the prepayment rules in sections 82KZME and 82KZMF. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Note (iv) below).

66. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

67. Where the services are not completed by 30 June of the first Financial Year the tax deductions allowable must be calculated by applying the above formula to the amount incurred in the first Financial Year by the Grower. The Project Manager will provide the relevant Growers with sufficient information to enable those Growers to calculate their tax deductions for the services that will be done in the first Financial Year.

Tax outcomes for Growers who are not 'STS taxpayers'

Assessable Income

Section 6-5

68. 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.

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

Deductions for Rent, Project Management fees, Vineyard Management fees and Operating Costs for a Grower who is accepted into the Project on or before 31 March 2002

Section 8-1

70. 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
Rent	8-1	Amount will require calculation – see Notes (i), (ii), (iii) & (iv) (below)	\$5,500 – see Notes (i), (ii) & (iv) (below)	\$5,500 – see Notes (i), (ii) & (iv) (below)
Project Management Fee	8-1	\$27,913 – see Notes (i), (ii) & (iv) (below)	\$14,163 – see Notes (i), (ii) & (v) (below)	\$6,875 – see Note (i), (ii) & (v) (below)
Vineyard Management Fee	8-1	\$2,258 – see Notes (i), (ii) & (iv) (below)	\$4,657 – see Notes (i), (ii) & (iv) (below)	\$4,657 – see Notes (i), (ii) & (iv) (below)
Operating Costs	8-1	\$3,005 – see Notes (i), (ii) & (iv) (below)	\$16,895 – see Notes (i), (ii) & (iv) (below)	\$24,795 – see Notes (i), (ii) & (iv) (below)

Notes:

- (i) If a Grower is accepted into the Project between 1 July 2002 and 31 March 2003, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table;
- (ii) 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 1 at paragraph 147;

- (iii) Rent to be calculated pro rata to 30 June of the First Financial year based on an annual rent of \$5,500. For example, if the lease commences on 31 March 2002, the rent payable to 30 June 2002 is approximately \$1,390. The Developer will inform Growers of the actual rent payable;
- (iv) The Rent, Project and Vineyard Management fees and the Grower's Share in the operating costs shown in the Grower Accession 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 above in paragraph 66 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;
- (v) Where the Project Management Fee shown in the Grower Accession Agreement is incurred on 1 July in the Financial Year to which the payment relates it will be deductible in full in the year that it is incurred. However, where the Project Management Fee is paid before the Financial Year to which the payment relates (i.e., before 1 July) the Project Management Fee may be subject to the prepayment rules of the ITAA 1936. In such cases, the tax deduction for the prepaid Project Management Fee **MUST** be determined using the formula shown above in paragraph 66.

Deductions for Rent, Project Management fees, Vineyard Management fees and Operating Costs for a Grower who is accepted into the Project between 1 April 2002 and 30 June 2002

Section 8-1

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

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Fee Type	ITAA 1997 Section	Year 1 Year ended 30 June 2002	Year 2 Year ended 30 June 2003	Year 3 Year ended 30 June 2004
Rent	8-1	Amount will require calculation – see Notes (vi), (vii) (viii) & (xi) (below)	\$5,500 – see Notes (vi) (vii) & (xi) (below)	\$5,500 – see Notes (vi) (vii) & (xi) (below)
First financial year - Project Management Fee Vineyard Management Fee Operating Costs	8-1	Amount may require calculation – see Notes (vi), (vii) & (ix) (below)	If apportioned in Year 1, the balance is allowed in this year. – see Notes (vi) & (vii) (below)	nil
Project Management Fee for subsequent years	8-1	nil	\$14,163– see Notes (vi), (vii) & (x) (below)	\$6,875 – see Note (vi), (vii) & (x) (below)
Vineyard Management Fee for subsequent years	8-1	nil	\$4,657 – see Notes (vi), (vii) & (xi) (below)	\$4,657 – see Notes (vi), (vii) & (xi) (below)
Operating Costs for subsequent years	8-1	nil	\$16,895 – see Notes (vi), (vii) & (xi) (below)	\$24,795 – see Notes (vi), (vii) & (xi) (below)

Notes:

- (vi) If a Grower is accepted into the Project between 1 April 2003 and 30 June 2003, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table;
- (vii) 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 1 at paragraph 147;
- (viii) Rent to be calculated pro rata to 30 June of the First Financial year based on an annual rent of \$5,500. For example, if the lease commences on 1 April 2002, the rent payable to 30 June 2002 is approximately \$1,375. The Developer will inform Growers of the actual rent payable;
- (ix) Where the services or things in consideration of the Project and Vineyard Management fees and the Grower's Share of the operating costs are not completed or provided by 30 June 2002 (or 2003 as the case may be), these fees as shown in paragraph 52 above are **NOT** deductible in full in the year incurred. The deduction for these fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 66). The Project Manager will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred (see Example 2 at paragraph 148);
- (x) Where the Project Management Fee shown in the Grower Accession Agreement is incurred on 1 July in the Financial Year to which the payment relates it will be deductible in full in the year that it is incurred. However, where the Project Management Fee is paid before the Financial Year to which the payment relates (i.e., before 1 July) the Project Management Fee may be subject to the prepayment rules of the ITAA 1936. In such cases, the tax deduction for the prepaid Project Management Fee **MUST** be determined using the formula shown above in paragraph 66;
- (xi) The Rent, Vineyard Management fee and the Grower's Share in the operating costs shown in the Grower Accession 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 above in paragraph 66 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.

Deductions for capital expenditure

Division 40

72. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to trellising, water facilities (e.g., irrigation) establishment of horticultural plant and the construction of a shed. 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 (xii), (xiii) & (xiv) (below)	Must be calculated - see Notes (xii), (xiii) & (xiv) (below)	Must be calculated - see Notes (xii), (xiii) & (xiv) (below)
Water facility (e.g., irrigation, dam, bore, etc)	40-515	\$7,013 - see Notes (xii), (xiii) & (xv) (below)	\$7,013 - see Notes (xii), (xiii) & (xv) (below)	\$7,013 - see Notes (xii), (xiii) & (xv) (below)
Establishment of horticultural plant	40-515	Nil - see Notes (xii), (xiii) & (xvi) (below)	Nil - see Notes (xii), (xiii) & (xvi) (below)	Nil - see Notes (xii), (xiii) & (xvi) (below)
Shed	40-25	Must be calculated - see Notes (xii), (xiii) & (xvii) (below)	Must be calculated - see Notes (xii), (xiii) & (xvii) (below)	Must be calculated - see Notes (xii), (xiii) & (xvii) (below)

Notes:

- (xii) If a Grower is accepted into the Project in the year ended 30 June 2003, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table;
- (xiii) 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 1 at paragraph 147;
- (xiv) 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 (or 2003 if a Grower is accepted in the year ended 30 June 2003). The Project Manager will advise Growers when that occurs to enable Growers to calculate the deduction for the decline in value;

- (xv) Any irrigation system, dam or bore 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);
- (xvi) 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 Project Manager will inform Growers of when the grapevines enter their first commercial season;

- (xvii) A shed is a 'depreciating asset'. Each Grower's interest in the shed 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 shed.

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 the shed has an 'effective life' of 33 years. The shed may be installed and first used during the year ended 30 June 2002. The Project Manager will advise Growers when that actually occurs to enable Growers to calculate the deduction for the decline in value.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5

73. 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.

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

Deductions for Rent, Project Management fees, Vineyard Management fees and Operating Costs for a Grower who is accepted into the Project on or before 31 March 2002

Section 8-1 and section 328-105

75. A Grower who is 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
Rent	8-1 & 328-105	Amount will require calculation – see Notes (xviii), (xix), (xx), (xxi) & (xxii) (below)	\$5,500 – see Notes (xviii), (xix), (xxi) & (xxii) (below)	\$5,500 – see Notes (xviii), (xix), (xxi) & (xxii) (below)
Project Management Fee	8-1 & 328-105	\$27,913 – see Notes (xviii), (xix), (xxi) & (xxii) (below)	\$14,163 – see Notes (xviii), (xix), (xxi) & (xxiii) (below)	\$6,875 – see Notes (xviii), (xix), (xxi) & (xxiii) (below)
Vineyard Management Fee	8-1 & 328-105	\$2,258 – see Notes (xviii), (xix), (xxi) & (xxii) (below)	\$4,657 – see Notes (xviii), (xix), (xxi) & (xxii) (below)	\$4,657 – see Notes (xviii), (xix), (xxi) & (xxii) (below)
Operating Costs	8-1 & 328-105	\$3,005 – see Notes (xviii), (xix), (xxi) & (xxii) (below)	\$16,895 – see Notes (xviii), (xix), (xxi) & (xxii) (below)	\$24,795 – see Notes (xviii), (xix), (xxi) & (xxii) (below)

Notes:

- (xviii) If a Grower is accepted into the Project between 1 July 2002 and 31 March 2003, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table;
- (xix) 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 1 at paragraph 147;
- (xx) Rent to be calculated pro rata to 30 June of the First Financial year based on an annual rent of \$5,500. For example, if the lease commences on 31 March 2002, the rent payable to 30 June 2002 is approximately \$1,390. The Developer will inform Growers of the actual rent payable;
- (xxi) 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;
- (xxii) Where a Grower who is an 'STS taxpayer' pays the Rent, Project and Vineyard Management fees and the Grower's Share in the operating costs shown in the Grower Accession 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 (see paragraphs 64 to 67). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 66, 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;

(xxiii) Where the Project Management Fee shown in the Grower Accession Agreement is incurred on 1 July in the Financial Year to which the payment relates it will be deductible in full in the year that it is paid. However, where the Project Management Fee is paid before the Financial Year to which the payment relates (i.e., before 1 July) the Project Management Fee may be subject to the prepayment rules of the ITAA 1936. In such cases, the tax deduction for the prepaid Project Management Fee **MUST** be determined using the formula shown above in paragraph 66.

Deductions for Rent, Project Management fees, Vineyard Management fees and Operating Costs for a Grower who is accepted into the Project between 1 April 2002 and 30 June 2002

Section 8-1 and section 328-105

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

Fee Type	ITAA 1997 Section	Year 1 Year ended 30 June 2002	Year 2 Year ended 30 June 2003	Year 3 Year ended 30 June 2004
Rent	8-1 & 328-105	Amount will require calculation – see Notes (xxiv), (xxv), (xxvi), (xxviii) & (xxix) (below)	\$5,500 – see Notes (xxiv), (xxv), (xxviii) & (xxix) (below)	\$5,500 – see Notes (xxiv), (xxv), (xxviii) & (xxix) (below)
First financial year - Project Management Fee Vineyard Management	8-1 & 328-105	Amount may require calculation – see Notes (xxiv), (xxv),	If apportioned in Year 1, the balance is allowed in this year. – see Notes	nil

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Fee		(xxvii) &(xxviii) (below)	(xxiv) & (xxv) (below)	
Operating Costs				
Project Management Fee for subsequent years	8-1 & 328-105	nil	\$14,163 – see Notes (xxiv), (xxv), (xxviii) & (xxx) (below)	\$6,875 – see Note see (xxiv), (xxv), (xxviii) & (xxx) (below)
Vineyard Management Fee for subsequent years	8-1 & 328-105	nil	\$4,657 – see Notes (xxiv), (xxv), (xxviii) & (xxix) (below)	\$4,657 – see Notes (xxiv), (xxv), (xxviii) & (xxix) (below)
Operating Costs for subsequent years	8-1 & 328-105	nil	\$16,895 – see Notes (xxiv), (xxv), (xxviii) & (xxix) (below)	\$24,795 – see Notes (xxiv), (xxv), (xxviii) & (xxix) (below)

Notes:

- (xxiv) If a Grower is accepted into the Project between 1 April 2003 and 30 June 2003, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table;
- (xxv) 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 1 at paragraph 147;
- (xxvi) Rent to be calculated pro rata to 30 June 2002 based on an annual rent of \$5,500. For example, if the lease commences on 1 April 2002, the rent payable to 30 June 2002 is approximately \$1,375. The Developer will inform Growers of the actual rent payable;

- (xxvii) Where the services or things in consideration of the Project and Vineyard Management fees and the Grower's Share of the operating costs are not completed or provided by 30 June 2002 (or 2003 as the case may be), these fees as shown in paragraph 52 above are **NOT** deductible in full in the year in which it is paid by, or on behalf of the 'STS taxpayer'. The deduction for these fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 66). The Project Manager will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred (see Example 2 at paragraph 148);
- (xxviii) 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;
- (xxix) Where a Grower who is an 'STS taxpayer' pays the Rent, Vineyard Management fee and the Grower's Share in the operating costs shown in the Grower Accession 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 (see paragraphs 64 to 67). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 66, 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;
- (xxx) Where the Project Management Fee shown in the Grower Accession Agreement is incurred on 1 July in the Financial Year to which the payment relates it will be deductible in full in the year that it is paid. However, where the Project Management Fee is paid before the Financial Year to which the payment relates (i.e.,

before 1 July) the Project Management Fee may be subject to the prepayment rules of the ITAA 1936. In such cases, the tax deduction for the prepaid Project Management Fee **MUST** be determined using the formula shown above in paragraph 66.

Deductions for capital expenditure

Subdivision 328-D and Subdivisions 40-F and 40-G

77. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to trellising, water facilities (e.g., irrigation) grapevines and the construction of a shed. Deductions relating to the 'cost' of trellising and the shed must be determined under Division 328. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F. If the 'water facility' 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.

78. The deductions shown in the following table assume, for representative purposes only, that a Grower has chosen to or can only claim deductions for expenditure on water facilities under Subdivisions 40-F and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Note (xxxiv) below.

79. 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	\$3,094-see Notes (xxxi), (xxxii) & (xxxiii) (below)	\$6,290 - see Notes (xxxi), (xxxii) & (xxxiii) (below)	\$5,435 - see Notes (xxxi), (xxxii) & (xxxiii) (below)
Water facility	40-515	\$7,013 -	\$7,013 -	\$7,013 -

(e.g., irrigation, dam, bore, etc.)		see Notes (xxxi), (xxxii) & (xxxiv) (below)	see Notes (xxxi), (xxxii) & (xxxiv) (below)	see Notes (xxxi), (xxxii) & (xxxiv) (below)
Establishment of horticultural plant	40-515	Nil - see Notes (xxxi), (xxxii) & (xxxv) (below)	Nil - see Notes (xxxi), (xxxii) & (xxxv) (below)	Nil - see Notes (xxxi), (xxxii) & (xxxv) (below)
Shed	328-125 & 328-190	\$206 - see Notes (xxxi), (xxxii) & (xxxvi) (below)	\$351 - see Notes (xxxi), (xxxii) & (xxxvi) (below)	\$245 - see Notes (xxxi), (xxxii) & (xxxvi) (below)

Notes:

- (xxxi) If a Grower is accepted into the Project in the year ended 30 June 2003, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table;
- (xxxii) 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 1 at paragraph 147;
- (xxxiii) 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.

The tax deduction allowable is determined in the year ended 30 June 2003 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 2003 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;

- (xxxiv) Any irrigation system, dam or bore 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);
- (xxxv) 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 Project Manager will inform Growers of when the grapevines enter their first commercial season;

(xxxvi) A shed is a 'depreciating asset'. Each Grower's interest in the shed 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 shed 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.

Tax outcomes for all Growers

Interest on loans

80. The deductibility or otherwise of interest arising from any loan agreements entered into by a Grower is outside the scope of this Ruling. However, Growers should read the discussion of the prepayment rules in paragraphs 108 to 116 (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.

Other capital expenditures

81. A Grower will **not** be able to claim the following capital expenditures as deductions:

- purchase price of the Community Lot;
- cost of the construction of access roads and headlands;
and

- Project Feasibility.

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

Section 35-55 – Commissioner’s discretion

82. For a Grower who is an individual and who enters the Project during the years ended 30 June 2002 and/or 30 June 2003 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided that the rule in section 35-10 does not apply to this business activity for the income years specified below:

- 30 June 2002 to 30 June 2005 for a Grower who is accepted into the Project in the year ended 30 June 2002; and
- 30 June 2003 to 30 June 2006 for a Grower who is accepted into the Project in the year ended 30 June 2003,

provided that the Project is carried out in the manner described in this Ruling.

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

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 135 in the Explanations part of this ruling, below);
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45;
- the Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

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

85. 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.

Section 82KL and Part IVA

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

- 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

Corporations Act 2001

87. For this Ruling to apply, an offer for an interest in the project must:

- have been made to, and accepted by a Grower, who qualifies as a wholesale client as defined in section 761G of the Corporations Act 2001; or
- be an offer which qualifies as a small scale offering as defined in section 1012E of the Corporations Act 2001.

Small scale offers and offers to wholesale clients do not require a prospectus or product disclosure statement.

88. A Grower in the Project may be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the person satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c)); or
- the 'professional investor test' (paragraph 761G(7)(d)).

89. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'product value test' 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.

90. A participant in a managed investment scheme, referred to below as ‘the person’ or ‘the person to whom the offer is made’, will satisfy the ‘individual wealth test’ where, 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:

- has net assets of at least \$2.5 million; or
- has a gross income for each of the last 2 financial years of at least \$250,000 a year.

91. A participant in a managed investment scheme, referred to below as ‘the person’ or ‘the person to whom the offer is made’, will satisfy the ‘professional investor test’ where:

- the person is a financial services licensee or:
- the person controls at least \$10 million for the purposes of investment in securities.

92. Alternatively, under section 1012E, a Grower may participate in the project by accepting a ‘personal offer’ for an interest in the project. Offers made under section 1012E 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 (subsection 1012E(2)).

93. 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 1012E(5)).

Is the Grower carrying on a business?

94. For the amounts set out in the tables above to constitute allowable deductions the Grower’s viticulture activities as a participant in the Padthaway Braithwaite Estate Vineyard Project 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.

95. For schemes such as that of the Padthaway Braithwaite Estate Vineyard Project, 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.

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

- the Grower has an identifiable interest in the land on which the Grower's grapevines are established;
- the Grower has a right to harvest and sell the grapes 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.

97. Under this Project, each Grower will have the option to enter into a Memorandum of Lease. They will each enter into a Grower Accession Agreement and become a party to a Project Management Agreement and a Vineyard Management Agreement.

98. Under the Memorandum of Lease each individual Grower will have rights over a specific and identifiable area of land. The Memorandum of Lease provides the Grower with an ongoing interest in the specific grapevines on 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 Project Manager and the Vineyard Manager to come onto the land to carry out their obligations under the Project Agreements.

99. Under the Project Agreements the Project Manager and the Vineyard Manager are engaged by the Grower to establish and maintain the Grower's Land during the term of the Project. The Project Manager and the Vineyard Manager have provided evidence that they hold the appropriate professional skills and credentials to provide the management services to establish and maintain the Grower's Land on the Grower's behalf. In establishing the Grower's Land, the Grower engages the Project Manager to purchase and install trellising and water facilities (e.g., irrigation) and to acquire and plant vine seedlings/rootlings on the Grower's Land. During the term of the Project, these assets will be used wholly to carry out the Grower's viticulture activities. The Vineyard Manager is also engaged to harvest

and sell, on the Grower's behalf, the grapes grown on the Grower's Land. 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.

100. 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 grapes 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. The pooling of grapes grown on the Grower's Land with the grapes of other Growers is consistent with general viticulture practices. Each Grower's proportionate share of the sale proceeds of the pooled grapes will reflect the proportion of the grapes contributed from their land.

101. The services of the Project Manager and the Vineyard Manager 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 Grower's Land is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

102. The Grower's degree of control over the Project Manager and the Vineyard Manager as evidenced by the Project Agreements, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Managers will provide the Grower with regular progress reports on the Grower's Land and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Project Manager and the Vineyard Manager in certain instances, such as cases of default or neglect.

103. 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 Padthaway Braithwaite Estate Vineyard Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

104. 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.

105. 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 the Rent, Project Management Fee, Vineyard Management Fee and Operating Costs

Section 8-1

106. Consideration of whether the Rent, Project Management Fee, Vineyard Management Fee and Operating Costs 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.

107. The Rent, Project Management Fee, Vineyard Management Fee and Operating Costs 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 grapes) 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 these fees is identifiable from the arrangement. These fees appear to be reasonable. There is no capital component of the management fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Prepayment provisions

Sections 82KZL to 82KZMF

108. 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.

109. For this Project, only section 82KZL (an interpretive 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 them from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

110. 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)).

111. 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;
- 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:
 - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (ii) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

112. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)).

113. 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.

114. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure.

115. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

116. 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

(i) Rent

117. The rent payable by a Grower is not for things to be done beyond 30 June in the year in which the relevant amount is incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

(ii) Project Management Fee, Vineyard Management Fee and Operating Costs for Growers accepted on or before 31 March 2002 or on or before 31 March 2003

118. Where a Grower is accepted into the Project on or before 31 March of the first Financial Year, these fees are not for things to be done beyond 30 June in the year in which the relevant amount is incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

(iii) Project Management Fee, Vineyard Management Fee and Operating Costs for Growers accepted into the Project between

1 April 2002 and 30 June 2002 or alternatively, 1 April 2003 and 30 June 2003

119. For a Grower accepted into the Project between 1 April and 30 June of the first Financial Year, these fees as incurred meet the requirements of subsections 82KZME(1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, where the services are not fully provided by 30 June in the Financial Year in which these fees are incurred the amount and timing of tax deductions for those fees are determined under section 82KZMF, unless one of the exceptions to section 82KZME applies.

120. The prepaid fees incurred by such Growers does not fall within any of the 5 exceptions to section 82KZME. Therefore, where the services are not fully provided by 30 June in the Financial Year in which these fees are incurred, the deduction for each year is determined using the formula in subsection 82KZMF(1) (see above paragraph 115). Section 82KZMF will apportion the deduction for prepaid Project Management Fee, Vineyard Management Fee and Operating Costs over the period that the services for which the prepayment is made, are provided.

121. Alternatively, for a Grower accepted into the Project between 1 April and 30 June of the first Financial Year, the Project Management Fee, Vineyard Management Fee and Operating Costs will be fully deductible in the Financial Year in which it is incurred where the services are fully provided by 30 June in the Financial Year to which the payment relates.

122. The Project Manager will provide such Growers with the relevant information to allow them to determine the tax deductions allowable for the Project Management Fee, Vineyard Management Fee and Operating Costs.

(iv) Annual Project Management Fee for all Growers accepted into the Project

123. All Growers accepted into the Project are required to pay the annual Project Management Fee on or before 1 July in the Financial Year to which this fee relates. Where this fee is incurred on 1 July of the year to which it relates, it is deductible in that year. However, where a Grower pays this fee before the 1 July of the Financial Year to which they relate, the fee may be subject to the prepayment provisions, unless the amount is 'excluded expenditure'. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000. Because the amount of the annual Project Management Fee is not an 'excluded expenditure' the prepayment provisions (see paragraphs 108 to 116) will apply to determine the amount and timing of the deductions regardless of

whether the Grower is an 'STS taxpayer' or not. See Example 2 at paragraph 148.

(v) Annual Vineyard Management Fee and Operating Costs for all Growers accepted into the Project

124. The annual Vineyard Management Fee and Operating Costs incurred by Growers after the first Financial Year are not for things to be done beyond 30 June in the year in which the relevant amount is incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

125. However, although not required under the Project Agreements, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Where this occurs, contrary to the conclusion reached in paragraph 124 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

126. For these Growers, the amount and timing of deductions for any relevant prepaid annual Vineyard Management Fee and Operating Costs will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

Interest deductibility

Section 8-1

127. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financiers are 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.

128. 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 108 to 116).

Expenditure of a capital nature

Division 40 and Division 328

129. 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, the establishment of the grapevines and the construction of a shed is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

130. 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'.

131. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 72 and 79 (above) in the tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

132. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2), a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

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

133. 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.

134. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

135. For the purposes of applying Division 35, 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.

136. In broad terms, the 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, or an interest in real property, (excluding any private dwelling) 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 (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

137. 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 Community Lot in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2006 if that Grower is accepted into the Project by 30 June 2002 or 30 June 2007 if that Grower is accepted into the Project by 30 June 2003. 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.

138. Therefore, prior to these respective times, 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.

139. 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 yet met one of the tests set out in Division 35; and
- (iii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

140. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Community Lot in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2006 if that Grower is accepted into the Project by 30 June 2002 or 30 June 2007 if that Grower is accepted into the Project by 30 June 2003. 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 2005 or 2006, respectively.

141. 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 82), in the manner described in the Arrangement (see paragraphs 14 to 56). 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.

142. 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 provided with the Product Ruling application; and
- independent, objective, and generally available information relating to the viticulture industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application.

Section 82KL - recouped expenditure

143. 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

144. 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).

145. The Padthaway Braithwaite Estate Vineyard Project 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 70 to 79 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.

146. 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 grapes. 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.

Examples

Example 1 - Entitlement to GST input tax credits

147. 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	<u>\$2 200*</u>
Total due and payable by 1 January 2002 (includes GST of \$600)	<u>\$6 600</u>

*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:

$$1/11 \times \$4400 = \$400.$$

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:

$$1/11 \times \$2200 = \$200.$$

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).

Example 2 – Apportionment of Fees

148. Murray decides to participate in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. 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 and 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. Murray 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 2002 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray is an 'STS taxpayer' who is not registered, nor required to be registered for GST. He calculates his tax deduction for management fees for the **2002 income year** as follows:

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

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

= **\$356** (this is Murray's total tax deduction in 2002 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2002 income year).

In the **2003 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

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

= **\$4,644** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2003 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 Murray in the 2003 income year).

\$4,644 + \$85 = \$4,729 (The sum of these two amounts is Murray's total tax deduction for management fees in 2003).

Murray 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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Commissioner of Taxation

27 March 2002

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