PR 2002/31 - Income tax: The Gnangara Vineyard Project

Product Ruling
Income tax: The Gnangara Vineyard Project

Contents Para

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

Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of Use of this Product Ruling

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

What this Product Ruling is about

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

Tax laws

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

- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Division 70 (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 the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement 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 purposes of the *Corporations Act 2001*, or will have accepted an offer which qualifies as a small scale offer for the purposes 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.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part 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 2005. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 18 December 2001;

- The Gnangara Vineyard Project Information Memorandum, dated 7 February 2002;
- Constitution for the Gnangara Vineyard Project, undated;
- **Vineyard Management Agreement for the Gnangara Vineyard Project between Viticultural Asset Management Pty Ltd [the 'Manager'], AVT Management Pty Ltd ['the Owner'] and the Grower, dated 15 February 2002;**
- **Lease Agreement for the Gnangara Vineyard Project between AVT Management Pty Ltd ('the Owner'), Viticultural Asset Manager Pty Ltd ('the Manager') and the Grower dated 15 February 2002;**
- Viticultural Services Agreement between Viticultural Asset Management Pty Ltd, AVT Management Pty Ltd and Selwyn Viticultural Services Pty Ltd, undated;
- Grape Supply Agreement between Viticultural Asset Management Pty Ltd and Grape Buyer 1 undated;
- Heads of Agreement between Viticultural Asset Management Pty Ltd and Grape Buyer 2, undated; and
- Additional correspondence dated 14 February 2002, 11 March 2002 and 13 March 2002.

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

15. The documents highlighted are those that the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

17. 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 for the purposes of the *Corporations Act 2001*. **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 purposes of the *Corporations Act 2001*.

18. Each of these categories is explained in paragraphs 72 to 78 in the Explanations area of this Product Ruling. The effect of the agreements may be summarised as follows.

Overview

19. This arrangement is called the Gnangara Vineyard Project.

Location	Manjimup, in the South West Region of Western Australia
Type of business each participant is carrying on	A commercial viticulture business.
Number of hectares under cultivation	290 hectares
Size of each Leased Area	1 hectare
Minimum Subscription	100 Vineyard Lots and 800,000 Units in the Australasian Vineyard Trust
Number of vines per hectare	1,850
The term of the investment	15 years
Initial cost	$26,015 for 2002 Growers, $48, 952.20 for 2003 Growers who are accepted into the Project on or before 30 September 2002 and/or $58,247.20 for 2003 Growers who are accepted into the Project on or after 1 October 2002.
Initial cost per hectare	$26,015 for 2002 Growers, $48, 952.20 for 2003 Growers who are accepted into the Project on or before 30 September 2002 and/or $58,247.20 for 2003 Growers who are accepted into the Project on or after 1 October 2002.
Ongoing costs	Annual Management Fees, Rent and Project Management Fee.

20. The Project Land is located at Manjimup in the South West Region of Western Australia. AVT Management Pty Ltd , as Trustee for the Australasian Vineyard Trust, is the owner of the property.

21. Growers participating in the Project will enter into a Lease Agreement and a Management Agreement. AVT Management Pty Ltd will lease the Vineyard Lot to the Grower to enable the Grower to carry on the business of the commercial production of grapes. Under the Lease, Growers lease an area of land called a 'Vineyard Lot' for a term of 15 years. Each Vineyard Lot is 1 hectare in size.

22. Under this offer, Growers may enter the Project in either the 2001/2002 income year (defined as '2002 Growers' for the purposes of this Ruling) or the 2002/2003 income year ('2003 Growers'). Viticultural Asset Management Pty Ltd may accept applications for 2002 Growers up until 15 June 2002, only where the Vineyard development services will be completed by 30 June 2002. Applications received after 15 June 2002 will be executed on or after 1 July 2002 and applicants will participate in the Project as 2003 Growers.

23. Under the Management Agreement, Growers appoint Viticultural Asset Management Pty Ltd as Manager to manage their Vineyard Lot. The Manager will be responsible for establishing and cultivating the vines and harvesting the grapes in accordance with good viticultural practice. Growers may elect to take delivery of and sell their own produce or the Manager will do so on their behalf.

24. Each Grower must apply for a minimum of one Vineyard Lot, at a cost (per Vineyard Lot) of $26,015 for 2002 Growers, $48,952.20 for 2003 Growers who are accepted into the Project on or before 30 September 2002 and/or $58,247.20 for 2003 Growers who are accepted into the Project on or after 1 October 2002. Growers may also subscribe for 8,000 Units (at 0.50 cents per unit) in the Australasian Vineyard Trust at a cost of $4,000 plus stamp duty. The minimum subscription for this Project is 100 Vineyard Lots and 800,000 units in the Australasian Vineyard Trust.

25. Growers will execute a Power of Attorney enabling the Manager, Viticultural Asset Management Pty Ltd, to act on their behalf as required, when they make an application for a Vineyard Lot.

Constitution

26. The Constitution for the Project sets out the terms and conditions under which the Manager, Viticultural Asset Management Pty Ltd agrees to act for the Grower and to manage the Project. The Manager will keep a register of Growers (cl. 26). The Lease Agreement and Management Agreement are annexed to the Constitution and will be executed on behalf of a Grower following them signing the Application and a Power of Attorney Form in the Information Memorandum. Growers are bound by the Constitution by virtue of their participation in the Project.

Interest in land

27. A lease is granted by the owner, AVT Management Pty Ltd, to the Grower under the terms of the Lease Agreement (cl. 8). Growers are granted an interest in land in the form of a lease to use their Vineyard Lot(s) for carrying on the business of a long term commercial viticulture project (cl. 6). Growers must pay rent annually to the Lessor. The term of a Grower's lease is up to 30 June 2017.

Management Agreement

28. Each Grower enters into a Management Agreement with the Manager for each Vineyard Lot. The expiration date of the Project will be 30 June 2017 subject to the performance of any obligations that are to be performed after that date (cl. 20).

29. Growers contract with the Manager to train, maintain, supervise and manage, in accordance with good commercial practice all the vines, the vineyard and the commercial viticultural activities to be carried on by the Grower on the Vineyard Lot. Growers pay a Management Fee for each Vineyard Lot on subscription and an annual management fee thereafter.

30. The Manager will perform the following duties during the period from the commencement date to 30 June 2002, for 2002 Growers, or from the commencement date to 30 June 2003 for 2003 Growers:

- ensure appropriate soil works are completed including ripping and mounding, fertilising, liming, cultivation and any other application;
- ensure control of all weeds and vermin on the Vineyard;
- ensure the Vineyard is well drained and level at all times;
- install an in-line dripper system to each vine to provide a wetting strip with maximum dripper spacing of 1 metre and a minimum dripper capacity of 2 litres per hour; and
- install all necessary pumps, filtration and fertilisation equipment to efficiently operate and monitor the irrigation system.

31. The Manager will perform the following ongoing services under this Agreement:

- cultivate, tend, train, prune, fertilise, replant, spray and otherwise care for the vines as and when required;
- maintain and repair all irrigation and trellising on the Vineyard Lot;
- replace any vines that fail to establish during the first two years of the Project excluding vines lost to fire, flood, hail, waterlogging or any other event or Act of God not attributable to the Manager;
- use all reasonable measures to keep the Vineyard Lot free from vermin, noxious weeds, pests and diseases;
- maintain the Vineyard Lot according to good viticultural practices; and
- harvest the grapes grown on the Vineyard Lot each year and deliver it up for sale.

32. Growers may elect to take delivery of all of the grapes harvested from their Vineyard Lot(s). This election shall be given to the Manager by written notice prior to the commencement of the Project in the application for Vineyard Lot(s) (cl. 6.2). However, where Growers do not elect, the Manager will sell the grapes from the Vineyard Lots on the Grower's behalf to the Grpae Buyers at such a price and on such terms and conditions as the Growers may by majority so determine (cl. 6.2).

33. Growers appoint the Manager as their attorney to enter into and negotiate forward sales agreements. The Manager intends to enter into contracts to sell up to 100% of the grapes grown from the Project to grape purchasers.

34. The Manager will be responsible for paying for the cost of annual insurance for the Vineyard and Improvements on the Land (excluding any grape crop) and against public risk in respect of the vineyard (cl.26, cl.27).

Fees

35. For 2002 Growers the initial fee payable under the Management Agreement and the Lease Agreement is $26,015 per Vineyard Lot payable on application. This includes a management fee of $16,885, rent of $275, trellising fee of $2,530, irrigation cost of $6,050 and landcare of $275. These services will be performed by 30 June 2002.

36. For 2003 Growers, who are accepted into the Project on or before 30 September 2002, the initial fee payable under the Management Agreement and the Lease Agreement is $48,952.20 payable on application. This includes a management fee

of $38,447.20, rent of $1,650, trellising of $2,530, irrigation cost of $6,050 and landcare of $275. For 2003 Growers who are accepted into the Project on or after 1 October 2002, the initial fee payable is $58,247.20. This includes a management fee of $38,447.20, rent of $1,650, trellising of $8,800, irrigation cost of $6,050, landcare of $275, and a planting fee of $3,025. These services will be completed by 30 June 2003 for all 2003 Growers.

37. A Management Fee of $21,562.20 is payable by 2002 Growers on 1 October 2002 for services to be carried out in the period 1 July 2002 to 30 June 2003. A Management Fee of $7,700 is payable by both 2002 Growers and 2003 Growers on 1 October 2003 for services to be carried out in the period 1 July 2003 to 30 June 2004.

38. For the year commencing 1 July 2004 and for each subsequent year, an annual Management Fee, equal to the previous years management fee is payable on 1 October of the year in which the services are provided, increased for the CPI (Perth) calculated on that date. These fees are the same for both 2002 Growers and 2003 Growers.

39. For 2002 Growers, rent of $1,650 is payable on 1 October 2002 for the period 1 July 2002 to 30 June 2003. For 2003 Growers this fee is payable on application for the period from the commencement date to 30 June 2003. For both classes of Growers, rent of $1,650 is payable on 1 October 2003 for the period 1 July 2003 to 30 June 2004. For the year commencing 1 July 2004 and for each subsequent year, annual rent, equal to the pervious years rent, is payable on 1 October of the relevant year, indexed for the CPI (Perth) on that date.

40. An amount of $6,270 is payable on 1 October 2002, by 2002 Growers and 2003 Growers who participate in the Project on or before 30 September 2002, for the erection of trellising, which is required to be completed by 31 October 2002. For those 2003 Growers who participate in the Project on or after 1 October 2002 an amount of $8,800 is payable on application for the erection of trellising which is required to be completed by 30 June 2003. A planting fee of $3,025 is also payable on 1 October 2002 for the supply and planting of vine rootlings during the 2002 planting season, being from 1 July 2002 to 30 November 2002 by 2002 Growers and 2003 Growers who participate in the Project on or before 30 September 2002. For those 2003 Growers who participate in the Project on or after 1 October 2002 this amount is payable on application for the supply and planting of vine rootlings during the period from application to 31 July 2003.

41. Growers must also pay to the Manager a Project Management fee of 8.25% (including GST) of actual harvest proceeds, at the time when the last instalment is received under the Grape Supply

Agreement. A performance fee of 22% (including GST) of the amount of actual harvest proceeds in excess of the projected harvest proceeds as set out in Table 2 of the Information Memorandum, within 21 days of receipt of the harvest proceeds for each financial year.

42. The Application Monies will be held in a trust account on trust for the Grower (cl 12.1 of the Constitution).

Cultivation and Harvesting

43. The Manager will maintain the vines in accordance with good viticultural practice. The services to be provided by the Manager over the term of the Project are outlined in the Schedule to the Management Agreement (item 5.3).

44. The Manager will advise the Grape Buyer when the grapes are approaching their optimum ripeness for winemaking. Where the Grower has not made an election to take delivery of the grapes harvested from their Vineyard Lot, the Manager will harvest the grapes into bins supplied by the Grape Buyer and load the bins onto the Grape Buyer's designated form of transport at the Vineyard (Item 5.3.12, Schedule to the Management Agreement).

45. The proceeds from the sale of the grapes from the vineyard will be paid into a separate produce fund, for Growers who have not elected to take delivery of their own grapes. Proceeds received by the Manager are to be distributed in the following order of priority:

- any unpaid rent to the Lessor;
- any unpaid annual management fee to the Manager;
- any unpaid irrigation costs or trellising costs to the Manager;
- the project management fee and performance fee (if any) payable; and
- the balance of the produce fund to each of the Growers in proportion to their interest in the fund.

Finance

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

47. 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

48. This Ruling applies only to Growers who are accepted to participate in the Project on or before 15 June 2002 or 30 June 2003 and who have executed a Management Agreement and a Lease Agreement before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production. This Ruling does not apply to those Growers who make an election under the Management Agreement to take delivery of and sell the grapes produced from their Vineyard Lot(s).

Minimum subscription

49. 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 100 Vineyard Lots and 800,000 Units in the Australasian Vineyard Trust is achieved.

The Simplified Tax System ('STS')

Division 328

50. 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

51. 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 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'

Assessable Income

Section 6-5

52. 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.

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

Trading stock

Section 70-35

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

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

Deductions for Management Fees and Rent

Section 8-1

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

2002 Growers

Fee Type	ITAA 1997 Section	Year ended 30/6/2002	Year ended 30/6/2003	Year ended 30/6/2004	Year ended 30/6/2005
Management Fee	8-1	$16,885 – See Note (i) (below)	$21,562.20 – See Notes (i) & (ii) (below)	$7,700 – See Notes (i) & (ii) (below)	$7,700 (indexed) – See Notes (i) & (ii) (below)
Rent	8-1	$275 – See Note (i) (below)	$1,650 – See Notes (i) & (ii) (below)	$1,650 – See Notes (i) & (ii) (below)	$1,650 (indexed) – See Notes (i) & (ii) (below)

2003 Growers

Fee Type	ITAA 1997 Section	Year ended 30/6/2003	Year ended 30/6/2004	Year ended 30/6/2005
Management Fee	8-1	$16,885 – See Notes (i) & (ii) (below)	$21,562.20 – See Notes (i) & (ii) (below)	$7,700 – See Notes (i) & (ii) (below)
Rent	8-1	$275 – See Notes (i) & (ii) (below)	$1,650 – See Notes (i) & (ii) (below)	$1,650 – See Notes (i) & (ii) (below)

Notes:

(i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example 1 at paragraph 134;

(ii) The management fees and rent shown in the Management Agreement and Lease Agreement are deductible in full in the year that they are incurred.

However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 107 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

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

2002 Growers

Fee type	ITAA 1997 section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004	Year Ended 30 June 2005
Trellising	40-25	Nil - See Notes (iii) & (iv) (below)	Must be calculated – See Notes (iii) & (iv) (below)	Must be calculated – See Notes (iii) & (iv) (below)	Must be calculated - See Notes (iii) & (iv) (below)
Water facility (e.g., irrigation, dam, bore, etc)	40-515	$2,017 – See Notes (iii) & (v) (below)	$2,017 - See Notes (iii) & (v) (below)	$2,016 – See Notes (iii) & (v) (below)	
Landcare operations	40-630	$275 – See Notes (iii) & (vi) (below)			
Establishment of horticultural plants (grapevines)	40-515	Nil – See Notes (iii) & (vii) (below)	Nil – See Notes (iii) & (vii) (below)	Must be calculated – See Notes (iii) & (vii) (below)	Must be calculated – See Notes (iii) & (vii) (below)

2003 Growers who participate in the Project on or before 30 September 2002

Fee type	**ITAA 1997 section**	**Year ended 30 June 2003**	**Year ended 30 June 2004**	**Year ended 30 June 2005**
Trellising	40-25	Must be calculated – See Notes (iii) & (iv) (below)	Must be calculated – See Notes (iii) & (iv) (below)	Must be calculated – See Notes (iii) & (iv) (below)
Water facility (e.g., irrigation, dam, bore, etc)	40-515	$2,017 – See Notes (iii) & (v) (below)	$2,017 - See Notes (iii) & (v) (below)	$2,016 – See Notes (iii) & (v) (below)
Landcare operations	40-630	$275 – See Notes (iii) & (vi) (below)		
Establishment of horticultural plants (grapevines)	40-515	Nil – See Notes (iii) & (vii) (below)	Must be calculated – See Notes (iii) & (vii) (below)	Must be calculated – See Notes (iii) & (vii) (below)

2003 Growers who participate in the Project on or after 1 October 2002

Fee type	**ITAA 1997 section**	**Year ended 30 June 2003**	**Year ended 30 June 2004**	**Year ended 30 June 2005**
Trellising	40-25	Must be calculated – See Notes (iii) & (iv) (below)	Must be calculated – See Notes (iii) & (iv) (below)	Must be calculated – See Notes (iii) & (iv) (below)
Water facility (e.g., irrigation, dam, bore, etc)	40-515	$2,017 – See Notes (iii) & (v) (below)	$2,017 - See Notes (iii) & (v) (below)	$2,016 – See Notes (iii) & (v) (below)
Landcare operations	40-630	$275 – See Notes (iii) & (vi) (below)		
Establishment of horticultural plants (grapevines)	40-515	Nil – See Notes (iii) & (vii) (below)	Nil – See Notes (iii) & (vii) (below)	Must be calculated – See Notes (iii) & (vii) (below)

Notes:

(iii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 134;

(iv) 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 2003. The Manager will advise

Growers when that occurs to enable Growers to calculate the deduction for the decline in value;

(v) 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);

(vi) Any capital expenditure incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630;

(vii) As grapevines are affixed to land which the Grower does not own, they are not owned by the Grower, the conditions in subsection 40-525(3) cannot be met, and the grapevines are not eligible for the 4 year write-off under section 40-550. However, grapevines are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530, item 2). The Manager will inform Growers of when the grapevines enter their first commercial season, which is estimated as being in the year ended 30 June 2004 for 2002 Growers and 2003 Growers who participate in the Project on or before 30 September 2003. For 2003 Growers who participate in the Project on or after 1 October 2002 the first commercial season is estimated as being in the year ended 30 June 2005.

Tax outcomes for Growers who are 'STS taxpayers'

Assessable Income

Section 6-5

58. 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.

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

Treatment of Trading Stock

Section 328-285

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

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

Deductions for Management fees and Rent

Sections 8-1 and 328-105

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

2002 Growers

Fee Type	ITAA 1997 Sections	Year ended 30/6/2002	Year ended 30/6/2003	Year ended 30/6/2004	Year ended 30/6/2005
Management Fee	8-1 & 328-105	$16,885 – See Notes (viii) & (ix) (below)	$21,562.20 – See Notes (viii), (ix) & (x) (below)	$7,700 - See Notes (viii), (ix) & (x) (below)	$7,700 (indexed) – See Notes (viii), (ix) & (x) (below)
Rent	8-1 & 328-105	$275 – See Notes (viii) & (ix) (below)	$1,650 - See Notes (viii), (ix) & (x) (below)	$1,650 - See Notes (viii), (ix) & (x) (below)	$1,650 (indexed) - See Notes (viii), (ix) & (x) (below)

2003 Growers

Fee Type	ITAA 1997 Section	Year ended 30/6/2003	Year ended 30/6/2004	Year ended 30/6/2005
Management Fee	8-1 & 328-105	$16,885 – See Notes (viii) & (ix) (below)	$21,562.20 – See Notes (viii), (ix) & (x) (below)	$7,700 – See Notes (viii), (ix) & (x) (below)
Rent	8-1 & 328-105	$275 – See Notes (viii) & (ix) (below)	$1,650 – See Notes (viii), (ix) & (x) (below)	$1,650 – See Notes (viii), (ix) & (x) (below)

Notes:

(viii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example 1 at paragraph 134;

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

(x) Where a Grower who is an 'STS taxpayer', pays the management fees and the rent in the relevant income years shown in the Management Agreement and Lease 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 101 to 107). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 107, 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

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

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

64. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities or a 'landcare operation' under Subdivisions 40-F or 40-G 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 Notes (xiii) and (xiv) below.

65. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than $1,000 (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.

2002 Growers

Fee type	**ITAA 1997 section**	**Year ended 30 June 2002**	**Year ended 30 June 2003**	**Year ended 30 June 2004**	**Year ended 30 June 2005**
Trellising	328-185 & 328-190	Nil – See Note (xii) (below)	$1,320 – See Notes (xi) & (xii) (below)	$2,244 – See Notes (xi) & (xii) (below)	$1,571 – See Notes (xi) & (xii) (below)
Water facility (e.g., irrigation, dam, bore, etc)	40-515	$2,017 – see Notes (xi) & (xiii) (below)	$2,017 – see Notes (xi) & (xiii) (below)	$2,016 – see Notes (xi) & (xiii) (below)	
Landcare operations	40-630	$275 – see Notes (xi) & (xiv) (below)			
Establishment of horticultural plants (grapevines)	40-515	Nil – see Notes (xi) & (xv) (below)	Nil - see Notes (xi) & (xv) (below)	Must be calculated – see Notes (xi) & (xv) (below)	Must be calculated – see Notes (xi) & (xv) (below)

2003 Growers who participate in the Project on or before 30 September 2002

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
Trellising	328-185 & 328-190	$1,320 – See Notes (xi) & (xii) (below)	$2,244 – See Notes (xi) & (xii) (below)	$1,571 – See Notes (xi) & (xii) (below)
Water facility (e.g., irrigation, dam, bore, etc)	40-515	$2,017 – See Notes (xi) & (xiii) (below)	$2,017 – See Notes (xi) & (xiii) (below)	$2,016 – See Notes (xi) & (xiii) (below)
Landcare operations	40-630	$275 – See Notes (xi) & (xiv) (below)		
Establishment of horticultural plants (grapevines)	40-515	Nil – See Notes (xi) & (xv) (below)	Must be calculated – See Notes (xi) & (xv) (below)	Must be calculated – See Notes (xi) & (xv) (below)

2003 Growers who participate in the Project on or after 1 October 2002

Fee type	**ITAA 1997 section**	**Year ended 30 June 2003**	**Year ended 30 June 2004**	**Year ended 30 June 2005**
Trellising	328-185 & 328-190	$1,320 – See Notes (xi) & (xii) (below)	$2,244 – See Notes (xi) & (xii) (below)	$1,571 – See Notes (xi) & (xii) (below)
Water facility (e.g., irrigation, dam, bore, etc)	40-515	$2,017 – See Notes (xi) & (xiii) (below)	$2,017 – See Notes (xi) & (xiii) (below)	$2,016 – See Notes (xi) & (xiii) (below)
Landcare operations	40-630	$275 – See Notes (xi) & (xiv) (below)		
Establishment of horticultural plants (grapevines)	40-515	Nil – See Notes (xi) & (xv) (below)	Nil – See Notes (xi) & (xv) (below)	Must be calculated – See Notes (xi) & (xv) (below)

Notes:

(xi) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 134;

(xii) 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 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;

(xiii) 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);

(xiv) Any capital expenditure incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630. 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-G (although expenditure on some items of plant can only be deducted under Division 328). 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 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', the expenditure is fully deductible under Subdivision 40-G;

(xv) As grapevines are affixed to land which the Grower does not own, they are not owned by the Grower, the conditions in subsection 40-525(3) cannot be met, and the grapevines are not eligible for the 4 year write-off under section 40-550. However, grapevines are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530(2)). The Manager will inform Growers of when the grapevines enter their first commercial season, which is estimated as being in the year ended 30 June 2004 for 2002 Growers and 2003 Growers who participate in the Project on or before 30 September 2003. For 2003 Growers who participate in the Project on or after 1 October 2002 the first commercial season is estimated as being in the year ended 30 June 2005.

Tax outcomes that apply to all Growers

66. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However, all Growers who borrow funds should read the discussion of the prepayment rules in paragraphs 101 to 107 (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.

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

Section 35-55 – Commissioner's discretion

67. For a Grower who is an individual and who enters the Project during the years ended 30 June 2002 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 will decide for the income years ending 30 June 2002 to 30 June 2004 for 2002 Growers and 30 June 2003 to 30 June 2004 for 2003 Growers that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- the 'exception' in subsection 35-10(4) applies (see paragraph 122 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).

69. 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.

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

assessment of the Project or the product from this perspective has not been made.

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

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

- expenditure by a Grower does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 101 to 115);
- 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

72. 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
- 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.

73. 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 persons satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a);
- the 'individual wealth test' (paragraph 761G(6)(c);
- the 'professional investor test' (paragraph 761G(7)(d).

74. An 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.

75. 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, 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.

76. 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.

77. 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)).

78. 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?

79. For the amounts set out in the Tables above to constitute allowable deductions the Grower's viticulture activities as a participant in The Gnangara 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.

80. For schemes such as that of The Gnangara 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.

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

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's grapevines are established;
- the Grower has a right to harvest and sell the 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.

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

83. Under the Lease Agreement each individual Grower will have rights over a specific and identifiable area of land. The Agreement provides the Grower with an ongoing interest in the specific grapevines on the Vineyard Lot 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 Manager to come onto the land to carry out its obligations under the Management Agreement.

84. Under the Management Agreement the Manager is engaged by the Grower to establish and maintain a Vineyard Lot on the Grower's identifiable area of land during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Vineyard Lot on the Grower's behalf.

85. The Manager is also engaged to harvest and sell, on the Grower's behalf, the grapes grown on the Grower's Vineyard Lot.

86. 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.

87. 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 it's 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.

88. The pooling of grapes grown on the Grower's Vineyard Lot 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 Vineyard Lot.

89. The Manager's services on the Grower's behalf are also consistent with general viticulture practices. While the size of a Vineyard Lot is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

91. 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 Gnangara Vineyard Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

92. 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.

93. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of Management Fees and Rent

Section 8-1

94. Consideration of whether the initial management fees and rent are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer is contractually committed to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

95. The management fees and rent associated with the viticulture activities will relate to the gaining of income from the Grower's business of viticulture (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of 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 the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Possible application of prepayment provisions

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

97. However, where a Grower chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 101 to115) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions

apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than $1,000.

Timing of deductions

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

99. If the Grower is not an 'STS taxpayer', the management fees and the rent are deductible in the year in which they are incurred.

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

Prepayment provisions

Sections 82KZL to 82KZMF

101. 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 (eg. 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.

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

Sections 82KZME and 82KZMF

103. 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)).

104. 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 :
    a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
    b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

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

106. 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.

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

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

108. 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

109. In this Project, an initial management fee of $16,885 and initial rent of $275 per Vineyard Lot for 2002 Growers will be incurred on the execution of the Management Agreement and the Lease Agreement. For 2003 Growers, an initial management fee of $38,447.20 and initial rent of $1,650, will be incurred upon execution of the Management Agreement and the Lease Agreement. The management fee and rent are charged for providing management services Grower by 30 June of the year of execution of the Management Agreement and Lease Agreement. Under the Management Agreement, further annual expenditure is required each year during the term of the Project for the provision of management services until 30 June in those years.

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

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

112. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 35 to 41 then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

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

113. Although not required under the Management Agreement and the Lease Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 112 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

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

Expenditure of a capital nature

Division 40 and Division 328

116. 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, a 'landcare operation', and the establishment of the grapevines is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

117. 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'.

118. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 57 and 65 (above) in the Tables and the accompanying Notes.

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

119. 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.

120. 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.

121. 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.

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

123. 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 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).

124. 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 investment in the Project of one Vineyard Lot during the years ended 30 June 2002 or 30 June 2003 is unlikely to pass one of the tests until the year ended 30 June 2007. Growers who acquire more than one Vineyard Lot may however, find that their activity meets one of the tests in an earlier income year.

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

126. 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; and

(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.

127. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Vineyard 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 2007. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2004. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

128. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 127) in the manner described in the Arrangement (see paragraphs 14 to 47). 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 8) the Commissioner's discretion will

not have been exercised because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

129. 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:

- independent, objective and generally available information relating to the viticulture industry which substantially supports cash flow forecasts and other claims, including prices and costs, as described by the independent experts in the Information Memorandum, and in the Product Ruling application submitted by the Manager.

Section 82KL

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

Part IVA

131. 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).

132. The Gnangara Vineyard Project will be a 'scheme' commencing with the issue of the Information Memorandum. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 56, 57, 62 and 65 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

133. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the trees. 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 are no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the

information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Example 1 - Entitlement to GST input tax credits

134. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

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

*Taxable supply

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

$$^{1}/_{11} \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively $4,400 *less* $400, or $4,000.

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

$$^{1}/_{11} \times \$2,200 = \$200.$$

Hence her outgoing for the power upgrade is effectively $2,200 *less* $200, or $2,000.

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 $4,000 (not $4,400).

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 $2,000 only, not one tenth of $2,200).

Detailed contents list

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

Commissioner of Taxation
27 March 2002

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 2000/8; PR 1999/95; TR 92/1; TR 92/20;TR 97/11; TR 97/16; TD 93/34; TR 98/22; IT 360

Subject references:

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

Legislative references:

- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 35-55(2)
- ITAA 1997 Div 40
- ITAA 1997 40-25
- ITAA 1997 40-70(1)
- ITAA 1997 40-75(1)
- ITAA 1997 40-100
- ITAA 1997 40-105
- ITAA 1997 40-515
- ITAA 1997 40-515(1)(a)
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(1)
- ITAA 1997 40-525(2)
- ITAA 1997 40-525(3)
- ITAA 1997 40-530
- ITAA 1997 40-530(2)
- ITAA 1997 40-535
- ITAA 1997 40-540
- ITAA 1997 40-545
- ITAA 1997 40-550
- ITAA 1997 40-630
- ITAA 1997 40-635
- ITAA 1997 Subdiv 40-F
- ITAA 1997 Subdiv 40-G
- ITAA 1997 Div 70
- ITAA 1997 70-35
- ITAA 1997 Div 328
- ITAA 1997 Subdiv 328-F

- ITAA 1997 Subdiv 328-G
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- ITAA 1997 328-105(1)(b)
- ITAA 1997 328-185
- ITAA 1997 328-190
- ITAA 1997 328-285
- ITAA 1997 328-285(1)
- ITAA 1997 328-285(2)
- TAA 1953 Pt IVAAA
- ITAA 1936 Pt III - Div 3
- ITAA 1936 Subdiv H
- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- Corporations Act 2001 761G
- Corporations Act 2001 761G(6)(c)
- Corporations Act 2001 761G(7)(a)
- Corporations Act 2001 761G(7)(d)
- Corporations Act 2001 1012E
- Corporations Act 2001 1012E(2)
- Copyright Act 1968

Case references:

- FCT v. Lau 84 ATC 4929

ATO references:
NO T2001/016602
ISSN: 1441 1172