



PR 2002/86 - Income tax: Beechworth Winegrape Special Offer

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 This document has changed over time. This is a consolidated version of the ruling which was published on *12 June 2002*



Product Ruling

Income tax: Beechworth Winegrape Special Offer

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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 Beechworth Winegrape Special Offer, 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 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 Farmer) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

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 have accepted an offer made under subsections 708(1)-(11) of the Corporations Law.

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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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 12 June 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 specified below. This arrangement incorporates the following documents:

- Draft Information Memorandum prepared for Beechworth Winegrape Special Offer ("draft IM"), received in the ATO on 31 May 2002;
- Draft copy of **Loan Application**, Principal and Interest Loan, included in the draft IM, received in the ATO on 31 May 2002;

- Draft copy of **Loan Deed** between BVL Management Limited (“BVLM”) and the Borrower, included in the draft IM, received in the ATO on 31 May 2002;
- Copy of Lease Agreement between beechworth Vineyards Limited (“BVL”) (“Landowner”), as Lessor, and Australian Rural Group Limited, as Lessee, dated 15 September 1999, received in the ATO on 24 April 2002;
- Draft copy of **Farm and Management Agreement** between BVLM and BVL and the Farmer, received by the ATO on 3 June 2002; and
- Correspondence received from the Applicant’s representative on 20 March 2002, 21 April 2002, 24 April 2002, 10 May 2002, 21 May 2002, 27 May 2002 and 28 May 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 Farmers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Farmer, or an associate of the Farmer 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. The effect of the agreements may be summarised as follows.

Overview

17. This arrangement is called the Beechworth Winegrape Special Offer (“BWSO” or “the Project”) and is an unregistered Managed Investment Scheme under the Corporations Act 2001 to which a disclosure document is not required to be lodged with the Australian Securities & Investments Commission. The salient features of the BWSO are shown in the table below.

Location	The Land, known as “Big Valley” is situated approximately 10 kilometres west of the town of Beechworth in North East Victoria.
Type of business each participant is carrying on	Commercial viticulture for eventual sale of winegrapes, wine product and bottled wines.
Number of hectares under cultivation	The Project aims to establish additional vineyard of up to 90 hectares. 40 hectares have already been established under earlier offers. The draft IM is an offer for a maximum of approximately 90 hectares.
Size of each interest or participation	1 hectare minimum. Under the current IM a maximum of 20 interests can be offered, unless otherwise applied as excluded offerees.
Vines planted per hectare	1,700
Term	20 years
Initial cost per participation (see paragraph 24)	\$41,850
Initial cost per hectare	\$41,850
Ongoing costs	Annual Management Fee and Licence Fee.

The Project Land

18. The project land is owned by BVL and is leased to Australian Rural Group Limited (“the Custodian”) for the term of the Beechworth Winegrape Project. The Farm and Management Agreement varies this lease to ensure that the Project land included in that lease may be used for the Project. The draft IM states that BVL is a wholly owned subsidiary of Indigo Wine Company Limited (“IWC”).

19. BVLM (“the Manager”) holds the interest in the land, being the lease, and will grant a licence to each Farmer to use a one hectare Licensed Area, to enable the Licensed Area to be planted out with grapevines in accordance with the Farm and Management Agreement.

The Farm and Management Agreement

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

21. The services to be provided by BVLM to the Project are specifically set out in the Farm and Management Agreement and they include:

- cultivating, fertilising and planting out the vineyard with rootstock in a healthy condition;
- carrying out field grafting, if required;
- applying water to the vineyard in order to maintain the grapevines on the vineyard in a healthy condition;
- pruning and/or training, stringing up, de-shooting and/or taking other measures that may be necessary in accordance with good viticultural practice to manage properly the growth of the grapevines to and along the trellises and to optimise as far as is reasonably possible in the circumstances the quality of the grapes produced therefrom;
- taking such reasonable measures as may be required to control the growth of weeds and other vegetable pests on the vineyard upon which the vines are growing;
- taking all reasonable measures in accordance with the principles of good viticultural practice and to the extent reasonably possible to deter and eradicate any insect, bird or animal pests from the vineyard that may detract from the health and vigour of the grapevines or yield thereof;
- taking representative soil samples from the vineyard from time to time and arranging to have those samples analysed by an accredited soil analysis laboratory and, having regard to the results and recommendations of any soil analysis undertaken, supply suitable fertiliser and apply it to the vineyard in accordance with the principles of good viticultural practice and in such quantities as may be required to promote healthy plant growth and yield;

- replacing any grapevines that die or become unproductive with juvenile grapevines of the same variety as those that die or have become unproductive;
- repairing and maintaining in a good condition all fences, trellises, accessways and other structural improvements and irrigation plant and equipment on the vineyard;
- arranging sales of the wine grapes and/or bulk wine from the vineyard, including entering into a contract or contracts to supply grapes harvested from the vineyard or bulk wine produced therefrom;
- harvesting the wine grapes from the vineyard at or about the time instructed by the buyers of the grapes or as estimated by the Manager as being the appropriate time for harvesting the same;
- effecting the insurances referred to in the Agreement;
- employing such staff and labour as are necessary for the aforesaid purposes;
- carrying out the accounting, financial control and reporting needs and functions of the Project;
- keeping proper books of account for the Project and preparation and filing of income tax returns; and
- doing all other things necessary or incidental to the carrying out of the Project to produce a viable business of growing, marketing and sale of wine grapes and/or bulk wine.

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

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

23. The Manager will either subcontract or hire its own staff to undertake all proposed services and work.

Project fees

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

Fee type	Year 1	Year 2	Year 3	Year 4
	30/06/2002	30/06/2003	30/06/2004	30/06/2005
Management fee – pre 30/6/02 - see Note (i)	\$11,000.00			
Management fee – post 30/6/02 – see Note (i)	\$8,250.00	\$14,162.50	\$14,587.10	\$15,024.90
Licence fee - see Note (ii)	\$550.00	\$708.40	\$729.30	\$751.30
Vineyard establishment fee to be applied as follows - see Note (iii):				
Rootstock purchase	-	\$8,415.00		
Land care expenses	\$1,100.00	-		
Land preparation	\$1,925.00	-		
Dam establishment	\$3,960.00	-		
Irrigation est.	\$10,450.00	-		
Trellising	\$8,800.00	-		
Vine establishment	-	\$550.00		
Total	\$46,035.00	\$23,835.90	\$15,316.40	\$15776.20

Notes:

- (i) Management fee for year 1 will be payable on the day the Manager accepts the application from the Farmer ('Settlement Date') and comprises a fee for services performed by the Manager to 30 June 2002 and a fee for services performed by the Manager after 30 June 2002. Management fees for year 2 and subsequent years are payable on each respective year's anniversary of the Settlement Date. The fees are payable for services to be provided by the Manager for the period of twelve (12) months from 1 July in each year to 30 June of each year.

The amount of management fees in years subsequent to the fourth year will be the year 4 amount increased by the Consumer Price Index (All Groups) Melbourne, or 3%, whichever is the greater, in each subsequent year,

until there are sufficient funds from income of the Project to enable management fees to be payable yearly from those funds.

- (ii) The Licence fee is payable in Year 1 for the period ended 30 June 2002 and for Year 2 onwards for the period of 12 months commencing 1 July in each year to 30 June in each year, the first payment being payable on the Settlement Date and on each anniversary thereafter. From Years 5 onwards, the previous year's Licence fee will be increased by the Consumer Price Index (All Groups) Melbourne, or 3%, whichever is the greater, for each interest in the Project.
- (iii) Year 1 vineyard establishment fee is payable on settlement date, and Year 2, on the first anniversary of the settlement date. The fee for year 1 will be applied for the establishment of 1 hectare within 13 months of the settlement date and necessary infrastructure work and the fee for year 2 will be applied to the acquisition of an interest in rootstock and vine establishment or established vineyard of 1 hectare per Farmer within 13 months of the first anniversary of the settlement date.

25. In the event that the Gross Income of the Project is insufficient in any year to meet payment of the relevant Management fees and Licence fees, the shortfall will be met by the Farmers and not from Gross Income of future years.

Finance

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

27. Farmers can fund their involvement in the Project by borrowing from BVLM ('the Lender'). Those Farmers may enter into the following finance arrangement. A finance option is offered by BVLM ('the Lender') to fund a Farmer's fees and expenses associated with the Project. The Lender will, if a loan option is taken, advance funds of \$41,850 on the Settlement Date, \$21,669 on the first anniversary of the Settlement Date and \$13,924 on the second anniversary of the Settlement Date, \$14,342 on the third anniversary of the Settlement Date and \$14,772 on the fourth anniversary of the Settlement Date, for each Project interest. Security is to be enforced over the Farmer's interest in the Project, i.e., the Farmer's interest in the Project including the rights obtained as a result of the various Agreements entered into and payments made.

28. An interest rate will be charged of 5.5% payable yearly in advance. The loans will be repayable by monthly repayments of \$5,000 per month with a minimum of \$15,000 prior to 30 June 2002, \$5,000 per month for three months, commencing 1 July 2002, \$2,500 per month commencing 1 October 2002 until 30 June 2003 and then \$1,000 per month from 1 July 2003 until the loan is repaid. The first repayment is required to be made on the first day of the month following the date of settlement of the loan. The finance is provided as full recourse loans and the Lender will pursue legal action against outstanding borrowers.

29. This Ruling does not apply if the finance arrangement entered into by the Farmer includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project other than BVLM are involved or become involved in the provision of finance to Farmers for the Project.

Ruling

Application of this Ruling

30. This Ruling applies only to Farmers who are accepted to participate in the Project on or before 16 June 2002 and who have executed a Farm and Management Agreement before that date. No

applications will be accepted after 16 June 2002. The Farmer's participation in the Project must constitute the carrying on of a business of primary production.

31. A Farmer is not eligible to claim any tax deductions until the Farmer's application to enter the Project is accepted and the Project has commenced.

The Simplified Tax System ('STS')

Division 328

32. For a Farmer participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Farmer is an 'STS taxpayer'. To be an 'STS taxpayer' a Farmer:

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

Qualification

33. This Product Ruling assumes that a Farmer who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Farmer may become an 'STS taxpayer' at a later point in time. Also, a Farmer 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 Farmers that cannot be accommodated in this Ruling. Such Farmers can ask for a private ruling on how the taxation legislation applies to them.

Prepaid fees

34. Management fees incurred by Farmers who are accepted into this Project are subject to the prepayment rules in sections 82KZME and 82KZMF. In this context, a prepayment refers to advance expenditure incurred by a Farmer 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 Farmer prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Farmer must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Note (iii) below).

35. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Farmer 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.

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

36. In this Project, the tax deductions allowable for Management fees must be calculated by applying the above formula to the amount incurred each year by the Farmer. The resulting tax deductions are reflected in the respective Tables of deductions shown below.

Tax outcomes for Farmers who are not 'STS taxpayers'

Assessable Income

Section 6-5

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

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

Trading stock

Section 70-35

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

40. 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 Farmer may claim the amount of that excess as an allowable deduction.

Deductions for Management Fees, Licence Fees and Interest

Section 8-1

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

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1	\$11,000.00 – See Notes (i) & (ii) (below)	\$22,412.50 – See Notes (i) & (ii) (below)	\$14,587.10 – See Notes (i) & (ii) (below)
Licenc Fee	8-1	\$550.00 – See Notes (i) & (iii) (below)	\$708.40 – See Notes (i) & (iii) (below)	\$729.30 – See Notes (i) & (iii) (below)
Interest	8-1	As incurred See Note (iv) (below)	As incurred See Note (iv) (below)	As incurred See Note (iv) (below)

Notes:

- (i) If the Farmer is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 109.
- (ii) The Management fees shown in the Table at paragraph 24 above are **NOT** deductible in full in the year incurred. The deduction for each year's fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 35 or 79).
- (iii) The Licence fees shown in the Farm and Management Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of licencing 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 35 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.
- (iv) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than BVLM is outside the scope of this Ruling. However all Farmers, including those who finance their

participation in the Project other than with BVLM, should read the discussion of the prepayment rules in paragraphs 73 to 80 (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 Farmer's choice.

Deductions for capital expenditure

Division 40

42. A Farmer 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.

Fee type	ITAA 1997 section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Trellising	40-25	Must be calculated - See Notes (iv) and (v) below	Must be calculated - See Notes (iv) and (v) below	Must be calculated - See Notes (iv) and (v) below
Water facility (e.g. irrigation, dam, bore, etc)	40-515	\$4803.33- see Notes (iv) & (vii) below	\$4803.33- see Notes (iv) & (vii) below	\$4803.33- see Notes (iv) & (vii) below
Landcare operations	40-630	\$1,100 - see Notes (iv) & (viii) below		
Establishment of horticultural plants (grapevines)	40-515	Nil - see Notes (iv) & (ix) below	Nil - see Notes (iv) & (ix) below	Nil - see Notes (iv) & (ix) below

Notes:

- (v) If the Farmer 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 109.
- (vi) Trellising is a 'depreciating asset'. Each Farmer's interest in the trellising is a 'depreciating asset'. The 'cost' of the asset is the amount paid by each Farmer. 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.

- (vii) Farmers 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 Project Manager will advise Farmers when that occurs to enable Farmers to calculate the deduction for the decline in value.
- (viii) 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 Farmer 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).
- (ix) 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.
- (x) As grapevines are affixed to land which the Farmer does not own, they are not owned by the Farmer, 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 Farmers hold the land under a licence, 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 Farmer 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 Farmers of when the grapevines enter their first commercial season.

Tax outcomes for Farmers who are ‘STS taxpayers’

Assessable Income

Section 6-5

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

44. The Farmer 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

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

46. 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, Licence fees and Interest

Section 8-1 and section 328-105

47. A Farmer who is an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1 & 328-105	\$11,000.00 – See Notes (iv) & (v) (below)	\$22,412.50 – See Notes (iv) & (v) (below)	\$14,587.10 – See Notes (iv) & (v) (below)
Lease Fee (Rent)	8-1 & 328-105	\$550.00 – See Notes (i) & (vi) (below)	\$708.40 – See Notes (i) & (vi) (below)	\$729.30 – See Notes (i) & (vi) (below)
Interest	8-1 & 328-105	When paid – See Note (vii) (below)	When paid – See Note (vii) (below)	When paid – See Note (vii) (below)

Notes:

- (xi) If the Farmer 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). See Example at paragraph 110.
- (xii) The Management fees shown in the paragraph 24 above are **NOT** deductible in full in the year in which they are paid by, or on behalf of the STS taxpayer. The deduction for each year's fees must be determined using the formula in subsection 82KZMF(1) (see paragraph 35 or 79).
- (xiii) Where a Member who is an 'STS taxpayer', pays the Rent in the relevant income years shown in the Lease Agreement, those fees are deductible in full in the year that they are paid. However, if a Farmer **chooses** to prepay fees for the doing of a thing (e.g., the provision of 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 73 to 80) . In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 35, 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.

- (xiv) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than BVLM is outside the scope of this Ruling. However all Farmers, including those who finance their participation in the Project other than with BVLM, should read the discussion of the prepayment rules in paragraphs 73 to 80 (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 Farmer's choice.

Deductions for capital expenditure

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

48. A Farmer 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.

49. The deductions shown in the following Table assume, for representative purposes only, that a Farmer 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 (x) and (xi) below.

50. 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 Farmer 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	Nil - See Notes (viii) & (ix) below	\$1320.00 - See Notes (viii) & (ix) below	\$1320.00 - See Notes (viii) & (ix) below
Water facility (e.g. irrigation, dam, bore, etc)	40-515	\$4803.33- see Notes (viii) & (x) below	\$4803.33- see Notes (viii) & (x) below	\$4803.33- see Notes (viii) & (x) below
Landcare operations	40-630	\$1,100 - see Notes (viii) & (xi) below		
Establishment of horticultural plants (grapevines)	40-515	Nil - see Notes (viii) & (xii) below	Nil - see Notes (viii) & (xii) below	Nil - see Notes (viii) & (xii) below

Notes:

- (xv) If the Farmer 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 109.
- (xvi) Trellising is a 'depreciating asset'. Each Farmer'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 Farmer. 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 Farmer'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.
- (xvii) 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 Farmer may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Farmer'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 Farmer 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, Farmers 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 Farmer 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).

- (xviii) 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 Farmer 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 Farmer'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 Farmer 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.

- (xix) As grapevines are affixed to land which the Farmer does not own, they are not owned by the Farmer, 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 Farmers hold the land under licence, 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 Farmer 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 Project Manager will inform Farmers of when the grapevines enter their first commercial season.

Tax outcomes that apply to all Farmers

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

Section 35-55 – Commissioner's discretion

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

52. 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 97 in the Explanations part of this ruling, below); or
- a Farmer's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or

- a Farmer'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)).

53. Where, the 'exception' in subsection 35-10(4) applies, the Farmer'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 Farmer will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

54. Farmers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Farmers should not see the Commissioner's decision to exercise the discretion in 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

55. For a Farmer 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:

- 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

Is the Farmer carrying on a business?

56. For the amounts set out in the Tables above to constitute allowable deductions the Farmer's viticulture activities as a participant in the Beechworth Winegrape Special Offer 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.

57. For schemes such as that of the Beechworth Winegrape Special Offer, Taxation Ruling TR 2000/8 sets out in paragraph 89 the

circumstances in which the Farmer'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.

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

- the Farmer has an identifiable interest (by licence) in the land on which the Farmer's grapevines are established;
- the Farmer has a right to harvest and sell the grapes each year from those grapevines;
- the viticulture activities are carried out on the Farmer's behalf;
- the viticulture activities of the Farmer 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.

59. In this Project, each Farmer enters into a Farm and Management Agreement.

60. Under the Farm and Management Agreement each individual Farmer will have rights over a specific and identifiable area of land. The Farm and Management Agreement provides the Farmer with an ongoing interest in the specific grapevines on the licensed area for the term of the Project. Under the licence the Farmer must use the land in question for the purpose of carrying out viticultural activities and for no other purpose. The licence allows the Project Manager come onto the land to carry out its obligations under the Management Agreement.

61. Under the Management Agreement the Project Manager is engaged by the Farmer to establish and maintain a Licensed Area on the Farmer's identifiable area of land ("Licensed Area") during the term of the Project. The Project Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Licensed Area on the Farmer's behalf.

62. In establishing the Licensed Area, the Farmer engages the Project Manager to purchase and install trellising and water facilities (e.g., irrigation), to carry out 'landcare operation' and to acquire and plant vine seedlings/rootlings on the Farmer's Licensed Area. During the term of the Project, these assets will be used wholly to carry out the Farmer's viticulture activities. The Project Manager is also engaged to harvest and sell, on the Farmer's behalf, the grapes grown on the Farmer's Licensed Area.

63. 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.

64. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Farmer 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.

65. The pooling of grapes grown on the Farmer's Licensed Area with the grapes of other Farmers is consistent with general viticulture practices. Each Farmer's proportionate share of the sale proceeds of the pooled grapes will reflect the proportion of the grapes contributed from their Licensed Area.

66. The Project Manager's services and the installation of assets on the Farmer'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 Licensed Area is relatively small, it is of a size and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

67. The Farmer's degree of control over the Project Manager as evidenced by the Farm and Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Farmer with regular progress reports on the Farmer's Licensed Area and the activities carried out on the Farmer's behalf. Farmers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

68. 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 Farmer's viticulture activities in the Beechworth Winegrape Special Offer will constitute the carrying on of a business.

The Simplified Tax System

Division 328

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

70. The question of whether a Farmer is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Farmer 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 licence fees

Section 8-1

71. Consideration of whether the initial management fees and licence fees 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.

72. The management fees and lease fees associated with the viticulture activities will relate to the gaining of income from the Farmer'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.

Prepayment provisions

Sections 82KZL to 82KZMF

73. 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.

74. 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

75. 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)).

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

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either:
 - a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

77. 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 Farmer in this Project who, in order to participate in the Project may borrow funds from a financier other than BVLM. 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 Farmer prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

78. There are a number of exceptions to these rules, but for Farmers 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 Farmers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

79. 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.

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

80. 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

81. The expenditure incurred by a Farmer in the Project for the management fees meets the requirements of subsections 82KZME(1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

82. The prepaid management fees incurred by Farmers do not fall within any of the 5 exceptions to section 82KZME. Therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF will apportion the deduction for

prepaid Management fees over the period that the services for which the prepayment is made are provided.

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

83. Although not required under either the Farm and Management Agreement a Farmer participating in the Project may **choose** to prepay Licence fees for a period beyond the 'expenditure year'. Similarly, Farmers who use financiers other than BVLM may either choose, or be required to prepay interest. Where this occurs section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

84. For these Farmers the amount and timing of deductions for any relevant prepaid Licence Fees or prepaid interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts. The prepaid licence fees, being amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF. A Farmer who is an 'STS taxpayer' can, therefore, claim an immediate deduction for a licence fee in the income year in which it is paid. A Farmer who is not an 'STS taxpayer' can claim an immediate deduction for a licence fee in the income year in which it is incurred.

85. However, where a Farmer acquires more than the minimum allocation of one interest in the Project and the quantum of the prepaid licence fees is \$1,000 or more, the deduction allowable for those amounts will also be subject to apportionment according to the formula in subsection 82KZMF(1).

Interest deductibility

Section 8-1

(i) Farmers who use BVLM as the finance provider

86. Some Farmers may finance their participation in the Project through a loan facility with BVLM. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of lease and management fees.

87. The interest incurred for the year ended 30 June 2002 and in subsequent years of income will be in respect of a loan to finance the Farmer's business operations - the cultivation and growing grapes and the licence of the land on which the grapevines will have been planted - that will continue to be directly connected with the gaining of

'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

88. As with the management fees, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF will apportion the deduction for prepaid interest over the period for which the prepayment is made (see paragraphs 73 to 80).

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

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

90. While the terms of any finance agreement entered into between relevant Farmers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Farmer 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 73 to 80).

Expenditure of a capital nature

Division 40 and Division 328

91. Any part of the expenditure of a Farmer 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.

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

93. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 42 and 50 (above) in the Tables and the accompanying Notes.

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

94. 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.

95. 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.

96. 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.

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

98. 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).

99. A Farmer 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 Farmer who acquires the minimum allocation of one Licensed Area in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2008. Farmers 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.

100. 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 Farmer's participation in the Project.

101. 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.

102. Information provided with the application for this Product Ruling indicates that a Farmer who acquires the minimum allocation of one Licensed Area 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 Farmer that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2006. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

103. This Product Ruling is issued on a prospective basis (i.e., before an individual Farmer'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 51), in the manner described in the Arrangement (see paragraphs 14 to 29). 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). Farmers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

104. 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 and supplementary reports of the independent viticulturalist in relation to the Beechworth Winegrape Project and a report from an independent research body; and
- the binding Grape Supply Contract between the Manager and the grapes Purchaser for the sale of the grapes setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the grapes are grown.

Section 82KL - recouped expenditure

105. 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

106. 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).

107. The Beechworth Winegrape Special Offer will be a 'scheme'. A Farmer will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 41, 42, 47 and 50 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.

108. Farmers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the grapes. There are no facts that would suggest that Farmers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax

consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Example 1 - Entitlement to GST input tax credits

109. 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:

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

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).

Detailed contents list

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Commissioner of Taxation

12 June 2002

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Not previously issued in draft form	- ITAA 1936 177A
	- ITAA 1936 177C
<i>Related Rulings/Determinations:</i>	- ITAA 1936 177D
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1936 177D(b)
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	- ITAA 1997 Div 35
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