



PR 2005/61 - Income tax: National Viticultural Fund of Australia Project No. 4 (31 May 2005 Growers)

 This cover sheet is provided for information only. It does not form part of *PR 2005/61 - Income tax: National Viticultural Fund of Australia Project No. 4 (31 May 2005 Growers)*

 This document has changed over time. This is a consolidated version of the ruling which was published on *27 April 2005*



Product Ruling

Income tax: National Viticultural Fund of Australia Project No. 4 (31 May 2005 Growers)

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Arrangement	14
Ruling	49
Explanation	74
Detailed contents list	114

Preamble

*The number, subject heading, **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

Potential participants may wish to refer to the Tax Office website at www.ato.gov.au or contact the Tax Office directly to confirm the currency of this Product Ruling or any other Product Ruling that the Tax Office has issued.

The Tax Office **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 and how the product fits an existing portfolio. 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 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, 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 Tax Office 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 law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

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 of the ITAA 1997;
- section 17-5 of the ITAA 1997;
- Division 27 of the ITAA 1997;
- Division 35 of the ITAA 1997;
- Division 40 of the ITAA 1997;
- Subdivision 61-J of the ITAA 1997;
- Division 328 of the ITAA 1997;
- Part 3-1 of the ITAA 1997;
- section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KL of the ITAA 1936;
- section 82KZL of the ITAA 1936;
- sections 82KZME and 82KZMF of the ITAA 1936; and
- Part IVA of the ITAA 1936.

Goods and Services Tax

3. All fees and expenditure referred to in this Ruling include the 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. Although this Ruling deals with the laws 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 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 (that is being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Growers'.

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:

Commonwealth Copyright Administration
Intellectual Property Branch
Department of Communications, Information Technology and
the Arts
GPO Box 2154
Canberra ACT 2601

or by e-mail: commonwealth.copyright@dcita.gov.au

Date of effect

11. This Ruling applies prospectively from 27 April 2005, 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 the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not 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 2007. 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 persons' 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 a Product Ruling dated 21 December 2004 as constituted by documents provided on 21 December 2004 and additional correspondence and documents provided on 21 January 2005, 28 February 2005, 24 March 2005, 4 April 2005, 8 April 2005, 14 April 2005 and 15 April 2005;
- Draft Prospectus and Product Disclosure Statement for National Viticultural Fund of Australia Project No. 4, received 29 March 2005;
- Draft **Constitution** of the National Viticultural Fund of Australia Project No. 4, received 29 March 2005;

- Draft **Management Agreement** between Food and Beverage Australia Ltd ('the Responsible Entity') and the Grower, received 11 April 2005;
- Draft **Licence Agreement** between National Vineyard Fund of Australia (No. 4) Ltd (the 'Land Owner'), Food and Beverage Australia Ltd (the 'Responsible Entity') and the Grower, received 29 March 2005;
- Draft Compliance Plan for the National Viticultural Fund of Australia Project No. 4, received 23 December 2004;
- Draft Custodian Agreement between Food and Beverage Australia Ltd (the 'Responsible Entity') and National Viticultural Fund of Australia Pty Ltd, received 23 December 2004; and
- Draft Grape Supply Agreement between Orlando Wyndham Group Pty Ltd, National Viticultural Fund of Australia Pty Ltd (the Custodian), National Vineyard Fund of Australia (No. 4) Ltd (the Landowner) and Food and Beverage Australia Ltd, received 11 April 2005.

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

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

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

Overview

17. The salient features of the National Viticultural Fund of Australia Project No. 4 (31 May 2005 Growers) are as follows:

Location	Langhorne Creek, South Australia
Type of business to be carried on by each participant	Commercial growing of Wine grapes
Number of hectares offered for cultivation	100
Size of each interest	0.25 hectares

PR 2005/61

Minimum allocation	1 interest
Minimum subscription	50 interests
Number of vines per hectare	1,680
Term of the Project	16 years
Initial cost	\$4,809 plus \$500 for part payment of shares
Initial cost per hectare	\$19,236
Ongoing costs	<ul style="list-style-type: none"> • Management fees of \$1,870 in Year 2 and \$2,050 in Year 3 and ongoing costs for the Years 4 to 16; • Licence fees of \$909 in Year 2, \$962 in Year 3 and ongoing costs for Years 4 to 16; • Capital costs for planting and irrigation installation of \$1,935 in Year 2; • Balance of cost of shares \$5,000 payable by 1 July 2009.
Other costs	Growers will be liable for ongoing Viticulture Costs

18. Under this Product Disclosure Statement and Prospectus, Food and Beverage Australia Ltd proposes to offer 400 interests called 'Allotments' of 0.25 hectares. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The Responsible Entity for the Project is Food and Beverage Australia Ltd ('FABAL'). For each interest acquired in the Project, a Grower is required to subscribe for 100 ordinary shares in National Vineyard Fund of Australia (No. 4) Ltd. Upon application, Growers will execute a Power of Attorney enabling FABAL to act on their behalf as required. There is a minimum subscription of 50 interests for this Project. The Project will terminate on 30 June 2020, a period of approximately 16 years.

19. The Project will be situated in the Langhorne Creek region of South Australia approximately 85 kilometres southeast of Adelaide. The land for the Project has been purchased by National Vineyard Fund of Australia (No. 4) Ltd (the 'Land Owner') which will lease the land to National Viticultural Fund of Australia Pty Ltd (the Custodian) which will then sublease the land back to the Land Owner. The Land Owner will grant a licence to the Growers to use and occupy the Allotment for the planting, growing and harvesting of grapes. A Grower acquiring a single interest in the Project will hold a licence over a separate and distinct area (called an 'Allotment') on which the Grower can plant and maintain 410 to 420 grape vines.

20. Growers enter into a Management Agreement with FABAL to manage their Allotments for the eventual harvest and sale of their grape produce. FABAL will manage and cultivate the vines and be responsible for harvesting and selling the grapes. FABAL has entered into an arrangement to pre-sell 100% of the Growers wine grapes for the Project to Orlando Wyndham Group Pty Ltd.

21. Under the Product Disclosure Statement offer, Growers can enter the Project during the period up to 31 May 2005 or during the period 1 July 2005 to 31 May 2006. Applications will not be accepted into the Project between 1 June 2005 and 30 June 2005 and after 31 May 2006.

Constitution

22. The Constitution establishes the Project and operates as a deed binding on all the Project's Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which FABAL agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 5 of the Constitution, the Responsible entity will keep a register of Growers.

23. Under the terms of the Constitution, all moneys received from applications shall be paid to the Responsible Entity which will deposit those moneys into an Application Fund in the name of the Responsible Entity. The application moneys will be released by the Responsible Entity when it is satisfied that specified criteria in the Constitution have been met (clause 4).

Compliance Plan

24. As required by the Corporation Law, a Compliance Plan has been adopted by FABAL for the Project. The purpose of the Compliance Plan is to ensure that FABAL manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Management Agreement

25. Growers participating in the arrangement will enter into a Management Agreement between FABAL (Responsible Entity) and the Grower.

26. The Management Agreement provides that each Grower appoints FABAL as an independent contractor to perform services under the agreement from the date FABAL accepts the Grower's application. FABAL will manage all viticultural activities on behalf of the Grower. The services to be performed are specified in Clauses 5,6,7 and 8 of the Management Agreement.

27. The Grower appoints the Responsible Entity to provide the Irrigation and Planting Services and the Initial Management Services for the Grower by 30 June 2005 ('Year 1'). The services to be provided in accordance with clauses 5 and 6 of the Agreement in respect of the Grower's allotment include:

- installation of an appropriate irrigation system on the Grower's Allotment;
- preparation for the planting of rootstock, rootlings or cuttings on the Grower's Allotment;
- obtaining healthy grapevine material and the planting of approximately 410 to 420 rootstock, rootlings or cuttings on the Grower's Allotment;
- spacing and trellising each grapevine on the Grower's Allotment in accordance with good viticultural practices;
- management of the grape vines that have been established on the Vineyard Allotment to ensure that the vines are of the quality required by the Responsible Entity;
- operating the irrigation system;
- applying fertigation through the irrigation system to the vines;
- eradicating any weeds, pests and vermin on the Allotment;
- undertaking fungicide control and vine disease measures;
- regular inspection of the trellising and the grapevines;
- conducting tests and taking action for growth of the vineyard in accordance with good viticultural practice;
- keeping in good order and condition any access road within the vineyard;
- undertaking other activities that may be required to generally maintain the vineyard in accordance with good viticultural practice;
- undertaking all administrative, technical and compliance duties incidental to the conduct of the Grower's Business; and
- maintenance of the cover crop on each Grower's Allotment.

28. Growers who enter the Project during the period up to 31 May 2005 will have their Irrigation & Planting Services and Initial Management Services carried out by 30 June 2005 (clauses 10.1 and 10.4).

29. The Responsible Entity agrees to do all things necessary to manage and maintain the Grower's Allotment following the establishment of the Allotment. These duties include, but are not limited to:

- irrigating the Allotment as and when required to maintain the vines in a healthy condition;
- pruning the vines at least once in each Year by mechanical or other methods;
- training the vines as required;
- control the growth of weeds and other pests on the Allotment;
- taking such steps as are reasonably required to prevent any outbreak of disease on the Allotment;
- conducting regular tests for any evidence of ill health or disease affecting vines on the Grower's Allotment; and
- maintaining all fences, farm access ways, roads and other improvements on the Allotment.

30. The Responsible Entity agrees to take such steps as are reasonably necessary to harvest, market and sell the grapes, including but not limited to:

- testing the maturity of the samples of grapes from the Grower's Allotment to determine whether the grapes are ready for harvesting;
- using reasonable endeavours to commence the harvesting of the grapes from the vines at the time which is best for the purposes of obtaining grapes of optimum quality;
- using reasonable endeavours to harvest the grapes as soon as is possible after the commencement of harvesting with a view to obtaining optimum quality grapes; and
- marketing and selling the grapes for the maximum price achievable having regard to any Agreement for the sale of the grapes that the Responsible Entity has obtained in respect of the Allotment and the long term future sale prospects of grapes under any such agreement.

Licence Agreement

31. Growers participating in the Project will, pursuant to the terms of the Licence Agreement, be granted an interest in the Allotment by the Land Owner in the form of a licence to use their Allotment for the purpose of conducting their viticultural business.

32. The Licence Agreement gives the Grower a licence over an identifiable area of land of 0.25 hectares for a period of 16 years ending on 30 June 2020 or until the termination of the Grower's Interest. The Licence Agreement also grants to the Grower access to water supplied by the Land Owner, the use of trellising installed by the Land Owner, and the use of plant and equipment owned by the Land Owner for the purposes of the Grower's Business.

33. Each Grower must pay the amount of Land and Water Licences Fees and Trellis, Plant & Equipment Rentals to the Land Owner as specified in Schedule 2 of the Licence Agreement. In return for payment of the amount specified in Schedule 2 the Land Owner agrees to grant the Grower licences to:

- use and occupy the Grower's Allotment for the purposes of the Business of developing, planting, growing, maintaining, cultivating and harvesting grapes;
- draw water supplied by the Land Owner for the purpose of the Business;
- use trellising installed by the Land Owner on the Allotment for the purposes of the Business; and
- use plant and equipment owned by the Land Owner which is suitable for the Business for the purpose of the Business only.

34. Under the Licence Agreement, the Grower must:

- use the Allotment for the purposes of the Business only;
- repair or make good any damage caused by an act or omission of the Grower or the Grower's authorised agents to the land or its improvements, or any neighbouring land;
- maintain the Allotment in good condition that is suitable for the Business;
- keep the Allotment free of weeds, pests, vegetation and vermin;
- do all things that are reasonably necessary to prevent or control the spread of infections, diseases, pests, weeds, insects or fire;
- ensuring that chemicals or other hazardous materials are only used and stored in such a manner so as to limit the possibility of damage or harm to livestock, water, soil, crops, vegetation or neighbouring land;
- take reasonable steps to combat land degradation on the Allotment; and

- permit the Land Owner and the Responsible Entity's employees, agents and contractors to enter upon the Allotment so as to fulfil their obligations under the Licence Agreement, Management Agreement and the Constitution.

35. The Land Owner will establish and maintain a water pipeline infrastructure for the purpose of servicing the Grower's Allotment and allow the Grower to draw water from the water infrastructure. The Land Owner will install and maintain trellising on the Allotment suitable for the Grower to carry out the Viticulture Business.

Grape Supply Agreement

36. Pursuant to a Grape Supply Agreement, Orlando Wyndham Group Pty Ltd has agreed to purchase the grapes from the Grower.

37. The proceeds of the sale are to be paid to the Responsible Entity as agent for each Grower. Clause 6 of the draft Grape Supply Agreement sets out the payment schedule.

Fees – Year 1 to 3

38. The fees payable by a Grower who enters the Project by 31 May 2005 in the first three years of the Project are as set out in the Table below for one Allotment:

	Payable on Application	Year ended 30 June 2005 Payable by 31 May 2005	Year ended 30 June 2006 Payable by 31 August 2005	Year ended 30 June 2007 Payable by 31 July 2006
On Application	220			
Management Agreement Fees				
Installation of irrigation		1,083	1745	
Pre-planting activities		286		
Initial Management Fee		1,778		
Supply and planting of rootlings		838	190	
Landcare		360		
Ongoing Management Fees			1,870	2,797

Licence Agreement Fees				
Water Licence		108	305	500
Land Licence		46	282	441
Plant & Equipment Rental		53	93	178
Trellis Rental		37	229	358

Ongoing Fees

39. A Grower is required to pay Ongoing Management Fees and Licence Fees for each of the Years 4 through to 16 in the amounts set out in the Management Agreement and the Licence Agreement. A Grower is required to pay Viticultural Costs to the Responsible Entity from Year 4 onwards to reimburse the Responsible Entity for all costs it incurs in performing its ongoing duties under the Management Agreement.

Call for Funds

40. The Responsible Entity is entitled to make a call on Growers of up to \$2,759 in any year for a contribution to the expenses of the Project.

Harvesting and Sale

41. Subject to any grape supply agreement negotiated, the Responsible Entity must use its reasonable endeavours to commence harvesting the grapes from the vines at the time which is best for the purposes of obtaining grapes of optimum quality.

42. The Grower has appointed FABAL to market and sell the grapes attributable to the Grower's Allotment for the maximum price achievable having regard to any Agreement for the sale of the grapes that the Responsible Entity has obtained in respect of the Allotment and the long term future sale prospects of grapes under any such agreement (clause 8.1.7 of the Management Agreement)

43. At all times, the Grower has full right, title and interest in the Grapes attributable to the Grower's Allotment (clause 9.2 of the Licence Agreement).

44. FABAL will ensure that the proceeds from the sale of Grapes attributable to the Grower's Allotment, after payment of any costs and expenses in relation to the harvest, will be paid into the Proceeds Fund trust bank account. A Grower is entitled to the money in the Proceeds Fund which represents the gross income from the Grower's Grapes attributable to the Grower's allotment for a particular period less:

- all fees payable under the Grower's Management Agreement;
- all fees payable under the Grower's Licence Agreement;
- any other amounts which the Responsible Entity reasonably considers will be required to meet anticipated Viticultural Costs; and
- any other amounts payable by the Grower under this Constitution or any other liabilities that attach to the Grower's Interest.

45. The surplus available for each Grower after all deductions are made by the Responsible Entity must be paid by the Responsible Entity to the relevant Grower within 5 months after 30 June each Year. The term 'Proceeds Fund' is defined in Schedule 1 to the Constitution.

Finance

46. Growers are required to fund their involvement in the Project themselves or by borrowing from an independent lender. There is no financing facility offered by the Responsible Entity or any other party to the arrangement.

47. Regardless of the source of loan funds, this Ruling will not apply to Growers if the Responsible Entity accepts their Application subject to finance approval by a lending institution and the full amount payable at the time of Application, are not paid to the Responsible Entity by 30 June in the year of Application.

48. 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

49. This Ruling applies only to Growers who are accepted to participate in the Project on or before 31 May 2005 and who have executed a Management Agreement and a Licence Agreement on or before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

50. 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 Prospectus and Product Disclosure Statement, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 50 interests is achieved.

The Simplified Tax System ('STS')

Division 328

51. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different under the STS where the Grower uses the cash accounting method.

Qualification

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

25% Entrepreneurs tax offset**Subdivision 61-J**

53. For the first income year starting on or after 1 July 2005, subdivision 61-J of the ITAA 1997 provides a tax offset of up to 25% of income tax liability related to the business income of a business in the STS with annual group turnover of less than \$75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

Prepaid expenditure for Management Fees and Licence Fees

54. Ongoing Management fees, Licence fees and Rental fees incurred by Growers 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 Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Note (v) below).

55. The following expenditure incurred by a Grower who is accepted into this Project is subject to the prepayment rules in sections 82KZME and 82KZMF:

- \$747 of the Year 3 Ongoing Management Fee which is paid in advance for services to be provided in Year 4;
- \$330 of the Year 3 Licence Fee which is paid in advance for the licence of the land and water in Year 4;
- \$185 of the Year 3 Rental Fee which is paid in advance for the rental of plant and equipment and trellis in Year 4.

56. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' means the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

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

57. Sections 82KZME and 82KZMF are discussed in greater detail in paragraphs 92 to 99.

Assessable income

Section 6-5 and section 328-105

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. Other than Growers referred to in paragraph 60, for 2005-06 income year and later years, a Grower will be assessable on ordinary income from carrying on their business of viticulture in the income year in which that income is derived.

60. For the 2005-06 income year and later years, a Grower who is an 'STS taxpayer' using the cash accounting method will be assessable on ordinary income from carrying on their business of viticulture in the income year in which that income is received.

Deductions for Management Fees and Licence Fees

Section 8-1 and section 328-105

61. A Grower may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the Tables below.

62. However, if for any reason, an amount shown or referred to in the Tables below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' (for the 2005 income year) or an 'STS taxpayer' using the cash accounting method (for the 2006 and 2007 income years), 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 Tables below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

Fee Type	ITAA 1997 Sections	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
On Application	8-1 & 328-105	\$220 – See Note (i)		
Management Fee	8-1 & 328-105	\$1,778 See Notes (i) & (ii)	\$1870 – See Notes (i), (iii), (iv) & (v)	\$2,050 – See Notes (i), (iii), (iv) & (v)
Prepaid Management Fee	8-1			Amount must be calculated – See Notes (i) & (vi)
Land Licence Fee	8-1 & 328-105	\$46 – See Notes (i) & (ii)	\$282 – See Notes (i), (iii), (iv) & (v)	\$289 – See Notes (i), (iii), (iv) & (v)
Prepaid Land Licence Fee	8-1			Amount must be calculated – See Notes (i) & (vi)
Water Licence Fee	8-1 & 328-105	\$108 – See Notes (i) & (ii)	\$305 – See Notes (i), (iii), (iv) & (v)	\$322 – See Notes (i), (iii), (iv) & (v)
Prepaid Water Licence Fee	8-1			Amount must be calculated – See Notes (i) & (vi)
Trellis Rental	8-1 & 328-105	\$37 – See Notes (i) & (ii)	\$229 – See Notes (i), (iii), (iv) & (v)	\$234 – See Notes (i), (iii), (iv) & (v)
Prepaid Trellis Rental	8-1			Amount must be calculated – See Notes (i) & (vi)
Plant & Equipment Rental	8-1 & 328-105	\$53 – See Notes (i) & (ii)	\$93 – See Notes (i), (iii), (iv) & (v)	\$117 – See Notes (i), (iii), (iv) & (v)
Prepaid Plant & Equipment Rental	8-1			Amount must be calculated – See Notes (i) & (vi)

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 (for example input tax credits): Division 27. See Example 1 at paragraph 113.

- (ii) For the 2004-05 income year, the Management Fees, Licence Fees and the Rental fees shown in the Management Agreement and the Licence Agreement, are deductible in full in the year that they are incurred (where the Grower is **not an 'STS taxpayer'**) or the year in which it is paid (where the Grower is an **'STS taxpayer'**).
- (iii) For the 2005-06 income year and later years, where a Grower pays the Management Fees, Licence Fees and the Rental Fees (excluding the prepaid Management Fee, prepaid Licence Fee and prepaid Rental Fees) in the relevant income years shown in the Management Agreement and Licence Agreement those fees are deductible in full in the year that they are incurred where the Grower is not an 'STS taxpayer' or, is an 'STS taxpayer' using the accruals accounting method.
- (iv) For the 2005-06 income year and later years, where a Grower pays the Management Fees, Licence Fees and the Rental Fees (excluding the prepaid Management Fee, prepaid Licence Fee and prepaid Rental Fees) in the relevant income years shown in the Management Agreement and Licence Agreement those fees are deductible in full in the year that they are paid where the Grower is an 'STS taxpayer' uses the cash accounting method.
- (v) However, if a Grower **chooses** to prepay fees for the doing of a thing (for example the provision of management services or the 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 56 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.
- (vi) The Management Agreement and the Licence Agreement require the following amounts to be prepaid:
- \$747 of the Year 3 Ongoing Management Fee which is paid in advance for services to be provided in Year 4;
 - \$330 of the Year 3 Licence Fee which is paid in advance for the licence of the land (\$152) and water (\$178) in Year 4; and

- \$185 of the Year 3 Rental Fee which is paid in advance for the rental of plant and equipment (\$61) and trellis (\$124) in Year 4.

For a Grower who acquires the minimum allocation of 1 Allotment the prepaid Ongoing Management Fee, Licence Fee, Rental Fee, are each less than \$1,000, and is therefore deductible in the year it is incurred as it qualifies as 'excluded expenditure'.

However, where a Grower acquires more than 1 Allotment, the amount of these prepaid fees may be \$1,000 or more. Where this occurs, such Growers **MUST** determine the relevant deductions for the prepaid Management fees, Licence Fee and Rental Fee, using the formula in paragraph 56.

Deductions for capital expenditure (Non-'STS taxpayers')

Division 40

63. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (for example 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 2005	Year ended 30 June 2006	Year ended 30 June 2007
Water facility (Irrigation)	40-515	\$942 See Notes (vii) & (viii)	\$942 See Notes (vii) & (viii)	\$942 See Notes (vii) & (viii)
Landcare operations	40-630	\$360 See Notes (vii) & (ix)	NIL	NIL
Establishment of horticultural plant (eg. Grapevines)	40-515	NIL See Note (x)	NIL See Note (x)	NIL See Note (x)

Notes:

- (vii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example input tax credits): Division 27. See Example 1 at paragraph 113.

- (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 of \$2827 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).
- (ix) Capital expenditure of \$360 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) Grapevines are a 'horticultural plant' as defined in subsection 40-520(2). As Growers 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 of \$1,314 incurred by the Grower that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the grapevines enter their first commercial season.

Deductions for Capital Expenditure ('STS taxpayers')

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

64. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g. irrigation), a 'landcare operation' and grapevines. 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.

65. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on 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 xii and xiii below.

66. 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.

Fee Type	ITAA 1997 Section	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Water facility (irrigation)	40-515	\$942 See Notes (xi) & (xii)	\$942 See Notes (xi) & (xii)	\$942 See Notes (xi) & (xii)
Landcare operations	40-630	\$360 See Notes (xi) & (xiii)	NIL	NIL
Establishment of horticultural plant (eg. grapevines)	40-515	NIL See Note (xiv)	NIL See Note (xiv)	NIL See Note (xiv)

Notes:

- (xi) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example input tax credits): Division 27. See Example 1 at paragraph 113.
- (xii) 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 deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1,000, 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 2005 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 of \$2827 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).

- (xiii) 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 of \$360 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 deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1,000, 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 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.

- (xiv) Grapevines are a 'horticultural plant' as defined in subsection 40-520(2). As Growers 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 of \$1,314 incurred by the Grower that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the grapevines enter their first commercial season.

Tax outcomes that apply to all Growers

Shares

67. The shares in National Vineyard Fund of Australia (No. 4) Ltd, the Land Owning Company, are CGT assets (section 108-5 of the ITAA 1997) and the amount paid by a Grower to acquire those assets is an outgoing of capital and not allowable as a deduction.

68. The amount paid for each share will represent the first element of the cost base of the share (subsection 110-25(2) of the ITAA 1997). Any disposal of the shares by a Grower will be a CGT event and may give rise to a capital gain or loss.

Dividends relating to the shares

69. Dividends paid out of profits by National Vineyard Fund of Australia (No. 4) Ltd are included in the assessable income of shareholders under subsection 44(1) of the ITAA 1936.

Interest

70. 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 in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 92 to 99 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.

Amounts not deductible under section 8-1

71. A Grower in this Project may be required to pay additional funds to meet Project costs at the request of the Responsible Entity. This call for funds is in addition to all other fees described in this Ruling and cannot exceed \$2,759 in any year of the project. Any such amounts are capital in nature and will not be deductible under section 8-1 of the ITAA 1997.

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

Section 35-55 – exercise of Commissioner’s discretion

72. A Grower who is an individual accepted into the Project by 31 May 2005 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending **30 June 2005 to 30 June 2009**. This conditional exercise of the discretion will allow those losses to be offset against the Grower’s other assessable income in the income year in which the losses arise.

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

73. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Licence 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 and 82KZMF (but see paragraphs 92 to 99);
- 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.

Explanation

Is the Grower carrying on a business?

74. For the amounts set out in the Tables above to constitute allowable deductions the Grower’s viticultural activities as a participant in the National Viticultural Fund of Australia Project No. 4 must amount to the carrying on of a business of primary production.

75. Where there is a business, or a future business, the gross proceeds from the sale of the grapes will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

76. For schemes such as that of the National Viticultural Fund of Australia Project No. 4, 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 *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

77. 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 vines are established;
- the Grower has a right to harvest and sell the grapes from those vines;
- the viticultural activities are carried out on the Grower's behalf;
- the viticultural activities of the Grower are typical of those associated with a viticultural business; and
- the weight and influence of general indicators point to the carrying on of a business.

78. In this Project, each Grower enters into a Management Agreement and a Licence Agreement.

79. Under the Licence Agreement each individual Grower will have rights over a specific and identifiable area of 0.25 hectares of land. The Licence Agreement provides the Grower with an ongoing interest in the specific vines on the licensed area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out viticultural activities, and for no other purpose. The licence allows the Responsible Entity to come onto the land to carry out its obligations under the Management Agreement.

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

81. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the grapes grown on the Grower's Allotment.

82. 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.

83. 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 the 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.

84. The pooling of grapes from vines grown on the Grower's Allotment with the grapes of other Growers is consistent with general viticultural practices. Each Grower's proportionate share of the sale proceeds of the pooled grapes will reflect the proportion of the grapes contributed from their Allotment.

85. The Responsible Entity's services are also consistent with general viticultural practices. They are of the type ordinarily found in viticultural ventures that would commonly be said to be businesses. While the size of a Allotment is relatively small, it is of a size and scale to allow it to be commercially viable.

86. The Grower's degree of control over the Responsible Entity as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's Allotment and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as cases of default or neglect.

87. The viticultural 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' viticultural activities in the National Viticultural Fund Of Australia Project No. 4 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

88. 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.

89. Changes to the STS rules apply from 1 July 2005. 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 licence fees**Section 8-1**

90. 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.

91. The Management Fees and Licence Fees 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 harvesting and 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**

92. 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 (for example, 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.

93. 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)(see paragraph 98). 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

94. 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)).

95. 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.

96. 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 unrelated financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the resulting 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.

97. 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.

98. 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.

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

99. 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

100. Under the Management Agreement and Licence Agreement, a Grower incurs fees which include the following amounts:

- \$747 of the Year 3 Ongoing Management Fee which is paid in advance for services to be provided in Year 4;
- \$330 of the Year 3 Licence Fee which is paid in advance for the licence of the land and water in Year 4; and
- \$185 of the Year 3 Rental Fee which is paid in advance for the rental of plant and equipment and trellis in Year 4.

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

102. Where a Grower acquires only one Allotment, the prepaid amounts set out in paragraph 100 are less than \$1,000 and 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 Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for the prepaid management fee, licence fee and rental fee

in the income year in which it is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for the prepaid management fee, licence fee and rental fee in the income year in which it is incurred.

103. However, where a Grower acquires more than one Allotment in the Project, the amount of these fees may be \$1,000 or more. Where this occurs, such Growers **MUST** determine the relevant deduction for the prepaid fees using the formula in subsection 82KZMF(1) shown in paragraph 98.

Expenditure of a capital nature

Division 40 and Division 328

104. Any part of the expenditure if 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 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.

105. 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'.

106. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 63 and 66 above in the Tables and accompanying notes.

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

Section 35-55 – exercise of Commissioner's discretion

107. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2005 to 30 June 2009** the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 Income tax: Division 35 – non-commercial business losses. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2005 up to and including 30 June 2009:

- it is because of its nature the business activity of a Grower will not satisfy one of the four tests in Division 35;
- there is an objective expectation that within a period that is commercially viable for the viticulture industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and

- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

108. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) is conditional on the Project being carried on in the manner described in this Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Ruling a Grower will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL – recouped expenditure

109. 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

110. 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).

111. The National Viticultural Fund of Australia Project No. 4 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 62 to 66 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

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

Example

Entitlement to GST input tax credits

113. 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 2003, 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 1/1/2004 to 30/6/2004	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2004 (includes GST of \$600)	<u>\$6,600</u>

*Taxable supply

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

$$\frac{1}{11} \times \$4,400 = \$400.$$

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:

$$\frac{1}{11} \times \$2,200 = \$200.$$

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 2004, 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

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

	Paragraph
What this Product Ruling is about	1
Tax law(s)	2
Good and services Tax	3
Changes in the Law	4
Note to promoters and advisors	6
Class of persons	7
Qualifications	9
Date of effect	11
Withdrawal	13
Arrangement	14
Overview	17
Constitution	22
Compliance Plan	24
Management Agreement	25
Licence Agreement	31
Grape Supply Agreement	36
Fees – Year 1 to 3	38
Ongoing Fees	39
Call for Funds	40
Harvesting and Sale	41
Finance	46
Ruling	49
Application of this Ruling	49
Minimum subscription	50
The Simplified Tax System ('STS')	51
<i>Division 328</i>	51
Qualification	52
25% Entrepreneurs tax offset	53
<i>Subdivision 61-J</i>	53
Prepaid expenditure for Management Fees and Licence Fees	54
Assessable income	58

<i>Sections 6-5 and section 328-105</i>	58
Deductions for Management Fees and Licence Fees	61
Section 8-1 and section 328-105	61
Deductions for capital expenditure (Non-'STS taxpayers')	63
<i>Division 40</i>	63
Deductions for Capital Expenditure ('STS taxpayers')	64
Subdivision 328-D and Subdivisions 40-F and 40-G	64
Tax outcomes that apply to all Growers	67
Shares	67
Dividends relating to the shares	69
Interest	70
Amounts not deductible under section 8-1	71
Division 35 – deferral of losses from non-commercial business activities	72
<i>Section 35-55 – exercise of Commissioner's discretion</i>	72
Sections 82KZME, 82KZMF and 82KL and Part IVA	73
Explanation	74
Is the Grower carrying on a business?	74
<i>The Simplified Tax System</i>	88
<i>Division 328</i>	88
Deductibility of Management Fees and Licence Fees	90
Section 8-1	90
<i>Prepayment provisions</i>	92
<i>Sections 82KZL to 82KZMF</i>	92
<i>Sections 82KZME and 82KZMF</i>	94
<i>Application of the prepayment provisions to this Project</i>	100
Expenditure of a capital nature	104
<i>Division 40 and Division 328</i>	104
Division 35 – deferral of losses from non-commercial business activities	107
<i>Section 35-55 – exercise of Commissioner's discretion</i>	107
Section 82KL – recouped expenditure	109
Part IVA – general tax avoidance provisions	110
Example	113
Entitlements to GST input tax credits	113
Detailed contents list	114

Commissioner of Taxation

27 April 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
 TR 97/11; TR 97/16; TR 98/22;
 TR 2000/8; TR 2001/14; TD 93/34

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- non-commercial business activities
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- taxation administration

Legislative references:

- ITAA 1936 44
- ITAA 1936 44(1)
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- 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)
- 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 35-55
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Div 40
- ITAA 1997 40-440
- ITAA 1997 Subdiv 40-F
- ITAA 1997 40-515(1)(a)
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(1)
- ITAA 1997 40-520(2)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530(2)
- ITAA 1997 40-540
- ITAA 1997 40-545
- ITAA 1997 Subdiv 40-G
- ITAA 1997 40-630
- ITAA 1997 40-635
- ITAA 1997 Subdiv 61-J
- ITAA 1997 108-5
- ITAA 1997 110-25(2)
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 Subdiv 328-D
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- TAA 1953 Pt IVAAA
- Copyright Act 1968
- Corporations Act 2001

Case references:

- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

ATO references

NO: 2005/127

ISSN: 1441-1172