



PR 2005/8 - Income tax: Barossa Vines Project 2004/2005 - Applicant Group 2

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 This document has changed over time. This is a consolidated version of the ruling which was published on *2 February 2005*



Product Ruling

Income tax: Barossa Vines Project 2004/2005 – Applicant Group 2

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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.

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

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 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 Barossa Vines Project 2004/2005 or simply as 'the Project'.

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;
- Section 108-5 of the ITAA 1997,
- Division 110 of the ITAA 1997,
- Division 328 of the ITAA 1997;
- Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Section 82KZME of the ITAA 1936;
- Section 82KZMF of the ITAA 1936; and
- Part IVA of the ITAA 1936.

Goods and services tax

3. In this Ruling, all fees and expenditure referred to include goods and services tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Changes in the law

4. 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 ATO suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. This Product Ruling applies to Applicant Group 2 who are Applicants who apply for an interest in the Project after 1 June 2005 and on or before 30 November 2005, and whose applications are accepted by the Responsible Entity on or after 1 July 2005.

8. The class of persons to whom this Ruling applies is the persons 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. In this Ruling, these persons are referred to as 'Growers'.

9. 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; or
- have entered into the arrangement specified below prior to the date this Ruling is made.

Qualifications

10. 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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Date of effect

12. This Ruling applies prospectively from 2 February 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).

13. 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

14. 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 person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling as constituted by documents provided on 21 September 2004, and additional correspondence dated 6 October 2004, 26 October 2004, 27 October 2004, 1 November, 9 November 2004, 15 November 2004, 22 November 2004 and 21 January 2005;

- Draft Prospectus and Product Disclosure Statement of the Barossa Vines Project 2004/2005 dated 21 January 2005;
- Draft **Constitution** of the Barossa Vines Project 2004/2005 dated 20 January 2005;
- **Draft Licence Agreement (Commencement Date to 30 June 2010)** of the Barossa Vines Project 2004/2005, between Barossa Vines Ltd ('Licensor') and the Grower dated 20 January 2005;
- **Draft Licence Agreement (1 July 2010 to 30 June 2015)** of the Barossa Vines Project 2004/2005, between Barossa Vines Ltd and the Grower dated 20 January 2005;
- **Draft Licence Agreement (1 July 2015 to 30 June 2020)** of the Barossa Vines Project 2004/2005, between Barossa Vines Ltd and the Grower dated 20 January 2005;
- Draft Memorandum Of Lease between Barossa Vines Landholding Limited ('Landholder' and 'Lessor') and Barossa Vines Ltd ('Lessee') received 21 September 2004;
- **Draft Management Agreement** of the Barossa Vines Project 2004/2005 between Barossa Vines Ltd ('Responsible Entity') and the Grower dated 20 January 2005;
- Compliance Plan for the Barossa Vines Project 2004/2005 dated 7 September 2004;
- Viticultural Report for the Barossa Vines Project 2004/2005 dated 4 November 2004;
- Draft Vineyard Management Agreement of the Barossa Vines Project 2004/2005, between the Responsible Entity and SA Viticulture Pty Ltd ('Vineyard Manager') dated 7 September 2004; and
- Loan Agreement with The Aussie Loan Company Pty Ltd received 11 November 2004.

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.

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

17. 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

18. The arrangement is called 'Barossa Vines Project 2004/2005' and is summarised as follows:

| | |
|--|--|
| Location | Barossa Valley, South Australia |
| Type of business | Viticulture |
| Name of development | Barossa Vines Project 2004/2005 |
| Size of each lot | 0.05 hectare |
| Number of lots available | 2,150 |
| Number of vines per lot | 93 vines |
| Minimum subscription | 100 lots |
| The term of the Project | Expires on 30 June 2020 |
| Initial cost per lot | \$4,950 plus a Licence Fee of \$13.75 per month. |
| Initial costs per hectare | \$99,000 |
| Subscription for one 'B' class share in Landholder | \$1 of the cost of \$1,250 for one share in Barossa Vines Landholding Limited paid on application, the balance of \$1,249 payable 1 July 2010. |
| Ongoing costs | Annual management fees, annual licence fees, vineyard operating costs, harvesting costs and insurance costs. |

The Project

19. The Barossa Vines Project 2004/2005 is registered as a Managed Investment Scheme under the Corporations Act 2001. The Responsible Entity for the Project is Barossa Vines Ltd.

20. The Project Land of approximately 121 hectares (108 hectares being available for use) is situated in the Barossa Valley Region of South Australia. The Project Land is owned by Barossa Vines Landholding Limited (the 'Landholder'). The Project Land is leased by the Responsible Entity from Barossa Vines Landholding Limited.

21. The Project is initially 2,150 Vineyard Lots, each being 0.05 of a hectare in size. The Landholder is seeking additional suitable land. The Responsible Entity is able to accept oversubscriptions to the extent of the additional land available. The Responsible Entity may allot additional Vineyard Lots and will only do so if it acquires additional land, with similar characteristics to the land already

acquired and a viticultural expert reports that the land is suitable for the Project.

22. The Responsible Entity will plant approximately 93 vines per Vineyard Lot (1,860 per hectare). Water for irrigation of the Vineyard Lots will be supplied from a combination of existing bores and SA mains water supply.

23. An interest in the Project is offered under a combined Prospectus and Product Disclosure Statement ('PDS'). The Prospectus and PDS state that the minimum subscription for the Project is 100 Vineyard Lots. Each Applicant may subscribe for a minimum of one Vineyard Lot and one 'B' class share in the Landholder.

24. Upon Application, the Grower will grant a Power of Attorney enabling the Responsible Entity to execute:

- the Licence Agreements between the Responsible Entity and the Grower;
- the Management Agreement between the Responsible Entity and the Grower; and
- the application for shares in Barossa Vines Landholding Limited.

25. Under each Licence Agreement, the Responsible Entity agrees to licence to the Grower an identifiable area of land (a 'Grower's Vineyard Lot') for the purpose of cultivating vines and harvesting grapes until the Project is terminated on 30 June 2020. Each Licence Agreement is for a term of approximately five years.

26. Under the Management Agreement, the Grower appoints the Responsible Entity to establish, maintain and manage the Grower's Vineyard Lot. The Grower also appoints the Responsible Entity to harvest, market and sell the grapes produced on the Vineyard Lot.

27. The Responsible Entity will enter into a Vineyard Management Agreement with SA Viticulture Pty Ltd (the 'Vineyard Manager') to perform the initial, ongoing and harvesting services required under the Management Agreement.

28. There will be two classes of Growers in the Project, determined by the date of application:

- Applicant Group 1 - Growers who apply on or after 2 February 2005 and on or before 1 June 2005; and
- Applicant Group 2 - Growers who apply after 1 June 2005 and on or before 30 November 2005. Applications made between 2 June 2005 and 30 June 2005 will be accepted on or after 1 July 2005.

This Ruling does not apply to Applicant Group 1 Growers.

29. Each Grower is required to subscribe for one 'B' Class Share in the Landholder, Barossa Vines Landholding Limited, at a cost of \$1,250 payable \$1 on application and \$1,249 on 1 July 2010.

Constitution

30. The Constitution establishes the Project and operates as a deed binding on the Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Barossa Vines Ltd agrees to act as the Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

31. All Project Property, as defined in clause 1 of the Constitution, will be held by the Responsible Entity acting as Custodian. Project Property includes the Application Fees paid by Growers and Gross Proceeds pending distribution to Growers. The Responsible Entity must open a trust with a bank trading in Australia into which all the application Fees must be deposited

32. All Gross Proceeds will be payable to the Responsible Entity. Gross Proceeds includes all interest and accretions received by the Responsible Entity from Authorised Investments and all moneys received from the sale of the Grapes (clause 1 of the Constitution). The Responsible Entity must deposit the full amount of Gross Proceeds into a Gross Proceeds Account. These proceeds will be invested in Authorised Investments until disbursed to Growers (clause 13 of the Constitution).

33. The balance of Gross Proceeds, after payment to the Responsible Entity of fees, costs and expenses, will be distributed to the Growers within 28 days of receipt of the Gross Proceeds. The amount each Grower receives will be based on the number of Vineyard Lots licensed to the Grower as a proportion of the total number of Lots licensed under the Project. However, in the event of a partial or total destruction of the vines or grapes on the Grower's Vineyard Lots, the Grower's Proportion will be reduced accordingly (clause 13.3.5 of the Constitution).

Compliance plan

34. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Law. Under the Compliance Plan, a Compliance Committee will monitor to what extent the Responsible Entity meets its obligations as the Responsible Entity of the Project and if the rights of the Growers are protected.

Lease

35. Under a Memorandum of Lease, Barossa Vines Landholding Limited (the 'Lessor') leases the Project Land to the Responsible Entity. The Lessor agrees the Responsible Entity may licence the land or portions of the land without the consent of the Lessor. Also, the Lessor agrees to provide, at the Lessor's cost, an adequate

water supply to enable the Responsible Entity to irrigate the vineyards on the leased land.

Licence Agreements

36. The Responsible Entity, as Licensor, grants a licence to the Grower for a portion of the Project Land, the Grower's Vineyard Lot, for the purpose of establishing and maintaining a vineyard and subsequently to harvest and sell grapes. The terms and conditions under which the licence of the Vineyard Lot is granted to the Grower are contained in the Licence Agreements.

37. Each Grower will enter into three consecutive Licence Agreements with the Licensor. The first Licence Agreement will be in effect from the Commencement Date until 30 June 2010, the second Licence Agreement will be in effect from 1 July 2010 to 30 June 2015 and the third Licence Agreement will be in effect from 1 July 2015 to 30 June 2020.

38. In consideration for the grant of the licence, the Grower agrees to annually pay a Licence Fee. The amount of the Licence Fee is \$13.75 per month or part thereof, totalling \$165 in a full year. From 1 July 2006, the Licence Fee is adjusted for movements in the Consumer Price Index (CPI).

Management Agreement

39. Each Grower enters into a Management Agreement with the Responsible Entity, contracting the Responsible Entity to establish, manage and maintain the Grower's Vineyard Lot in accordance with good viticultural practices.

40. During the Establishment Period, the Responsible Entity will carry out the following activities to establish the vineyard on behalf of the Grower:

- preparing that part of the Grower's Vineyard Lot which can be used to satisfactorily grow Grapevines, obtaining healthy grapevine rootlings for planting and planting these grapevine rootlings on the Grower's Vineyard Lot;
- spacing and trellising each Grapevine rootling on the Grower's Vineyard Lot in accordance with good viticultural practices so that grapes can be harvested commercially; and
- installing the appropriate irrigation equipment.

41. The Responsible Entity will provide the following initial management services during the Establishment Period:

- eradicating vermin;
- operating irrigation;

- conducting tests and taking action for growth of the vineyard;
- fertilising;
- controlling diseases,
- regular inspection of trellising, irrigation and Grapevines; and
- providing any other services incidental to conduct of the Grower's Business, including engaging the services of an external viticultural consultant.

42. The Establishment Period, for Growers in Applicant Group 2, is defined in the Management Agreement (clause 30) as from the Commencement Date to 1 January 2006.

43. After the Establishment period, the Responsible Entity will provide the following ongoing vineyard maintenance and management services for the term of the Project:

- pruning the Grapevines by mechanical or other methods;
- as permitted by Law, eradicate vermin which have or may cause damage to the Grapevines or the Grower's Vineyard Lot and put in place measures to control such vermin;
- operating the irrigation system in order to irrigate the Grower's Vineyard Lot;
- fertilising the Grower's Vineyard Lot as required to maintain satisfactory rates of growth and productivity of the Grapevines;
- protecting the Grapevines from insect infestation and competition from competing growth using good viticultural practices, including but not limited to applying herbicides to the Grower's Vineyard Lot and spraying under the Grapevines;
- regularly inspecting the Grapevines, trellising and irrigation equipment;
- replacing any of the Grapevines in need of replacement after the Establishment Period; and
- any other service or thing, which, in the reasonable opinion of the Responsible Entity, is incidental and/or ancillary to the conduct of the Grower's business.

44. The Responsible Entity will send a report to the Grower within 90 days of the end of each financial year containing information on matters considered material to the Grower's Business, including harvest and sales results, the Proceeds of Sale and the condition of the Grower's Vineyard Lot.

45. In addition, the Responsible Entity must ensure that insurance policies are taken out to cover the destruction or loss of Grapevines and the Grapes as well as a public liability insurance policy. Each Grower will pay the Grower's Proportion of the Insurance Premiums or the premiums will be reimbursed to the Responsible Entity from the Gross Proceeds of the Project (clause 11 of the Management Agreement and clauses 9.7 and 13.3 of the Constitution).

Harvesting

46. Under the Management Agreement, the Responsible Entity must harvest all of the mature Grapes grown on the Grower's Vineyard Lot (clause 5). The Responsible Entity will determine when the harvest will commence by assessing the maturity of the Grapes in accordance with good viticultural practices.

47. The Responsible Entity will determine how and where the Grapes are to be stored and whether mechanical or hand harvesting will be the most cost efficient option.

48. The costs of providing the harvesting services will be met from the Grower's payment of Harvesting Costs (clauses 9 and 12) which will be deducted from the Gross Proceeds.

Sale of Grapes

49. The Grower unconditionally appoints the Responsible Entity as its sole and exclusive agent to market and sell the Grapes, for the term of the Project (clause 6). The Grapes from each Vineyard Lot in the Project will be pooled and sold, by the Responsible Entity on behalf of the Growers. The Responsible Entity will use all reasonable endeavours to sell the Grapes at a price equivalent to the price likely to be paid for the majority of the fruit variety grown in the vicinity of the land.

Vineyard Management Agreement

50. Under the Vineyard Management Agreement, the Responsible Entity will engage the Vineyard Manager, SA Viticulture Pty Ltd, to establish the Growers' Vineyard Lots and to manage and maintain the Vineyard Lots on the terms and conditions contained in the Agreement. The Vineyard Manager will be subject to the direction of the Responsible Entity in all matters relating to the Vineyard Management Agreement.

51. The Vineyard Manager will perform services including planting and the installation of irrigation during the Establishment Period. After the Establishment Period the Vineyard Manager will provide Ongoing Services and Harvesting Services in relation to the Vineyard Lots.

Fees

52. Under the Management Agreement and the Licence Agreements the Grower is required to pay the following:

- initial fees on application;
- Vineyard Operating Costs;
- annual Management Fees;
- reimbursement of insurance costs;
- Harvesting Costs; and
- Licence Fees.

From 1 July 2007, all the fees other than Licence Fees will be deducted from Gross Proceeds.

Initial Fees on application

53. For each Grower, the amount of the initial fees payable on application for services to be provided in the Establishment Period are:

- initial planting and preparation (\$121);
- trellising (\$358);
- installing irrigation (\$302); and
- all other maintenance and management services (\$3,509).

54. The fees paid on application include an amount of \$660 for Vineyard Operating Costs consisting of \$330 for the year ending 30 June 2006 and a prepaid amount of \$330 for the year ending 30 June 2007.

55. Also, on application a Licence Fee is payable of \$13.75 for each month, or part thereof, for the period from the Commencement Date to 30 June 2006.

Vineyard Operating Costs

56. The Vineyard Operating Costs for the financial years ending 30 June 2006 and 2007 are \$330 per year. These amounts (totalling \$660) are paid as part of the initial fees on application.

57. From 1 July 2007, Vineyard Operating Costs will be the actual direct costs incurred by the Vineyard Manager (on behalf of the Responsible Entity) in maintaining and managing the Grower's Vineyard Lot. The Vineyard Operating Costs will be payable on 1 July in each financial year.

Annual Management Fees

58. From 1 July 2007 until the end of the Project, the Management Fee will be an amount equal to 8.25% of the Grower's Proportion of the Gross Proceeds for each succeeding financial year.

Insurance Costs

59. The Grower's Proportion of the cost of insurance taken out by the Responsible Entity on behalf of the Growers will be reimbursable to the Responsible Entity from Gross Proceeds.

Harvesting Costs

60. Harvesting Costs will be deducted from the Grower's Proportion of the Gross Proceeds commencing on 1 July immediately following the first harvest and thereafter on 1 July immediately following each succeeding harvest. Harvesting Costs is defined in the Management Agreement as meaning any costs or expenses incurred by the Responsible Entity when harvesting (clause 30).

Licence Fees

61. For the financial year beginning 1 July 2006, the Licence Fee payable for all Growers will be the amount of \$165 adjusted to reflect movements in the CPI. From the financial year beginning 1 July 2007, the Licence Fee payable for all Growers will be the annual Licence Fee paid in the preceding year adjusted to reflect movements in the CPI. All Licence Fees will be payable on 1 July of each financial year.

Ongoing Fees

62. The Gross Proceeds from the sale of the Grapes will be paid into a Gross Proceeds Account to be established by the Responsible Entity. From 1 July 2007 Management Fees, Vineyard Operating Costs, Harvesting costs and Insurance Premiums due and payable, will be deducted from the Gross Proceeds before the proceeds are distributed to the Grower.

63. If Gross Proceeds are insufficient to pay any fees in any financial year, the Grower will either be required to pay the amount of the excess, or if the Responsible Entity chooses, the amount will be carried forward to be deducted in a later financial year. The maximum period that such amounts will be carried over is two years, after which Growers will be required to pay any amounts outstanding. No amount may be carried forward beyond the final year of the Project (clause 13.3 of the Constitution).

Shares

64. Each Grower must also subscribe for a share in the Landholder, Barossa Vines Landholding Limited, for each Vineyard Lot. The cost of each share is \$1,250 of which \$1 is payable on application and \$1,249 on 1 July 2010.

Finance

65. Growers may fund their involvement in the Project themselves, borrow from an independent lender or borrow from The Aussie Loan Company Pty Ltd, a finance company associated with the Responsible Entity.

66. Growers are able to borrow the full amount of their initial fees from The Aussie Loan Company. The amount borrowed from The Aussie Loan Company will be paid into the Application Fund that is maintained by the Responsible Entity (clause 7.11 of the Constitution). There is no application fee charged on the loan. All loans are personally secured. There are two finance options:

- Option 1 – one year term interest free; or
- Option 2 – for Growers taking three or more Vineyard Lots, a two year term with interest charged at 12% per annum, repayable by monthly instalments over the term of the loan.

The loan is provided by The Aussie Loan Company on a full recourse basis and recovery action will be taken in respect of any default by the borrower.

67. This Ruling will not apply to Growers who enter into finance arrangements with The Aussie Loan Company or its associates, if the terms and conditions differ in any way from those set out in paragraph 66.

68. The Responsible Entity may conditionally accept a Grower's Application, subject to the approval of finance by the lender identified in the Application. The lender has 28 days after the date of the Application to provide the funds. If the funds have not been provided within 28 days, the Application will be deemed to be refused and any moneys paid to the Responsible Entity by the Applicant will be refunded by the Responsible Entity (clause 7.6 of the Constitution).

69. 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 other than The Aussie Loan Company are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

70. This Ruling applies only to Growers who are accepted to participate in the Project on or after 1 July 2005 and on or before 30 November 2005 (Applicant Group 2). A Grower's participation in the Project must constitute the carrying on of a business of primary production.

71. This Ruling does not apply to Growers in Applicant Group 1.

Minimum Subscription

72. 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 PDS, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 100 interests is achieved.

The Simplified Tax System ('STS')

Division 328

73. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and

- must have elected to be an 'STS taxpayer'.

Qualification

74. 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.

Assessable income

Sections 6-5 and 328-105

75. That part of the Gross 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.

76. The Grower who is not an 'STS taxpayer' recognises ordinary income from carrying on the business of viticulture at the time that income is derived.

77. The Grower who is an 'STS taxpayer' recognises ordinary income from carrying on the business of viticulture at the time the income is received (paragraph 328-105(1)(a)).

Deductions for Management Fees, Vineyard Operating Expenses, Licence Fees and Interest

STS and Non STS taxpayers

Sections 8-1 and 328-105

78. A Grower may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the Table at paragraph 82.

79. However, under section 328-105, an STS taxpayer can only claim an amount deductible under section 8-1 when the amount is paid. Where 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' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

Prepaid fees

80. Growers who are accepted into this Project are subject to the prepayment rules in sections 82KZME and 82KZMF. 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'. '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.

81. In this Project, there is a prepayment of Vineyard Operating Costs of \$330 for the year ending 30 June 2007, included in the initial fees on application. The amount of prepaid expenditure is less than \$1,000 and meets the definition of 'excluded expenditure'. Therefore, section 82KZMF will not apply and the prepayment is deductible in the year the Grower is accepted into the Project. However, if more than three interests are held by a Grower, the amount of the tax deductions allowable for the prepaid Vineyard Operating Costs in the initial period must be calculated by applying the formula in section 82KZMF (see paragraph 119).

82. A Grower may claim tax deductions for the following revenue expenses on a per Vineyard Lot basis:

| Fee Type | ITAA 1997 sections | Year ended 30 June 2005 | Year ended 30 June 2006 | Year ended 30 June 2007 |
|---|--------------------|-------------------------|--|---|
| Management Fees | 8-1 & 328-105 | Nil | \$3,509 See Notes (i) & (ii). | Nil |
| Licence Fees | 8-1 & 328-105 | Nil | See Notes (i), (ii) & (iv) | \$165 (Indexed) See Notes (i), (ii) & (v) |
| Prepaid Vineyard Operating Costs | 8-1 & 328-105 | Nil | \$660 Must be calculated if Grower holds more than three interests . See Notes (i) & (iii) | |
| Interest | 8-1 & 328-105 | Nil | As incurred for Non-STS taxpayers . As paid for STS taxpayers . See Note (vi) | As incurred for Non-STS taxpayers . As paid for STS taxpayers . See Note (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 at paragraph 137).
- (ii) The Initial Management Fee, Vineyard Operating Expenses, Licence Fees and Interest are deductible under section 8-1 in full in the year that they are incurred, (where the Grower is not an 'STS taxpayer') or in the year in which they are paid (where the Grower is an 'STS taxpayer'). If an amount shown is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower.
- (iii) The deduction for the prepaid Vineyard Operating Costs is determined by the application of sections 82KZME and 82KZMF. Where the Grower holds up to three interests, the prepayment meets the definition of 'excluded expenditure' and section 82KZMF does not operate to apportion deductibility of the payment. Where the Grower holds **more than three interests**, the formula in subsection 82 KZMF(1) must be used to determine the apportionment of the prepaid fee (see paragraph 119).
- (iv) The Licence Fee included in the initial fees on application is \$13.75 per month or part thereof, for the period from the Commencement Date to 30 June 2006. The Licence fee is deductible in the income year in which it is incurred (where the Grower is not an 'STS taxpayer') or the income year in which it is paid (where the Grower is an 'STS taxpayer').
- (v) If a Grower **chooses** to prepay fees for the doing of a thing (for example. the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 119 unless the expenditure is 'excluded expenditure'.

- (vi) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than The Aussie Loan Company Pty Ltd, is outside the scope of this Ruling. However all Growers, including those who finance their participation in the Project other than with The Aussie Loan Company Pty Ltd, should read the discussion of the prepayment rules in paragraphs 113 to 126 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.

Deductions for capital expenditure

Non STS taxpayers

Division 40

83. A Grower who is not an 'STS taxpayer' will be entitled to tax deductions relating to trellising, irrigation and the establishment and decline in value of the Grapevines. All deductions shown in the following Table are determined under Division 40.

| Fee Type | ITAA 1997 sections | Year ended 30 June 2005 | Year ended 30 June 2006 | Year ended 30 June 2007 |
|--|--------------------------|----------------------------|---|---|
| Trellising | 40-25 | Nil | Must be calculated. See Notes (vii) & (viii) | Must be calculated. See Notes (vii) & (viii) |
| Irrigation | 40-515 | Nil | \$100.66 See Notes (vii) & (ix) | \$100.66 See Notes (vii) & (ix) |
| Establishment of Grapevines | 40-515 | Nil | Nil | Must be calculated. See Notes (vii) & (x) |

Notes:

- (vii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (for example, input tax credits): Division 27 (see example at paragraph 137).
- (viii) Trellising meets the definition of a 'depreciating asset' in section 40-30 and therefore each Grower's interest in the trellising is a 'depreciating asset'. The 'cost' of the asset is the amount paid by the Grower. The decline in value of the asset is calculated using the formula in either subsection 40-70(1) ('diminishing

value method') or subsection 40-75 (1) ('prime cost method'). Both formulas rely on the 'effective life' of the trellising.

Growers can either self-assess the 'effective life' (section 40-105) or use the Commissioner's determination of 'effective life' (section 40-100). The Commissioner has determined that trellising has an 'effective life' of 20 years.

For a Grower who purchases the minimum allocation of one Vineyard Lot in this Project, their interest in the trellising will be a 'low cost asset' that is, an asset costing less than \$1,000. A 'low-cost asset' can be allocated to a 'low-value pool'. Once any 'low-cost asset' of a Grower is allocated to a 'low-value pool', all other 'low-cost assets' the Grower starts to 'hold' in that year or a later year must be allocated to that pool. If the Grower has already allocated an asset to a 'low-value pool', the trellising would also have to be allocated to that pool. Otherwise, the Grower must decide whether to create a 'low-value pool'.

If the asset is allocated to a 'low-value pool', the capital expenditure on the trellising will be deducted under the diminishing value methodology of the pool based on a rate of 18.75% in the year the trellising is first used and a rate of 37.5% in subsequent years (section 40-440). If the trellising is not allocated to a 'low-value pool', it can be written off based on the 'effective life' of the asset.

- (ix) An 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 for water facilities is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).
- (x) The Grapevines meet the definition of 'horticultural plant' in subsection 40-525(2). As Growers hold the land under a licence, the condition in item 3 of subsection 40-525(2) is met and a deduction for the decline in value of 'horticultural plants' is available under paragraph 40-515(1)(b).

The deduction for the Grapevines is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the Grapevines have an 'effective life' of greater than 13 but fewer than

30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13% per annum. The deduction is allowable when the Grapevines enter their first commercial season (section 40-530, item 2). The Project Manager will inform Growers of when the Grapevines enter their first commercial season.

STS taxpayers

Division 328 and Subdivision 40-F

84. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to trellising, irrigation and the establishment and decline in value of the Grapevines.

85. Trellising meets the definition of a 'depreciating asset' and deductions relating to the 'cost' of trellising must be determined under Division 328. 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.

86. An 'STS taxpayer' may claim deductions in relation to irrigation under Subdivision 40-F because irrigation meets the definition of a 'water facility'. As expenditure on irrigation would also meet the definition of a 'depreciating asset', an 'STS taxpayer' may choose to claim a deduction under Division 328.

87. Deductions for the Grapevines must be determined under Subdivision 40-F.

88. The deductions shown in the following Table assume the Grower has **one interest in the Project** and has chosen to claim deductions for expenditure on irrigation under Division 328. If the expenditure is claimed under Subdivision 40-F, the deduction is determined as for Non-STS Taxpayers (see the Table at paragraph 83).

| Fee Type | ITAA 1997 | Year ended 30 June 2005 | Year ended 30 June 2006 | Year ended 30 June 2007 |
|------------------------------------|--------------|-------------------------|----------------------------------|---|
| Trellising | Subdiv 328-D | Nil | \$358 See Notes (xi) & (xii) | Nil |
| Irrigation | Subdiv 328-D | Nil | \$302 See Notes (xi) & (xiii) | Nil |
| Establishment of Grapevines | 40-515 | Nil | Nil | Must be calculated. See Notes (xi) & (xiv) |

Notes:

- (xi) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (for example, input tax credits): Division 27 (see example at paragraph 137).
- (xii) Trellising meets the definition of a 'depreciating asset' in section 40-30. Where a Grower acquires one or two Vineyard Lots, the Grower's interest in the trellising is a 'low-cost asset' as defined in subsection 40-425(2). 'Low cost assets' cannot be allocated to a 'general STS pool' (section 328-180). A deduction equal to the amount of the Grower's expenditure for the trellising is available in the income year in which they are used or 'installed ready for use'. This is 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.

Where a Grower acquires **more than two Interests**, the Grower's interest in the trellising may not be a 'low cost asset' as the cost may be \$1,000 or greater. For these Growers, their interest in the trellising is a 'depreciating asset' that can be allocated to a 'general STS pool'. The 'cost' of the asset is the amount paid by each Grower.

For trellising allocated to a 'general STS pool' the tax deduction allowable is determined in the year ended 30 June 2006 by multiplying the 'cost' of the interest by half the 'general STS pool rate, that is, by 15%.

Each Grower's interest in the trellising is allocated to their 'general STS pool' at the end of the financial year ended 30 June 2006 and that part of the 'cost' not deducted in the first year is added to the pool balance. In subsequent years, the full pool rate of 30% will apply.

- (xiii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F.

For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is 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 2006 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 the Grower chooses to use Subdivision 40-F, the deductions are claimed under Subdivision 40-F, paragraph 40-515(1)(a). The deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility', in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

- (xiv) The Grapevines meet the definition of 'horticultural plant' in subsection 40-525(2). As Growers hold the land under a licence, the condition in item 3 of subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value.

The deduction for the Grapevines is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the Grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%.

The deduction is allowable when the Grapevines enter their first commercial season (subsection 40-530(2)). The Project Manager will inform Growers of when the Grapevines enter their first commercial season.

Shares

89. The shares in Barossa Vines Landholding Limited are CGT assets (section 108-5 of the ITAA 1997) and the amounts paid by a Grower to acquire the shares are an outgoing of capital and not allowable as a deduction.

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

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

Section 35-55 – Commissioner’s discretion

91. A Grower who is an individual accepted into the Project 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 the income years ending **30 June 2006 to 30 June 2008** for Applicant Group 2 Growers. 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.

Section 82KL and Part IVA

92. 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:

- 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?

93. For the amounts set out in the Tables above to constitute allowable deductions the Grower’s viticulture activities as a participant in the Barossa Vines Project 2004/2005 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.

94. For schemes such as that of the Barossa Vines Project 2004/2005, 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.

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

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's grapevines are established;
- the Grower has a right to harvest and sell the grapes each year from those grapevines;
- the viticulture activities are carried out on the Grower's behalf;
- the viticulture activities of the Grower are typical of those associated with a viticulture business; and
- the weight and influence of general indicators point to the carrying on of a business.

96. In this Project, each Grower enters into a Management Agreement and three Licence Agreements.

97. Under the Licence Agreements, each individual Grower will have rights over a specific and identifiable area of land. The Licence Agreements provide the Grower with an ongoing interest in the specific Grapevines on the licenced area for the term of the Project. Under the licences the Grower must use the land in question for the purpose of carrying out viticultural activities and for no other purpose. The licences allow the Responsible Entity to come onto the land to carry out its obligations under the Management Agreement.

98. Under the Management Agreement, the Responsible Entity is engaged by the Grower to establish and maintain a Vineyard Lot(s) 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 Vineyard Lot on the Grower's behalf.

99. In establishing the Vineyard Lot(s), the Grower engages the Responsible Entity to purchase and install trellising, irrigation and to acquire and plant vine seedlings/rootlings on the Grower's Vineyard Lot. During the term of the Project, these assets will be used wholly to carry out the Grower's viticulture activities. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the grapes grown on the Grower's Vineyard Lot.

100. 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.

101. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of its grapes that will return a before-tax profit, which is a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

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

103. The Responsible Entity's services and the installation of assets on the Grower's behalf are also consistent with general viticultural practices. The assets are of the type ordinarily used in carrying on a business of viticulture. While the size of a Vineyard Lot is relatively small, it is of a size and scale to allow it to be commercially viable.

104. 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 Vineyard Lot 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.

105. The viticulture activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' viticulture activities in the Barossa Vines Project 2004/2005 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

106. 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.

107. 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 project fees**Section 8-1**

108. Consideration of whether the Management Fees, Vineyard Operating Expenses, Licence Fees and Interest (the 'project 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.

109. The project fees associated with the viticulture activities will relate to the gaining of income from the Grower's business of viticulture, 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 fees is identifiable from the arrangement. The project fees appear to be reasonable. There is no capital component of the project fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Timing of deductions

110. In the absence of any application of the prepayment provisions, the timing of deductions of the Project Fees will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

111. If the Grower is not an 'STS taxpayer', the Project fees are deductible in the year in which they are incurred.

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

Prepayment provisions***Sections 82KZL to 82KZMF***

113. 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 licencing 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.

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

Sections 82KZME and 82KZMF

115. Where the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF (1) (see paragraph 119) 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)).

116. 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.

117. For the purpose of these provisions, the agreement referred to includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier other than The Aussie Loan Company. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deductions 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.

118. 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.

119. 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.

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

120. 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

121. The prepaid expenditure for Vineyard Operating Costs incurred by a Grower in the Project as part of the initial fees on application 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.

122. Under Exception 3 (subsection 82KZME (7)) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF. The prepaid Vineyard Operating Costs, being amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). A Grower who is an 'STS taxpayer' can claim an immediate deduction for the prepaid Vineyard Operating Costs 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 Vineyard Operating Costs in the income year in which it is incurred.

123. However, where a Grower acquires more than three interests in the Project and the quantum of the prepaid Vineyard Operating Costs is \$1,000 or more, the deduction allowable for those amounts will be subject to apportionment according to the formula in subsection 82KZMF(1).

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

124. Where a Grower chooses to prepay fees under the agreements for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 113 to 126) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF.

125. For these Growers, the amount and timing of deductions for any relevant prepaid Project Fees will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

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

Expenditure of a capital nature

Division 40 and Division 328

127. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to trellising, irrigation 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.

128. 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'.

129. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 83 to 88.

Deferral of losses from non-commercial business activities

Division 35

130. The Commissioner has applied the principles set out in Taxation Ruling TR 2001/14, Income tax: Division 35 – non-commercial business losses in deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ending **30 June 2006 to 30 June 2008** (Applicant Group 2).

131. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2006 up to and including 30 June 2008:

- 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.

132. 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

133. 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

134. 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).

135. The Barossa Vines Project 2004/2005 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 82 to 88 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.

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

Example

Entitlement to GST input tax credits

137. 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:

$$1/11 \times \$4,400 = \$400.$$

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

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

$$1/11 \times \$2,200 = \$200.$$

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

In preparing her income tax return for the year ended 30 June 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

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Commissioner of Taxation

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Previous draft:

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Related Rulings/Determinations:

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

Subject references:

- carrying on a business
 - commencement of business
 - fee expenses

- horticulture
 - irrigation expenses
 - management fees expenses
 - non commercial losses
 - primary production
 - primary production expenses
 - primary production income
 - producing assessable income
 - product rulings
 - public rulings
 - schemes and shams
 - tax administration
 - tax avoidance

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- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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