



PR 2005/94 - Income tax: Limestone Coast Vignettes Project - 2005 Development Vignette Owners (to 30 June 2005)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *22 June 2005*



Product Ruling

Income tax: Limestone Coast Vignettes Project – 2005 Development Vignette Owners (to 30 June 2005)

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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.

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.

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 'Limestone Coast Vignettes Project', 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;
- Subdivision 61-J of the ITAA 1997;
- Division 328 of the ITAA 1997;
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 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 an Owner) 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 'Owners'.

8. The class of persons to whom this Ruling applies does **not** include:

- persons who are accepted to participate in the Project before the date the Ruling is made;
- persons who are accepted to participate in the Project after 30 June 2005;
- persons who participate in the Project through offers made other than through the Product Disclosure Statement; and
- persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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Barton ACT 2600

or posted at: <http://www.ag.gov.au/cca>

Date of effect

11. This Ruling applies prospectively from 22 June 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 that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 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

14. 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 5, 7 and 20 April 2005, 13, 18, 20 and 27 May 2005 and 9 June 2005 and additional correspondence dated 6 April 2005, 9, 11, 13, and 18 May 2005 and 9 June 2005;
- Draft Product Disclosure Statement ('PDS'), which includes the **Licence Agreement** and **Sale Agreement** for the Limestone Coast Vignettes Project, received 9 June 2005;
- Draft **Constitution** of the Limestone Coast Vignettes Project, received 9 June 2005;
- Draft Constitution of LC Land Proprietary Limited, received 5 April 2005;

- Draft Compliance Plan for the Limestone Coast Vignettes Project, received 5 April 2005;
- Draft Custodian Agreement for the Limestone Coast Vignettes Project between Ironstone RE Limited (as Responsible Entity) and the Custodian, received 5 April 2005;
- Draft Resolution Agreement between Ironstone RE Limited and the Joint Venturer, received 5 April 2005;
- Joint Venture Agreement between Ironstone RE Limited and the Joint Venturer, dated 21 May 2004;
- Option Agreement between the Landowner and the Joint Venturer, received 5 April 2005;
- Draft Standby Option Agreement between the Landowner and the Ironstone RE Limited, received 5 April 2005;
- Draft Contract for the Sale and Purchase of Land between the Landowner and the Joint Venturer, received 5 April 2005;
- Draft Nomination Agreement between the Landowner, Joint Venturer and LC Land Proprietary Limited, received 5 April 2005;
- Draft Memorandum of Underlease for the Limestone Coast Vignettes Project between the Lessor and LC Land Proprietary Limited (as Underlessee), received 5 April 2005;
- Draft Community Title documents including the, Scheme Description, By-Laws, Plan of Community Division, Application for Opinion and the Development Contract between Ironstone RE Limited and LC Land Proprietary Limited (as Developer), received on 5 April 2005;
- Draft Grape Purchase Agreement between the Lessor and Ironstone RE Limited, received 27 May 2005; and
- Draft Vineyard Management Agreement between the Vineyard Manager and Ironstone RE Limited, received 9 June 2005.

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

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

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16. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

Overview

17. The main features of Limestone Coast Vignettes Project – 2005 Development Vignette Owners (to 30 June 2005) are as follows:

Location	Elgin Valley, South East region of South Australia
Type of business to be carried on by each participant	Commercial growing of wine grapes for the purpose of harvesting and selling the produce.
Number of hectares offered for cultivation	46
Size of each interest	0.05 hectares
Number of vines per hectare	Approximately 2,020 vines per hectare.
Term of the Project	Indefinite.
Initial cost	\$6,325 (includes an amount for the purchase of land, prepaid fees for the years ending 30 June 2006 to 30 June 2008, irrigation, trellising and planting fee).
Initial cost per hectare	\$126,500
Ongoing costs per Vignette	Annual Operating Costs.

18. The Limestone Coast Vignettes Project is located on the Elgin Valley property, 20 kms east north east of Beachport in South Australia. Each participant in the Project will acquire, after a process of subdivision, an equitable (or legal and equitable) interest in two or more 0.05 hectare community lots ('Vignettes') in a community title scheme for the purpose of commercial growing and sale of wine grapes.

19. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. Ironstone RE Pty Limited ('IRE') has been issued with an Australian Financial Service Licence and will be the Responsible Entity for the Project. The term of the Project is indefinite.

20. An offer to participate in the Project will be made through a Product Disclosure Statement ('PDS') offering 920 'Development Vignettes' and up to 428 'Mature Vignettes' for sale. Participants ('Owners') will be invited to subscribe for the purchase of Development Vignettes and/or Mature Vignettes. Owners must apply to purchase at least 2 Vignettes, whether Development Vignettes or Mature Vignettes, or a combination of both. **This Ruling only applies to participants whose application to purchase a Development Vignette(s) is accepted on or before 30 June 2005.**

21. To participate in the Project, Owners must complete the Application and Power of Attorney Form in the PDS and pay the 'Application Money'.

22. The minimum subscription required under the PDS is 1,000 Vignettes. If the minimum subscription is not reached within 4 months after the issue of the PDS, IRE will refund the 'Application Money' and the Project will not proceed.

Constitution

23. The Constitution for the Project sets out the general functions, powers and duties under which the Responsible Entity agrees to act for the Owners and to manage the Project. Upon acceptance into the Project, Owners are bound by the Constitution by virtue of their participation in the Project.

24. All scheme property will be held on trust by the Custodian. Scheme property includes the Application Money paid by Owners and proceeds from the sale of grapes pending distribution to the Owners (clause 9 of the Constitution).

25. The Constitution (clauses 35 and 36) and the PDS set out the rules relating to the pooling of Owners' grapes and the distribution of the proceeds from the sale of each pool. The grapes from the Development Vignettes will only be pooled with the grapes from the Mature Vignettes when the Development Vignettes reach their fifth year of development.

26. The net proceeds from each pool will be distributed to the Owners on the last day of the financial year for which the net proceeds were calculated. Owners are entitled to a share of proceeds in each pool to which they have contributed. The Owner's share of the pool is based on the proportion of the grapes contributed from their Vignettes in relation to the total pool. The Owner's entitlement in relation to the sales proceeds will be reduced accordingly in the event of total or partial destruction of the vines/grapes on their Vignettes.

27. If an Owner fails to contribute to operating expenses or is otherwise in breach of their obligations then IRE may upon written notice to the Owner:

- suspend services to all or any of the Vignettes owned by the Owner;

- recover IRE's time charges for executives at \$100 per hour (subject to CPI increase) and costs necessarily incurred in respect of the forfeiture;
 - recover interest on the unpaid amount at the highest overdraft rate then charged by the MIS principal bankers to its customers;
 - deduct the contribution and interest from any distribution otherwise payable to the Owner and apply that amount towards satisfaction of the contribution and interest;
 - sue for the contribution and interest; and/or
 - if the intention has been declared in the written notice, at any time until the matter is rectified declare the interest to be forfeited.
28. After an Interest is forfeited IRE should:
- give to the Owner notice of the forfeiture;
 - record the forfeiture and its date in the register of members; and
 - either cancel the Interest or sell the Interest to any person willing to purchase at fair market value.

By signing the Application and Power of Attorney Form attached to the PDS, each Owner appoints any director of IRE as their attorney to sell their forfeited Interest.

Compliance Plan

29. The Responsible Entity has prepared a Compliance Plan in accordance with the *Corporations Act 2001*. Under the Compliance Plan, a Compliance Committee will monitor to ensure the Responsible Entity meets its obligations as the Responsible Entity of the Project and the rights of the Owners are protected.

Land and Water Allocation purchase

30. The Project Land is currently owned by the Landowner. The Land is currently leased by the Lessor. IRE has entered into a Joint Venture Agreement with the 'Joint Venturer' to establish the Project. The Joint Venturer has been granted an option to purchase the land and water allocations under an Option Agreement between the Joint Venturer and the Landowner. The option must be exercised before 30 June 2006. Under the Joint Venture Agreement IRE will subdivide the land which will be the subject of a community title scheme under the South Australian *Community Titles Act 1996*.

31. The Joint Venturer will exercise the option to purchase the land upon minimum subscription for the Project being reached. The Joint Venturer has nominated LCL Land Pty Ltd ('LCL') to hold the legal title of the land as bare trustee on trust for the Joint Venturer. If the option is only exercised over a portion of the property, the Joint Venturer may exercise the option again in relation to the remaining land.

32. After the settlement of the sale of land and water allocations to LCL (as trustee for the Joint Venturer), LCL (as appointed by IRE) will lodge a community plan with the Lands Titles Registration Office (South Australia) and subdivide the portion of the land purchased into:

- Vignettes (community lots) of 0.05 hectares each; and
- appropriate areas of common property, to be used for access roads, water bores and sheds.

33. Owners enter into a Sale Agreement on application with LCL and the Joint Venturer. The sale will be completed after community titles for the Owners' Vignettes issue from the Land Titles Registration Office. LCL will retain legal title to the land as bare trustee of each Owner separately. However, an Owner may require LCL to transfer the legal title of the land into the Owner's name at any time.

34. In the event that the Joint Venturer does not exercise the option to purchase the land, the Landowner has granted IRE an option to purchase the land under the Standby Option Agreement.

Underlease

35. The Lessor's lease over the Project land will be surrendered when the title of the land is transferred from the Landowner to LCL. The Lessor will grant an Underlease to LCL for the period from minimum subscription being reached until the transfer date as described in this paragraph.

Licence Agreement

36. Owners participating in the Project will enter into a Licence Agreement with LCL for the period from commencement (the later of minimum subscription or when the Owner's application for the land is accepted) to so long as LCL retains title to the land. Under the Licence, Owners are permitted to use their Vignettes for the purpose of conducting their wine grape growing business upon the terms and conditions set out in the Licence.

37. The Licence also includes a right to the benefit of any water allocation held by LCL in connection with the land.

Management Agreement

38. Under the Management Agreement, which forms part of the Project's Constitution, the Owner appoints IRE to develop the Vignettes and provide ongoing management services.

39. The development of an Owner's Vignettes will commence on 1 July 2005 and will be completed by 30 November 2005. The development work includes:

- if necessary, obtain planning and development consents for the use of the Vignette as part of a vineyard;
- to install an repair boundary fences and gate(s), access road(s), windbreaks, headlands, culverts, irrigation, frost control and other service infrastructure on the Vineyard of which the Vignette is part;
- clearing the land and soil and contour preparation;
- installing a irrigation system, trellising and providing frost control; and
- planting vine rootlings.

40. The ongoing management services that will be provided include:

- procuring insurance against public and product liability;
- if required by an Owner and at the Owners own expense, IRE may also negotiate insurance cover for the loss or destruction of the Owner's vines/grapes;
- manage watering, mulching, pruning, salinity, frost protection, stringing and training and pruning of vines, nutrition of vines, replacement of dead or defective vines and also keep down soil or plant diseases, weeds, pests and fire;
- supply such goods and materials as IRE thinks reasonable;
- pay outgoings for rates, taxes, levies, electricity, water, diesel and other consumables. However, IRE will not pay the municipal council rates for an Owner's Vignettes where the legal title of the Vignettes has been transferred to the Owner's name. In this situation, the Owner will be liable to pay its own municipal council rates;
- harvest grapes;
- (as agent for the Owner) sell grapes harvested in such manner (as grapes or, after processing and storage, as bulk juice or wine) and at such times as IRE thinks desirable in order to increase profits or minimise losses; and

- to any extent not otherwise required by law, give to the Owner at least once each calendar year a report on the management of the vineyard (clause 42 of the Constitution).

41. Under the Vineyard Management Agreement, the IRE will engage the Vineyard Manager, to carry out the above services on the terms and conditions contained in the agreement. The Vineyard Manger will be subject to the direction of IRE in matters relating to the Vineyard Management Services.

42. For the services provided the Owner will contribute the annual 'Vineyard Operating Costs', which are described at paragraphs 45 to 47.

Fees

43. Under the Project's Constitution (clause 16) the Owner is required to pay the following:

- Application Money; and
- Vineyard Operating Costs.

44. These costs are described below.

Application Money

45. Application Money of \$6,325 per Vignette is payable on application. The Application Money will be applied towards the following:

- \$753 to purchase the land;
- \$166 for development costs for the period from 1 July 2005 to 30 November 2005;
- \$1,480 for trellising, to be installed during the period from 1 July 2005 to 30 June 2006;
- \$969 for irrigation, to be installed during the period from 1 July 2005 to 30 November 2005;
- \$1,087 for land preparation and vine planting to be conducted during the period from 1 July 2005 to 30 November 2005; and
- \$1,870 for Vineyard Operating Costs for the period from 1 December 2005 to 30 June 2008 (that is, \$550 for 1 December 2005 to 30 June 2006, \$660 for 1 July 2006 to 30 June 2007 and \$660 for 1 July 2007 to 30 June 2008).

Vineyard Operating Costs

46. Contributions for Vineyard Operating Costs are due annually in advance on 1 July, commencing on 1 July 2008. The Vineyard Operating Costs due, are an estimate of the next financial year's costs and will be notified to the Owner at about May of each year before each due date.

47. If the actual Vineyard Operating Costs for a year exceed the estimated Vineyard Operating Costs for a year, IRE may recoup the shortfall in the following year's contribution of Vineyard Operating Costs, or require Owners to pay the shortfall by 30 June. If current year actual costs are less than the total estimates, IRE will credit the excess against the next financial year's contribution to operating costs.

Finance

48. Owners can fund their involvement in the Project themselves or borrow from an independent lender. Owners are required to obtain their own finance for the Project.

49. This Ruling does not apply if the finance arrangement entered into by the Owner 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 Owners for the Project.

Ruling

Application of this Ruling

50. Subject to paragraph 8, this Ruling applies only to Owners who are accepted to participate in the Project on or before 30 June 2005. The Owner's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

51. An Owner is not eligible to claim any tax deductions until the Owner's application to enter the Project is accepted and the Project has commenced. Under the terms of the PDS, an Owner's application will not be accepted until the minimum subscription of 1,000 Interests is achieved.

The Simplified Tax System (STS)

Division 328

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

Qualification

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

25% Entrepreneurs tax offset

Subdivision 61-J

54. For the first income year starting on or after 1 July 2005, Subdivision 61-J of the ITAA 1997 provides a 25% tax offset 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.

Assessable income**Section 6-5 and section 328-105**

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

56. Other than Owners referred to in paragraph 57, for the 2005-06 income year and later years, an Owner will be assessable on ordinary income from carrying on their business of viticulture in the income year in which that income is derived.

57. For the 2005-06 income year and later years, an Owner 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 Vineyard Operating Costs**Section 8-1 and section 328-105**

58. An Owner may claim deductions, on a per Vignette basis, for the revenue expenses in the following Table.

59. However, if for any reason, an amount shown or referred to in the Table below is not fully paid in the year in which it is incurred by an Owner 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 Owner. Any amount or part of an amount shown in the Table 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	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Land Purchase and development costs	Nil – See Note (ii)		
Vineyard Operating Costs	Nil See Notes (i) & (iii)	\$421 See Notes (i) & (iii)	\$724 See Notes (i) & (iii)

Notes:

- (i) If the Owner 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 103.

- (ii) The amount paid on application for the purchase of land and development costs is capital in nature and not deductible under section 8-1.
- (iii) The Vineyard Operating Costs of \$1,870 paid on application for the period from 1 December 2005 to 30 June 2008, are prepaid and are not deductible in full in the year incurred (where the Owner is not an STS taxpayer) or the year in which they are paid (where the Owner is an 'STS taxpayer'. Deductions for these amounts must be determined using the formula in subsection 82KZMF(1) (see paragraphs 84 to 93). This provision operates to apportion expenditure over the eligible service period.

The eligible service period for these Vineyard Operating Costs is from 1 December 2005 to 30 June 2008. Therefore, an amount of \$421 in the year ending 30 June 2006, \$724 in the year ending 30 June 2007 and \$725 in the year ending 30 June 2008 is deductible.

Deductions for capital expenditure

Division 40 and Subdivision 328-D

Non-STs taxpayers

60. An Owner who is not an STS taxpayer will be entitled to tax deductions relating to trellising, irrigation and the establishment and decline in value of grapevines. All deductions for 'non-STs taxpayers' shown in the Table below are determined under Division 40.

STs taxpayers

61. An Owner who is an STS taxpayer will also be entitled to tax deductions relating to trellising, irrigation and the establishment and decline in value of grapevines.

62. Deductions relating to the 'cost' of trellising must be determined under Division 328. An STS taxpayer may claim deductions in relation to irrigation under Subdivision 40-F. If the irrigation 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.

63. The deductions shown in the following Table assume that an Owner has either chosen to or can only claim deductions for expenditure on irrigation under Subdivision 40-F and not under Division 328. If the expenditure has been incurred on depreciating assets and is claimed under Division 328, the deduction is determined as discussed in Note (vi).

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Fee Type	ITAA 1997 Section	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Trellising	Non – STS taxpayers 40-25	Nil	Non – STS taxpayers Amount must be calculated See Notes (i) & (iv)	Non-STS taxpayers Amount must be calculated See Notes (i) & (iv)
	STS taxpayers 328-185 & 328-190		STS taxpayers \$222 See Notes (i) & (v)	STS taxpayers \$377 See Notes (i) & (v)
Irrigation	40-515	\$323 See Notes (i) & (vi)	\$323 See Notes (i) & (vi)	\$323 See Notes (i) & (vi)
Establishment of grapevines	40-515	Nil	Nil	To be calculated See Notes (i) & (vii)

Notes:

- (iv) For Non-STS taxpayers trellising is a depreciating asset. Each Owner's interest in the trellising is a depreciating asset. The cost of the asset is the amount of \$1,480 per Vignette paid by each Owner. 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.

Owners can either self-assess the effective life (section 40-105) or use the Commissioner's determination of 'effective life' (section 40-100). The Commissioner has determined that trellising has an effective life of 20 years. Trellising will be installed and first used during the year ending 30 June 2006. The Manager will advise Owners when that occurs to enable Owners to calculate the deduction for the decline in value.

- (v) For STS taxpayers, each Owner's interest in the trellising is a depreciating asset which can be allocated to a 'general STS pool'. The cost of the asset is the amount of \$1,480 per Vignette paid by each Owner. The tax deduction allowable is determined in the year ending 30 June 2006 by multiplying the cost of the interest by half the general STS pool rate that is by 15%. Each Owner's interest in the trellising is allocated to their general STS pool at the end of the year ending 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.

- (vi) 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 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 of \$969 per Vignette incurred by each Owner 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 40-450).

For STS taxpayers, if the expenditure is on a depreciating asset the Owner may choose to claim the deduction for irrigation expenditure under Subdivision 328-D. The taxation deduction allowable in the year ending 30 June 2005 is determined by multiplying its cost by half the relevant STS pool rate. At the end of the income year, the depreciating asset is allocated to the relevant STS pool and in subsequent years the full pool rate will apply.

- (vii) Grapevines meet the definition of a 'horticultural plant' in subsection 40-520(2). As Owners 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 \$1,087 per Vignette incurred by the Owner 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). IRE will inform Owners of when the grapevines enter their first commercial season.

Interest

64. The deductibility or otherwise of interest incurred by Owners 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 Owners who borrow funds in order to participate in the Project should read the discussion of the prepayment rules in paragraphs 84 to 91. Subject to the 'excluded expenditure exception', the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Owner's choice.

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

Section 35-55 – exercise of Commissioner’s discretion

65. An Owner who is an individual accepted into the Project by 30 June 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 Owners 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 Owner’s other assessable income in the income year in which the losses arise.

Section 82KL and Part IVA

66. For an Owner who participates in the Project and incurs expenditure as required by the Constitution 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 Owner carrying on a business?

67. For the amounts set out in the Tables in paragraph 59 and 63 to constitute allowable deductions the Owner’s viticulture activities as a participant in the Limestone Coast Vignettes Project must amount to the carrying on of a business of primary production. These viticulture activities will fall within the definitions of ‘horticulture’ and ‘commercial horticulture’ in section 40-535 of the ITAA 1997.

68. For schemes such as this Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Owner’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.

69. Generally, an Owner will be carrying on a business of viticulture, and hence primary production, if:

- the Owner has an identifiable interest in the land (by lease) or rights over the land (by licence) on which the Owner’s vines are established;

- the Owner has a right to harvest and sell the grapes each year from those vines;
- the viticulture activities are carried out on the Owner's behalf;
- the viticulture activities of the Owner 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.

70. In this Project, each Owner enters into a Licence Agreement, Sale Agreement and a Management Agreement.

71. Under the Licence Agreement and Sale Agreement each individual Owner will have rights over the land on which the vines will be planted. The Licence Agreement together with the Sale Agreement provides the Owner with an ongoing right to the vines for the term of the Project. Under the Licence Agreement and Sale Agreement the Owner must use the land in question for the purpose of carrying out viticultural activities and for no other purpose. The agreements allow IRE as Manager to come onto the land to carry out its obligations under the Management Agreement.

72. Under the Management Agreement IRE is engaged by the Owner to establish and maintain a Vignette during the term of the Project. IRE has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Vignette on the Owner's behalf.

73. In establishing the Vignette, the Owner engages IRE to install the trellising, irrigation and to plant the vines on the Owner's Vignette. During the term of the Project, these assets will be used wholly to carry out the Owner's viticulture activities. IRE is also engaged to harvest and sell, on the Owner's behalf, the grapes grown on the Owner's Vignette.

74. 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.

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

76. The pooling of grapes grown on the Owner's Vignette with the grapes of other Owners is consistent with general viticulture practices. Each Owner's proportionate share of the sale proceeds of the pooled grapes will reflect the proportion of the grapes contributed from their Vignette.

77. The Manager's services and the installation of assets on the Owner's behalf are also consistent with general viticulture practices. The assets are of the type ordinarily used in carrying on a business of viticulture. While the size of a Vignette is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

79. 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 Owners viticulture activities in the Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

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

81. Changes to the STS rules apply from 1 July 2005. The question of whether an Owner is eligible to be an STS taxpayer is outside the scope of this Product Ruling. Therefore, any Owner 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.

Deductions for Vineyard Operating Costs

Section 8-1

82. Consideration of whether the Vineyard Operating Costs are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and

- where all that happens in a year of income is that a taxpayer is contractually committed to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

83. The Vineyard Operating Costs associated with the viticulture activities will relate to the gaining of income from the Owner's business of viticulture (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of grapes) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component found in the Vineyard Operating Costs. 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

84. 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.

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

Sections 82KZME and 82KZMF

86. 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)).

87. 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.

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

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

90. 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.

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

91. 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

92. The expenditure incurred by an Owner in the Project for the Vineyard Operating Costs for the years ending 30 June 2006, 30 June 2007 and 30 June 2008 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.

93. The prepaid Vineyard Operating Costs incurred by Owners do not fall within any of the 5 exceptions to section 82KZME. Therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF will apportion the deduction for prepaid Vineyard Operating Costs over the period that the services for which the prepayment is made are provided.

Expenditure of a capital nature

Division 40 and Division 328

94. Any part of the expenditure of an Owner 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 vines is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

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

96. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 60 to 63 in the Tables and the accompanying Notes.

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

Section 35-55 – exercise of Commissioner’s discretion

97. 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 an Owner 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, an Owner’s business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- an Owner 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.

98. 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 an Owner will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL – recouped expenditure

99. 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

100. 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).

101. The Limestone Coast Vignettes Project – 2005 Development Vignette Owners (to 30 June 2005) will be a 'scheme'. An Owner will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 58 to 63 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.

102. Owners 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 Owners have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Examples

Example – entitlement to GST input tax credits

103. 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 2004, 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 1/1/2005 to 30/6/2005	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2005 (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 2005, 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

22 June 2005

<i>Previous draft:</i>	- ITAA 1997 40-70(1)
Not previously issued as a draft	- ITAA 1997 40-75(1)
	- ITAA 1997 40-100
	- ITAA 1997 40-105
<i>Related Rulings/Determinations:</i>	- ITAA 1997 40-450
PR 1999/95; TR 92/1; TR 92/20;	- ITAA 1997 Subdiv 40-F
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1997 40-515
TR 2000/8, TR 2001/14;	- ITAA 1997 40-515(1)(a)
TD 93/34; IT 360	- ITAA 1997 40-515(1)(b)
	- ITAA 1997 40-520(1)
	- ITAA 1997 40-525(2)
<i>Subject references:</i>	- ITAA 1997 40-530
- carrying on a business	- ITAA 1997 40-535
- commencement of business	- ITAA 1997 40-545
- management fee expenses	- ITAA 1997 Subdiv 61-J
- non-commercial losses	- ITAA 1997 Div 328
- primary production	- ITAA 1997 328-105
- primary production expenses	- ITAA 1997 Subdiv 328-D
- producing assessable income	- ITAA 1997 328-185
- product rulings	- ITAA 1997 328-190
- public rulings	- ITAA 1997 Subdiv 328-F
- schemes and shams	- ITAA 1997 Subdiv 328-G
- tax avoidance	- ITAA 1936 82KL
- tax benefits under tax avoidance schemes	- ITAA 1936 Pt III Div 3 Subdiv H
- tax shelters	- ITAA 1936 82KZL
- taxation administration	- ITAA 1936 82KZL(1)
	- ITAA 1936 82KZM
	- ITAA 1936 82KZMA
<i>Legislative references:</i>	- ITAA 1936 82KZMB
- TAA 1953 Pt IVA	- ITAA 1936 82KZMC
- ITAA 1997 6-5	- ITAA 1936 82KZMD
- ITAA 1997 8-1	- ITAA 1936 82KZME
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- ITAA 1997 35-10(2)	- ITAA 1936 82KZME(7)
- ITAA 1997 35-55	- ITAA 1936 82KZMF
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- ITAA 1997 Div 40	- ITAA 1936 Pt IVA
- ITAA 1997 40-25	- ITAA 1936 177A

- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- Copyright Act 1968
- Corporations Act 2001
- Community Titles Act 1996 (SA)

Case references:

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