PR 2006/85 - Income tax: National Viticultural Fund of Australia Project No. 6 (October 2006 Growers)

Product Ruling

Income tax: National Viticultural Fund of Australia Project No. 6 (October 2006 Growers)

Contents Para

This Ruling provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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 scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document.

If the scheme 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 scheme 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 scheme has been implemented as described below and to ensure that the participants in the scheme 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 entity(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 Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Ruling, this scheme is referred to as the 'National Viticultural Fund of Australia Project No. 6 (October 2006 Growers)' or simply as 'the Project'.

Relevant provision(s)

2. The relevant provisions 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;
- section 25-25 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;
- Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
- section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KL of the ITAA 1936;
- section 82KZL of the ITAA 1936;
- sections 82KZME and 82KZMF of the ITAA 1936; and
- Part IVA of the ITAA 1936.

Note: All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

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 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 taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Entities 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 entities in projects such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that entities are fully informed of any legislative changes after the Ruling is issued.

Class of entities

7. The class of entities to whom this Ruling applies is the persons who enter into the scheme, specified below, on or after the date this Ruling is made. They will have a purpose of staying in the scheme 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'.

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

- intend to terminate their involvement in the scheme prior to its completion or who otherwise do not intend to derive assessable income from it;
- have entered into the scheme specified below prior to the date this Ruling is made or after 31 October 2006; or
- enter into finance arrangements with entities associated with the Project other than Total Beverage Australia Pty Ltd as described in paragraphs 51 and 52.

Qualifications

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 17 to 53.

10. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

Date of effect

12. This Ruling applies prospectively from 17 May 2006, 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

13. If this Product Ruling is inconsistent with a later public or private ruling, the relevant classes of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

14. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

15. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

16. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. The Ruling continues to apply, in respect of the relevant provisions ruled upon, to all persons within the specified class who enter into the scheme specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no change in the scheme or in the persons' involvement in the scheme.

Scheme

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

- Application for a Product Ruling dated 16 March 2006 and additional correspondence and documents received 23 March 2006, 24 March 2006, 5 April 2006, 10 April 2006, 11 April 2006 and 18 April 2006, 26 April 2006, 27 April 2006, 1 May 2006 and 2 May 2006;
- Draft Product Disclosure Statement for National Viticultural Fund of Australia Project No. 6, received 26 April 2006;
- Draft **Constitution** of the National Viticultural Fund of Australia Project No. 6, received 21 March 2006;
- Draft **Management Agreement** between Food and Beverage Australia Ltd ('the Responsible Entity') and the Grower, received 1 May 2006;
- Draft **Licence Agreement** between National Vineyard Fund of Australia (No. 2) Ltd (the 'Land Owner'), Food and Beverage Australia Ltd (the 'Responsible Entity') and the Grower, received 1 May 2006;
- Draft Compliance Plan for the National Viticultural Fund of Australia Project No. 6, received 21 March 2006;
- Draft Custodian Agreement between Food and Beverage Australia Ltd (the 'Responsible Entity') and National Viticultural Fund of Australia Pty Ltd, received 21 March 2006;
- Grape Supply Agreement between Orlando Wines, National Viticultural Fund of Australia Pty Ltd (the Custodian), and National Vineyard Fund of Australia (No. 2) Ltd (the Landowner), received 23 March 2006;

- Draft Lease Agreement between National Vineyard Fund of Australia (No. 2) Ltd (the 'Land Owner') and National Viticultural Fund of Australia Pty Ltd (the Custodian), received 21 March 2006; and
- Terms Loan Agreement ('Loan Agreement') between Total Beverage Australia Pty Ltd and the Grower, received 18 April 2006.

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

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

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

Overview

20. The salient features of the National Viticultural Fund of Australia Project No. 6 (October 2006 Growers) are as follows:

Location	Clare Valley, South Australia
Type of business to be carried on by each participant	Commercial growing of Wine grapes
Number of hectares offered for cultivation	50
Size of each interest	0.25 hectares
Minimum allocation	1 interest
Minimum subscription	20 interests
Number of vines per hectare	1,667
Term of the Project	16 years
Initial cost	$11,294
Initial cost per hectare	$30,052

Ongoing costs	• Management fees of $1,231 in Year 3 and $1,307 in Year 4 and ongoing costs for Years 5 to 16; and • Licence fees of $1,328 in Year 3, $1,340 in Year 4 and ongoing costs for Years 5 to 16.
Other costs	Growers will be liable for ongoing Viticulture Costs

21. The National Viticultural Fund of Australia Project No. 6 is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The Responsible Entity for the Project is Food and Beverage Australia Ltd ('FABAL'). Under the Product Disclosure Statement ('PDS'), FABAL proposes to offer 200 interests called 'Allotments' of 0.25 hectares each. Upon application, Growers will execute a Power of Attorney enabling FABAL to act on their behalf as required. There is a minimum subscription of 20 interests for this Project.

22. For each interest acquired in the Project, a Grower has the option to subscribe for 100 ordinary shares in National Vineyard Fund of Australia (No. 2) Ltd.

23. The Project will be situated in the Clare Valley region of South Australia approximately 140 kilometres north of Adelaide. The land for the Project has been purchased by National Vineyard Fund of Australia (No. 2) Ltd (the 'Land Owner') which will lease the land to National Viticultural Fund of Australia Pty Ltd (the 'Custodian') which will then sublease the land back to the Land Owner. The Land Owner will grant a licence to the Growers to use and occupy the Allotment for the planting, growing and harvesting of grapes. A Grower acquiring a single interest in the Project will hold a licence over a separate and distinct area (called an 'Allotment') on which the Grower can plant and maintain 410 to 420 grape vines.

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

25. Under the PDS offer, Growers can enter the Project during the period up to 31 May 2006, during the period 1 July 2006 to 31 October 2006 or during the period 1 November 2006 to 31 May 2007. Applicants will not be accepted into the Project between 1 June 2006 and 30 June 2006 and after 31 May 2007. This Ruling only applies to Growers who enter into the Project during the period 1 July 2006 to 31 October 2006.

Constitution

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

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

Compliance Plan

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

Management Agreement

29. Growers participating in the scheme will enter into a Management Agreement between FABAL and the Grower.

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

31. The Grower appoints the Responsible Entity to provide Irrigation and Planting Services and the Initial Management Services for the Grower by 31 December 2006 ('Year 2'). The services to be provided in accordance with clauses 5 and 6 of the Agreement in respect of the Grower's allotment include:

- design, supply and specifications for the irrigation system;
- installation of the main and sub-lines for the irrigation system on the Grower's Allotment;
- preparation for the planting of rootstock, rootlings or cuttings on the Grower's Allotment;
- obtaining healthy grapevine material and the planting of approximately 410 to 420 rootstock, rootlings or cuttings on the Grower's Allotment;

- spacing and trellising each grapevine on the Grower's Allotment in accordance with good viticultural practices;
- design, layout and undertake land preparation services by use of laser siting (using Global Positioning Systems) to ensure landcare and drainage of the Allotment;
- management of the grapevines that have been established on the Vineyard Allotment to ensure that the vines are of the quality required by the Responsible Entity;
- eradicating any weeds, pests and vermin on the Allotment;
- undertaking fungicide control and vine disease measures;
- regular inspection of grapevines;
- conducting tests and taking action for growth of the vineyard in accordance with good viticultural practice;
- keeping in good order and condition any access road within the vineyard;
- undertaking other activities that may be required to generally maintain the vineyard in accordance with good viticultural practice;
- undertaking all administrative, technical and compliance duties incidental to the conduct of the Grower's Business; and
- maintenance of the cover crop on each Grower's Allotment.

32. Growers who enter the Project during the period 1 July 2006 to 31 October 2006 will have their Irrigation Services, Planting Services and Initial Management Services carried out by 31 December 2006 (clauses 10.2 and 10.5).

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

- operating the irrigation system and where necessary, maintaining its performance and integrity as part of the vineyard;
- applying fertigation through the irrigation system to the vines as required;
- irrigating the Allotment as and when required to maintain the vines in a healthy condition;

- doing such things and taking such measures as may be reasonably necessary to properly manage the growth of the vines on the trellis on the Allotment including replacing vines that fail to grow during the first threes years of each established allotment;
- pruning the vines at least once in each Year by mechanical or other methods;
- training the vines as required;
- control the growth of weeds and other pests on the Allotment;
- taking such steps as are reasonably required to prevent any outbreak of disease on the Allotment;
- conducting regular tests for any evidence of ill health or disease affecting vines on the Grower's Allotment; and
- maintaining all fences, farm access ways, roads and other improvements on the Allotment.

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

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

Licence Agreement

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

36. The Licence Agreement gives the Grower a licence over an identifiable area of land of 0.25 hectares for a period of 15 years ending on 30 June 2021 or until the termination of the Grower's Interest. The Licence Agreement also grants to the Grower access to water supplied by the Land Owner, the use of trellising installed by the Land Owner and the use of plant and equipment owned by the Land Owner for the purposes of the Grower's Business.

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

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

38. Under the Licence Agreement, the Grower must:

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

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

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

Grape Supply Agreement

40. Pursuant to a Grape Supply Agreement, Orlando Wines has agreed to purchase the grapes from the Grower.

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

Fees – Years 1 to 3

42. Under the Management Agreement and the Licence Agreement a Grower is required to pay the following fees, as set out in the Table below, for the first four years of the Project:

	Payable on Application	Year 1 Payable by 31 October 2006	Year 2 Payable by 31 October 2006	Year 3 Payable by 31 July 2007	Year 4 Payable by 31 July 2008
Management Agreement Fees					
Installation of irrigation		2,549			
Initial Management Fee	4,359				
Supply and planting of rootlings		1,152			
Landcare	535				
Ongoing Management Fees			1,158	1,231	1,307 plus viticulture costs

Licence Agreement Fees					
Water Licence			225	262	264
Land Licence		61	375	384	394
Plant & Equipment Rental		60	128	128	128
Trellis Rental		138	554	554	554

Note: A Grower who enters during the period 1 July 2006 to 31 October 2006 will be required to make payment for Year 1 and Year 2 fees by 31 October 2006.

Ongoing fees

43. A Grower is required to pay ongoing Management Fees and Licence Fees for each of the Years 4 through to 16 in the amounts set out in the Management Agreement and the Licence Agreement. From Year 5 onwards, ongoing Management Fees and Licence Fees are expected to be paid from the Grower's share of the proceeds from the sale of the Grapes. If the proceeds are insufficient the Grower must pay the shortfall. A Grower is required to pay Viticultural Costs to the Responsible Entity from Year 4 onwards to reimburse the Responsible Entity for all costs it incurs in performing its ongoing duties under the Management Agreement (clause 14 of Management Agreement).

Call for funds

44. The Responsible Entity is entitled to make a call on Growers of up to $3,300 in any year for a contribution to the expenses of the Project.

Harvesting and sale

45. Subject to any Grape Supply Agreement negotiated, the Responsible Entity must use its reasonable endeavours to commence harvesting the grapes from the vines at the time which is best for the purposes of obtaining grapes of optimum quality.

46. The Grower has appointed FABAL to market and sell the grapes attributable to the Grower's Allotment for the maximum price achievable having regard to any Agreement for the sale of the grapes that the Responsible Entity has obtained in respect of the Allotment and the long term future sale prospects of grapes under any such agreement (clause 8.1.5 of the Management Agreement).

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

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

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

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

Finance

50. Growers can fund their participation in the Project themselves, borrow from Total Beverage Australia Pty Ltd (a lender associated with the Responsible Entity) or borrow from an independent lender.

51. Total Beverage Australia Pty Ltd will lend on a full-recourse commercial basis under the Loan arrangement. Normal debt recovery procedures, including legal action, will be taken in the case of defaulting Growers. Total Beverage Australia Pty Ltd will offer finance under the following arrangements:

Option A 12 Months Interest Free Finance

- equal monthly principal instalments over 12 months;
- instalments paid by direct debit;
- no interest applicable; and
- the loan is secured by a Charge over the Grower's interest in the Project.

Option B Principal and Interest Finance

Term: 2 years or 5 years

Interest: 10.55%, fixed for the term of the loan;

- equal monthly principal and interest instalments over the term of the loan;
- instalments paid by direct debit; and

- the loan is secured by a Charge over the Grower's interest in the Project.

52. An application fee of $50 is payable upon application to enter into the Loan Agreement.

53. 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 of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 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 Total Beverage Australia Pty Ltd, as described at paragraphs 51 and 52, are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

54. This Ruling applies only to Growers who are accepted to participate in the Project during the period 1 July 2006 to 31 October 2006 and who have executed a Management Agreement and a Licence Agreement during that period. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

55. This Ruling does not apply to Growers who enter into finance arrangements with entities associated with this Project, other than Total Beverage Australia Pty Ltd as specified in paragraphs 51 and 52.

Minimum subscription

56. 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 PDS, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 20 interests is achieved.

The Simplified Tax System (STS)

Division 328

57. To be an 'STS taxpayer', a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer' (Division 328 of the ITAA 1997). For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

58. For such Growers, a reference in this Ruling to an amount being deductible when 'incurred' will mean that amount is deductible when paid and a reference to an amount being included in assessable income when 'derived' will mean that amount is included in assessable income when received.

25% entrepreneurs tax offset

Subdivision 61-J

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

Assessable income

Section 6-5

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

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

Deductions for Management Fees, Licence Fees, Interest and Borrowing Costs

Sections 8-1 and 25-25

62. A Grower may claim tax deductions under sections 8-1 and 25-25, on a per Allotment basis, for the revenue expenses set out in the Table below:

Fee Type	**Years 1 & 2** **Year ended 30 June 2007**	**Year 3** **Year ended 30 June 2008**	**Year 4** **Year ended 30 June 2009**
Management Fee	$5,517 ($4,359 + $1,158) See Notes (i) and (ii)	$1,231 See Notes (i), (ii) & (v)	$1,307 plus viticulture costs See Notes (i), (ii) & (v)
Land Licence Fee	Amount must be calculated See Notes (i) & (iii)	$384 See Notes (i), (ii) & (v)	$394 See Notes (i), (ii) & (v)
Water Licence Fee	Amount must be calculated See Notes (i) & (iii)	$262 See Notes (i), (ii) & (v)	$264 See Notes (i), (ii) & (v)
Trellis Rental	Amount must be calculated See Notes (i) & (iii)	$554 See Notes (i), (ii) & (v)	$554 See Notes (i), (ii) & (v)
Plant & Equipment Rental	Amount must be calculated See Notes (i) & (iii)	$128 See Notes (i), (ii) & (v)	$128 See Notes (i), (ii) & (v)
Interest on Terms Loan Agreement - Total Beverage Australia Pty Ltd	As incurred See Notes (iv) & (v)	As incurred See Notes (iv) & (v)	As incurred See Notes (iv) & (v)
Borrowing Costs – Total Beverage Australia Pty Ltd	Must be calculated See Note (vi)	Must be calculated See Note (vi)	Must be calculated 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.

(ii) Where a Grower pays the Management Fees, Licence Fees and the Rental Fees in the relevant income years shown in the Management Agreement and Licence Agreement, those fees are deductible in full in the year that they are incurred.

(iii) Where a Grower pays the Year 2 fees for Water Licence ($225), Land Licence ($375), Plant and Equipment Rental ($128) and Trellis Rental ($554) those fees are deductible under section 8-1 on a pro-rata monthly basis to reflect the period of time the Grower has been a party to the Licence Agreement. The following amounts are deductible under section 8-1 for each month or part month that the Grower is in the Project for the 2006–2007 Income Year:

- $18.75 per month for the Water Licence;
- $31.25 per month for the Land Licence;
- $10.67 per month for Plant and Equipment Rental; and
- $46.17 per month for Trellis Rental.

(iv) Interest payable under the Loan Agreement with Total Beverage Australia Pty Ltd is deductible in the year in which it is incurred.

(v) If a Grower chooses to prepay fees for the doing of a thing (for example the provision of management services or the licensing 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 104 unless the expenditure is 'excluded expenditure'.

(vi) The Loan Application Fee is a borrowing cost and is deductible under section 25-25. It is incurred for borrowing funds that are used or are to be used during that income year solely for income producing purposes. Borrowing expenses of $100 or less are deductible in the year in which they are incurred. The deductibility or otherwise of borrowing costs arising from loan agreements entered into with financiers other than Total Beverage Australia Pty Ltd is outside the scope of this Ruling.

Deductions for capital expenditure (Non-STS taxpayers)

Division 40

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

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Water facility (Irrigation)	$850 See Notes (vii) & (viii)	$850 See Notes (vii) & (viii)	$849 See Notes (vii) & (viii)
Landcare operations	$535 See Notes (vii) & (ix)	Nil	Nil
Establishment of grapevines	Nil See Note (x)	Nil See Note (x)	Nil See Note (x)

Notes:

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

(viii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one-third of the capital expenditure of $2,549 incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one-third in each of the next 2 years of income (section 40-540).

(ix) Capital expenditure of $535 incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630.

(x) Grapevines are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 and is based on the capital

expenditure of $1,152 incurred by the Grower that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the grapevines enter their first commercial season.

Deductions for capital expenditure (STS taxpayers)

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

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

65. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities or a 'landcare operation' under Subdivisions 40-F or 40-G and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Notes (xii) and (xiii).

66. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than $1,000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Water facility (irrigation)	$850 See Notes (xi) & (xii)	$850 See Notes (xi) & (xii)	$849 See Notes (xi) & (xii)
Landcare operations	$535 See Notes (xi) & (xiii)	Nil	Nil
Establishment of grapevines	Nil See Note (xiv)	Nil See Note (xiv)	Nil See Note (xiv)

Notes:

(xi) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.

(xii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than $1,000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2007 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply.

If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one-third of the capital expenditure of $2,549 incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one-third in each of the next 2 years of income (section 40-540).

(xiii) Any capital expenditure incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630. If the expenditure of $535 is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-G (although expenditure on some items of plant can only be deducted under Division 328). For the purposes of Division 328, each Grower's interest in the underlying asset is deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than $1,000, the deemed asset is treated as a

'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years, the full pool rate will apply. If the expenditure is not on a 'depreciating asset', the expenditure is fully deductible under Subdivision 40-G.

(xiv) Grapevines are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 and is based on the capital expenditure of $1,152 incurred by the Grower that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the grapevines enter their first commercial season.

Interest

67. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier, other than Total Beverage Australia Pty Ltd under their Loan Agreement, is outside the scope of this Ruling. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 98 to 105 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.

Trading stock

Section 70-35

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

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

Section 328-285

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

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

Amounts not deductible under section 8-1

72. A Grower in this Project may be required to pay additional funds to meet Project costs at the request of the Responsible Entity. This call for funds is in addition to all other fees described in this Ruling and cannot exceed $3,300 in any year of the Project. Any such amounts are capital in nature and will not be deductible under section 8-1.

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

Section 35-55 – exercise of Commissioner's discretion

73. A Grower who is an individual accepted into the Project during the period 1 July 2006 to 31 October 2006 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending **30 June 2007 to 30 June 2010**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

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

74. 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 apply:

- expenditure by a Grower does not fall within the scope of sections 82KZME and 82KZMF (but see paragraphs 98 to 105);
- 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.

Commissioner of Taxation
17 May 2006

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Is the Grower carrying on a business?

75. For the amounts set out in the Tables above to constitute allowable deductions, the Grower's viticultural activities as a participant in the National Viticultural Fund of Australia Project No. 6 must amount to the carrying on of a business of primary production.

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

77. For schemes such as that of the National Viticultural Fund of Australia Project No. 6, 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 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.

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

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

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

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

81. Under the Management Agreement the Responsible Entity is engaged by the Grower to establish and maintain a vineyard 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 on the Grower's behalf.

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

83. 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.

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

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

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

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

88. The viticultural activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' viticultural activities in the National Viticultural Fund of Australia Project No. 6 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

89. 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.

90. Changes to the STS rules apply from 1 July 2005. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of management fees and licence fees

Section 8-1

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

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

92. The Management Fees and Licence Fees associated with the viticulture activities will relate to the gaining of income from the Grower's business of viticulture (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of grapes) is to be gained from this business. They will thus be deductible under the first limb of section 8-1, apart from the Landcare activities component of the fee. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the scheme. The fee appears to be reasonable. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

93. One of the exclusions under section 8-1 relates to expenditure which is capital, or capital in nature. Any part of the expenditure of a Grower entering into a viticultural business which is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and hence will not be deductible under section 8-1. The Commissioner is of the view that a portion of the fees payable under the Licence Agreement is capital expenditure and therefore the amount allowed as a deduction under section 8-1 will be reduced as described in paragraph 94.

94. A Grower who enters the Project during the period 1 July 2006 to 31 October 2006 does not use the Water Licence, Trellis, Plant and Equipment or rent the land for a full income year in the initial year of the Project. As there is no reduction in the Licence Fees and rent in the 2006-07 income year to reflect the actual period that the Grower is in the Project, it is considered that the Year 1 Licence Fees and rent and part of the Year 2 Licence Fees and rent are a premium paid by the Grower and are capital in nature. Growers will not be entitled to a deduction under section 8-1 for the Year 1 Licence Fees and rent incurred but will be entitled to a partial deduction for Year 2 Licence Fees and rent incurred. The deduction is calculated on a pro-rata monthly basis, for each month that the Grower is in the Project in the 2006-07 Income Year as follows:

- $18.75 per month for the Water Licence;
- $31.25 per month for the Land Licence;
- $10.67 per month for Plant and Equipment Rental; and
- $46.17 per month for Trellis Rental.

Interest deductibility

Section 8-1

(i) Growers who use Total Beverage Australia Pty Ltd as the finance provider

95. Some Growers may finance their participation in the Project through a loan facility with Total Beverage Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the management fees and licence fees.

96. The interest incurred for the year ended 30 June 2007 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

(ii) Growers who DO NOT use Total Beverage Australia Pty Ltd as the finance provider

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

Prepayment provisions

Sections 82KZL to 82KZMF

98. 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.

99. For this Project, only section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME and 82KZMF of the ITAA 1936 are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1) (see paragraph 104). 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

100. Where the requirements of subsections 82KZME(2) and (3) of the ITAA 1936 are met, the formula in subsection 82KZMF(1) of the ITAA 1936 (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) of the ITAA 1936).

101. The requirements of subsection 82KZME(3) of the ITAA 1936 will be met where the agreement (or scheme) 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 scheme 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.

102. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)) of the ITAA 1936. This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from an unrelated financier. Although undertaken with an unrelated party, that financing would be an element of the scheme. The funds borrowed and the resulting interest deductions are directly related to the activities under the scheme. If a Grower prepays interest under such financing schemes, the deductions allowable will be subject to apportionment under section 82KZMF of the ITAA 1936.

103. 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) of the ITAA 1936 is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1) of the ITAA 1936. However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the scheme that is less than $1,000. Such expenditure is immediately deductible.

104. Where the requirements of section 82KZME of the ITAA 1936 are met, section 82KZMF of the ITAA 1936 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.

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

105. In the formula 'eligible service period' (defined in subsection 82KZL(1) of the ITAA 1936) 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

106. In this Project, an Initial Management Fee of $6,052, and Rent of $1,541 per Allotment will be incurred on the execution of the Management Agreement and the Licence Agreement. These fees are charged for management services, the lease of land, access to water, and for the use of trellis and plant and equipment by a Grower until 30 June of the year of the Management Agreement and Licence Agreement coming into effect. Under these agreements, further annual expenditure is required each year during the term of the Project for the provision of management services, the lease of land, access to water and for the use of trellis and plant and equipment until 30 June in those years.

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

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

109. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 42 and 43, then the basic precondition in subsection 82KZME(2) of the ITAA 1936 is not satisfied and, in these circumstances, section 82KZMF of the ITAA 1936 will have no application.

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

110. Although not required under either the Management Agreement or the Licence Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 109, section 82KZMF of the ITAA 1936 will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

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

112. 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 of the ITAA 1936.

Expenditure of a capital nature

Division 40 and Division 328

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

114. 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'.

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

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

Section 35-55 – exercise of Commissioner's discretion

116. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years **30 June 2007 to 30 June 2010** 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 2007 up to and including 30 June 2010:

- it is because of its nature the business activity of a Grower that 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.

117. 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

118. The operation of section 82KL of the ITAA 1936 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 of the ITAA 1997.

Part IVA – general tax avoidance provisions

119. For Part IVA of the ITAA 1936 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).

120. The National Viticultural Fund of Australia Project No. 6 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 62, 63 and 66 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

121. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the grapes. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) of the ITAA 1936, it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Appendix 2 – Detailed contents list

122. Below is a detailed contents list for this Ruling:

References

Previous draft:
Not previously issued as a draft

Related Rulings/Determinations:
TR 97/11; TR 98/22; TR 2000/8; TR 2001/14

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

Legislative references:
- ITAA 1936 44
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