



PR 1999/102 - Income Tax: Shaw Vineyard Estate Project 1999

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Product Ruling

Income tax: Shaw Vineyard Estate Project 1999

Contents	Para
What this Product Ruling is about	1
Date of effect	10
Withdrawal	12
Arrangement	13
Ruling	31
Explanations	35
Detailed contents list	70

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. 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 investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities in future years to confirm the arrangement has been implemented as described below and to ensure that participants in the arrangement include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Shaw Vineyard Estate Project, or simply as 'the Project' or 'the product'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA1997');
- section 8-1 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997)
- Part 2-25 (ITAA 1997);
- Part 3-1 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM (ITAA 1936); and
- Part IVA (ITAA 1936).

3. This Ruling does not deal with the consequences or effects of the Goods and Services Tax or any associated 'A New Tax System' legislative reforms, including the proposed changes announced as part of The New Business Tax System or their effect on the various Income Tax Acts (including the provisions set out above).

4. On 21 September 1999, the Government announced a number of changes to the tax system as part of the New Business Tax System. A number of those changes could affect the tax laws dealt with in this Ruling. On 11 November 1999 the Government announced further changes, some of which could also affect the tax laws dealt with in this ruling, especially those to do with 'tax shelters'. Some of those changes apply from the dates of announcement and others are proposed to apply from nominated dates in the future.

5. This Ruling does not deal with the announced changes. We cannot rule on those changes until the relevant legislation is enacted.

Class of persons

6. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until its completion (i.e., being a party to the relevant agreements until their terms expire), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Growers'.

7. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

8. 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, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

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Date of effect

10. This Ruling applies prospectively from 24 November 1999, 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).

11. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered

by the private ruling has not begun to be carried out, 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

12. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. 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 specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into 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

13. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Information Memorandum issued by Shaw Projects Pty Limited;
- **Contract for sale of land** between Shaw Projects and each Grower;
- **Deed of Agreement** between Shaw Projects and each Grower;
- By-Laws of Community Plan for Olleyville Vineyard;
- **Management Agreement** between Shaw Projects and each Grower;
- Corporation Management Agreement between the Community Corporation, Shaw Projects and Duesburys;
- **Fruit Sale and Purchase Agreement** between BRL Hardy Limited and Shaw Projects and each Grower;
- Lease agreement between Shaw Projects and Growers (optional);
- Application dated 7 September 1999 and letters from Duesburys; and

- Further information provided by Duesburys on 26 October 1999.

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

14. The documents highlighted are those Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate (as defined in section 318 of the ITAA 1936) of a Grower, will be a party to, that are part of the arrangement to which this Ruling applies. The effect of these agreements listed above is summarised below.

15. This arrangement is called the Shaw Vineyard Estate Project. Growers are invited by the Manager to develop collectively a vineyard of up to 30 hectares on a site at Murrumbateman, New South Wales, approximately 35 kilometres north-west of Canberra.

16. The Project will in the first year be limited to 20 Growers with each Grower having a minimum of one lot, each lot being 1.5 hectares in size. The initial term of the Project will be the period to 30 June 2014 with Growers having the ability to extend the term of the Project.

17. On each lot approximately 1,885 vines per hectare will be planted; a total of 2,828 vines per 1.5 hectare lot. The grape varietal mix will be determined by the Manager and is proposed to include Cabernet Sauvignon (17%), Shiraz (17%), Merlot (33%), Riesling (17%) and Semillon (16%).

18. A Grower or an entity associated with each Grower will have freehold title to the property through Community Title lots registered under the Community Land Development Act 1989 (NSW). Growers may either own the Lots themselves or through an associated entity.

19. The Growers initially appoint Shaw Projects to act as Manager of each lot and to plant, develop, manage and maintain the vines and to harvest the grape produce. All of the grapes grown will be sold to BRL Hardy.

20. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

21. The fees payable by a Grower in the first three years commencing during the year ended 30 June 2000 are:

PR 1999/102

	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>
	\$	\$	\$
Trellis	10,000	1,965	
Irrigation	11,828		
Preplanting costs	5,459		
Vines	4,788		
Maintenance in advance	12,175	8,979	8,647
Administration in advance	7,750	2,456	2,353
Total vineyard costs	52,000	13,400	11,000
Land cost	25,000		
Total costs	77,000	13,400	11,000

22. Growers who invest during the year ended 30 June 2000 will pay the Year 1 fees which will include payment for certain services, some of which may be performed after that date. Growers will continue to pay Vineyard Maintenance and Administration costs during the term of the Project.

Summary of Documents***Deed of Agreement***

23. The Deed of Agreement is entered into by Shaw Projects and the Grower (or an associated entity) when the contract for sale of land is executed by the parties. The deed requires the Grower, upon entering into the contract for sale of land, to enter into:

- the Fruit Sale and Purchase Agreement through its agent, Shaw Projects; and
- the Management Agreement in its own capacity.

By-Laws of Community Plan for Shaw Vineyard Estate

24. Pursuant to the Community Land Development Act 1989 and the Community Land Management Act 1989, By-Laws are established in respect of the property. Pursuant to the by-laws, a Community Corporation will be established which will be responsible for the administration, management and control of the Common Property, that is, property which is not owned by any Grower but which is set aside for use of all Growers. The by-laws restrict the use of the Common Property to purposes necessary for the production of wine grapes such as the storage of plant and equipment and restrict the use of Community Lots to the production of wine grapes. Each owner is required under the by-laws to establish a vineyard on its lot and appoint the Manager to establish and manage the vineyard.

Management Agreement

25. The Management Agreement between Shaw Projects and each Grower sets out the role and obligations of the Manager to control the Project. The Grower engages the Manager (Shaw Projects) until 30 June 2014 to develop, cultivate and maintain a vineyard on the lots and to sell grapes on behalf of the grower under the Fruit Sale and Purchase Agreement. The manager is to provide a number of services including:

- Acquisition of rootlings
- Establishment of vineyard on lots
- Prune vines at least once each year
- Provide irrigation, fertilisers and nutrients
- Minimise soil erosion and maintain soil quality
- Maintain any buildings, sheds, fire breaks, windbreaks, access roads or tracks in good repair
- Control vermin and other vegetation
- Minimise impact of any insects and diseases on vines
- Maintain records of all fertilisers, nutrients and chemicals applied
- Destroy any vines not consistent with best viticultural practice
- Develop and adhere to a management plan for the vineyard
- Re-establish the vineyard in the event of any natural disaster
- Harvest and sell the grapes on behalf of the grower
- Test the maturity of grapes to determine whether the vines can be harvested
- Commence harvesting when appropriate
- Arrange collection of grapes by the purchasers
- Arrange loading of grapes
- Co-ordination of vineyard services
- Obtain and maintain insurance against fire and other insurable risks if economically justifiable

- Arrange for an audit to be conducted of the Project's operations
- Prepare a six-monthly report on developments in the Project

26. The growers are entitled to terminate the agreement if the Manager defaults in the performance of the services and the default is capable of remedy.

Corporation Management Agreement

27. The Corporation Management Agreement is between Shaw Projects, the Community Corporation and Duesburys, Chartered Accountants. The Agreement provides for the engagement of Duesburys to perform various services including the maintenance of a register of owners, preparation of financial statements for the Project and the Community Corporation, assistance with financial management, maintenance of records for the Community Corporation, the collection of moneys due and payment of moneys owing by the Community Corporation.

Fruit Sale and Purchase Agreement

28. The Fruit Sale and Purchase Agreement is between Shaw Projects (as agent for each Grower) and BRL Hardy. Under the Agreement, the Manager has agreed to sell to BRL Hardy all of the grapes grown at a fixed price (adjusted for movements in the Consumer Price Index) for the first 10 years of the Project.

Lease Agreement

29. If there is a delay in the registration of the Community Title, a Grower can for a nominal fee enter into a lease agreement with Shaw Projects in respect of the Grower's section of property.

Finance

30. Growers are responsible for financing their investment in the Project. No arrangement, agreement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance for any purpose associated with the Project exists.

Ruling

31. For a Grower who is also a Lot Owner and who invests in the Project by 30 June 2000, the following deductions will be available for the years ended 30 June 2000 to 30 June 2002:

<i>Expense</i>	<i>Legislation</i>	<i>Refer Note</i>	<i>Deductions Available each Year</i>		
			<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>
	ITAA 1997		30.6.00	30.6.01	30.06.02
Trellis	42-15	(i)	1,300	1,555	1,555
Irrigation	387-125	(ii)	3,943	3,943	3,943
Preplanting	387-305	(iii)	1,024	1,365	1,365
Vines	387-305	(iii)	898	1,197	1,197
Maintenance	8-1		12,175	8,979	8,647
Administration	8-1		7,750	2,456	2,353

Notes:

(i) Deductibility under section 42-15 for depreciation will depend on whether the “prime cost” or “diminishing value” method is used to calculate the depreciation and on the number of days in the financial year in which the grower owned an interest in the trellising. Shaw Projects will advise the Growers of this for the financial year ending 30 June 2000. Deductions in the following years have been calculated using the prime cost method and a depreciation rate of 13%.

(ii) Deductibility under section 387-125 is based on one-third of the capital expenditure in the year in which the expenditure is incurred and one-third of the capital expenditure in each of the following two years.

(iii) Deductibility under section 387-305 is calculated based on the estimated cost to the Grower of establishing the grape vines. The capital cost can be written off over a four year period from the time of planting. For the purposes of the above, the vines are assumed to be planted in October 1999. Shaw Projects will advise the Growers of the allowable deduction.

32. For Growers who are not Lot Owners, but have been granted a lease or a licence over a Lot by an associated entity, the following deductions will be available for the years ended 30 June 2000 to 30 June 2002:

<i>Expense</i>	<i>Legislation</i>	<i>Refer Note</i>	<i>Deductions Available each Year</i>		
			<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>
	ITAA 1997		30.6.00	30.6.01	30.06.02
Trellis	42-15	(i)	1,300	1,555	1,555
Irrigation	387-125	(ii)	3,943	3,943	3,943
Preplanting	387-165	(iii)			710

PR 1999/102

Vines	387-165	(iii)			622
Maintenance	8-1		12,175	8,979	8,647
Administration	8-1		7,750	2,456	2,353

Notes:

- (i) see note (i) to paragraph 32
- (ii) see note (ii) to paragraph 32
- (iii) the costs of the vines and other "establishment expenditure" will be deductible under section 387-165. These other costs include expenditure on preplanting and planting work. These Growers cannot claim deductions under section 387-305 as they are not the owners of the grape vines. The deductible amounts allowable under section 387-165 start in respect of the year that the grape vines, as horticultural plants, enter their first commercial season (which may be in year 3) and are calculated using the formula in section 387-185.

33. For a Grower who invests in the Project, any income received from the sale of grapes from the Lot will be assessable income under section 6-5.

Sections 82KZM, 82KK and 82KL and Part IVA

34. For a Grower who invests in the Project, the following provisions of the ITAA 1936 have application as indicated:

- the expenditure by Growers does not fall within the scope of section 82KZM;
- sections 82KK and 82KL do 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.

Division 35 – Deferral of losses from non-commercial business activities**Section 35-55 – Commissioner's discretion**

34.1 For a Grower who is an individual and who entered the Project on or after 24 November 1999 and prior to any withdrawal of this Product Ruling the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner has decided for the income years ended 30 June 2001 to 30 June 2003 that the rule in section 35-10 does not apply to this business activity provided that the Project has been, and continues to be carried on in a manner that is not materially different to the arrangement described in this Ruling.

34.2 This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies.

34.3 Where, either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, ie, any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

34.4 Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from such a perspective has not been made.

Explanations

Section 8-1

35. Consideration of whether the Maintenance and Administration fees are deductible under section 8-1 proceeds on the following basis:

- the outgoings 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 paragraph 8-1(b) if they are incurred when the business has not commenced; and
- where a taxpayer contractually commits itself 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 paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoings in question have a sufficient connection with activities to produce assessable income of the taxpayer.

36. An outgoing or a loss incurred in carrying on a business for the purpose of gaining or producing assessable income is deductible under the general deduction provision (section 8-1), provided the expenditure or loss is not of a capital, domestic or private nature. A business includes a "primary production business", which is defined in subsection 995-1(1) to include a business of propagating and cultivating plants. Where there is a business, or a future business, of growing grapes for sale at a profit, the gross sale proceeds from the sale of grapes from the Project will constitute assessable income under section 6-5. 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. These operations will be the planting, tending, and maintaining of grape vines and the harvesting of the grapes.

Is the Grower in business?

37. Generally, a Grower will be carrying on a business of viticulture where:

- the Grower has an identifiable interest in specific grape vines coupled with a right to harvest and sell the grapes produced;
- the viticulture activities are carried out on the Grower's behalf; and
- the weight of the general indicators of a business, as developed by the Courts, points to the carrying on of such a business.

38. By weighing up all of the attributes of the Project, the Growers in the Project are regarded as being in a business of primary production from the date that "business operations" are first commenced on their behalf. Business operations in this context mean such things as surveying of the land, installation of the trellising and irrigation items, and other preplanting work, all conducted as part of a coordinated and concerted plan to grow and harvest grapes for sale at a profit.

39. For this Project, investors acquire an identifiable area of land consistent with the intention to carry on a business of a commercial vineyard. The investors are either Lot Owners or are Licence Holders through an associated entity. Each lot will have approximately 2,828 vines. This is consistent with the intention to carry on a business of growing grape vines.

40. Under the Management Agreements, Growers appoint Shaw Projects as Manager to provide services such as preplanting and

planting of grape vines, the installation of trellising and irrigation, and all cultural operations necessary to develop a mature fruit bearing vine.

41. Growers must use the land in question for viticulture purposes and Shaw Projects is able to come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over Shaw Projects, as evidenced by the Agreements and supplemented by the Corporations Law, is sufficient to establish that the activities are carried out on behalf of the Growers. Under the Management Agreement, Growers are entitled to receive regular progress reports on the project. Growers are able to terminate arrangements with Shaw Projects in certain instances, such as cases of default. The viticulture activities described in the Management Agreement are carried out on the Growers' behalf. Growers control their investment.

42. The general indicators of a business, as developed by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description in this Ruling for all these indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Information Memorandum that suggest the Project should return a "before-tax" profit to the Growers, i.e., a "profit" in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

43. Growers will engage the professional services of a Manager who holds itself out as having the appropriate credentials. There is a means to identify in which vines Growers have an interest. The services are based on accepted viticultural practices and are of the type ordinarily found in viticulture ventures that would commonly be regarded as businesses.

44. Growers have a continuing interest in the vines from the time they are acquired until the termination of the Project. 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. The Growers' viticulture activities will constitute the carrying on of a business.

Deductibility of expenses

45. The Maintenance and Administration fees payable in years one, two and three, associated with the viticulture activities, will relate to the gaining of income from this business and hence have a sufficient connection to the operations by which such income will be gained. They will be deductible under the first limb of section 8-1, to the extent that they are not capital or of a capital nature (see further

below). Further, no "non-income producing" purpose in incurring the fees is identifiable from the arrangement. The fees, on the basis of the information provided, are not excessive. No capital component is identifiable. The tests of deductibility under paragraph 8-1(1)(a) are met. The exclusions do not apply, except as set out below.

Expenditure of a capital nature

46. Any part of the expenditure of a Grower entering into the viticulture business 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. Pursuant to the Project's Agreements, certain payments made are attributable to the acquisition of capital assets. These include preplanting costs, the cost of establishing the vines, the erection and establishment of such items as trellising and irrigation to support and water the vines. However, expenditures of this nature can fall for consideration under specific deduction provisions relevant to the carrying on of a business of primary production and under the general depreciation provisions of the ITAA 1997.

47. The Manager, Shaw Projects, has identified the relevant expenditures that are of a capital nature. A Grower entering into the Project incurs and pays a separate amount to Shaw Projects for these capital items in Year 1 amounting to \$32,075 and \$1,965 in Year 2 (refer Management Agreement). These amounts are detailed at paragraph 21 of this Ruling.

Capital allowances for primary producers - Division 387; Vine establishment - section 387-305, Subdivision 387-C

48. The capital costs of establishing the vines can be written off under Division 387 of ITAA 1997. Participants who are Lot Owners are entitled to the deductions provided for by section 387-305. The capital cost of establishing grape vines may be written off by the owner over a four year period.

49. On the other hand, where a Grower is the holder of a Licence in relation to the land, the Grower cannot claim a deduction under section 387-305 on the basis that the ownership will vest in the associated entity. However, in these circumstances, Subdivision 387-C provides that the establishment costs are eligible for write-off over the effective life of the plants. Costs of establishing horticultural plants may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is the cost of draining swamps or clearing land. The cultivation of grape vines would come within the definition of "horticultural plant" in subsection

387-170(1). For the purposes of this Subdivision, a licensee or lessee of land carrying on a business of horticulture is treated as owning the plants growing on that land rather than the actual owner of the land.

50. Under Subdivision 387-C, if the effective life of the plant is more than 3 years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The effective life is to be determined on an objective basis and should take into account all relevant circumstances. The Manager has estimated that the grape vines may be expected to have a useful life of 15 years. The write-off commences when the vines are first used or held ready for use for the purpose of producing assessable income in commercial horticulture. The write-off deductions will commence when the vines enter their first commercial season. The responsible entity will advise the Grower of this event.

51. The write-off rate will be 13% per year, assuming an effective life of the plants of greater than 13 but less than 30 years (see section 387-185). The write-off deductions will, for a Grower who has been accepted into the Project by 30 June 2000 and whose primary production business has commenced, start in the third year of the Project, on the basis that the grapevines then enter their first commercial season and, hence, begin to be used for the purpose of producing assessable income in a horticultural business.

52. The Manager has identified that the relevant expenditure attributable to the establishment of the vines is \$10,247. This amount will be subject to the horticultural provisions and allowable as a deduction under Subdivision 387-C.

53. For a Grower entering into the Project by 30 June 2000, no deduction will be allowable for the years ended 30 June 2000 or 30 June 2001. A deduction may be available for the year ended 30 June 2002 if this is the first commercial season. This will be for the amount of \$1,332.

Alternative view

54. The applicant has indicated disagreement with the view that the grape vines do not commence to be used for the purpose of producing assessable income in a horticultural business until their first commercial season, and has submitted an alternative view that the grape vines commence to be so used immediately after their establishment. This view is submitted by the applicant to be more consistent with the inclusion of propagation and cultivation within the meaning of "horticulture" under the relevant provisions, the timing aspects of other distinctions drawn between capital and revenue costs and the acceptance of the use of the trellises for income producing purposes from the earlier time.

Trellis - section 42-15

55. Growers accepted into the Project incur a number of expenses under the Management Agreement for items of plant that are to be used on their behalf in the operation of the vineyard business. Such expenditure includes that on trellising upon which the vines are attached. The trellis is attached to the land as a fixture. This expenditure is also of a capital nature.

56. Generally speaking, if a taxpayer incurs expenditure of a capital nature on plant or equipment, used during the year of income for the purposes of producing assessable income, and is expenditure to which section 42-15 applies, a deduction will be allowed for depreciation on the item under that section. Accordingly, a Grower who is a Lot Owner may claim a deduction for depreciation over the effective life of the trellis. Under the Management Agreement, the Grower, to the extent permitted by law, will own all plant, equipment and other property that is acquired by the Grower, or on its behalf, and which is installed on the Grower's Lot.

57. If the Grower is a licensee or lessee, the licensee or lessee is entitled to claim depreciation in certain circumstances where they are considered to be the owner of those improvements. Our views on this issue are set out in Taxation Ruling IT 175. Where a licensee is considered to own the improvements under a State/Territory law, or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, we accept the licensee is entitled to claim depreciation for the fixture.

58. The Manager will advise Growers the date the trellising is installed and begins to be used for the purpose of producing assessable income. Under Taxation Ruling IT 2685, the effective life of trellising is estimated to be 20 years and that depreciation is therefore allowable on a prime cost basis at the rate of 13% per annum.

Irrigation - section 387-125

59. Expenditure on water facilities incurred primarily and principally for the purposes of conserving or conveying water for use in a primary production business conducted on land in Australia is deductible under section 387-125 in equal instalments over three years, commencing in the year the expenditure was incurred. Deductions will be allowable for the costs of installing irrigation equipment in the Shaw Vineyard commencing from and including the year ended 30 June 2000.

Vineyard maintenance and administration charges

60. The vineyard maintenance and administration charges incurred by the Growers are deductible under section 8-1.

Section 82KZM

61. Under the Management Agreement, maintenance and administration fees of \$19,925 per 1.5 hectare lot of 2,828 vines will be incurred on execution of that Agreement. In addition, maintenance and administration fees of \$11,435 and \$11,000 are payable in years two and three respectively. In each instance the fees are charged for providing services to a Grower only for the period of 12 months from the time they are incurred. The fees are expressly stated to be for a number of specified services. In effect, the Manager is promising to provide significantly more services, in terms of value in the first year of the Project, compared to years two and three and later years.

62. No explicit conclusion can be drawn from the arrangement's description that the fees in the first four years have been inflated to result in reduced fees being payable for subsequent years. There is no evidence that might suggest the services covered by the fee could not be provided within 13 months of incurring the expenditure in question. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and therefore will not apply to the expenditures identified above in each of the financial years ended 30 June 2000 to 30 June 2002.

Section 82KK and 82KL

63. These provisions allow the Commissioner to deny or defer deductions that have been incurred under certain tax avoidance schemes. Section 82KK deals with tax deferral arrangements while section 82KL deals with certain expenditure recoupment schemes.

64. The operation of section 82KL depends, among other things, on the identification of a certain quantum of "additional benefit(s)".

65. The specific anti-avoidance provisions of sections 82KK and 82KL should not apply to deny deductions to the Growers. Insufficient "additional benefits" will be provided to trigger the application of section 82KL. Section 82KL will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

66. 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).

PR 1999/102

The Shaw Vineyard Project will be a "scheme". The Growers will obtain a "tax benefit" from entering into the scheme in the form of tax deductions that would not have been obtained but for the scheme. However, the scheme will not be entered into or carried out with the dominant purpose of obtaining this tax benefit.

67. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of grapes. Further, there are no features of the Project, such as the payment of excessive management fees, or the provision of finance on a non-recourse or limited recourse basis, that might suggest the Project was so "tax driven", and so designed to produce a tax deduction of a certain magnitude, that would attract the operation of Part IVA.

Assessable income

68. Gross sale proceeds derived from the sale of grapes harvested from the Project will be assessable income of the Growers under section 6-5 in the year in which a recoverable debt accrues to them.

69. Once harvested, a Grower's grapes will in most circumstances be trading stock of that Grower. If grapes are on hand at the end of the income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions contained in Part 2-25 of the ITAA 1997. In Taxation Ruling IT2001, the costs associated with the establishment of a vineyard do not form part of the trading stock ultimately produced by the vineyard.

Detailed contents list

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

	Paragraph
What this Product Ruling is about	1
Tax Law(s)	2
Class of persons	6
Qualifications	8
Date of effect	10
Withdrawal	12
Arrangement	13
Summary of Documents	23
<i>Deed of Agreement</i>	23

<i>By-Laws of Community Plan for Shaw Vineyard Estate</i>	24
<i>Management Agreement</i>	25
<i>Corporation Management Agreement</i>	27
<i>Fruit Sale and Purchase Agreement</i>	28
<i>Lease Agreement</i>	29
Finance	30
Ruling	31
Sections 82KZM, 82KK and 82KL and Part IVA	34
Division 35 – Deferral of losses from non-commercial business activities	34.1
Section 35-55 – Commissioner’s discretion	34.1
Explanations	35
Section 8-1	35
Is the Grower in business?	37
Deductibility of expenses	45
Expenditure of a capital nature	46
Capital allowances for primary producers - Division 387; Vine establishment - section 387-305, Subdivision 387-C	48
<i>Alternative view</i>	54
<i>Trellis - section 42-15</i>	55
<i>Irrigation - section 387-125</i>	59
<i>Vineyard maintenance and administration charges</i>	60
Section 82KZM	61
Sections 82KK and 82KL	63
Part IVA	66
Assessable income	68
Detailed contents list	70

Commissioner of Taxation

24 November 1999

Previous draft:

Not previously released to the public in
draft form

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 97/16;
TR 97/11; TD 93/34; IT 175; IT 2685;
IT 2001; TR 92/20; PR 1999/4

PR 1999/102

Subject references:

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

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ATO references:

NO 99/13318-0

BO

FOI number: I 1020937

ISSN: 1039-0731