

PR 1999/22 - Income tax: Limestone Hill Vineyard Project

 This cover sheet is provided for information only. It does not form part of *PR 1999/22 - Income tax: Limestone Hill Vineyard Project*

 This document has changed over time. This is a consolidated version of the ruling which was published on *12 May 1999*



Contents	Para
What this Product Ruling is about	1
Date of effect	9
Withdrawal	11
Arrangement	12
Ruling	50
Explanations	55
Detailed contents list	98

Product Ruling

Income tax: Limestone Hill Vineyard Project

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 98/1 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.*

What this Product Ruling is about

1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax laws’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Limestone Hill Vineyard Project, or just simply as ‘the Project’ or the ‘product’.

Tax law(s)

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

- section 8-1 of the *Income Tax Assessment Act 1997* (‘ITAA 1997’);
- section 25-25 of the ITAA 1997;
- section 42-15 of the ITAA 1997;
- section 43-10 of the ITAA 1997;
- section 110-25 of the ITAA 1997;
- section 387-125 of the ITAA 1997;
- section 387-305 of the ITAA 1997;
- Part IVA of the *Income Tax Assessment Act 1936* (‘ITAA 1936’);
- section 82KL of the ITAA 1936; and
- section 82KZM of the ITAA 1936.

Class of persons

3. 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 it is completed (i.e., being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Farmers'.

4. 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

5. The Ruling provides this specified class of persons with a binding ruling as to the tax consequences of this product. The Commissioner accepts no responsibility in relation to the commercial viability of this product, and gives no assurance the prices charged for the product are reasonable, appropriate, or represent industry norms. A financial (or other) adviser should be consulted for such information.

6. The Commissioner rules on the precise arrangement identified in the Ruling.

7. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 12 to 47) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

8. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

9. This Ruling applies prospectively from 12 May 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).

10. 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

11. 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, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- application for Product Ruling dated 21 January 1999;
- The Limestone Hill Vineyard Project Draft Prospectus (Draft 11) dated 12 April 1999;
- Limestone Hill Vineyard Scheme Compliance Plan provided on 16 March 1999;
- draft copy of the Constitution of Limestone Hill Management Limited ('LHML' or 'the Manager') provided on 16 March 1999;

- draft copy of the Constitution of Limestone Hill Estate Limited ('LHEL' or 'the Winemaker') provided on 16 March 1999;
- Draft Vineyard and Option Agreement between the Manager, the Winemaker and the Farmer (the investor in the Project), undated, and provided on 12 April 1999;
- Draft Grape Sale Agreement between the Winemaker and the Farmer provided on 16 March 1999;
- Declaration of Trust made by the Winemaker in relation to the land;
- Flow of Funds and Notes attached to the Flow of Funds, undated, and provided on 16 March 1999; and
- Draft Lease Agreement for the lease of land between LHEL as trustee for the Farmers and LHEL as the Winemaker for the period beginning 1 July 1999 and ending 30 June 2017, undated, and provided on 16 March 1999.

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

13. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Farmer, or any associate within the meaning of section 318 of the ITAA 1936, will be a party to, except for the provision of finance to which paragraph 48 and 49 applies.

14. All Australian Securities and Investment Commission requirements are, or will be, complied with for the term of the Agreements.

15. The effect of these agreements relating to the Project is summarised as follows.

16. This arrangement is called the 'Limestone Hill Vineyard Project' which will be registered as a managed investment scheme under the Corporations Law. Farmers entering into the Project must make the following payments:

- \$2,000 to purchase a beneficial interest in two properties:
 - ◆ 199.5 hectares in the Mt Benson district, South Australia; and

- ◆ 82.5 hectares in the Jindong district, Western Australia;
- \$5,000 to purchase two shares in the Winemaker company for an agreed price of \$2,500 per share;
- \$14,950 by 30 June 1999, comprised of \$1,644 for the acquisition and installation of trellises, \$1,069 for the acquisition and installation of irrigation, \$367 for the construction of sheds, roads and other buildings, \$1,057 for land preparation, purchase of grapevines and planting work and \$10,813 for management services to be provided in the first 13 months;
- \$5,750 by 30 June 2000, comprised of \$623 for the further acquisition and installation of irrigation, \$110 for the further acquisition and installation of trellising and \$5,017 for other management services to be provided in the second year;
- \$2,300 by 30 June 2001 for management services to be provided in the third year; and
- \$2,250 by 30 June 2003 for management services provided in the year ending 30 June 2003. This amount will be increased annually by 3%. The Farmers will be liable to pay the indexed amounts, which will be for the ongoing management services provided in that year, by 30 June of each subsequent year until the end of the Project.

Years 1 to 3 per hectare rate

17. The fees payable by a participant in the Project in the first three years, expressed as the equivalent for a one hectare area of land, are:

	Year 1 Hectare rate	Year 2 Hectare rate	Year 3 Hectare rate	Total Y1-3 Hectare rate
Vines	\$5,872			
Irrigation	\$5,939	\$3,461		
Trellising	\$9,134	\$611		
Internal roads and buildings	\$2,039			
Management fee	\$60,073	\$27,872	\$12,777	
Total	\$83,057	\$31,944	\$12,777	\$127,778

18. Farmers entering the Project will enter into the following Agreements:

- a 'Vineyard and Option Agreement' with the Manager under which the Farmer pays the Manager the management fees outlined above. In return, the Manager provides services that include the establishment and maintenance of two vineyards and annual harvesting and selling of the grapes. Also, under this Agreement, the Farmer grants an option to the Winemaker to purchase the farmer's interest in the Vineyard within sixty days of 30 June 2017;
- a Grape Sale Agreement with the Winemaker, providing a set purchase price per tonne for all grapes produced by the Farmer for the life of the Project;
- a Declaration of Trust, in relation to the land, made by the Winemaker on behalf of the Farmers; and
- a Lease Agreement with the Winemaker to lease 37.8 hectares of the Farmer's land on which the Winemaker will construct a winery and crushing plant.

19. It is initially intended to plant on the Mt Benson property the particular grape varieties in the following proportions: Shiraz 25%, Grenache 4%, Mouverdere 4%, Merlot 6%, Cabernet Sauvignon 4%, Cabernet Franc 2%, Petit Verdot 2%, Sangiovese 2%, Tempranillo 2%, Semillon 7%, Sauvignon Blanc 4%, Riesling 4%, Chardonnay 12%, Marsanne 12%, Rousanne 5% and Viognier 5%.

20. Of the above varieties, the Shiraz, Grenache and Mouverdere grapes will provide the 'Rhone Style' in the red wines, while the Marsanne, Rousanne and Viognier will be used to provide this 'style' in white wines.

21. On the Jindong property, the varieties will be grown in the following proportions: Merlot 82%, Sauvignon Blanc 9% and Semillon 9%.

Vineyard and Option Agreement

22. The Manager, the Farmer and the Winemaker are parties to this Agreement.

23. Under Clause 2 of the Agreement, the Farmer requests the Manager to grow grapes on the Farmer's Vineyard for the term of the Project ('term' is defined as being 18 years from the commencement of the Agreement or until the Agreement is terminated) either personally, by its servants or agents, or by an independent contractor or as otherwise provided for in the Agreement.

24. Upon the expiration of the Agreement, the parties acknowledge that the Project is at an end and that the Farmer has granted to the Winemaker an option to purchase the Farmer's Vineyard for \$3,000 within 60 days of 30 June 2017. Should the Winemaker not exercise the option, the vineyards will be sold and proceeds of the sale will be distributed to the Farmers in proportion to their Vineyard interests.

25. Clause 3 of the Agreement provides for access to the Farmer, his servants, agents and contractors at all reasonable times with such rights of access and egress as are necessary for the Farmer, his servants, agents and contractors to conduct the Farmer's Project on the Farmer's land.

26. Clause 4 provides the details in relation to the responsibilities that the Manager agrees to undertake. These responsibilities are as follows:

- in accordance with Clause 2.1 of the Agreement, the Manager shall assume possession of the Farmer's Vineyard for the Term of the Farmer's Project;
- the Manager shall on Non Project Land do all things necessary to enable proper access to and egress from the Farmer's Vineyard for the Term;
- the Manager shall procure drainage works to ensure adequate drainage of excess surface water from the Farmer's Vineyard;
- the Manager shall procure the design and survey of the Farmer's Vineyard and will record and shall prepare a Farm Plan for the Farmer's Vineyard.

27. Clause 5 provides that the Farmer engages the Manager for the Term to manage the Project on the Farmer's Vineyard in accordance with the Agreement and the Manager accepts such appointment in accordance with the Agreement.

28. Under the Agreement the Farmer, through his or her agent, undertakes over the Term of the Project to:

- cultivate the rootstock acquired by the Farmer into mature fruit bearing vines;
- maintain the vines and vine placements according to principles of good husbandry and harvest the grapes;
- conduct the business of farming grapes in an efficient manner according to good farming practice.

29. Under the Agreement the Farmer will not:

- use or permit any other person to use the Farmer's Vineyard for any purpose other than the Farmer's Project;
- install or remove any trees, earth, minerals or fixtures from the Farmer's Vineyard or from any other section of the Land without the prior written consent of the Manager;
- do anything which would cause to be invalid, or increase the premiums of, any insurance policy in respect of the Farmer's Vineyard;
- use or store any inflammable or dangerous substance on the Farmer's Vineyard;
- cause or permit anything on the Farmer's Vineyard that may cause a nuisance, disturbance, obstruction or damage; and
- mortgage, change or encumber the Farmer's interest in the Farmer's Vineyard.

30. Clause 11 provides details on the payments to be made by Farmers to the Manager for the services provided under the Vineyard and Option Agreement. The fees for the first three years of the Project are payable yearly in advance with \$14,950 being required to be paid by 30 June 1999, at which time the Vineyard and Option Agreement will be executed. The Farmer remains liable for the management fees regardless of the income from the Project.

Grape Sale Agreement

31. The Farmer and the Winemaker are parties to this Agreement.

32. Under the terms of the Agreement, the Farmer agrees to sell to the Winemaker and the Winemaker agrees to purchase from the Farmer the grapes produced by the Farmer from the Vineyard. The Winemaker also agrees to pay a commission on wine sales from wine produced from grapes grown on the Farmer's land.

33. The amount paid per tonne for all varieties of grapes is set for the life of the Project by the Agreement. The price starts at \$1,236 per tonne for the year ended 30 June 1999 and increases by 3% per annum for the life of the Project.

34. Wine commission is defined in the Agreement as '...an amount equivalent to 59% (or such other amount as the Winemaker and the Project Manager may agree from time to time) of the gross profit made by the Winemaker on sales of wine produced from grapes purchased under this Agreement calculated at the wholesale price from time to time'.

35. Both the wine commission and the payments for grapes are paid in arrears on behalf of the Farmer to the Manager, who may deduct any management fees owing. Any funds in excess of the management fees will be paid to the Farmer.

Lease Agreement

36. The Agreement is made between the Farmers and the Winemaker.

37. The Winemaker is permitted to construct a winery on the allocated area of the Mt Benson land.

38. Rent payable by the Winemaker (the lessee) is determined under the attachment to the Agreement and is set at an annual rent of \$16,364 plus a CPI increase for each year after the first year. The rent is to be paid in arrears by annual instalments of \$16,364 plus CPI increase within sixty days of the last day of June in each and every year during the Term, the first of such instalments is to be paid within sixty days after 30 June 2002.

39. Upon completion of the winery, production will commence immediately to establish the Winemaker's label in the market place. Grapes for this process will be selected from premium vineyards in the area and purchased at commercial rates. This means the income to the Winemaker should commence prior to the production of wine from grapes grown in the Limestone Hill Estate Vineyards.

40. Under the Grape Sale Agreement, Farmers receive a commission on sales of wine made by the Winemaker from wine produced from grapes grown on the Farmer's land.

Vineyard establishment

41. Under the Vineyard and Option Agreement, once a Farmer has subscribed for shares in the Winemaker and requested the services of the Manager, the Manager will be responsible for planting vines on the land no later than the following 30 June 2000. The Manager will maintain the vines in accordance with good viticultural practice.

42. For persons who are accepted as Farmers on or before 30 June 1999, it is proposed that certain preplanting work will have been carried out for them before this time. For example, for the purposes of advising Farmers about their taxation claims, specifically when certain 'business operations' have been commenced on their behalf, the Manager will advise them of the year in which the irrigation expenses were incurred, when their trellising items are installed, and when their vines have been planted.

43. The Manager will also be responsible for arranging the harvesting and sale of the grapes to the Winemaker. The Farmer will

receive from the Manager reports on the progress of the vineyards and be informed of the price received for their grapes.

44. Possible projected returns for the whole Project for Farmers are outlined in the Draft Prospectus. These depend upon a range of assumptions made by the Manager. There is no assurance or guarantee whatsoever in respect of the future success of or financial returns associated with the Project.

45. The Farmers' grapes are pooled together to sell to the Winemaker. Proceeds of the grape sales and commissions on wine sales will be distributed to the Farmers based on their Vineyard Interests, less any outstanding management fees they owe.

Vineyard ownership

46. The Winemaker will hold legal title to the land. However, the Winemaker will execute a Declaration of Trust whereby it will declare that it holds title to the land as Trustee for each of the Farmers. A Farmer will hold a 1/1200 undivided interest in all the land as tenant in common with all the Farmers for each purchased interest in the Project and each parcel of two shares purchased in the Winemaker by the Farmer.

47. The Farmers jointly will bear the risk of any loss, destruction or damage to the vineyard or any part of the vineyard.

Finance

48. Farmers may fund the investment themselves or borrow from an unassociated lending institution. No entity or related entity involved in the Project is involved in the provision of financing for the Project.

49. Farmers who enter into any financing arrangement will only do so under the following conditions:

- all loan terms are of an arm's length nature;
- borrowers remain fully liable for the balance of the loan outstanding at any time and lenders will take legal action against defaulting borrowers;
- there is no right to assign;
- there are no 'round robin' characteristics;
- there are no split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are no indemnity arrangements or any other collateral agreements in relation to the loan;

- repayments of principal and payments of interest are not linked to derivation of income from the Project and are made regularly, starting shortly after the making of the loan.

Ruling

50. For a Farmer who invests in the Project by 30 June 1999 and who utilises the services of the Manager, the following deductions will be available for the years ended 30 June 1999 to 30 June 2002:

Fee type	ITAA 1997 section	Deductions available each year			
		Year 1 30/06/1999	Year 2 30/06/2000	Year 3 30/06/2001	Year 4 30/06/2002
Management fee	8-1	\$10,813	\$5,017	\$2,300	
Interest on loans	8-1	as incurred	as incurred	as incurred	as incurred
Borrowing costs associated with loans	25-25	(see Note 1 below)			
Capital expenditure specifically deductible					
Irrigation	387-125	\$356 (see Note 2 below)	\$564	\$564	\$207
Grapevine establishment	387-305		\$132 (see Note 3 below)	\$264	\$264
Trellising	42-15			\$321 (see Note 4 below)	\$287
Buildings and roads	43-10		\$5 (see Note 5 below)	\$9	\$9

Notes:

1. Farmers can deduct borrowing costs in relation to securing a loan for this Project over 5 years, or the period of the loan, whichever is the lesser period.
2. Deductibility under section 387-125 is dependent on the Farmer carrying on a 'primary production business' conducted on land in Australia. A Farmer who applies and is accepted into the Project on 30 June 1999, but is in the situation where no activities have been undertaken by the Manager in that year of income, will not be considered to be carrying on such a business. Where activities have been undertaken, deductibility under section 387-125 is calculated on the basis of one-third of the capital expenditure in the year in which the expenditure is incurred and for each of the next 2 years of income.
3. Deductibility under section 387-305 is calculated on the basis of the grapevines being planted after 1 July 1999. The expenditure incurred in establishing a grapevine is spread over four years from the time the vine is

planted. There is a given formula in section 387-305 for calculating the amount of the deduction for each year. Establishment expenditure does not include draining of swamps or clearing of land. For illustrative purposes, the amount is calculated based on the grapevines being planted by 1 January 2000.

4. Deductibility under section 42-15 for depreciation on trellising will depend, for the purposes of either section 42-160, 'Diminishing value method', or section 42-165, 'Prime cost method', on the number of 'days owned', being the number of days in the income year in which the farmer owned an interest in the trellising. The Manager is to advise farmers of this for the year ended 30 June 2001. Deductions for the succeeding years have been calculated, for illustrative purposes, on the basis of using the diminishing value method at a rate of 20%, assuming this is the method the Farmer has chosen under section 42-25 and that \$1,754 worth of trellising was installed ready for use by 31 July 2000.

5. Deductibility under section 43-10 for capital works for the year ended 30 June 2000 will depend on whether any construction of buildings has been completed in a construction expenditure area. The rate of the deduction is 2.5% of the construction expenditure. For illustrative purposes it is assumed that all capital works are completed by 1 January 2000. However, the Manager will advise farmers of any deductible amount for the year ended 30 June 2000.

Assessable income

51. For Farmers who invest in the Project, gross income received by them, from the sale of grapes from their Vineyard and from commissions on wine sales made by the Winemaker, will be assessable income to them under section 6-5.

Division 100 - capital gains and losses

52. Farmers entering into the Project pay an amount of \$2,000 for a beneficial interest in land as described in paragraph 16 above (first dot point). This amount will form part of the cost base under section 110-25 of the interest in the land, being an asset acquired at the time the contract to acquire this interest is made. This amount is relevant should the beneficial interest in the land be disposed of in the future, as a capital gain or loss may arise at that time.

53. Farmers entering into the Project pay an amount of \$5,000 for two shares in the Winemaker company as described in paragraph 16 above (second dot point). This amount will form part of the cost base under section 110-25 of the shares, being an asset acquired at the time the contract to acquire the shares is made. This amount is relevant should the shares be disposed of in the future, as a capital gain or loss may arise at that time.

Sections 82KZM and 82KL; Part IVA

54. For a Farmer who invests in the Project the following provisions of the ITAA 1936 do not apply:

- the expenditure by Farmers does not fall within the scope of section 82KZM;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the provisions of Part IVA will not be applied to the arrangement described in this Ruling.

Explanations

Section 8-1

55. Consideration of whether the management 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(1)(b) if they are incurred when the business has not commenced; and
- where a taxpayer contractually commits themselves 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 outgoing in question would have a sufficient connection with activities to produce assessable income of the taxpayer.

56. 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 it is not a loss of capital or expenditure of a capital, domestic or private nature. A business includes a 'primary production business', which is defined under 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 gross 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 grapevines and the harvesting of the grapes.

57. Under the Vineyard and Option Agreement, a Farmer engages the Manager to grow and harvest grapes from the Farmer's Vineyard. Farmers have the right to have the harvested grapes made available to themselves to sell or utilise how they wish, providing all costs of producing the grapes are reimbursed and the Winemaker has first refusal. The purpose for which the participant utilises the grapes will then be a determining factor as to whether the amounts incurred on any management fee will be an allowable deduction.

58. This Ruling applies only to those parties engaging the Manager to provide management services, including the harvesting of the grapes and the selling of the grapes to the Winemaker, according to the terms of the Grape Sale Agreement.

Is the Farmer in business?

59. Generally, a Farmer will be carrying on a business of viticulture where:

- they have an identifiable interest in growing vines coupled with a right to harvest and sell the grapes resulting from those vines;
- the viticulture activities are carried out on their behalf; and
- the weight of the general indicators of a business, as developed by the Courts, points to them carrying on such a business.

60. By weighing up all of the attributes of the Project, it is accepted that Farmers in the Project will be in a business of primary production from the date that 'business operations' are first commenced on their behalf. 'Business operations', in this context, means such things as surveying of the land, installation of the trellising and irrigation items, and other preplanting work, all conducted as part of a co-ordinated and concerted plan to grow and harvest grapes for sale at a profit.

61. For this Project, investors have an undivided 1/1200 interest in two vineyards that will be developed on land owned by themselves jointly through a trust. This is considered to be consistent with the intention to carry on a business of viticulture. Farmers also have a beneficial interest in the general right to occupy the land as held by the Trustee and in the improvements to the land for the duration of the venture.

62. Under the Vineyard and Option Agreement, Farmers appoint the Manager to provide services such as preplanting and planting of grape vines, the installation of trellising and irrigation, and all operations necessary to develop a mature fruit bearing vine.

63. Farmers have the right to use the land in question for viticulture purposes and to have the Manager come onto the land to carry out its obligations under the Vineyard and Option Agreement. The Farmers' degree of control over the Manager, as evidenced by the Agreement and supplemented by the Corporations Law, is sufficient. Under the general terms of the Project, Farmers are entitled to receive regular progress reports on the Manager's activities. Farmers are able to terminate arrangements with the Manager in certain instances, such as cases of default.

64. 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. Farmers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Draft Prospectus that suggest the Project should return a 'before-tax' profit to the Farmers, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

65. Farmers will engage the professional services of the Manager, who holds itself out as having the appropriate credentials. Farmers have an undivided interest in the whole of the viticultural activity. The services are based on accepted viticultural practices and are of the type ordinarily found in viticulture ventures that would commonly be said to be businesses.

66. Farmers 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 Farmers' viticulture activities will constitute the carrying on of a business.

Deductibility of expenses

67. The management fee 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 this income is to be gained. The management fees will thus be deductible under paragraph 8-1(1)(a), 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 fee is identifiable from the arrangement. 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

68. Any part of the expenditure a Farmer incurs in 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. It is apparent from the Project's Agreements that certain payments made are attributable to the acquisition of capital assets. These include the cost of preparing the ground and establishing the vines, the erection and establishment of items, such as trellising and irrigation, to support and water the vines and the construction of buildings and roads to support the whole activity. 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 and building write-off provisions of the ITAA 1997.

69. The Vineyard and Option Agreement identifies the relevant expenditures incurred by the Farmers that are of a capital nature. A Farmer entering into the Project incurs and pays to the Manager an amount of \$4,137 in the year ending 30 June 1999 for various capital expenditures. A further \$733 is to be paid by 30 June 2000 for further capital items (refer to Clause 11 of the Vineyard and Option Agreement). These amounts are detailed at paragraph 16 of this Ruling.

Subdivision 387-B: expenditure on conserving or conveying water

70. Capital expenditure incurred by a person carrying on a primary production business, on the construction, acquisition and installation of plant, equipment and structural improvements to be used primarily and principally for the purpose of conserving or conveying water for use in such a business, qualifies for a write-off over a three year period (i.e., 33 $\frac{1}{3}$ % with no pro rating required), under Subdivision 387-B. A taxpayer incurring such expenditure must do so in respect of a primary production business conducted on land in Australia. The Farmer's activities on their Vineyard will amount to such a primary production business and the water facilities to be acquired for them under the Vineyard and Option Agreement will be for use in this business. The requirements of Subdivision 387-B have thus been met in this respect.

71. The Vineyard and Option Agreement identifies the expenditure incurred by the Farmers applicable to the conserving or conveying of water for the vineyards, that meets the requirements of section 387-130. These amounts are **\$1,069** in 1999 and **\$623** in 2000. For a Farmer entering into the Project by 30 June 1999, and commencing to carry on a primary production business by that date, a deduction will be allowable under section 387-125 for the years ended

30 June 1999 to 30 June 2001 inclusive, of **\$356** per year. A further **\$208** will be allowed for the years ended 30 June 2000 to 30 June 2002 inclusive.

Subdivision 387-D: provisions for establishing grapevines

72. The capital costs relating to establishing the grapevines can be written off under Subdivision 387-D. As the Farmer will be the 'owner' of the vines for the purposes of these 'write-off' provisions, the costs will be an allowable deduction to the Farmer.

73. The write-off commences from the time the vines are planted in the ground owned by the Farmer. The write-off rate is 25% of the establishment expenditure. This amount must be apportioned, based on the number of days in the year in which the vines are owned by the farmer (see section 387-305). The deductions, for a Farmer who has been accepted into the Project by 30 June 1999 and whose primary production business has commenced, will start in the second year of the Project on the basis that the vines will not be planted until sometime after 1 July 1999.

74. Costs of establishing grapevines may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of ploughing, contouring, top dressing and fertilising the land. Expressly excluded is expenditure incurred on draining swamps or the clearing of land (see section 387-310).

75. The Vineyard and Option Agreement identifies the relevant expenditure attributable to the establishment of the vines as **\$1,057**. This amount will be subject to the grapevine write-off provisions, and allowable as a deduction under Subdivision 387-D.

76. For a Farmer entering into the Project by 30 June 1999 a deduction will be available for the year ended 30 June 2000. This will be for an apportioned amount of **\$264**, depending on the number of days the vines have been planted in the financial year ending 30 June 2000. The amount of \$264 will be deductible in the following four years up to the whole amount of the expenditure.

Section 42-15: trellising

77. Farmers accepted into the Project incur a number of expenses under the Vineyard and Option 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. This is attached to the land as a fixture. This expenditure is also of a capital nature.

78. 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 it is expenditure to which section 42-15 applies, a deduction will be allowed for depreciation on the item under that section. Where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, absolutely owned by the owner of the land.

79. A Farmer accepted into the Project pays an amount that entitles them to an undivided beneficial interest in land upon which they are entitled to grow vines to conduct a business of viticulture. Any buildings and trellising used in the viticultural business will thus belong to the Farmer.

80. A deduction for depreciation is allowable on plant from the date it is installed and ready for use. The Manager will advise Farmers when the trellising is installed and begun to be used for the purpose of producing assessable income.

81. The amount of \$1,754, as advised by the Manager, that relates to the acquisition and installation of trellises on the land, will be eligible for a depreciation deduction by the Farmers, under section 42-125, at a rate of 13% prime cost or 20% diminishing value. Using the diminishing value method, this equates to a deduction for the year ended 30 June 2001 of an apportionable amount of \$351 based on the number of days the trellising is held ready for use in that year. In subsequent years an amount based on the written down value of 1 July of each of those years will be an allowable deduction until the written down value is nil.

Section 43-10: capital works

82. Farmers accepted into the Project incur a number of expenses, under the Vineyard and Option Agreement, for construction of buildings and roads that are to be used on their behalf in the operation of the vineyard business. If these amounts were incurred in relation to a construction expenditure area, they maybe written off at 2.5% per year from the date the relevant construction is completed.

83. The Manager will advise Farmers when an identified construction area is completed. The Manager has advised that an amount of **\$367** in the year ended 30 June 1999 will form relevant construction expenditure.

84. When construction is completed, Farmers will be entitled to an apportionable deduction of 2.5% of **\$367** from the time the relevant construction is completed. The maximum deduction in a full year following completion of construction will be **\$9**.

Section 82KZM

85. Under the Vineyard and Option Agreement a fee of **\$10,813** will be incurred on execution of that Agreement to undertake preplanting, planting and post planting services for the first year. In addition, management fees of **\$5,017** and **\$2,300** are payable in each of years two and three, respectively. In each instance the fees are charged for providing services to a Farmer 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 respect of Clause 8, in the first year of the Project, compared to years two and three.

86. No explicit conclusion can be drawn from the arrangement's description that the fees in the first three 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. Thus, for the purposes of this Ruling, no part of the first year fee of **\$10,813** or the fees incurred in years two and three is for the Manager doing 'things' that are not to be wholly done within 13 months of each fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditures identified above in each of the financial years ended 30 June 1999 to 30 June 2002.

Section 82KL

87. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

88. An 'additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

89. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

Part IVA

90. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C), and a dominant purpose of entering into or carrying out the scheme to enable the relevant taxpayer to obtain a tax benefit in connection with the scheme (section 177D).

91. The Limestone Hill Vineyard Project will be a 'scheme'. The Farmers will obtain a 'tax benefit' from entering into the scheme, in the form of the deductions for the management fees allowable under section 8-1, and deductions allowable under Subdivisions 387-B and 387-D, and sections 42-15 and 43-10, 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.

92. Farmers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the yearly sale of grapes and receipt of commission on wine sales. Further, there are no features of the Project, such as the payment of excessive management fees or non-recourse loan financing by any entity that it might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that it would attract the operation of Part IVA.

Assessable income

93. Gross sale proceeds derived from the sale of grapes harvested from the Project and commission income received from the sale of wine will be assessable income of the Farmers under section 6-5 in the year in which a recoverable debt accrues to them.

Interest deductibility

94. Some Farmers may finance their investments through a loan facility. Whether the resulting interest fees are deductible under section 8-1 depends on the same reasoning as that applied to whether the management fees are deductible. The interest fees incurred will be in respect of a loan to finance the establishment of the vineyard, and its development in the first years - which will continue to be directly connected with the gaining of 'business income' from the Project. These fees will, thus, also have a sufficient connection with the gaining of assessable income. No capital, private or domestic component is identifiable in respect of them.

95. Farmers may also finance the purchase of shares in the Winemaker and the beneficial interest in land through loans. As the purchase of these assets is to derive assessable income, the interest in relation to those loans will also be deductible.

Borrowing costs

96. Costs incurred by Farmers in respect of borrowing to finance their involvement in the Project will be deductible to Farmers under section 25-25, to the extent that the money borrowed is for the purpose of producing assessable income.

97. The borrowing costs will be deductible over the period of the loan or five years, whichever is shorter.

Detailed contents list

98. Below is a detailed table of contents list for this Ruling:

	paragraph
What this Ruling is about	1
Tax law(s)	2
Class of persons	3
Qualifications	5
Date of effect	9
Withdrawal	11
Arrangement	12
Years 1 to 3 per hectare rate	17
Vineyard and Option Agreement	22
Grape Sale Agreement	31
Lease Agreement	36
Vineyard establishment	41
Vineyard ownership	46
Finance	48
Ruling	50
Assessable income	51
Division 100 - capital gains and losses	52
Sections 82KZM and 82KL; Part IVA	54
Explanations	55
Section 8-1	55
Is the Farmer in business?	59
Deductibility of expenses	67
Expenditure of a capital nature	68
Subdivision 387-B: expenditure on conserving or conveying water	70
Subdivision 387-D: provisions for establishing grapevines	72

Section 42-15: trellising	77
Section 43-10: capital works	82
Section 82KZM	85
Section 82KL	87
Part IVA	90
Assessable income	93
Interest deductibility	94
Borrowing costs	96

Commissioner of Taxation

12 May 1999

Previous draft:

No draft issued

Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 97/11;
TR 97/16; TR 98/22; TD 93/34

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

- ITAA36 82KZM
- ITAA36 Pt IVA
- ITAA36 177A
- ITAA36 177C
- ITAA36 177D
- ITAA36 318
- ITAA97 6-5
- ITAA97 8-1
- ITAA97 8-1(1)(a)
- ITAA97 8-1(1)(b)
- ITAA97 25-25
- ITAA97 42-15
- ITAA97 42-25
- ITAA97 42-125
- ITAA97 42-160
- ITAA97 42-165
- ITAA97 43-10
- ITAA97 110-25
- ITAA97 Subdiv 387-B
- ITAA97 387-125
- ITAA97 387-130
- ITAA97 Subdiv 387-D
- ITAA97 387-305
- ITAA97 387-310
- ITAA97 995-1(1)

Legislative references:

- ITAA36 82KH(1)
- ITAA36 82KH(1F)(b)
- ITAA36 82KL

Case references:

ATO references:

NO 98/8635-4
BO PUL 84107
FOI number: I 1018774
ISSN: 1039-0731
Price: \$2.20