



# ***PR 1999/55 - Income tax: Warren River Project No 1***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *9 June 1999*



## Product Ruling

### Income tax: Warren River Project No 1

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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 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

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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 ‘Warren River Project No 1’ or simply as ‘the Project’.

#### **Tax law(s)**

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

- section 6-5 of the *Income Tax Assessment Act 1997* (‘ITAA 1997’);
- section 8-1 (ITAA 1997);
- Part 3-1 (ITAA 1997);
- Subdivision 387-A (ITAA 1997);
- Subdivision 387-B (ITAA 1997);
- Subdivision 387-C (ITAA 1997);
- section 82KJ of the *Income Tax Assessment Act 1936* (‘ITAA 1936’);
- section 82KK (ITAA 1936);
- section 82KL (ITAA 1936);
- section 82KZM (ITAA 1936); and

- Part IVA (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 people are referred to as ‘Growers’.

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 assurances 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 from paragraph 12 to paragraph 33) 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.

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## Date of effect

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9. This Ruling applies prospectively from 9 June 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, the Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

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## Withdrawal

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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, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

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## Arrangement

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12. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement:

- application for a Product Ruling dated 27 April 1999;
- Prospectus for Warren River Project No 1;
- draft Management Agreement between Each Several Grower ('the Grower'), Warren River Management Pty Ltd ('the Manager') and Fox Securities Limited ('the Responsible Entity') dated 24 May 1999;

- draft Fruit Sale Agreement between the Grower, the Responsible Entity, Warren River Winery Limited ('the Winery') and Gillard Turner and O'Brien, trading as Custodian and Funds Management Services ('the Custodian) dated 22 April 1999;
- draft Sublease Agreement between the Grower, the Responsible Entity and Treendale Vineyard Pty Ltd ('the Lessor') dated 22 April 1999;
- draft Head Lease between the Lessor and Roland John Dawson, Shirley Ann Dawson, Rodney Scott Morris and Cheryl Ann Morris ('the Owners');
- Constitution for Warren River Projects between the Responsible Entity, Fox Securities Ltd ('the Bare Trustee') and the Grower;
- Rules for Warren River Projects, and
- additional correspondence received from the applicant dated 14 May 1999, 18 May 1999, 19 May 1999, 20 May 1999, 21 May 1999, 24 May 1999 and 28 May 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 Grower, or any associate of the Grower, will be a party to. The effect of the agreements described above is as follows.

## Overview of the Project

14. This Project is called the Warren River Project No 1. The Project is to carry out a primary production business of viticulture upon land held by the Lessor and located in the vicinity of Pemberton, Western Australia. Growers entering into the Project will sublease a 'plot' from the Lessor on which they will carry out viticultural farming. Growers contract with Warren River Management Pty Ltd for the establishment and management of the vineyard and the harvesting of their grapes. Unless Growers elect to take possession of their grapes, the Manager will sell the grapes on behalf of the Growers.

15. As part of the Project Growers also purchase shares in Warren River Winery Limited. Warren River Winery Limited will construct

and operate a Winery. Under the Fruit Sale Agreement the Winery will purchase the grapes grown by the Growers.

16. The minimum holding is one plot. Each plot is 0.1 of a hectare. It is anticipated that, initially, 40 hectares will be planted with vines. For every plot a Grower must also apply for 1,250 ordinary shares in the Winery. There is no requirement that the plot and shares must be applied for, or held, by the same person. The term of the Project is approximately 17 years, from commencement of the Project until 30 June 2016. The Project commences on allotment of a plot to a Grower.

### **The Sublease Agreement**

17. Under the Sublease Agreement the Lessor grants to the Grower a lease over a plot. The specific plot is allotted to the Grower by the Responsible Entity under the Prospectus. The term of the sublease is approximately 17 years, from the date of allotment to the Grower until 29 June 2016. As consideration for granting the sublease the Grower agrees to pay the Lessor rent of \$150 per year. The rent is due on 30 June for each year of the Project.

18. Under the Sublease Agreement the Grower covenants to do a number of things, including preparing and cultivating the plots in a skilful manner pursuant to the Management Plan. The Grower will not use or permit any other person to use the plots or any part of the plots for any purpose other than cultivation and harvesting of grapes.

### **The Management Agreement**

19. Under the Management Agreement the Grower appoints the Manager as an independent contractor and farm manager to supervise, carry out and administer viticulture farming on the plots. The Manager agrees to carry out or cause to be carried out during the term of the Project such services and duties in relation to the plots as are set out in the Management Plan. The Grower will pay a fee to the Manager for the performance of these services. In addition, fees are payable to the Manager for the purchase and planting of vine rootlings/cuttings, the installation of irrigation on a Grower's plot and the provision of trellising on a Grower's plot. The trellis remains the property of the Grower at all times during the Project.

20. The Manager will arrange the harvesting of the grapes. Before starting the harvesting the Manager will provide to the Grower a harvest plan for the Project. The harvest plan will include information on the dates for harvesting and delivery of the grapes and the expected volume of grapes to be harvested.

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21. Growers may elect to market the grapes themselves. Where a Grower elects personally to market the grapes the Manager will advise the Grower in writing of the date and time the Grapes can be collected.

22. Under the Management Agreement the Responsible Entity and Manager are to obtain and to provide regularly to the Grower various reports on the progress and conduct of the Project.

## **Fruit Sale Agreement**

23. Under the Fruit Sale Agreement the Winery agrees to purchase all the grapes grown on the plots. The purchase price is determined under the Agreement as being a fair and reasonable aggregate market price per tonne as determined by an independent and suitably qualified person. This person's appointment is to be mutually agreed upon by the parties to the Fruit Sale Agreement.

24. The Winery also agrees to pay to Growers \$1 for each bottle of wine sold, which was made using grapes grown on their individual plot and purchased from the Growers under the Fruit Sale Agreement.

## **Fees**

25. A Grower will make the following payments per plot for the first year of the Project:

- a management fee of \$7,207 payable to the Manager for the management of the vineyard for the period 30 June 1999 to 29 June 2000;
- rent of \$150 payable to the Lessor for the sublease of the Grower's plot for the period 30 June 1999 to 29 June 2000;
- a fee for landcare expenses of \$163 payable to the Manager for the period 30 June 1999 to 29 June 2000;
- a fee for the installation of the irrigation system on the Grower's plot of \$503 payable to the Manager;
- a fee for the trellising on the Grower's plot of \$490 payable to the Manager;
- a fee for the purchase and establishment of vine cuttings/rootlings of \$837 payable to the Manager; and
- subscription moneys for the subscribing for 1,250 shares at \$1.20 per share.

26. A Grower will make the following payments per plot in the second year of the Project:

- a management fee of \$2,814 payable to the Manager for the management of the vineyard for the period 30 June 2000 to 29 June 2001;
- a fee for additional trellising on the Grower's lot of \$186; and
- rent of \$150 payable to the Lessor.

27. A Grower will make the following payments per plot in the third year of the Project:

- a management fee of \$825 per plot payable on or before 30 June 2001 to the Manager for the period 30 June 2001 to 29 June 2002; and
- rent of \$150 payable to the Lessor.

28. For the fourth and subsequent years of the Project a Grower will pay:

- a management Fee of \$886 per plot for each year. This fee will be indexed annually in accordance with the Management Agreement; and
- rent of \$150 indexed annually in accordance with the Sublease Agreement.

29. A Harvest Supervision Fee is also payable; the amount is set at 5% of the receipts from the sale of the grapes.

30. A 'bonus' is payable to the Manager where receipts from the sale of the grapes are more than the amount estimated in the Prospectus.

## **Finance**

31. Growers can fund the subscription fee for the Project themselves, borrow from an independent lender, or borrow through finance arrangements organised by the Manager. Finance arrangements organised by a Grower with independent lenders are outside the arrangement to which this Ruling applies. The Manager has engaged the services of Laton Finance Pty Ltd ('Laton'). Laton is not associated with any of the entities involved in the Project nor any associates of entities involved in the Project. Laton's function is to arrange loans with a nominated financial institution.

32. The loans arranged by Laton will be on normal commercial terms; they will be in both form and substance, full recourse. Borrowers will be obliged to make regular repayments regardless of any income being derived from the Project. The Manager will receive funds directly as a result of these loans. Neither the Manager nor any other entity involved in the Project will be putting these funds on



deposit with Laton, the lender or any associated entities of Laton, the Manager or the lender. Warren River Management will substantially use these funds in carrying out its obligations under the Management Agreement.

33. Apart from the arrangement with Laton, there is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance to the Growers for any purpose associated with the Project.

## Ruling

34. For a Grower who invests in the Project the following deductions will be available:

- management fees paid for the services outlined in the Management Agreement will be allowable deductions to the Grower in the year incurred (section 8-1);
- rent paid by the Grower for the Grower's plot will be an allowable deduction in the year incurred (section 8-1);
- expenses incurred on landcare will be an allowable deduction for the Growers in the year incurred (section 387-55);
- expenses incurred on the establishment and purchase of the vines will be an allowable deduction to the Grower at a rate of 13% per year commencing from the first day of what is to be the vines' first commercial season (section 387-165);
- expenses incurred on irrigation will constitute allowable deductions to the Grower in the year incurred and the next two years at the rate of 33.3% per year (section 387-125); and
- depreciation of trellising will be an allowable deduction to a Grower at a rate of 20% per year diminishing value or 13% per year prime cost (section 42-15).

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

35. For a Grower who invests in the Project the following provisions have application as indicated:

- section 82KJ will not apply to deny the deduction otherwise allowable under section 8-1;

- provided Growers do not fall within the definition of ‘associates’ of the Manager, the Winery or the Lessor, section 82KK will not apply to deny the deduction otherwise allowable under section 8-1;
- section 82KL does not apply to deny the deductions otherwise allowable under section 8-1;
- the expenditure incurred by a Grower for services to be provided by the Manager does not fall within the scope of section 82KZM; 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.

**Section 6-5**

36. Gross sale proceeds derived from the sale of grapes harvested from the Project will be assessable income of the Growers under section 6-5.

**Explanations**

37. Consideration of whether the Lease and Management fees are deductible begins with paragraph 8-1(1)(a). This consideration 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 outgoing is not deductible under paragraph 8-1(1)(b) if it is 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 the activities to produce assessable income of the taxpayer.

38. A viticulture project can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the Project will constitute gross assessable income

in their own right. The generation of 'business income' from such a 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, maintaining and harvesting of the grapes.

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

- the Grower has an identifiable interest in specific growing 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 and influence of the general indicators of a business, as used by the Courts, point to the carrying on of a business.

40. Under the Sublease Agreement, a Grower has rights in the form of a lease over an identifiable area of land consistent with the intention to carry on the business of a commercial vineyard. Under the Management Agreement, a Grower appoints Warren River Manager Pty Ltd as an independent contractor and farm manager to supervise, carry out and administer the viticulture farming on the plots. The Manager is also to arrange the harvesting and the sale of the grapes on behalf of the Grower.

41. The Sublease Agreement gives Growers an identifiable interest in specific vines and a legal interest in the land. Growers have the right personally to market the produce attributed to their plot or they can elect to use the Manager to market the produce for them.

42. A Grower has the right to use the land in question for viticultural purposes and to have the Manager come onto the land to carry out the viticultural farming on the Grower's behalf. Under the Management Agreement a Grower is entitled to receive regular reports on the Manager's activities and the progress of the Project. A Grower is able to terminate arrangements with the Manager in certain instances. A Grower's degree of control over the Manager, as evidenced by the various agreements which the Grower enters into and supplemented by Corporations Law, is sufficient.

## **General indicators of a business**

43. 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 arrangement's description for all the indicators. The independent horticultural report considers that the Project is realistic

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

44. Growers will engage the professional services of a Manager with appropriate credentials. There is a means to identify which vines Growers have an interest in. The services are based on accepted viticulture practices and are of the type ordinarily found in viticulture businesses.

45. A Grower has a continuing interest in the vines from the time they are acquired until the Project ceases in 2017. The vineyard 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. A Grower's vineyard activities will constitute the carrying on of a business.

46. The management fees and rent associated with the vineyard activities will relate to the gaining of income from this business and, hence, have a sufficient connection to the operations by which the income is to be gained. Therefore, they will be deductible under paragraph 8-1(1)(a). Further, no 'non-income producing' purpose in incurring the fee is identifiable from the Project. No capital component is identifiable. The tests of deductibility under paragraph 8-1(1)(a) are met. The exclusions of subsection 8-1(2) do not apply.

### **Expenditure of a capital nature**

47. Any part of the expenditure of a Grower entering into a horticultural 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. In this Project, the costs of landcare, installation of irrigation, establishment and purchase of the rootlings/cuttings and trellising are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, expenditure of this nature can fall for consideration under specific capital write-off provisions of the ITAA 1997.

### **Subdivision 387-A: landcare expenditure**

48. Under Subdivision 387-A, capital expenditure incurred by a person carrying on a primary production business in respect of various measures primarily and principally for the prevention of land

degradation qualifies for a 100% deduction in the year in which the expenditure is incurred.

49. In order for the expenditure to qualify as a deduction under section 387-55, a business must be being carried on at the time the expenditure was incurred. A taxpayer incurring such expenditure need not be the owner of the land so long as it is used at that time for carrying on a primary production business. In this case there will generally be no delay between the signing of the agreements and the commencement of 'business operations'. Accordingly, a Grower's business of primary production will generally have commenced at the time that the expenditure is incurred. The necessary requirements under Subdivision 387-A will be met in this respect.

50. However, where all that occurs in an income year is that a person has been accepted into the Project as a Grower, but no business operations have been commenced on their behalf, they will not be accepted as having commenced a primary production business, and no deduction under Subdivision 387-A will be allowable for that, or any other, year of income.

51. The Manager has identified that the relevant expenditure attributable to eligible Landcare measures for the purposes of sections 387-55 and 387-60 is \$163. A deduction for this amount will be allowed in the year in which a participant enters into contractual arrangements with the Manager and commences to carry on a primary production business.

#### **Subdivision 387-B: irrigation expenditure**

52. Subdivision 387-B allows a taxpayer who is carrying on a business of primary production on land in Australia to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. An irrigation system of the kind proposed in this Project would be covered by this Subdivision.

53. The taxpayer who can claim the deduction does not have to actually own the land but can be a tenant or lessee. A deduction will be available to a Grower in the Project at a rate of 33.3% per annum for the cost of the irrigation system.

#### **Subdivision 387-C: horticultural plant expenditure**

54. Subdivision 387-C allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. For the

purpose of this Subdivision a lessee or licensee 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 (section 387-210).

55. Costs of establishing horticultural plants may include the costs 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 expenditure incurred on draining swamps or clearing land.

56. Under this Subdivision, where the effective life of the plant is more than three years an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The effective life of the plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the vines have an effective life of 13 to 30 years. For a plant with an effective life of 13 to 30 years the write-off rate is 13% per annum.

57. The Manager has identified that the relevant expenditure attributable to the establishment of the vine rootlings/cuttings as being \$837. This amount will be subject to the horticultural provisions and allowable as a deduction under Subdivision 387-C. The write-off under this Subdivision commences on the first day of what is to be the vines' first commercial season. The Manager will advise the Growers of this event.

#### **Section 42-15: trellising expenditure**

58. Growers accepted into the Project incur expenditure on trellising upon which the vines are attached and are to be used on their behalf in the operation of the vineyard business. This is attached to the land as a fixture. This expenditure is of a capital nature.

59. Under section 42-15, a taxpayer can deduct an amount for the purpose or purposes of producing assessable income where they are the owner or quasi-owner of that plant. However, 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 and absolutely owned by the owner of the land.

60. However, it is accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. Taxation Ruling IT 175 sets out the Australian Taxation Office's (ATO's) view on this issue. Where a lessee is considered to own the improvements under a state law, as detailed in the Ruling, or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the lessee is entitled to claim depreciation for the trellising.

61. A Grower accepted into the Project enters into a sublease for a right to occupy certain land upon which they are entitled to grow grapes to conduct a viticulture business. On expiry of the sublease a Grower agrees to sell the trellising to the Owners and the Owners agree to purchase that trellising. It is accepted that a Grower is entitled to claim depreciation for the fixture.

62. A deduction for depreciation is allowable on plant from the date it is installed and ready for use. The Manager will advise the Growers the date the trellising is installed and begins to be used for the purpose of producing assessable income. From this date the cost that relates to the acquisition and installation of the trellises on the land, will be eligible for depreciation by the Growers under section 45-125. The depreciation rate for the trellising will be 13% per annum using the prime cost method or 20% using the diminishing value method.

## Section 82KJ

63. Section 82KJ denies a deduction in respect of certain prepaid outgoings that are incurred as part of a tax avoidance agreement. Section 82KJ's operation depends, among other things, on the taxpayer acquiring, or being reasonably expected to acquire property and the consideration for that property is less than that which might reasonably be expected to have been payable.

64. 'Property' is defined broadly and includes a chose in action and any estate, interest, right or power, whether at law or in equity, in or over property. The Grower's interest in the Project falls within this definition.

65. The consideration paid by the Growers in respect of the 'property' is not less than that which might reasonably be expected to have been payable. Section 82KJ will not apply to deny the deduction otherwise allowable under section 8-1.

## Section 82KK

66. Section 82KK applies where a taxpayer incurs an allowable outgoing to an associate in an income year and the associate does not include that amount as assessable income until a subsequent year. Where the section applies the outgoing is allowable to the taxpayer only in the year in which it is included in the assessable income of the associate.

67. Section 82KH(1) defines 'associate' broadly. The definition includes a company where the company or its directors are accustomed to or are under an obligation to act in accordance with the directions of the taxpayer, or where the taxpayer and associates might

have the capacity to control the casting vote of more than 50% of the maximum number of votes that could be cast at a general meeting of such a company.

68. Provided Growers do not fall within the definition of associates of the Manager, the Winery or the Lessor, section 82KK will not apply to deny the deduction otherwise allowable under section 8-1.

### **Section 82KL**

69. 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'.

70. 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.

71. Section 82KL's operation 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.

### **Section 82KZM**

72. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

73. Under the Management Agreement a fee of \$9,200 will be incurred on execution of the Agreement. This fee is charged for providing services to a Grower only for the period of 13 months from the execution of the Agreement. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees payable for subsequent years. The fee is expressly stated to be for a number of



specified services. There is evidence this fee is for services to be provided within 13 months of incurring the expenditure in question.

74. Thus, for the purposes of this Ruling, it is accepted that no part of the fee of \$9,200 is for the Manager to do ‘things’ that are not to be done wholly within 13 months of the 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 expenditure by Growers for which a deduction is allowable under section 8-1.

#### **Part IVA: general tax avoidance provision**

75. 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).

76. The Warren River Project No 1 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, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of enabling the relevant taxpayer to obtain this tax benefit.

77. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of the grapes from the vines. Further, there are no features of the Project, such as the payment of excessive management fees and non-recourse loan financing by any entity associated with the Project, that 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. No ruling is given on the application of Part IVA to financing arrangements entered into between investors and other financiers in respect of lending arrangements to invest in the Project.

#### **Part 3-1: capital gains tax**

78. Unless any shares in the Winery are trading stock of the Grower or otherwise assessable on revenue account to the Grower, a capital gain or loss may arise on the happening of a CGT event to those shares.

**Section 6-5: assessable income**

79. Gross sale proceeds derived from the sale of grapes harvested from the Project will be assessable income of the Growers, under section 6-5.

80. Once harvested, a Grower's grapes will in most circumstances be trading stock of the Grower. As a consequence, if grapes or grape juice 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 in Part 2-25 of the ITAA 1997. In Taxation Ruling IT 2001, it is accepted that costs associated with the establishment of a vineyard do not form part of the trading stock ultimately produced by the vineyard.

**Detailed contents list**

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

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