PR 2000/103 - Income tax: The Port Robe Estate Vineyard Project

Product Ruling
Income tax: The Port Robe Estate Vineyard Project

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Potential investors may wish to refer to the ATO's Internet site at **http://www.ato.gov.au** or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

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, Previous Ruling, 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 to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

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

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 Port Robe Estate Vineyard Project, or just 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);
- section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- section 35-55 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 43-10 (ITAA 1997);
- section 110-25 (ITAA 1997);
- section 387-305 (ITAA 1997);
- section 387-125 (ITAA 1997);
- subsection 44(1) of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KJ (ITAA 1936);
- section 82KK (ITAA 1936);
- section 82KL (ITAA 1936);
- section 82KZM (ITAA 1936);
- sections 82KZMA to 82KZMD (ITAA 1936);
- section 82KZME (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling, all fees and expenditure referred to include Goods and Services Tax ("GST") where applicable. In order for an entity (referred to in this Ruling as a "Farmer") to be entitled to claim

input tax credits for the GST included in its expenditure, it must be registered, or required to be registered for GST and hold a valid tax invoice.

Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the Ralph *Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in Projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. 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'.

8. 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. Neither does it include persons or entities who are associates, as that term is defined in subsection 82KH(1) of the ITAA 1936, of any of the entities involved in the arrangement.

Qualifications

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

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 16 to 61) 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

12. This Ruling applies prospectively from 27 September 2000 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).

13. 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

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. 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.

Previous Rulings

15. This Ruling replaces Product Ruling PR 2000/13, which is withdrawn on and from the date this Ruling is made. The Project Manager has confirmed that no Stapled Interest was offered and accepted in the arrangement described in PR 2000/13. Thus, PR 2000/13 does not apply to any Farmer as contemplated by that Ruling.

Arrangement

16. The arrangement that is the subject of this Ruling is described below. The relevant documents or parts of documents lodged with the Australian Taxation Office ("ATO") that incorporate into this description of the arrangement are:

- Application for a Product Ruling, dated 2 August 1999;
- A draft Port Robe Estate Prospectus, issued by Port Robe Management Ltd ("the Project Manager") which was sent to the ATO via e-mail on 24 August 2000;
- A draft undated Constitution of the Project Manager, received on 25 November 1999;
- **A draft undated Vineyard Agreement between the Project Manager, Port Robe Estate Ltd ("the Winemaker") and a Farmer which was sent to the ATO via e-mail on 4 September 2000**;
- A draft undated Constitution of the Winemaker;
- A draft undated Custodian Agency Agreement between the Project Manager and Custodian and Funds

Management Services ("the Custodian"), received on 25 November 1999;

- A draft undated Compliance Plan for the Project Manager as the Responsible Entity, received on 25 November 1999;
- Amendments to Constitution and Compliance Plan of the Project Manager to be lodged with the Australian Securities and Investments Commission and sent to the ATO via e-mail on 1 August 2000;
- **A draft undated Declaration of Trust between the Project Manager and the Farmers, sent to the ATO via e-mail on 1 August 2000**;
- **A draft undated Grape Sale Agreement between the Winemaker and the Farmers, sent to the ATO via e-mail on 24 July 2000**;
- A draft undated Vineyard Management Agreement between the Project Manager and Cape Jaffa Viticulture Pty Ltd ("Cape Jaffa"), sent to the ATO via e-mail on 9 September 2000;
- Cygne Blanc Agreement between D and D E Mann ("the Owners"), Taurius Pty Ltd ("Taurius"), Surepoint Securities Pty Ltd and Kevin J Parry, dated 15 March 1999;
- A draft Plant Rights Options and Licences Amending Deed, sent to the ATO via e-mail on 24 July 2000;
- A draft Put and Call Option Deed (Consolidated), dated 15 March 1999, for the Grant of Plant Rights Licence between Taurius and the Winemaker, sent to the ATO via e-mail on 24 July 2000;
- A draft Plant Rights Head Licence (Consolidated), dated 15 March 1999, between the Owners and Taurius, sent to the ATO via e-mail on 24 July 2000;
- A draft undated Plant Rights Sub-Licence (Consolidated) between Taurius, the Winemaker and the Owners, sent to the ATO via e-mail on 24 July 2000;
- A draft undated Plant Rights Sub-Sub-Licence between the Owners, Taurius, the Winemaker and the Project Manager, sent to the ATO via e-mail on 24 July 2000; and
- Correspondence from the following:

(a) Letter from Deacons, Graham and James ('Deacons'), dated 4 August 1999;

(b) Facsimile transmission from Deacons, dated 10 August 1999;

(c) Facsimile transmission from Deacons, dated 11 August 1999;

(d) Facsimile transmission from Kevin Parry, dated 18 August 1999;

(e) Electronic mail from Robeco Pty Ltd, dated 30 August 1999;

(f) Letter from Cape Jaffa Viticulture Pty Ltd to the Project Manager, dated 25 November 1999;

(g) Copy of letter from Cape Jaffa Pty Ltd to the Winemaker, dated 29 November 1999;

(h) Letter from the Project Manager, dated 29 November 1999;

(i) Two facsimile transmissions from the Project Manager, dated 1 December 1999;

(j) Facsimile transmission from the Project Manager, dated 4 December 1999;

(k) Facsimile transmission from the Project Manager, dated 29 May 2000; and

(l) Correspondence and Attachments sent to the ATO through e-mails and facsimile transmission by the Consultant to the Project Manager on 8 June 2000, 24 July 2000, 1 August 2000, 24 August 2000, 4 September 2000, 6 September 2000 and 9 September 2000.

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.

17. The documents highlighted are those Farmers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Farmer, or any associate[1] of a Farmer, will be a party to, which are part of the arrangement to which this Ruling applies. The effect of these agreements is summarised as follows.

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[1] In this Ruling 'associate' has the meaning as defined in section 318 of the ITAA 1936.

Overview

18. This arrangement is called the Port Robe Estate Vineyard Project. It will be registered as a managed investment scheme under the Corporations Law. The Project is briefly described in the Table below.

Location	Mt Benson district, near Robe in South Australia
The Land	239 hectares consisting of 2 properties with 172 hectares considered suitable for establishing a vineyard
Term of the Project	18 years
Number of investments available	1,800 Stapled Interests subject to a minimum subscription of 700 being obtained on or before 30 June 2001. **This Ruling does not apply if the minimum subscription is not achieved by 30 June 2001.** Oversubscription will not be accepted.
Minimum initial cost	$9,560 per each Stapled Interest consisting of: • Farm interest ($7,810); • Vineyard interest ($750); and • Share interest of 2 shares in the Winemaker at $500 a share.
Management Fee allocation of the $7,810 Farm interest	• Year 1 - $5,720 payable in advance on or before 30 June 2001. • Year 2 - $1,254 payable in advance on or before 30 June 2002. • Year 3 - $836 payable in advance on or before 30 June 2003 (See Table in paragraph 23 for break-up of fees by expenditure type)
Annual on-going cost after Year 3	• Year 4 - $440 payable in advance on or before 30 June 2004. • Year 5 - $1,320 • Years 6 to 18 (inclusive) - previous year's fee plus 3% Fees from year 5 will be payable in arrears by 30 June each year.

19. The properties will be purchased with funds received from the Farmers' Vineyard Interests subscriptions of $750 per Farmer. However, the Project Manager reserves the right to purchase the properties ahead of the Farmers' subscriptions and hold them in trust

for the Farmers. As the Farmers' subscriptions are received, their entitlements will be allocated to them through the Custodian. The properties will be registered in the name of the Project Manager and will be held in trust for the Farmers. The Project Manager will construct a cellar door outlet, a manager's residence and other associated buildings on portions of the land that are not considered suitable for viticulture.

20. The Winemaker will purchase the rights to propagate the Cygne Blanc variety of grapes. The rights will be purchased from Taurius for a once-only payment of $2m. This will be partly funded from the Share Interest subscriptions received by the Winemaker from the Farmers. The rights are exclusive and will be for the duration of the Project. The Winemaker will sub-licence its Cygne Blanc rights to the Project Manager.

21. The Farmers will enter into a Vineyard Agreement with the Project Manager and the Winemaker. The Project Manager will be authorised to purchased Cygne Blanc cuttings from the Winemaker to enable the Project Manager to grow the grapes. Under the Vineyard Agreement, the Project Manager will manage the Project vineyard.

22. The Winemaker will enter into a Grape Sale Agreement with the Farmers to purchase the grapes produced by the Farmers. The Winemaker will also enter into a contract with Cape Jaffa to make the wine from the grapes purchased. The Winemaker will then market the wines domestically and internationally.

23. The Table below shows the expenditure items covered by each Farm Interest.

Item	**Year 1**	**Year 2**	**Year 3**	**Total**
Purchase of Rootstock, Ground Preparation and Planting	$618			$618
Dams/Irrigation	$535	$364		$899
Trellising	$1,024			$1,024
Sheds and other Capital Expenditure	$134			$134
General Management Fees	$3,409	$890	$836	$5,135
Total	**$5,720**	**$1,254**	**$836**	**$7,810**

24. When applying for their Stapled Interests under the Prospectus, Farmers will authorise the Project Manager to act as their agent and attorney for the purposes of entering into the Vineyard

Agreement in accordance with the provisions of the Project Manager's Constitution.

25. The Project Manager expects to plant the following grape varieties in the following proportions:

- Shiraz 37.5%
- Cabernet Sauvignon 25%
- Malbec 6.25%
- Merlot 6.25%
- Cygne Blanc 25%

Constitution of the Project Manager

26. The Constitution sets out the terms and conditions under which the Project Manager agrees to act for the Farmers and to manage the Project. Under the Constitution, each Farmer shall have an interest in the relevant funds of the Project equal to his Proportional Interest. The Project Manager will keep a register of Farmers. Farmers are entitled to assign their Interest in certain circumstances. Farmers are bound by the Constitution by virtue of their participation in the Project.

27. No Farmer has a right to withdraw from the Project and the Constitution places no obligation on the Project Manager to purchase, repurchase or buy-back a Vineyard Agreement from a Farmer.

28. The application monies payable by the Farmers will be banked into an Application Fund created under the Constitution. These monies will be released from the trust account to the Project Manager when certain specified criteria have been met.

Compliance plan

29. The Project Manager has prepared a Compliance Plan in accordance with the Corporations Law. Its purpose is to ensure that the Project Manager meets its obligations as the Responsible Entity of the Project and that the rights of the Farmers are protected.

Declaration of trust

30. The Project Manager will hold the legal title to the Land. It will execute a Declaration of Trust whereby it will hold title to the Land as trustee for the Farmers. Each Farmer will have an undivided 1/1800th interest in the Land for every Stapled Interest held.

Vineyard Agreement

31. A Vineyard Agreement is entered into between the Project Manager, the Winemaker and the Farmer for each of the Vineyard Interests. The term of the Agreement is 18 years from the commencement date of the Agreement. Farmers contract with the Project Manager to establish and maintain the vineyard for the duration of the Project. In consideration of the Project Manager agreeing to carry out the management services, Farmers pay management fees for the term of the Project. $7,810 are payable in advance for the first three years and are tabled above at paragraph 23.

32. The fees for Year 5 and subsequent years shall be deducted from each Farmer's share of the gross income from the Project. The Farmers remain liable for these fees regardless of the income of the Project.

33. In the first 13 months after the commencement of the Project, the Project Manager is obliged to plant rootstock on the Project vineyard, erect and maintain fencing to protect the vines, prevent soil degradation, provide drainage, erect trellises, provide fertilisers, eradicate pests and weeds, effect and maintain insurance and to do all necessary things to conduct the Project in a commercial manner in keeping with accepted wine industry standards.

34. The Project Manager will harvest and sell the grapes to the Winemaker on the Farmers' behalf.

35. Grape sale proceeds and costs are pooled. The Project Manager's Constitution provides that the gross proceeds are paid into a Proceeds Fund and that each Farmer is entitled to a proportionate share of the net sale proceeds.

36. The Vineyard Agreement provides the process in which the Project Manager may be removed from its appointment.

37. Not later than three months prior to the completion of the 18-year project term, the Farmers will collectively decide to either continue the Project under the management of the Project Manager or to sell the vineyard.

Grape sale Agreement

38. The Farmer and the Winemaker are parties to this Agreement. 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 vineyard.

39. In purchasing the grapes from the Farmers, the Winemaker agrees to pay the Grape Price, that is, the price determined at the time of purchase by the winemaker with reference to current market prices but subject to the minimum prices specified in the Schedule as follows:

- $1,750 per tonne for the cygne blanc variety; and
- $1,350 per tonne for other varieties.

40. Wine Commission is defined in this Agreement to mean "…an amount equivalent to 50% (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".

41. Both the grape sale proceeds and wine commission are paid in arrears to the Project Manager on behalf of the Farmer.

Plant Rights Sub-Licence (Consolidated) Agreement

42. In a separate Head-Licence agreement, the Owners have granted Taurius a licence to cultivate and grow Cygne Blanc grapes and produce and sell wines from those grapes within Australia for a term of 18 years. The Head-Licence also allows Taurius to grant a sub-licence of its rights to the Winemaker.

43. The Sub-Licence Agreement is made between the Winemaker, Taurius and the Owners. Under this Agreement, Taurius grants a sub-licence of its rights to the Winemaker. The grant is subject to the Project Manager raising minimum subscription. A Put and Call Option Deed shall be executed between the two parties to secure the position of each pending the successful raising of the minimum subscription.

44. In consideration of the grant, the Winemaker pays Taurius a one-off payment of $2 million, such payment to be made on Settlement Date.

45. Taurius is obligated to deliver Cygne Blanc cuttings to the Winemaker in each of September 1999 and September 2000 and to provide technical assistance in connection with the planting and development of the vines.

46. The Sub-Licence can be terminated in accordance with clauses 13.1 and 13.2.

Put and call option deed (consolidated)

47. The Deed is entered into by the Winemaker and Taurius to enable the Winemaker to secure the Cygne Blanc rights pending the raising of the minimum subscription.

48. Under the Deed, Taurius will grant a Call Option to the Winemaker, on the Winemaker paying an option fee of $500 . This will give the Winemaker the irrevocable option to purchase the Cygne Blanc rights from Taurius. At the same time, the Winemaker will grant a Put Option to Taurius, on the latter paying an option fee of $10. This will give Taurius the irrevocable option of requiring the Winemaker to purchase the Cygne Blanc rights.

49. Both options may be exercised at any time prior to 30 June 2001 by one party delivering a Notice to the other . The Option Fees are refundable if both Options are not exercised but are otherwise not refundable.

50. On the Winemaker paying the one-off licence fee of $2 million, Taurius will subscribe a total of $1,000,050 for 113 Farm Interests, 226 Shares and 113 Vineyard Interests as Stapled Interest.

Sub-sub-licence Agreement

51. This Agreement is made between the Owners, Taurius, the Winemaker and the Project Manager. Under this Agreement, the Winemaker, with the consent of the Owners and Taurius, will grant a sub-sub-Licence of its rights to the Project Manager.

52. In consideration for the grant of the Sub-Sub-Licence, the Project Manager will plant and cultivate the Cygne Blanc vines on the Land it holds as trustee for the Farmers and harvest the crop therefrom.

53. The Project Manager will pay the Winemaker $2.75 per vine cutting or such other price as may be agreed from time to time.

Vineyard Management Agreement

54. The Project Manager will contract with Cape Jaffa under this Agreement to provide for the planting and maintenance of the Project vineyard.

55. Cape Jaffa shall be appointed for an initial term of 5 years, after which the Agreement may be extended for another 5-year term.

56. The duties of Cape Jaffa under this Agreement are set out at cl. 4 and in a Schedule attached to the Agreement. They include:

- spraying the Land with herbicides and insecticides;

- applying fertiliser to the Land and undertaking soil management practices and nutrient checks;
- maintaining fire breaks, boundary fences and vehicle access tracks;
- operating an irrigation system;
- inspecting and pruning the vines;
- undertaking leaf removal and thinning; etc.

57. The fees payable by the Project Manager to Cape Jaffa are set out at cl. 5. and are as follows:

(a) reimbursement of all costs and expenses incurred by Cape Jaffa in establishing the Project;

(b) management fee of 3% of the establishment costs upon completion of Stage 1 of the Project; and

(c) thereafter, an annual fee of:

  (i) $3,599 per hectare for the period to 30 June 2001;

  (ii) $6,997 per hectare for the income year to 30 June 2002;

  (iii) $7,155 per hectare for the income year to 30 2003;

  (iv) $5,277 per hectare for all subsequent income years.

58. Under cl. 5.4, Cape Jaffa reserves the right to increase the charges at (c) above at six monthly intervals in accordance with the formula given in the clause.

59. The Agreement may be terminated on or at any time after the happening of any or more of the events set forth at cl. 11.

Finance

60. Farmers can fund their investment in the Project themselves, or borrow from an independent lender.

61. This Ruling does not apply if a Farmer enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower’s risk;

- ‘additional benefits’ are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a ‘scheme’ to which Part IVA may apply;
- loan or rate of interest is non-arm’s length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, are involved or become involved, in the provision of finance to Farmers for the Project.

Ruling

Assessable income

62. A Farmer’s share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5 of the ITAA 1997. Section 17-5 of the ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

63. Dividends from a Farmer’s shareholdings in the Winemaker will be assessable income to the Farmer under subsection 44(1) of the ITAA 1936.

Section 8-1

64. Expenditure incurred by a Farmer who participates in this Project that is otherwise deductible under section 8-1 falls within subsections 82KZME(9), (10) and (11). Such expenditure is an exception (Exception 5) to the prepayment rules contained in sections 82KZME and 82KZMF. The amount and timing of tax deductions of such expenditure for a Farmer who participates in the Project is therefore, determined under section 82KZM where the Farmer is a ‘small business taxpayer’, or under sections 82KZMA-82KZMD where the Farmer is NOT a ‘small business taxpayer’.

65. A Farmer will not incur the fees before the minimum subscription for the Project is reached and the Farmer's application to enter the Project is accepted (the date the investment is made).

Tax deductions for a Farmer who is a 'small business taxpayer'

(i) Deductions where a Farmer is not registered or not required to be registered for GST

66. A Farmer may claim the tax deductions shown in the Table below and those tax deductions shown in the Table in paragraph 75 where the Farmer:

- is a 'small business taxpayer';
- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 23; and
- is not registered or is not required to be registered for GST.

Fee Type	ITAA 1997 Section	Year ended 30 June 2001	Year ended 30 June 2002	Year ended 30 June 2003
Management Fees	Section 8-1	$3,409 – See Note (i) below	$890 – See Note (i) below	$836 – See Note (i) below
Interest	Section 8-1	See Note (ii) below	See Note (ii) below	See Note (ii) below

Notes:

(i) Where a Farmer incurs the Management Fees in accordance with the Vineyard Agreement, those fees are deductible in full in the year incurred. However, if a Farmer **chooses** to prepay fees for the doing of things (eg, the provision of planting and maintenance services) that will not be wholly done within 13 months of the fees being incurred, then the prepayments rules in section 82KZM of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 101 to 102 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than $1,000, is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred.

(ii) The deductibility or otherwise of interest arising from agreements that Farmers enter into to finance their participation in the Project is outside the scope of this Ruling. However, Farmers who are 'small business taxpayers' and who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 113 to 114 below as those rules may be applicable if interest is prepaid for a period exceeding 13 months.

(ii) Deductions where a Farmer is registered or is required to be registered for GST

67. Where a Farmer who is registered or is required to be registered for GST:

- is a 'small business taxpayer';
- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 23; and
- is entitled to an input tax credit for the fees

then the tax deductions shown in the Tables in paragraphs 66 and 75 will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 162.

Tax deductions for a Farmer who is NOT a 'small business taxpayer'

(i) Deductions where a Farmer is not registered or not required to be registered for GST

68. A Farmer may claim tax deductions using the methods or amounts shown in paragraphs 69 to 71 below and those tax deductions shown in the Table in paragraph 75 where the Farmer

- is not a 'small business taxpayer';
- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 23; and
- is not registered or is not required to be registered for GST.

69. A Farmer who is NOT a 'small business taxpayer' cannot claim the $3,409 management fee in full in the year ended 30 June 2001 (that is, the year in which the fee is incurred). The tax

deduction must be determined using the formula in subsection 82KZMB(3) (shown below). This formula apportions the tax deduction over the 'eligible service' period that the prepaid management services are to be provided.

$$\$3,409 \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of eligible service period}}$$

70. Because of the operation of the capping provisions in section 82KZMC, there is no additional deductible amount from the Table in subsection 82KZMB(5) for the year ended 30 June 2001. The balance of the management fee is deductible in year ended 30 June 2002.

71. The Project Manager must provide the Farmer with the number of days of eligible service period for the income year ended 30 June 2001. This figure is necessary to calculate the Farmer's tax deduction for both the income year ended 30 June 2001 and the income year ended 30 June 2002.

72. The management fees for year 2 ($890) and year 3 ($836), being amounts of less than $1,000, constitute 'excluded expenditure' and both are deductible in full in the year in which they are incurred. However, if a Farmer who is NOT a 'small business taxpayer' acquires more than a single Stapled Interest, the quantum of the management fees will be $1,000 or more. Where this occurs the Farmer must determine the tax deduction allowable using the subsection 82KZMB(3) formula in paragraph 69.

73. A Farmer who chooses to prepay the Management Fee other than yearly as is required under the relevant agreements, should read carefully the information shown in paragraph 112 below. The tax deductions for prepaid fees with an 'eligible service period' exceeding 13 months must be determined using the formula shown in paragraph 111 (below) unless the expenditure is 'excluded expenditure'.

(ii) Deductions where a Farmer is registered or is required to be registered for GST

74. Where a Grower who is registered or is required to be registered for GST:

- is NOT a 'small business taxpayer';
- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 23; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables in paragraphs 66 and 75 will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 162.

Tax deductions for capital expenses

75. A Farmer who participates in the Project will also be entitled to the following tax deductions:

Fee type	ITAA 1997 section	Year ended 30 June 2001	Year ended 30 June 2002	Year ended 30 June 2003
Trellising	42-15	See note (iii) below	See note (iii) below	See note (iii) below
Irrigation costs - incurred 30/6/2001	387-125	$178 - see notes (iv) & (v) below	$178 - see notes (iv)& (v) below	$178 - see notes (iv) & (v) below
Irrigation costs - incurred 30/6/2002	387-125	$nil - see notes (iv) & (v) below	$121 - see notes (iv)& (v) below	$121 - see notes (iv) & (v) below
Establishment of grapevine	387-305	$nil - see note (vi)	$129 - see note (vi)	$154 - see note (vi)
Sheds, etc	43-10	$nil - see note (vii)	$3 - see note (vii)	$3 - see note (vii)

Notes:

(iii) The tax deduction for depreciation of trellising will depend upon whether or not the Farmer is a 'small business taxpayer' (see paragraphs 103 to 105 below).

For a Farmer who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the tax deduction for depreciation of **trellising** is determined using the rates in section 42-125 and the formula in either subsection 42-160(1) ('diminishing value method') or subsection 42-165(1) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Farmer owned an interest in the trellising and the extent to which the trellising is installed ready for use during the year. The Project Manager is to advise

Farmers of relevant details to calculate their depreciation deductions for the year ended 30 June 2002. Depending upon the method the Farmer elects to use, the rate for calculating the tax deduction will be 13% prime cost method or 20% diminishing value method.

Note: The depreciation deductions for 'small business taxpayers' discussed above apply until the introduction of the Simplified Tax System on 1 July 2001 (see paragraphs 125 to 129).

For a Farmer who is NOT a 'small business taxpayer' or who is a 'small business taxpayer' who does not satisfy the conditions in section 42-345, the tax deductions for depreciation of **trellising** is determined using the formula in either subsection 42-160(3) ('diminishing value method') or subsection 42-165(2A) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Farmer owned an interest in the trellising and the extent to which each is installed ready for use during the year. The formulae use 'effective life' rather than rate to determine the deduction for depreciation. The Project Manager is to advise Farmers of relevant details to calculate their depreciation deductions for the year ended 30 June 2002. **Note**: This is only applicable to plant acquired after 21 September 1999 (see paragraphs 125 to 127).

In certain circumstances, a Farmer who is NOT a 'small business taxpayer' is able to allocate plant to a 'low value pool' (see paragraphs 132 to 135 below). Note: This choice is only available from 1 July 2000.

(iv) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.

(v) A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on landcare operations and/or facilities to conserve or convey water. This is an alternative to claiming deductions under sections 387-55 and 387-125.

(vi) A deduction is allowable under section 387-305 for the cost of establishing the vines. The amount deductible is worked out by the formula at subsection 387-305(2). The total Project establishment expenditure is $618 and deductible over the period shown in the Table. Deductibility is allowed on the basis of the vines being planted by 1 September 2001.

(vii) A deduction is allowable under section 43-10 for capital works constructed for income producing purposes. The rate of deduction is 2.5% of the construction expenditure and is allowed on the basis that the capital works are completed by 1 September 2001.

Section 35-55 – losses from non-commercial business activities

76. For a Farmer who is an individual and who enters the Project during the year ended 30 June 2001 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 will decide for the income years ending 30 June 2001 to 30 June 2003 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- a Farmer'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 (see paragraph 141 in the Explanations part of this Ruling, below).

78. Where either the Farmer'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 Farmer 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.

Section 110-25 - cost base of an asset

79. A Farmer entering into the Project pays an amount of $750 for a Vineyard Interest, being the beneficial interest in the Land as described in paragraph 19 above. Under section 110-25, this amount will form part of the cost base of the Vineyard Interest, being an asset acquired at the time the contract to acquire this interest is made. This amount is relevant in determining a capital gain or loss should the Vineyard Interest be disposed of in the future.

80. A Farmer also pays an amount of $500 for each of the two shares in the Winemaker. This amount will form part of the cost base of the share, being an asset acquired at the time the contract to acquire the share is made. This amount is relevant in determining a capital gain or loss should the shares be disposed of in the future.

81. In addition, borrowing costs incurred on a loan taken to finance the above assets will not form part of the cost base of those assets.

Sections 82KZM, 82KZMB-82KZMD, 82KJ, 82KK, 82KL and Part IVA

82. For a Farmer who participates in the Project the following provisions have application as indicated:

- expenditure by a Farmer who is a ‘small business taxpayer’ does not fall within the scope of section 82KZM (but see paragraph 101);
- section 82KZMB applies to expenditure by a Farmer who is not a ‘small business taxpayer’ (but see paragraph 112);
- sections 82KJ and 82KL do not apply to deny the deductions otherwise allowable;
- section 82KK does not apply to defer 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.

Explanations

Section 8-1

83. In determining whether management fees are deductible under section 8-1, consideration is given to the following:

- the management fees in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the management fees 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 himself or herself to a venture that may not turn out to be a business, there is doubt 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.

84. 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 provisions of 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.

85. Under the Vineyard Agreement, a Farmer engages the Project Manager to grow and harvest grapes from the Farmer's vineyard. The Project Manager may pool the grapes produced by the Project and sell them at its discretion. The purpose for which the Project Manager, on behalf of the Farmers, utilises the grapes will be a determining factor as to whether the amounts incurred on any management fee will be an allowable deduction.

86. This Ruling applies only to those Farmers engaging the Project 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?

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

- the Farmer has 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 the Farmer's behalf; and
- the weight of the general indicators of a business, as developed by the Courts, points to the Farmer carrying on such a business.

88. 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 surveyance 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.

89. For this Project, Farmers have an undivided interest in two vineyards that will be developed on land held in trust for them by the Project Manager. It is considered essential the Farmers have the intention to commence and carry on a business of viticulture on the vineyards. Farmers also have a right to access the land as held by the Trustee and they have a beneficial interest in the improvements to the land for the duration of the venture.

90. Under the Vineyard Agreement, Farmers appoint the Project Manager to provide services such as the preplanting and planting of grapevines, the installation of trellising and irrigation and all operations necessary to develop a matured fruit-bearing vine.

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

92. 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 reflected in the Budgeted Cash-Flow projections that suggest the Project should return a 'before-tax' profit to the Farmers, i.e., a 'profit' in cash terms that does not, in its calculation, depend on the fees in question being allowed as a deduction.

93. Farmers will engage the services of the Project 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.

94. 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 them, 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.

95. The management fees payable in respect of Years 1, 2 and 3, associated with the viticulture activities, will relate to the gaining of income from this business and hence will 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.

Sections 82KZME and 82KZMF

96. Unless one of the statutory exceptions applies, if the requirements of section 82KZME are met, section 82KZMF operates to set the amount and timing of deductions for expenditure that a taxpayer incurs in a year of income. Effectively, these provisions apportion the allowable tax deductions over the period during which the prepaid benefits will be provided.

97. This Product Ruling is issued in response to an application received by the Commissioner on or before 1pm (by legal time in the Australian Capital Territory) on 11 November 1999. Therefore, the Project is an arrangement to which Exception 5 (subsections 82KZME(9), (10) and (11)) applies. Because Exception 5 applies, sections 82KZME and 82KZMF do not apply to set the amount and timing of expenditure incurred by Farmers who participate in the Project. Expenditure incurred by a Farmer for the doing of a thing not to be wholly done within the expenditure year will therefore, be

determined under section 82KZM (for a 'small business taxpayer') or sections 82KZMA – 82KZMD (for a taxpayer who is NOT a 'small business taxpayer').

Section 82KZM - Farmers who are 'small business taxpayers'

98. 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. The term 'small business taxpayer' is explained below in paragraphs 103 to 105.

99. Under the Vineyard Agreement, the initial Management Fee will be incurred upon execution of the Agreement. This fee is charged for providing services to Farmers for a period of 13 months from the date of 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 being payable for subsequent years. The fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years.

100. Thus, for the purposes of this Ruling, it is accepted that no part of the initial Management Fee is for the Project Manager to do 'things' that are not to be wholly done 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 for the Management Fee by Farmers who are 'small business taxpayers'.

101. Although not required by the Vineyard Agreement, some Farmers who are 'small business taxpayers' may choose to prepay fees for periods longer than that required by the Agreement. Where a prepayment is incurred and the 'eligible service period' is greater than 13 months then, contrary to the conclusion reached above, unless the expenditure is 'excluded expenditure' section 82KZM will apply. 'Excluded expenditure' being expenditure of less than $1,000, (subsection 82KZL(1)) is an exception to section 82KZM.

102. Where the 'eligible service period' exceeds 13 months the formula in paragraph 82KZM(1)(c) (shown below) is used to apportion the tax deduction over the period that the benefits relating to the prepaid fees are provided.

$$\frac{\textbf{Period in year}}{\textbf{Eligible service period}}$$

Where:

Period in year is the number of days in the whole or the part of the eligible service period in the year of income;

Eligible service period is the number of days in the eligible service period.

Subdivision 960-Q - small business taxpayers

103. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than $1,000,000 or their turnover recalculated under section 960-350 is less than $1,000,000.

104. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

105. Whether a Farmer is a 'small business taxpayer' depends upon the circumstances of each Farmer and is beyond the scope of this Product Ruling. It is the responsibility of each Farmer to determine whether or not they are within the definition of a 'small business taxpayer'.

Section 82KZMA – 82KZMD - Farmers who are NOT 'small business taxpayers'

106. For a Farmer who is NOT a 'small business taxpayer', sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the expenditure year). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

107. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Farmers participating in the Project, transitional treatment applies to prepayments initially incurred in the year ended 30 June 2001. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service

period ends more than 13 months after the date the expenditure was occurred.

108. Under the Vineyard Agreement, the Management Fee is for services to be wholly done within 13 months of the fee being incurred. Therefore, the tax deduction available to a Farmer for the Management Fee of $3,409 will be determined in accordance with the rules contained in section 82KZMB and 82KZMC. The amount of the deduction available to Farmers in the 'expenditure year' (that is, the year ended 30 June 2001) is determined using the formula in subsection 82KZMB(3) and the table in subsection 82KZMB(5).

109. However, section 82KZMB is subject to the capping provisions in section 82KZMC. For Farmers who participate in the Project and incur the Management Fee in the year ended 30 June 2001, the 'later year amount' for the purposes of the table in subsection 82KZMB(5) is nil. Therefore, for the year ended 30 June 2001, the tax deduction for a Farmer who is NOT a 'small business taxpayer' will be the amount determined using the formula in section 82KZMB(3) only. The balance of the tax deduction is then determined under subsection 82KZMC(4) using the formula in subsection 82KZMC(5). For Farmers in this Project, the balance of the 13 month 'eligible service period' is in the year ended 30 June 2002, therefore the balance of the Management Fee is deductible in that year.

110. A Farmer who is NOT a 'small business taxpayer' also incurs management fees in subsequent years. These fees of $890 and $836 are incurred on or before the 30 June for the following 12 months. Both fees constitute 'excluded expenditure' for a Farmer who takes up a single Stapled Interest. 'Excluded expenditure' being expenditure of less than $1,000, (subsection 82KZL(1)) is an exception to sections 82KZMB and 82KZMC. These management fees of $890 and $836 are therefore deductible in full in the year in which a Farmer who is NOT a 'small business taxpayer' incurs them.

111. However, if a Farmer who is NOT a 'small business taxpayer' acquires more than a single Stapled Interest in the Project and the quantum of the Management Fee is $1,000 or more, then the amount and timing of the deduction allowable must be determined under sections 82KZMB and 82KZMC.

112. Although not required by the Vineyard Agreement, some Farmers who are NOT 'small business taxpayers' may choose to prepay fees for periods longer than that required by the Agreements. Where a prepayment is made and the 'eligible service period' is greater than 13 months then section 82KZMB and 82KZMC do not apply. Instead, unless the expenditure is 'excluded expenditure' section 82KZMD will apply to apportion the tax deduction over the

period that the benefits relating to the prepaid fees are provided. The relevant formula contained in subsection 82KZMD(2) is:

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

Interest deductibility

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

114. While the terms of any finance agreement entered into between relevant Farmers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid, relevant Farmers will be required to determine any tax deduction under section 82KZM (for a Farmer who is 'small business taxpayer'), or sections 82KZMA-82KZMD (for a Farmer who is not a 'small business taxpayer') – see discussion above.

Expenditure of a capital nature

115. 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 costs of preparation of the ground and establishment of 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 amenities 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 primary production business, and under the general depreciation and building write-off provisions of the ITAA 1997.

116. The Vineyard Agreement identifies the relevant expenditures incurred by the Farmers that are of a capital nature. These expenditures are detailed in paragraph 23 of this Ruling.

Subdivision 387-B - irrigation expenditure

117. Section 387-125 allows a taxpayer, who is carrying on a primary production business 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 (i.e., at 33 1/3% per annum) 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. A taxpayer need not be the owner of the land to claim the deduction, so long as he is in a primary production business.

118. The Farmers' activities in the Project amount to a primary production business and it is a business conducted on land in Australia. The water facilities acquired for them under the Vineyard Agreement will be for use in this business. The requirements of Subdivision 387-B have thus been met.

119. It should be noted however that a deduction under section 387-125 is denied where the Farmer is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Farmer can only choose a water facility tax offset where:

- had the Farmer chosen a deduction instead of the tax offset, the Farmer's taxable income for the income year would have been $20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Subdivision 387-D - cost of establishment of grapevines

120. The capital costs of establishing grapevines can be written off under Subdivision 387-D. As a Farmer in the Project will be the 'owner' of the vines for the purposes of these 'write-off' provisions, the costs will be deductible to the Farmer under section 387-305.

121. The write-off commences from the time the vines are planted in the ground by the Farmer. The write-off rate is 25% per annum, over four years, 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. Thus, where the vines are planted part-way through the income year, the write-off period will extend over five income years, with the deduction being pro-rated in the first and last years.

122. The 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).

Section 42-15 – depreciation of trellising

123. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used 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, absolutely owned by the owner of the land.

124. Under section 42-15, Farmers in the Project are entitled to depreciation deductions for capital expenditure in relation to the acquisition and installation of trellises on the land. The deduction available, however, will depend upon the date the investment is made, when the plant is installed ready for use and whether or not a Farmer is a 'small business taxpayer' (see paragraphs 103 to 105).

125. For plant acquired or constructed after 11:45 a.m. by legal time in the Australian Capital Territory on 21 September 1999, accelerated rates of depreciation are no longer available except to some 'small business taxpayers'. The Government has announced that 'small business taxpayers' who meet the conditions in section 42-345 will have access to accelerated rates of depreciation until the introduction of the proposed Simplified Tax System on 1 July 2001.

126. The immediate deduction for items of plant costing $300 or less has been removed from 1 July 2000, except for 'small business taxpayers'. The Government has announced that 'small business taxpayers' will be able to claim the immediate deduction until the introduction of the proposed Simplified Tax System.

127. The depreciation of trellising as explained in this Product Ruling is based on existing legislation and may be subject to change.

Depreciation deductions for Farmers who are 'small business taxpayers'

128. The depreciation deduction for **trellising** available to a Farmer who is a 'small business taxpayer' and who complies with the conditions contained in section 42-345 is calculated using the formula in either subsection 42-160(1) or subsection 42-165(1). The depreciation deduction depends on the cost of the trellising and the number of days the trellising was owned by the Farmer during the income year. It also depends on the extent to which the trellising is installed ready for use during the year.

129. The deduction is calculated using a rate of 13% prime cost or 20% diminishing value. These accelerated rates of depreciation are shown in section 42-125 and apply to plant with an effective life of between 13 and 30 years. The Project Manager will advise Farmers of

the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

Depreciation deductions for Farmers who are not 'small business taxpayers'

130. A Farmer who is NOT a 'small business taxpayer' or is a 'small business taxpayer' who does not satisfy the conditions in section 42-345 will not be able to claim accelerated depreciation on plant used in the Project because of section 42-118. The depreciation deduction for trellising for such a Farmer is calculated using the formula in either subsection 42-160(3) or subsection 42-165(2A).

131. The deduction depends on the cost of the plant, the number of days the plant was owned by the Farmer during the income year and the 'effective life' of the plant (see paragraph 136). It also depends upon the extent to which the plant is installed ready for use during the year. The Project Manager will advise Farmers of the date that the trellising are installed and begin to be used for the purpose of producing assessable income.

132. From 1 July 2000, however, the immediate 100% depreciation deduction for plant costing $300 or less has been replaced by a 'low value pool' arrangement for all taxpayers except 'small business taxpayers'.

133. Under subsection 45-455(1), a Farmer who is not a 'small business taxpayer' can choose to allocate 'low cost plant' to a 'low value pool' in the year of acquisition. 'Low cost plant' is plant costing less than $1,000. Once the choice is made to allocate 'low cost plant' to the pool, <u>all</u> 'low cost plant' acquired in that income year and subsequent income years must be included in the pool (subsection 42-460(1)).

134. A 'low value pool' is depreciated using a diminishing value rate of 37.5%. However, low cost plant is depreciated at 18.75% in the year it is allocated to the pool, irrespective of the date it is allocated. The value of plant included in or disposed of from such a pool will be added to or subtracted from the value of the pool.

135. Under the Vineyard Agreement, for a single Stapled Interest acquired in the Project, a Farmer incurs expenditure of $1,024 for trellising and will first be entitled to claim a deduction for depreciation in the year ended 30 June 2002. Provided that the Farmer uses the diminishing value method to depreciate the trellising, the plant can be allocated to a 'low value pool' after it has been depreciated below $1,000 (paragraph 42-455(3)(b)).

Determination of effective life

136. Subdivision 42-C provides the choice of methods for determining the 'effective life' of plant. Farmers can either self-assess the effective life of plant or use the effective life specified by the Commissioner. In the schedule, the Commissioner has determined that the effective life of trellising is 20 years.

Section 43-10 - Capital Works

137. Under the Vineyard Agreement, Farmers incur expenditure on the construction of sheds and other buildings for use in the vineyard business. If the expenditure is incurred in relation to a construction expenditure area (section 43-75), it may be written off at 2.5% per annum from the date the relevant construction is completed. The Project Manager will advise Farmers when an identified construction area is completed.

Division 35 - losses from non-commercial business activities

138. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law partnership) from certain business activities will not be allowable in an income year unless:

- the 'Exception' in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

139. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

140. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

141. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than $40,000 (excluding any net capital gain). As

both subsections relate to the individual circumstances of Farmers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

142. In broad terms, the objective tests require:

(a) at least $20,000 of assessable income in that year from the business activity (section 35-30);

(b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);

(c) at least $500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or

(d) at least $100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

143. A Farmer who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Farmer who acquires a single Stapled Interest in the Project is unlikely to pass one of the objective tests in the years covered by this Ruling.

144. Therefore, during this period, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Farmer's participation in the Project.

145. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Farmer who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the term of this Product Ruling.

146. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

(i) the business activity has started to be carried on; and

(ii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

147. This Product Ruling is issued on a prospective basis (i.e., before an individual Farmer's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years

specified above (see paragraph 76), in the manner described in the Arrangement (see paragraphs 16 to 61), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

148. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the independent Viticultural Report; and
- the binding Grape Sale Agreement between the Farmers and the Winemaker for the sale of the grapes setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the grapes are grown.

Section 82KJ

149. Under section 82KJ, a deduction for certain expenditure will be denied if it is incurred as a result of or part of a tax avoidance scheme. Generally, the section would apply to totally deny the deduction if a benefit is available to the taxpayer or an associate of the taxpayer which would not have been available if the expenditure had not been incurred. A benefit is one which will result in the acquisition of property by the taxpayer or associate. 'Property' is defined very broadly in subsection 82KH(1) to include choses in action, interests, rights, etc.

150. In this Project, a Farmer or his associate will not acquire any other property or additional benefits other than what is contractually acquired under all the relevant agreements. It is therefore concluded that section 82KJ will not apply to deny any deduction which would otherwise be allowable under section 8-1 of the ITAA 1997.

Section 82KK

151. Section 82KK applies to arrangements entered into by associates to defer tax. It ensures that when a taxpayer incurs an expenditure to an associate, a deduction is only allowed in the year when the associate returns the amount as assessable income regardless of when the expenditure is incurred. Thus, where the income is assessable in a later year, a deduction will only be allowed in that later year.

152. For this section to apply, there must be an involvement of an associate as required by paragraph 82KK(1)(a). The term 'associate' is broadly defined in subsection 82KH(1). For a company, it includes

a person whose directions and wishes the company (or its directors) is accustomed or obligated to follow, or who can cast, or control the casting of, more than 50% of the maximum number of votes that can be cast at the company's general meeting.

153. Provided a Farmer is not an associate of the Project Manager or Winemaker, section 82KK will not apply to defer the timing of any of the deductions otherwise allowable to the Farmer under section 8-1 of the ITAA 1997.

Section 82KL

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

155. An 'additional benefit' (defined 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. A taxpayer will have received an additional benefit if that benefit, together with the expected tax saving, recoups the expenditure for the taxpayer so that effectively no real deductible loss is suffered.

156. The operation of section 82KL thus depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. For the Project, no conclusion can be drawn that a Farmer's participation has resulted, or will result, in the Farmer obtaining any 'additional benefit'. Accordingly, there is no basis on which to find that this precondition for the operation of the section will be satisfied, so as to deny the deduction otherwise allowable under section 8-1.

Part IVA

157. 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).

158. The Project will be a 'scheme'. In entering the scheme, the Farmers will obtain a 'tax benefit' in the form of the deductions for the amounts indicated in this Ruling 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.

159. 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 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 might suggest the Project was 'tax driven' and so designed to produce a tax deduction of a certain magnitude that it would attract the operation of Part IVA.

Cost base of an asset – section 110-25 ITAA 1997

160. Generally, interest incurred on a loan taken to finance the purchase of an asset will not form part of the cost base of that asset where the interest is or will be an allowable deduction under section 8-1 (subsection 110-25(7)). This Ruling does not deal with whether such interest incurred by a Farmer will or will not form part of the cost base of the asset.

161. In addition, borrowing costs incurred on such a loan will not form part of the cost base of that asset because the borrowing costs are incurred in obtaining the loan; they are not part of the consideration or accidental costs of acquiring the asset and they are not non-capital costs of ownership of the asset (subsections 110-25(2) to (4)).

Example

Entitlement to 'input tax credit'

162. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of $5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees however, is reduced by the amount of any 'input tax credit' to which she is entitled. The Project Manager provides Margaret with a tax invoice which includes its ABN and shows the price of the taxable supply for management services ($5,500). Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

1/11 x $5,500 = $500

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is $5,000 ($5,500 *less* $500).

Detailed contents list

163. Below is a detailed contents list for this Product Ruling:

Commissioner of Taxation
27 September 2000

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
TR 92/1; TR 92/20; TD 93/34; TR 97/11; TR 97/16; TR 98/22; PR 1999/95

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

Legislative references:
- ITAA 1936 44(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZME
- ITAA 1936 82KZMF
- ITAA 1936 82KH(1)
- ITAA 1936 82KH(1F)(b)
- ITAA 1936 82KJ
- ITAA 1936 82KK
- ITAA 1936 82KL
- ITAA 1936 82KL(1)
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZM(1)(c)
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMB(3)
- ITAA 1936 82KZMB(5)
- ITAA 1936 82KZMC
- ITAA 1936 82KZMC(4)
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZME(9)
- ITAA 1936 82KZME(10)
- ITAA 1936 82KZME(11)
- ITAA 1936 82KZMF
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(1)(a)
- ITAA 1997 8-1(1)(b)
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55

- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 42-15
- ITAA 1997 42-118
- ITAA 1997 Subdiv 42-C
- ITAA 1997 42-125
- ITAA 1997 42-160
- ITAA 1997 42-160(1)
- ITAA 1997 42-160(3)
- ITAA 1997 42-165
- ITAA 1997 42-165(1)
- ITAA 1997 42-165(2A)
- ITAA 1997 42-460
- ITAA 1997 42-460(1)
- ITAA 1997 42-345
- ITAA 1997 43-10
- ITAA 1997 45-455
- ITAA 1997 45-455(1)
- ITAA 1997 45-455(3)(b)
- ITAA 1997 110-25
- ITAA 1997 110-25(2)
- ITAA 1997 110-25(4)
- ITAA 1997 110-125
- ITAA 1997 Subdiv 387-B
- ITAA 1997 387-125
- ITAA 1997 387-130
- ITAA 1997 387-150
- ITAA 1997 Subdiv 387-D
- ITAA 1997 387-305
- ITAA 1997 387-305(2)
- ITAA 1997 387-310
- ITAA 1997 388-55
- ITAA 1997 Subdiv 960-Q
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
- ITAA 1997 995-1(1)

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