PR 2000/104 - Income tax: Black George Warren River Project No. 1 - Supplementary Prospectus

Product Ruling
Income tax: Black George Warren River Project No.1 - Supplementary Prospectus

Contents	**Para**

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 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 Black George Warren River Project No.1, 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);
- Division 35 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 42-125 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM;
- sections 82KZMB - 82KZMD (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling, all fees and expenditure referred to include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a Wine Producer) 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 and on or before 22 June 2001. 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 'Wine Producers'.

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.

Qualifications

9. The Commissioner rules on the precise arrangement identified in this Ruling. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

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- the Ruling will be withdrawn or modified.

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

Date of effect

11. This Ruling applies prospectively from 4 October 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).

12. 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).

Withdrawal

13. 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 change in the arrangement or in the persons' involvement in the arrangement.

Previous Rulings

14. This Ruling applies to the Project that was ruled upon in Product Ruling PR 2000/72. PR 2000/72 is withdrawn on and from the date this Ruling is made. The former Ruling applies to investors who entered into the arrangement during the period 14 June 2000 to 4 October 2000 inclusive. This Ruling applies to Wine Producers wishing to take up an interest or interests that were not sold prior to 4 October 2000.

Arrangement

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

- Application for Product Ruling dated 5 September 2000;
- Supplementary Prospectus dated 21 September 2000;
- Application for Product Ruling dated 14 March 2000;
- Prospectus for the Black George Warren River Project No.1;
- **Draft Constitution for the Black George Warren River Project No.1 between Primary Securities Ltd (the 'Responsible Entity'), Primary Securities Ltd ('the Bare Trustee') and the Wine Producer, undated**;
- **Draft Management Agreement between Black George Management Pty Ltd (the Manager), Primary Securities Ltd (the 'Responsible Entity'), Primary Securities Ltd ('the Bare Trustee') and the Wine Producer, undated, received 8 September 2000;**
- **Draft Vinelot Lease Agreement between Warren River Property Ltd (the 'Developer'), Primary Securities Ltd (the 'Responsible Entity'), and the Wine Producer, dated 6 April 2000;**
- Draft Head Lease between R.J. Dawson, S.A. Dawson, R.S. Morris & C.A. Morris and Warren River Property Ltd (the 'Developer'), dated 28 February 2000;
- Deed of Variation to Head Lease between R.J. Dawson, S.A. Dawson, R.S. Morris & C.A. Morris

and Warren River Property Ltd (the 'Developer'), undated, received 5 September 2000;

- Option to Purchase Land between R.J. Dawson, S.A. Dawson, R.S. Morris & C.A. Morris and Warren River Property Ltd;
- Deed of Variation to Option to Purchase Interest in Black George Wines Pty Ltd between Warren River Holdings Pty Ltd and Black George Wines Pty Ltd and Douglas Fairhurst Wilson & Margaret Joy Wilson, undated, received 5 September 2000;
- **Draft Licence Agreement between Black George Management Pty Ltd (the 'Manager'), Primary Securities Ltd (the 'Responsible Entity'), Primary Securities Ltd (the 'Bare Trustee'), Warren River Holdings Pty Ltd ('the Licensor') and the Wine Producer, dated 6 April 2000;**
- Draft Agreement for Sale of Name and Marks between Warren River Property Ltd (the 'Developer') and Warren River Holdings Pty Ltd;
- Wine Production Agreement between Black George Management Pty Ltd (the 'Manager') and Black George Wines Ltd;
- Draft Project Supervision Agreement between Brand & Associates Pty Ltd and Black George Management Pty Ltd ('the Manager') dated 6 April 2000;
- Draft Vineyard Management Agreement between Roland John Dawson and Rodney Scott Morris ('the Vineyard Manager') and Black George Management Pty Ltd ('the Manager') dated 6 April 2000;
- Draft Wine Marketing Agreement between Global Wines (Australia) Pty Ltd and Black George Management Pty Ltd dated 6 April 2000;
- Compliance Plan for the Black George Warren River Project No.1, undated; and
- Additional correspondence received from the applicant dated 7 April 2000, 28 April 2000, 11 May 2000, 16 May 2000, 24 May 2000, 30 May 2000, 31 May 2000, 2 June 2000, 22 September 2000 and 6 June 2001.

Note: certain information received from Black George Management Pty Ltd has been provided on a commercial-in-

confidence basis and will not be disclosed or released under Freedom of Information legislation.

16. The documents highlighted are those the Wine Producers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Wine Producer, or any associate of the Wine Producer, will be a party to, with the exception of finance agreements to which paragraphs 42 and 43 apply. The effect of these agreements is summarised as follows.

Overview

17. This arrangement is called the Black George Warren River Project No.1.

Location	Pemberton in the South West Region of Western Australia.
Type of business each participant is carrying on	A commercial viticulture and wine production business.
Number of hectares under cultivation	35 hectares
Name used to describe the Project.	Black George Warren River Project No.1
Size of each Vinelot	0.035 hectares
Number of vines per hectare	1,666
Average yield of Grapes	10 tonnes per hectare
Expected wine production	72.2 cases per tonne of grapes crushed
The term of the investment in years	Approximately 25 years
Initial cost	$8,559
Initial cost per hectare	$244,545
Ongoing costs	Annual Management Fees and Rent

18. Wine Producers applying under the Prospectus enter into a Management Agreement and a Vinelot Lease Agreement. Under the Vinelot Lease Agreement Wine Producers lease an identifiable area of land called a ‘Vinelot’ from Warren River Property Ltd until the Project is terminated on 29 June 2025. Each Vinelot is 0.035 hectares

in size. Wine Producers are also required to subscribe for shares in Warren River Property Ltd.

19. The Project is situated on two parcels of land in the South West Region of Western Australia, approximately 10kms south of Pemberton, known as 'Dawson Land' and 'Warren Land'. Warren River Property Ltd has been granted a Head Lease and an option for purchase over the Dawson Land and the Warren Land.

20. Warren River Property Ltd will lease the Vinelot to the Wine Producer for the purpose of Cultivating Vines and Harvesting Grapes.

21. Overall, it is proposed to plant 35 hectares representing 1,000 interests. Each investor may subscribe for a minimum of one Vinelot and 2,265 shares at $1 each. There is no minimum subscription for the Project. The Manager will plant approximately 58 vines per Vinelot (1,666 per hectare) following the execution of the Management Agreement and Vinelot Lease (cl 3.2 of Constitution). Growers wishing to participate in the Project during the 2000/2001 income year must apply by 22 June 2001. The Manager will be monitoring on a daily basis its ability to complete all of the required services by 30 June 2001 and the Responsible Entity will not execute agreements for any Vinelots where it is reasonably apparent that they will not be able to do so.

22. Possible projected returns for Wine Producers are outlined in the Prospectus. The projected returns are subject to the inherent risks of primary production and the commercial risks of a long term venture. Black George Management Pty Ltd has outlined these risks in the Prospectus. Based on the example set out on pages 30 - 37 of the Prospectus, a Wine Producer could expect to achieve an internal rate of return of 12.0% per Vinelot on the Wine Production business and 11.9% per Vinelot including the final value of the shares.

23. The Viticultural Consultant has reported at pages 45 - 48 of the Prospectus that with appropriate establishment procedures and sound management, this project can achieve its aims and objectives as outlined in the Prospectus.

Constitution

24. The Constitution for the project sets out the terms and conditions under which the Responsible Entity agrees to act for the Wine Producers and to manage the Project. The Responsible Entity will keep a register of Wine Producers. A Wine Producer is entitled to assign their Wine Producer's Interest in certain circumstances.

25. The Management Agreement will be executed on behalf of a Wine Producer following them signing the Application in the Prospectus. Wine Producers are bound by the Constitution, the

Vinelot Lease, Management Agreement and Licence Agreement by virtue of their participation in the Project.

26. The Subscription Monies will be held in the Trust Account by the Bare Trustee formed under the Project's Constitution (cl 6.1(a)).

Compliance plan

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

Interest in land

28. A lease is granted by the Developer, Warren River Property Ltd, to the Wine Producers under the terms of the Vinelot Lease (cl.2.1). Wine Producers are granted an interest in land in the form of a lease to use their Vinelots for the purpose of cultivating vines and harvesting grapes for commercial grape production (Recital E). Wine Producers must pay rent to the Developer of an amount specified in Part 5 the Schedule to the Vinelot Lease. Rent is payable in advance. An amount of $57.75 per Vinelot is payable for the first year ending on 30 June 2001 and is paid in proportion to the number of months remaining in the first year from the commencement date. The amounts payable for the years commencing 1 July 2001 and 1 July 2002 are $57.75 and $59.40 respectively. Rent will be reviewed and indexed annually commencing on 30 June 2005. The term of a Wine Producer's lease is from the Commencement Date until 29 June 2025.

Management Agreement

29. Each Wine Producer enters into a Management Agreement with the Manager. The termination of the project is the date on which all wine has been sold, proceeds from the sale of wine have been paid, and all accounts and reports have been given in relation thereto (cl.3). Wine Producers contract with the Manager to plant, manage, maintain and harvest grapes from the vines and to produce, package, market and sell wine from the grapes. Wine Producers pay a Management Fee of $7,547.15 in Year One, $2,712.05 in Year Two, $2,854.50 in Year Three and an amount annually thereafter which is the Wine Producer's proportion of the Manager's actual costs for performing the services under this agreement.

30. The Manager will carry out the following services under this agreement:

- prepare and cultivate the Vinelots in a proper and skilful manner pursuant to the Management Plan;
- take any necessary steps to prevent or combat land degradation in relation to the Vinelots;
- purchase and plant rootlings and vines in a healthy condition;
- tend to the rootlings and vines according to the principles of good husbandry, including applying fertiliser;
- maintain existing fences to prevent soil degradation and protect the placement of vines;
- keep the Vinelots in good and substantial repair and condition and conduct activities on them in a commercial manner in keeping with accepted viticulture industry standards;
- repair damage to roads and fences on the Vinelots resulting from the performance of the Manager; and
- do such things as may reasonably be required to eradicate, exterminate and keep the Vinelots and the land free from disease, vermin, noxious weeds, rabbits, insect pests and all other pests.

31. The Manager will harvest (cl 7) each season (except for the initial growing seasons) as and when deemed appropriate in keeping with sound viticultural practice, to produce the best results for the Wine Producer. The Manager will be responsible for paying for the cost of annual insurance on the Vinelots (cl. 12).

Fees

32. The total fee payable in the first year under the Management Agreement for the Project is $8,501.35 per Vinelot. This fee includes the Management Fee of $7,547.15 which is payable 30 days from the Commencement Date. The balance of the fee is made up of fees for rootlings expenses of $224.62, irrigation costs of $288.75, landcare expenses of $153.12 and trellising expenses of $287.71 which are all payable 30 days from the Commencement Date. These services will be provided in the period from the Commencement Date to 30 June 2001, with the exception of planting the vines which will be carried out during September and October 2001.

33. A Management Fee of $2,712.05 is payable for services to be carried out in the period commencing 1 July 2001 until 30 June 2002 which is payable in the following instalments. $1,311.75 is payable

on 1 July 2001 and $1,400.30 is payable by quarterly instalments at the beginning of each quarter commencing 1 July 2001.

34. A Management Fee of $2,854.50 is payable for services to be carried out in the period commencing 1 July 2002 until 30 June 2003 which is payable in the following instalments. $975.70 is payable on 1 July 2002 and $1,878.80 is payable by quarterly instalments at the beginning of each quarter commencing 1 July 2002.

35. For the years from 1 July 2003 to 30 June 2025, Management Fees are payable by the Wine Producer each year for the Wine Producer's proportion of the actual cost to the Manager of performing the services under the Management Agreement for the relevant financial year.

36. Rent is payable by the Wine Producer under the Vinelot Lease Agreement. Rent for the first year shall be $57.75 if the lease commencement date is on or before 30 June 2000 or a proportion of that amount determined by the number of whole months remaining in the first year.

37. Rent of $57.75 is payable on 1 July 2001 for the year 1 July 2001 to 30 June 2002.

38. Rent of $59.40 is payable on 1 July 2002 for the year 1 July 2002 to 30 June 2003.

Planting

39. During September and October 2001 the Manager will be responsible for planting rootlings and vines on the leased area. After planting the Manager will tend to the rootlings and vines according to the principles of good husbandry. The services to be provided by the Manager over the term of the project are outlined in the Management Agreement (cl 5).

Wine production

40. The Manager will be responsible for the harvesting of the grapes, and/or purchase of the grapes and delivery of the grapes to the winery and for production of wine from those grapes and storage of the wine. The harvest will take place each season (except for the initial growing seasons) as and when deemed appropriate by the Manager in keeping with sound viticultural practice to produce the best results for the Wine Producer.

41. The receipts from the sale of wine will be paid into the Trust Account held by the Bare Trustee in the name of the Custodian. Receipts received by the Bare Trustee are to be distributed in the following order of priority:

- to the Responsible Entity for any outstanding fees and expenses payable by the Wine Producer to the Responsible Entity under the Constitution;
- to the Manager for any outstanding fees, costs or interest owing by the Wine Producer to the Manager under the Management Agreement;
- to the Developer for any outstanding rent or other fees, costs, interest or expenses owing by the Wine Producer to the Owner under the Lease; and then
- to the Wine Producer provided that if the aggregate sum to be distributed to all of the Wine Producers is less than $1,000, then, at the discretion of the Responsible Entity, distribution to Wine Producers may be postponed. (cl 12 of Constitution).

Finance

42. All Wine Producers are required to fund their investment in the Project themselves or borrow from an independent lender.

43. This Ruling does not apply if a Wine Producer 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;
- entities associated with the Project are involved in the provision of finance for the Project;
- 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;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender; or

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

Ruling

Section 8-1

Deductions where a Wine Producer is <u>not</u> registered or <u>not</u> required to be registered for GST

44. A Wine Producer may claim the deductions in the following table, where the Wine Producer:

- participates in the Project by 30 June 2001 to carry on the business of viticulture;
- incurs the fees shown in the table below; and
- is not registered or required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 30/6/2001	Year 2 30/6/2002	Year 3 30/6/2003
Management Fee	8-1	$7,160 see note (i) below	$2,712	$2,854
Lease Fee	8-1	see note (ii) below	$57	$59
Rootlings and Planting	387-165	Nil see note (iii) below	Nil	Nil

Notes:

(i) A deduction under section 8-1 is allowable to the extent that the fee is incurred in producing assessable income and is not capital in nature. An amount of $231 per Vinelot has been identified as capital expenditure in respect of buildings and $155.32 in respect of pre-planting and planting costs (please note, however, paragraph 51).

(ii) A deduction is allowable for the lease fee incurred in the first year. The amount of the deduction will depend on the date the Wine Producer enters the Project as the lease fee for the first year is paid in proportion to the number of months remaining in the first year from the commencement date (please note, however, paragraph 51).

(iii) A deduction under section 387-165 for expenditure on acquiring and planting the vines is calculated on the basis of the grapevines, as horticultural plants, entering their first commercial season in the year ended 30 June 2004 and a Wine Producer determining, under section 387-175, that they have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years. This results in a write-off rate of 13%. The relevant expenditure has been identified as $224.62 for the cost of rootlings and $155.32 for planting costs.

Tax deductions for capital expenses

45. A Wine Producer who invests in the Project will also be entitled to the following tax deductions:

Fee Type	ITAA 1997 Section	Year 1 30/6/2001	Year 2 30/6/2002	Year 3 30/6/2003
Trellising	42-15	See note (iv) below	See note (iv) below	See note (iv) below
Landcare operations	387-55	$153 see notes (v) & (vii) below		
Irrigation	387-125	$96 see notes (vi) & (vii) below	$96 see notes (vi) & (vii) below	$96 see notes (vi) & (vii)
Establishment of horticultural plants	387-165	Nil see note (viii) below	Nil see note (viii) below	Nil see note (viii) below

Notes:

(iv) The tax deduction for depreciation of trellising will depend upon whether or not the Wine Producer is a 'small business taxpayer' (see paragraphs 84 to 87 below).

Under section 42-167 a Wine Producer who is a 'small business taxpayer' is entitled to an immediate deduction for 100% of the cost of trellising being plant the cost of which is $300 or less.

For a Wine Producer who acquires a number of interests in the Project, 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 Wine Producer owned an interest in the trellising and the extent to which the trellising is installed ready for use during the year. The Project's Manager is to advise Wine Producers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Depending upon the method the Wine Producer 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 81 to 82).

For a Wine Producer 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 deduction 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 Wine Producer owned an interest in the trellising and the extent to which it is installed ready for use during the year. The formulae use 'effective life' rather than a rate to determine the deduction for depreciation. The Project's Manager is to advise Wine Producers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Note: This is only applicable to plant acquired after 21 September 1999 (see paragraphs 81 to 82).

A Wine Producer who is NOT a 'small business taxpayer' has the option of allocating the trellising to a 'low value pool' and calculating the depreciation deduction under section 42-470 using the diminishing value method (see paragraphs 93 to 97 below).

(v) A deduction is allowable under section 387-55 for capital expenditure incurred for landcare operations.

The deduction is allowed in the year that the expenditure is incurred.

(vi) 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.

(vii) 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.

(viii) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the grapevines for use in a horticultural business. The deduction is allowable when the grapevines, as horticultural plants, enter their first commercial season. If the grapevines have an 'effective life' for the purposes of section 387-185 of greater than '13 but fewer than 30 years', this results in a write-off rate of rate of 13% prime cost. The Project's manager will inform Wine Producers of when the grapevines enter their first commercial season.

Deductions where a Grower is registered or required to be registered for GST

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

- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 44; and
- is entitled to an input tax credit for the fees then the tax deductions shown in the Table(s) above will exclude any amounts of input tax credit (Division 27, ITAA 1997). See example 1 at paragraph 124.

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

47. For a Wine Producer 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 2007 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.

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

- a Wine Producer'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 69 in the Explanations part of this Ruling, below).

49. Where either the Wine Producer'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 Wine Producer will not be required to defer any excess of the deductions attributable to their business activity in excess of any assessable income from that activity, i.e. 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.

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

50. For a Wine Producer who invests in the Project and incurs expenditure as required by the Vinelot Lease and Management Agreements the following provisions of the ITAA 1936 have applications as indicated:

(i) the expenditure by Wine Producers does not fall within the scope of section 82KZM (but see paragraph 51 below);

(ii) the expenditure by Wine Producers does not fall within the scope of sections 82KZMB-82KZMD (but see paragraph 51 below);

(iii) section 82KL does not apply to deny the deductions otherwise allowable; and

(iv) 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.

Prepaid fees

51. In this Project the Vinelot Lease and Management Agreements that Wine Producers enter into do not require fees to be paid by Wine Producers prior to the commencement of each eligible service period. If however, a Wine Producer chooses to incur expenditure in respect of services to be provided for a period that has not yet commenced then the prepayment will not be deductible in full in the year in which it is incurred. Rather, using the formula shown below, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are provided (see paragraphs 113 to 117).

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

Section 6-5 - ITAA 1997: assessable income

52. Gross sale proceeds derived from the sale of wine from the project will be assessable income of the Wine Producers under section 6-5 of ITAA 1997. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

53. Once harvested, a Wine Producer’s grapes will be trading stock of the Wine Producer, as will any bottled wine. As a consequence, if grapes or grape juice or bottled wine are on hand at the end of the income year, the Wine Producer will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of ITAA 1997.

54. Each Wine Producer will be notified by Black George Management Pty Ltd of the respective amounts to be brought to account in proportion to their total holding in the Project, in accordance with Part 2-25 and Taxation Ruling IT 2001.

Explanations

Section 8-1 - ITAA 1997

55. It is appropriate, as a starting point, to consider whether the lease and management fees are deductible under 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 activities to produce assessable income of the taxpayer.

56. A vineyard and wine production project can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from wine from the scheme will constitute gross assessable income under section 6-5 of the ITAA 1997. 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, maintaining and harvesting the vines and the production and marketing of the wine.

57. Generally, a Wine Producer will be carrying on a vineyard and wine production business where:

- the Wine Producer has an identifiable interest in specific grape vines coupled with a right to harvest and sell the grapes produced;
- the vineyard activities are carried out on the Wine Producer'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.

58. Under the Vinelot Lease, Wine Producers have rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of a commercial vineyard. Under the Management Agreement, Wine Producers appoint Black George Management Pty Ltd, as Manager, to carry out viticulture farming in accordance with the agreement. The agreements give Wine Producers full right, title and interest in the grapes produced and the right to have the wine sold for their benefit.

59. Under the Management Agreement, Wine Producers appoint the Manager to provide services such as purchasing and planting rootlings and vines in a healthy condition on the Vinelots, installing

trellising and irrigation, and tending to the rootlings and vines according to the principles of good husbandry. The Manager is also responsible for harvesting and purchasing grapes, arranging for the grapes to be processed into wine and marketing the wine. The specific cost of these services provided in the first year is $8,501.35.

60. The Lease gives Wine Producers an identifiable interest in specific vines and a legal interest in the land by virtue of a lease. Wine Producers elect to use the Manager, Black George Management Pty Ltd, to market the produce for them.

61. Wine Producers have the right to use the land in question for the cultivation of vines and harvesting of grapes and to have the Manager enter the land to carry out its obligations under the Management Agreement. The Wine Producers' degree of control over the Manager, as evidenced by the Agreement and supplemented by the Corporations Law, is sufficient. Under the Project, Wine Producers are entitled to receive regular progress reports on the Manager's activities. Wine Producers are able to terminate arrangements with the Manager in certain instances, such as cases of neglect, failure to satisfy any substantial duty or the Manager going into liquidation. The activities described in the Management Agreement are carried out on the Wine Producers' behalf.

62. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Wine Producers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections in the Prospectus that suggest the Project should return a 'before-tax' profit to the Wine Producers, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

63. Wine Producers will engage the professional services of a Manager with appropriate credentials. The services are based on accepted viticulture practices and are of the type ordinarily found in viticulture activities. In addition, the Manager will provide winemaking and marketing services.

64. Wine Producers have a continuing interest in the vines from the time they are acquired until they reach the end of the most productive period of their life. There is a means to identify which vines Wine Producers have an interest in. The vineyard and wine production activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Wine Producers' vineyard and wine production activities will constitute the carrying on of a business. In addition, the Wine Producers have an interest in the wine produced.

65. The management fees and lease fees 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 this income (from the sale of wine) is to be gained from the business. They will, thus, be deductible under the first limb of section 8-1. 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 amount deductible under section 8-1 is $7,160.83 after removing the capital component identified in the fee.

Division 35 - losses from non-commercial business activities

66. 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.

67. 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.

68. 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.

69. 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 Wine Producers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

70. 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).

71. A Wine Producer 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 Wine Producer who acquires the minimum investment in the Project of one Vinelot during the year ended 30 June 2001 is unlikely to pass one of the objective tests until the year ended 30 June 2008. Wine Producers who acquire more than one Vinelot may however, pass one of the tests in an earlier year.

72. Therefore, prior to this time, 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 Wine Producer's participation in the Project.

73. 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 Wine Producer 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) until the year ended 30 June 2008.

74. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised 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.

75. This Product Ruling is issued on a prospective basis (i.e., before an individual Wine Producer'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 47) in the manner described in the Arrangement (see paragraphs 15 to 43), 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.

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

- the report of the Independent Viticulturist and additional expert or scientific evidence provided with the application by the Responsible Entity;
- independent, objective and generally available information relating to the viticulture industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Expenditure of a capital nature

77. Any part of the expenditure of a Wine Producer entering into a viticultural 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 irrigation, trellising, rootlings and planting, landcare operations and buildings 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.

Section 42-15 - ITAA 1997: trellising expenditure

78. 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.

79. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. Income Tax Ruling IT 175 sets out the Australian Taxation Office's (ATO's) views 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 fixture.

80. Under section 42-15 Wine Producers 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 Wine Producer is a 'small business taxpayer' (see paragraphs 84 to 87).

81. 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.

82. 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.

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

Subdivision 960-Q - ITAA 1997: small business taxpayers

84. In this Product Ruling the term 'small business taxpayer' is relevant for the purposes of the depreciation of trellising.

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

86. 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.

87. '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).

Depreciation deductions for Wine Producers who are 'small business taxpayers'

88. Under section 42-167, a Wine Producer who is a 'small business taxpayer' is entitled to a 100% depreciation deduction for expenditure on trellising, being an item of plant with a cost of $300 or less.

89. The depreciation deduction for a Wine Producer who acquires a number of interests in the Project, is a 'small business taxpayer' and who complies with the conditions 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 Wine Producer during the income year. It also depends on the extent to which the trellising is installed ready for use during the year.

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

Depreciation deductions for Wine Producers who are <u>not</u> small business taxpayers

91. A Wine Producer 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 Wine Producer is calculated using the formula in either subsection 42-160(3) or subsection 42-165(2A).

92. The deduction depends on the cost of the plant, the number of days the plant was owned by the Wine Producer during the income year and the 'effective life' of the plant (see paragraph 98). It also depends upon the extent to which the plant is installed ready for use during the year. The Project Manager will advise Wine Producers of the date that the trellising is installed and begun to be used for the purpose of producing assessable income.

93. 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'

94. Under subsection 45-455(1), a Wine Producer 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, all 'low cost plant' acquired in that income year and subsequent income years must be included in the pool (subsection 42-460(1)).

95. 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.

96. Under the Management Agreement, for each interest acquired in the Project a Wine Producer incurs expenditure of $287.10 for trellising and will first be entitled to claim a deduction for depreciation in the year ended 30 June 2001. Therefore, a Wine Producer who is not a 'small business taxpayer' will have the option of including trellising in a 'low value pool'

97. Where a Wine Producer acquires more than one interest in the Project the cost of the trellising could exceed $1,000 and, therefore, the trellising may not qualify as 'low cost plant. However, provided the Wine Producer 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

98. Subdivision 42-C provides the choice of methods for determining the 'effective life' of plant. Wine Producers 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.

Subdivision 387-A: expenditure for landcare operations

99. Section 387-55 allows a taxpayer a deduction for capital expenditure incurred on a landcare operation for land used to carry on a primary production business. Wine Producers need not own the land to qualify for the deduction, so long as it is used by them to carry on a primary production business.

100. 'Landcare operation for land' includes constructing a levee or a similar improvement or constructing surface or sub-surface drainage works on the land, if the construction is principally for the purpose of controlling salinity or assisting in drainage control.

101. Under the Management Agreement a Wine Producer incurs expenditure for dams, water ways and drainage excavation on the Vinelots. A Wine Producer in the Project is accepted as carrying on a

business of primary production and these expenses will be deductible under section 387-55.'

102. However, a deduction under section 387-55 is denied where the Wine Producer is entitled to claim a landcare tax offset under section 388-55 and chooses to do so. A Wine Producer can only choose a landcare tax offset where:

- had the Wine Producer chosen a deduction instead of the tax offset, the Wine Producer's taxable income for the income year would have been $20,000 or less; and
- the expenditure is incurred before the end of the 2000-2001 income year.

Subdivision 387-B - ITAA 1997: irrigation expenditure

103. Section 387-125 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. Irrigation systems of the kind proposed would be covered by Subdivision 387-B.

104. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant or lessee, a deduction would be available to the Wine Producers in the Project at a rate of 33.3% per annum for the cost of the irrigation system. However a deduction under Section 387-125 is denied where the Wine Producer is entitled to claim a water facility tax offset under Section 388-55 and choose to do so. A Wine Producer can only choose a water facility tax offset where:

- had the Wine Producer chosen a deduction instead of the tax offset, the Wine Producers 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-C - ITAA 1997: horticulture expenditure

105. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. Costs of establishing horticultural plants may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on

draining swamps or clearing land. Under subsection 387-170(3), the definition of 'horticulture' includes the cultivation of grapevines. 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.

106. The write-off commences from the time the vines are used or held ready for use for the purpose of producing assessable income in commercial horticulture. The write-off deductions will commence when the vines enter their first commercial season. Where the vines are planted in or about September 2001, it is projected that these vines will become commercially productive after a period of 2.5 years. The Manager will advise the Wine Producer of this event.

107. Under this Subdivision, if the effective life of the plant is more than 3 years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period.

108. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the vines will have an effective life in excess of 13 years. The write-off rate for horticultural plants with an effective life of 13 to 30 years is 13%.

Section 82KZM - ITAA 1936

109. 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 of the ITAA 1997. The section applies to certain expenditure incurred under an agreement in return for doing of a thing under the agreement that is not wholly done within the same year of income as the execution of the relevant agreement.

110. Under the Management Agreement, fees of $8,501.35 per Vinelot will be incurred for the year ended 30 June 2001. The fees are charged for providing services to a Wine Producer and include the amount of $7,160.83 deductible under section 8-1 for a number of specified services to be provided by 30 June 2001. 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.

111. There is also no evidence that might suggest the services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Wine Producer incurs expenditure as required by the

agreements as set out in paragraphs 44 and 45 the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure incurred by the Wine Producer.

112. New sections 82KZMB, 82KZMC and 82KZMD also have no application to this Project since the services to be provided in respect of the initial fee are completed in the same year of income as the expenditure is incurred (see paragraph 82KZMA(3)(c)).

Prepaid fees

113. The amount and timing of deductions for any prepaid Management Fees, Lease Fees or interest otherwise deductible under section 8-1 will depend on when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means generally, the period over which the services are to be provided.

114. Where a Grower participating in this Project incurs expenditure in respect of the doing of things (eg. the performance of management services or the lending of money), prior to the commencement of the eligible service period, the prepaid expenditure is not deductible in the year in which it is incurred. Rather, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and whether the Grower is a 'small business taxpayer'.

115. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

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

116. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Grower is a small business taxpayer or section 82KZMD if the Grower is not a small business taxpayer. For small business taxpayers the amount and timing of the allowable deductions will then be calculated under the formula in subsection 82KZM(1) and for non-

small business taxpayers under the formula in subsection 82KZMD(2) Both formulae are the same, or effectively the same as that shown in paragraph 115 above, concerning section 82KZMF).

117. Prepaid management and lease fees of less than $1,000 in each expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(4) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than $1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of prepaid management fees or prepaid lease fees is $1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Interest deductibility

118. The deductibility of interest incurred by Wine Producers who finance their participation in the Project through a loan facility with a bank or other 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.

119. While the terms of any finance agreement entered into between relevant Wine Producers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in section 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and will encompass activities, such as a loan to finance participation in the Project that is not described in the Arrangement or otherwise dealt with in the Product Ruling.

120. Therefore, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Wine Producers will be required to determine any tax deduction using the formula in subsection 82KZMF(1), as shown above at paragraph 115.

Section 82KL - ITAA 1936

121. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits'. In the project, insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA - ITAA 1936

122. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C), and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Project will be a 'scheme', commencing when the Prospectus is issued. The Wine Producers will obtain an initial 'tax benefit' from entering into the scheme, in the form of tax deductions per leased area 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 obtaining this tax benefit.

123. Wine Producers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of bottled wine from the Project. The Viticulturist's Report contained in the Prospectus states that the Project can achieve its aims and objectives if appropriate establishment and sound management procedures are put in place. There are no features of 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.

Example

Example 1 – entitlement to 'input tax credit'

124. 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

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

Commissioner of Taxation
4 October 2000

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TR 98/22; TD 93/34; IT 175; IT 2001

Subject references:

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

- avoidance schemes
- tax shelters

Legislative references:

- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 27-5
- ITAA 1997 Div 35
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-55(1)(b)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 42-15
- ITAA 1997 42-25
- ITAA 1997 42-118
- 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 42-345
- ITAA 1997 Pt 2-25
- ITAA 1997 387-55
- ITAA 1997 387-125
- ITAA 1997 387-165
- ITAA 1997 387-170
- ITAA 1997 387-175
- ITAA 1997 387-185
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
- ITAA 1936 82KL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA(3)(c)
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 Pt IVA

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