



PR 2000/76 - Income tax: Magarey Wine Grape Project

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Product Ruling

Income tax: Magarey Wine Grape 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**, **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.*

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee these products as investments. Further, we give no assurance that the products are 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 products. 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 arrangements are 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 arrangements will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities in future years to confirm the arrangements have been implemented as described below and to ensure that participants in the arrangements 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.

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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 person, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Magarey Wine Grape 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 27-5 (ITAA 1997);
- section 27-30 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM (ITAA 1936);
- sections 82KZMA to 82KZMD (ITAA 1936);
- Part IVA (ITAA 1936).

3. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of those changes could affect the tax laws dealt with in this Ruling. The changes which relate to 'tax shelters' will not apply to this Ruling as there are no payments for services which will not be wholly provided within the year of income to which the payments relate.

Class of persons

4. 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 'Growers'.

5. 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

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

7. 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

9. This Ruling applies prospectively from 21 June 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).

10. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2003. The Ruling continues to apply, in respect of the tax

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law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Magarey Wine Grape Project Application forwarded to the Australian Taxation Office ('ATO') under a covering letter dated 22 February 2000;
- Draft Prospectus forwarded to the ATO under a covering letter dated 22 February 2000 prepared for Magarey Vineyards Limited ('MVL') and revised Draft Prospectus forwarded to the ATO on 19 June 2000;
- **Lease Agreement** forwarded to the ATO under a covering letter dated 22 February 2000 between Schoolhouse Projects Pty Ltd ('Landowner') and each Grower;
- **Vineyard Management Agreement** forwarded to the ATO under a covering letter dated 22 February 2000 between MVL and each Grower;
- Custodian Agreement forwarded to the ATO under a covering letter dated 22 February 2000 between MVL and Sandhurst Trustees Ltd ('Custodian');
- Draft Responsible Entity Constitution which will be registered as a Managed Investment Scheme under the Corporations Law;
- Correspondence from MVL dated 7 April 2000;
- Facsimile from Applicant's advisers dated 11 April 2000;
- E-mail from MVL dated 15 May 2000;

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

The documents highlighted are those Growers enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any

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associate¹ of a Grower, will be a party to, which are part of the arrangements to which this Ruling applies

Overview

Location	Coonawarra region. Western side of Riddoch Highway approx. 11km north of the Coonawarra Post Office.
Type of business each participant is carrying on	Commercial Viticulture
Number of acres under cultivation	250 acres
Name used to describe the product	Magarey Wine Grape Project
Size of participation	0.5 acres
Number of vines per acre	800
Number of vines per participation	400
The term of the investment	14 years and 9 months
Initial cost per acre	Vines \$1,500, Management Fee \$5,500, and Lease Fee \$2000.
Minimum subscription	There is no minimum subscription level in order for the Project to proceed.
Other aspects	A ten year sales agreement is in place for the grapes that are harvested.
Note	It is anticipated that the management and lease charges will be subject to goods and services tax and that the charges will therefore be 10% greater than those noted

13. This arrangement is called the Magarey Wine Grape Project. Growers entering into the Project will lease land from the Landowner on a property in the Coonawarra region of South Australia. Growers will also enter into a Vineyard Management Agreement with MVL to, firstly, acquire and plant, on behalf of a Grower varieties of vine

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

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seedlings on the leased land and, secondly, immediately after the planting of the vine seedlings to maintain the vineyard and to sell the grapes produced from the vines throughout the Project which will operate until 30 June 2015.

14. There are approximately 500 Allotments on offer of 0.5 acres each. Growers will lease each Allotment at a fee of \$1,000 for the period ending 30 June 2001. Growers will be required to pay Lease Fees for each year of the Project.

15. Growers will engage MVL to acquire and plant out the vine seedlings on each Allotment. The Vine Establishment Fee is \$750 per Allotment.

16. Growers will engage MVL to maintain the vineyard from the time immediately following the planting out and to care and maintain the vineyard for the duration of the Project. The Management Fee for the period ending 30 June 2001 is \$2,750 per Allotment. Management Fees will be payable by the Growers for each year of the Project.

17. Estimated returns to Growers are included at page 20 of the Draft Prospectus. The estimated returns depend on a range of assumptions and MVL cannot give any assurance or guarantee of the success or financial returns to Growers from participating in the Project.

18. Growers will execute a Power of Attorney enabling MVL as the Project Manager to act on their behalf as required when they make an application for Allotments.

Lease agreement

19. Under the Lease Agreement Growers enter into a lease for a period commencing no earlier than 1 October 2000 and ending at 30 June 2015. Growers may lease a minimum of one Allotment for the purpose of grape production.

20. Prior to the commencement of the lease the Landowner at its own cost will establish the required vineyard infrastructure on the land. To this end the Landowner will install irrigation systems, trellising and undertake other required land works.

21. Part 2 of the Lease Agreement grants an interest in the leased land to the Grower. Growers are not entitled to assign their interest in the lease of an Allotment without the consent of the Landowner (Part 8).

22. The Grower will remit the lease fee for the period ending 30 June 2001 to the Custodian on application. The Custodian will forward the lease fee to the Landowner on the commencement of the lease which will be immediately following the completion by the

Landowner of the infrastructure works but in any case no earlier than 1 October 2000. In the event the Landowner fails to undertake the required infrastructure work in relation to the Project Land by 31 October 2000, the lease fee will be returned by the Custodian.

23. The lease fee from the commencement date until 30 June 2001 is \$1,000 per Allotment. For each of the years of income ending 30 June 2002 and 2003 the lease fee is \$1,000 per Allotment. For the year ending 30 June 2004 the lease fee is \$1,100 per Allotment. Thereafter the lease fee is calculated in accordance with the formula contained in clause 3.5 of the Lease Agreement.

24. In summary, the formula provides for the lease fee for the year of income to be based on the lease fee for the immediately preceding year of income increased by Consumer Price Index movement.

25. The lease fee in the Lease Agreement is expressed to be 'exclusive of GST'. The Landowner will therefore require each Grower to increase the fee by the applicable amount of tax arising under the Goods and Services Tax Act. Registered Growers should be entitled to claim a refund as an input credit for the GST paid to the Landowner.

Vineyard management agreement

26. The Growers will engage MVL to acquire on the Growers' behalf the vine seedlings and to plant out the seedlings on the Growers' land at a cost of \$750 per Allotment. The vine planting services to be provided by MVL is described in the documents as the 'Vine Establishment Fee'.

27. Growers will pay on application the Vine Establishment Fee sum of \$750 per Allotment to the Custodian. In the event the Landowner fails to undertake the required infrastructure work in relation to the Project Land by 31 October 2000, the Growers Vine Establishment Fee payment will be returned by the Custodian.

28. MVL will plant the vine seedlings on the Growers Allotments immediately after the Lease of each Allotment commences (i.e. no earlier than 1 October 2000).

29. Under the Vineyard Management Agreement Growers engage MVL for a period commencing upon planting the vine seedlings to 30 June 2015 to maintain a vineyard on each Allotment of the Grower. Growers are not entitled to assign their interest in the Vineyard Management Agreement without the consent of MVL (Part 14.3).

30. A Grower appoints MVL to act as the Grower's sole and exclusive agent to market and sell the produce from the Growers Allotment. A Grower will be entitled to a pro-rata share of the

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proceeds arising from the sale of the grape harvest over all the Allotments in the Project.

31. The vine establishment fee and the management fees are expressed in the Vineyard Management Agreement to be 'exclusive of GST'. MVL will therefore require each Grower to increase the vine establishment fee and the management fees by the applicable amount of GST. Registered Growers should be entitled to claim a refund as an input credit for the GST paid to MVL.

Fees

32. The Grower will be required to pay a Lease Fee of \$1,000 per Allotment for the period ending 30 June 2001. The Lease Fee for each of the years of income ending 30 June 2002 and 2003 is also \$1,000 per Allotment. For the year ending 30 June 2004 the year Lease Fee will be \$1,100 per Allotment. For each year of income thereafter the Lease Fee per Allotment will be based on the Lease Fee for the previous year increased by movements in the Consumer Price Index. The Lease Fee for the year ending 30 June 2002 and each subsequent year is due for payment by 1 October of the year of income.

33. The Vine Establishment Fee of \$750 per Allotment is payable by the Grower immediately following the Landowner making the Project Land available to the Growers.

34. The Grower will be required to pay a Management Fee of \$2,750 per Allotment for the period ending 30 June 2001. The Management Fee for the year of income ending 30 June 2002 is \$2,000 per Allotment, \$1,650 per Allotment for the year ending 30 June 2003 and \$1,700 per Allotment for the year ending 30 June 2004.

35. For each year of income after the year of income ending 30 June 2004 the yearly Management Fee per Allotment will be based on the Management Fee for the previous year increased by movements in the Consumer Price Index.

36. The Management Fees for the period ending 30 June 2001 will be due by 1 April 2001. The Management Fees for each year thereafter will be due on 1 April of the year of income. A Grower will therefore pay the yearly Management Fees nine months in arrears and three months in advance of the performance of the management services.

Harvest income

37. Gartner Wines Pty Ltd has entered into a contract with the Manager for the purchase of all of the fruit to be harvested from the vineyard for a period of 10 years from the date of the first commercial harvest (expected to be 2003). The Gross Harvest Proceeds from the sale of the grapes each year will be paid to MVL. MVL will remit to the ATO on behalf of the Growers the applicable GST payable from the Gross Harvest Proceeds. Each Grower's proportional share of the costs of harvest and insurance will also be deducted from the Gross Harvest Proceeds and the balance, net of any deductions made pursuant to the Lease Agreement and the Vineyard Management Agreement, will be remitted to the Custodian within five working days of receipt.

Finance

38. All Growers are required to fund their investment in the Project themselves or borrow from an independent lender. MVL has arranged for the Australian and New Zealand Banking Group Limited ("ANZ") to offer finance to Growers satisfying the ANZ lending criteria to meet the management fees for the first three years of the Project.

39. This Ruling does not apply if a Grower 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 or become involved in the provision of the finance;
- 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 purposes of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- terms or conditions are 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

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

Ruling**Section 6-5 – assessability of income from the project**

40. For a Grower who invests in the Project, all income received or receivable by them from the sale of their wine grapes will be assessable income to them under section 6-5 of the ITAA 1997.

Section 8-1 - allowable deductions

41. Section 8-1 of the ITAA 1997 will apply to Growers who enter into the Project on or before 1 October 2000 as follows:

Deductible Items Per Allotment	Year 1 30 June 2001	Year 2 30 June 2002	Year 3 30 June 2003
Lease Fee	\$1,000 see note (i) below	\$1,000	\$1,000
Management Fee	\$2,750 see note (ii) below	\$2,000	\$1,650
Interest Expense	As accrued see note (iii) below	As accrued	As accrued

(all figures shown are exclusive of GST)

Notes:

- The Lease Fee per Allotment is incurred by a Grower at the time the Landlord completes the required infrastructure works on the Project Land no later than 31 October 2000;
- A Grower incurs the Management Fee for the period ending 30 June 2001 at the time the Lease Agreement commences. The Management Fee for the period ending 30 June 2001 is payable by 1 April 2001;
- Where a Grower borrows funds in order to fund their obligation to pay the management fee for the period ending 30 June 2001 and incurs interest on such borrowing for the period to 30 June 2001, that interest will be an allowable deduction for the period ending 30 June 2001.

Goods and Services Tax

42. For a Grower who invests in the Project, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Grower is entitled or, in the case of section 27-5, a decreasing adjustment that a Grower has.

Section 82KL, 82KZM and sections 82KZMB - 82KZMD and Part IVA

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

- (i) section 82KL does not apply to deny any deductions for the Lease Fees, Management Fees or interest on any loans taken out to fund payment of the Management Fees; and
- (ii) the expenditure by Growers does not fall within the scope of sections 82KZM, or 82KZMB - 82KZMD;
- (iii) the relevant provisions of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Vine establishment fees – subdivision 387-C

44. The costs of purchasing and planting vines are capital in nature. A deduction is allowable under Subdivision 387-C of the ITAA 1997 at the rate of 13% per annum, commencing from the time the vines commence their first commercial season. For Growers who enter the Project before 1 October 2000 it is likely the first commercial season will be in the financial year ended 30 June 2003.

Proposed new laws**Losses from non-commercial business activities**

45. Provisions introduced into Parliament, but not yet enacted, will mean that in some circumstances, losses arising from a business activity will not be allowed as deductions in the year that they arise. These provisions will only apply from 1 July 2000 to individual taxpayers (including individual taxpayers in general law partnerships) carrying on a business activity. They will not apply however, to an individual with a loss from a primary production business activity where their non primary production assessable income for the income

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year (excluding any net capital gain) is less than \$40,000 (proposed subsection 35-10(4)).

46. Under proposed subsection 35-10(2), where an individual taxpayer's business activity does not meet one of the objective tests set out in proposed sections 35-30, 35-35, 35-40 and 35-35 then, unless the Commissioner exercises the discretion in proposed section 35-55, a loss arising in an income year from the taxpayer's business activity cannot be claimed as a deduction in that year. A loss, in this context, refers generally to the excess of a taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

47. The Project's agreements, its unregistered draft prospectus, and its cash flow projections, show that Growers are expected to incur losses relating to interests in the Project during the Project's early years and, that none of the objective tests are expected to be met in those years. However, provided that a Grower's business activity under the Project is carried on during the income years specified below in the manner described in the Arrangement, the Commissioner will exercise his discretion under proposed paragraph 35-55(1)(b). The discretion will be exercised for each of the income year commencing 1 July 2000 and ending 30 June 2002.

48. In accordance with the decision to exercise the discretion during this period, and subject only to the above condition relating to the Arrangement (discussed below at paragraphs 72 and 73), Growers can deduct losses arising from their interest(s) they hold in the Project in the years that such losses arise.

Explanations

Section 6-5 – assessability of income from the project

49. For a Grower who invests in the Project, all income received or receivable by them from the sale of their wine grapes will be assessable income to them under section 6-5 of the ITAA 1997.

Section 8-1 - allowable deductions

50. Consideration of whether Lease and Management Fees are deductible under section 8-1, begins with the first limb of the section. This view 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 are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that 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 the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

Are the growers carrying on a business?

51. A viticulture scheme can constitute the carrying on of a business. Where there is a business, or a future business, the Gross Harvest Proceeds each year from grapes from Allotments comprising the Project will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoing in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the grapes each year from the vineyard.

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

- the Grower has an identifiable interest in specific growing vines coupled with a right to harvest and sell the grapes each year from the vines;
- the viticulture activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

53. For this Project Growers have rights under the Lease Agreement in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing vines. Under the Vineyard Management Agreement Growers engage MVL, to acquire vine seedlings and plant out the seedlings on the leased land and to provide ongoing services to care and maintain the vines. Growers control their operations.

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54. The Lease Agreement provides Growers with more than a chattel interest in the vines. The Project documentation contemplates Growers will have an ongoing interest in the vines.

55. Growers have the right to use the land in question for viticulture purposes and to have MVL come onto the land to carry out its obligations under the Vineyard Management Agreement. The Growers' degree of control over MVL as evidenced by the Vineyard Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on MVL's activities. Growers are able to terminate arrangements with MVL in certain instances, such as cases of default or neglect. The viticulture activities described in the Vineyard Management Agreement are carried out on the Growers' behalf.

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

57. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify which vines Growers have an interest in. These services are based on accepted viticulture practices and are of the type ordinarily found in viticulture ventures that would commonly be said to be businesses.

58. Growers have a continuing interest in the vines from the time they are acquired until the cessation of the Project. The viticulture activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Growers' viticulture activities will constitute the carrying on of a business.

59. The lease fees and management fees associated with the viticulture activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which income (from the regular sale of grapes) is to be gained from this 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 fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Goods and Services Tax

60. Section 27-5 of the ITAA 1997 operates to deny a deduction, that would be otherwise available under section 8-1, to the extent that the loss or outgoing incurred (on or after 1 July 2000) includes an amount relating to an input tax credit to which a Grower is entitled, or a decreasing adjustment that a Grower has.

Section 82KL

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

Section 82KZM - prepaid expenditure

62. 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 to certain expenditure incurred under an agreement in return for the 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.

63. Under the Lease Agreement a lease fee of \$1,000 will be incurred following the Landowner completing the required infrastructure works by 1 October 2000. The fee, which will be payable at the commencement of the lease (i.e., no earlier than 1 October 2000), is charged for the lease of an Allotment for the period to 30 June 2001. For each year thereafter the lease fee for the year of income will be payable by 1 October of the year of income.

64. The Vineyard Management Agreement that provides for the management fee of \$2,750 per Allotment for the period ending 30 June 2001 is to be paid by 1 April 2001. The fee is incurred on the commencement of the Vineyard Management Agreement, which will be no earlier than 1 October 2000. For each year after the year ending 30 June 2001 the management fee will be payable by 1 April of the year of income.

65. The lease fee per period is for the provision by the Landowner of an Allotment to the Grower for the relevant year of income. The management fee is for MVL providing specific vineyard management services during each year of income. 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.

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66. 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 lease fee payable to the Landowner or management fee payable to MVL is for the doing of 'things' that are not to be wholly done within the year of income of the fees being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure by Grower. New sections 82KZMC and 82KZMD also have no application to these Projects since the services to be provided are completed in the same year of income as the expenditure is incurred.

Proposed changes to losses from non-commercial business activities

67. Under the rule in proposed subsection 35-10(2), a deduction for losses incurred by individuals (including individuals in general law partnerships) from certain business activities will not be allowable in an income year unless:

- one of four statutory objective tests is met; or
- the Commissioner exercises a discretion to allow the losses.

68. In broad terms, the statutory 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 35-35).

69. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities of a similar kind. And, under subsection 35-10(4), there is an 'Exception' to the general rule in section 35-55(2) where the losses are from primary production business activities and the individual taxpayer has other assessable income for the income year of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of taxpayers they are beyond the scope of this Product Ruling and are not considered further.

70. Information provided with the application for this Product Ruling indicates that investors in the Project are unlikely to pass one of the statutory tests until the income year ended 30 June 2003 and therefore, unless the Commissioner exercises a discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer the loss from the business activity to a future year.

71. 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 individual investors who acquire interests in the Project, the Commissioner has determined that it would be unreasonable not to exercise the discretion in paragraph 35-55(1)(b).

72. 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 with an interest in the Project will either pass one of the statutory tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

73. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above in the manner described in the Arrangement, the Commissioner's discretion will not have been exercised as one of the key conditions in paragraph 35-55(1)(b) will not have been met.

74. In deciding to exercise his discretion, should the proposed new law be enacted as introduced into Parliament, 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;
- the binding Grape contract(s) with the (named independent) winemaker(s) 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;
- 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;

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- expert opinion independently obtained by the Commissioner that specifically relates to the Project.

Vine establishment fee - subdivision 387-C

75. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. Under subsection 387-170(3), the definition of 'horticulture' includes the cultivation of grape vines. 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.

76. Horticultural establishment expenditure 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 the clearing of land. The Grower's cost of vine establishment is \$750 per Allotment.

77. The rate of the write-off will be 13% per year on a prime cost basis, assuming the effective life of the vines is greater than 13 but less than 30 years (section 387-185).

78. The write-off commences from the date the vines are used or held ready for use for the purpose of producing assessable income in a horticultural business (sections 387-165 and 387-170). MVL anticipates the vines will enter their first commercial season and, hence, begin to be used for the purpose of producing assessable income in a horticultural business in the year ended 30 June 2003. Each Grower's cost of vine establishment will be eligible for write-off deductions at a rate of 13% from 1 July 2002.

79. MVL has given an undertaking to the ATO to advise Growers of the actual date of commencement of the first commercial season if it differs from that anticipated.

Part IVA

80. 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).

81. The Magarey Wine Grape Project will be a 'scheme' commencing generally on the date when the prospectus is issued. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the deduction for the lease and management fees allowable under section 8-1, 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.

82. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the yearly harvest of grapes. Further, there are no features of the Project, for example, such as the Lease Fee, Vine Establishment Fee and Management Fee being 'excessive', and uncommercial, and predominantly financed by a non-recourse loan, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Detailed contents list

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Commissioner of Taxation

21 June 2000

Previous draft:

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Related Rulings/Determinations:

PR 2000/21E; PR 1999/95; TR 92/1;
 TR 92/20; TR 94/25; TR 98/22;
 TR 97/11; TR 97/16; TD 93/34;
 IT 2001

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 82KL
- TAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- 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(2)
- ITAA 1997 27-5
- ITAA 1997 27-30
- ITAA 1997 Subdiv 387-C
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