PR 2000/84 - Income tax: Loxley Vineyard Project

Product Ruling
Income tax: Loxley Vineyard Project

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 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 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' identified below applies 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 Loxley Vineyard Project, or just simply as 'the Project', or the 'product'.

Tax law(s)

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

- section 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 42-15 (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 (ITAA 1936);
- sections 82KZMA to 82KZMD (ITAA 1936); and
- 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, especially those to do with 'tax shelters', could affect the tax laws dealt with in this Ruling. Some of the changes apply from the date of announcement and others are proposed to apply from nominated dates in the future.

4. Although this Ruling mentions certain of those announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally binding advice in respect of those changes cannot be given until the relevant law(s) are enacted.

5. However, if the changes become law the operation of that law will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded. If requested, when the relevant law(s) are enacted, the Commissioner will formalise the non-binding

information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

Class of persons

6. The class of persons to whom this Ruling applies are 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'.

7. 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

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

9. 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

11. This Ruling applies prospectively from 28 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).

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, this 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 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

14. The arrangement that is the subject of this Ruling is described below. The description is based on the documents listed below and these documents, or related parts of them, as the case may be, form part of and are to be read with this description:

- Loxley Vineyard Project original Application for Product Ruling dated 9 April 1999;
- Loxley Vineyard Project new Application for Product Ruling dated 6 April 2000;
- The Loxley Vineyard Project Unregistered Draft Prospectus received by the Australian Taxation Office ('ATO') undated;
- **Lease Agreement** between the Grower and Loxley Vineyard Holdings Limited ('Lessor') received 21 June 2000;
- **Management Agreement** between the Grower and Sandhurst Nominees (Vic) Limited ('Manager') received 21 June 2000;

- Project Management Agreement between the Manager and Loxley Vineyard Management Pty Ltd ('Project Manager')received 21 June 2000;
- Draft Compliance Plan;
- E-mail received from applicant's adviser dated 5 June 2000; and
- Information memorandum received by ATO on 21 June 2000.

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

15. The documents highlighted above are those that the Growers enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be party to, other than those to which paragraphs 40-42 applies. The arrangement is summarised as follows:

16. The arrangement is called the 'Loxley Vineyard Project' in which this document will refer to as 'the Project'.

Overview

Location	Pipers Creek near Kyneton in the Macedon Ranges wine region of Victoria.
Type of business each participant is carrying on	Commercial Viticulture
Number of hectares under cultivation	45 hectares
Name used to describe the product	Loxley Vineyard Project
Size of each participation ('Allotment')	0.25 hectares
Number of vines per hectare	2,400
Number of vines per participation	600

The term of the investment	15 years (to following completion of harvest in Autumn 2016).
Initial cost	$14,324 Project Management Fee, comprising Vineyard Establishment Fee of $7,178, and a Management Services Fee of $7,146, and $938 Lease Fee per Allotment.
Initial cost on a per hectare basis	$61,048
Ongoing costs	The ongoing management fee will be $1,875 per Allotment per annum adjusted to the greater of 2% or CPI and $938 per Allotment per annum.
Other Costs	The Manager will retain out of gross proceeds of the grape sales a sum in reimbursement of cost and outgoings in harvesting the grapes and the sale thereof.
Other aspects	Letter of intent has been obtained from Granite Hills and Hanging Rock Winery to collectively acquire all of the production up to year 5 and thereafter up to 60% of the production.
Minimum Subscription	The Project does not require a minimum Grower participation before proceeding. However this is not a Project to which the prospectus requirements of the Corporations Law apply. The offer in the Unregistered Prospectus is made to and applications will only be accepted from persons that satisfy the exceptions of section 708 of the Corporations Law. Section 708 deals with offers that do not need disclosure.
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.

17. Growers entering the Project will lease from the Lessor land located at Pipers Creek near Kyneton in the Macedon Ranges wine

region in Victoria. The term of the lease is to expire immediately following the grape harvest for the year ending 30 June 2016. Growers will also enter into a Management Agreement with the Manager to have varieties of vine rootlings planted on this leased land for the purpose of establishing a vineyard to sell the grapes produced.

18. There are 180 Allotments on offer, of 0.25 hectares each in size. Growers will lease each Allotment at a fee of $938 per annum for each year of the lease. The lease fee for each year will be payable in advance of the period of the payment. At the time of commencement of a lease of an Allotment the Lessor will have established the land to the stage of planting. That is the Lessor will have undertaken landcare works, land preparation and dam construction. Note at the time of commencement of the lease of each Allotment the vines will not have been planted and the vineguards and irrigation will not have been installed.

19. Under the Management Agreement Growers will engage the Manager for the period ending immediately following the harvest in the year ending 30 June 2016. The Manager will be engaged to establish and maintain a vineyard on each Grower's Allotment.

20. The Management Agreement provides for the Manager immediately following the commencement of the Management Agreement to undertake the Vineyard Establishment Services. The Vineyard Establishment Services incorporates the supply and planting of approximately 600 vine rootlings per Allotment supply and attachment of vineguards and the supply and installation of irrigation equipment.

21. The Manager will receive from each participant a Project Management Fee of $14,324, which comprises the Vineyard Establishment Fee and the Management Services Fee.

22. For Growers who are accepted into the Project, the Manager will within two weeks of the being appointed undertake the Vineyard Establishment Services. For the balance of the year from the time of participation the Manager will perform the Management Services detailed in the Management Agreement.

23. The fee for Vineyard Establishment Services comprises the following components:

Description	$
Vines	600
Vine Planting Costs	350
Vineguards	1,222
Vine Attachment Costs	850
Irrigation Equipment	1,856
Irrigation Installation Costs	2,300
Total	7,178

24. The Management Services fee is $7,146 per Allotment and will commence from the time immediately following the planting of the vines rootlings on the Allotment and the installation of the irrigation equipment. The Growers are required to pay the total Project Management Fee to the Manager on entering into the Management Agreement.

25. For each subsequent year of the Management Agreement the Grower will be required to pay to the Manager the Annual Management Fee in advance of the commencement of the period to which the Annual Management Fee relates.

26. The first Annual Management Fee is $1,875 per Allotment. For each year thereafter the Annual Management Fee is the fee for the previous year increased by the greater of 2% or the percentage movement in the consumer price index.

27. All Lease Fees, Project Management Fees and Annual Management Fees are stated at their Goods and Services Tax ("GST") exclusive price.

28. Growers may also choose to subscribe for one non-voting share in the Lessor at a price of $5,000 for each two Allotments obtained.

29. The Project does not require a minimum Grower participation before proceeding.

30. Applications will only be accepted where the exception requirements of section 708 of the Corporations Law will be complied with. Section 708 specifies either certain requirements that a Grower must satisfy and/or certain requirements relating to the level of Grower participation in the Project.

Lease agreement

31. Under the Lease Agreement Growers enter into a lease for one or more Allotments for a period to end following the grape harvest for the year ending 30 June 2016, for the purpose of establishing a vineyard on which to produce grapes for sale. Clause 1 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 to anyone else, without the consent of the Lessor (cl 5).

32. Clause 2.1 provides that the Grower shall have the right to use the Land for the establishment of a vineyard, planting, tending, growing and caring for grapevines on the Land. This clause also gives the Grower the right to harvest the grapes during the term of the lease.

33. Upon expiration of the Project, the Lessor will acquire the vines from the Growers at $1.00 per vine, cls 4.2.

Management agreement

34. Under the Management Agreement Growers will engage the Manager, for a period to end following the grape harvest for the year ending 30 June 2016, to establish and maintain a vineyard on their leased Allotment. Growers are not permitted to assign their interest in the Management Agreement without the consent of the Manager (cl 14).

35. Under clause 7 Growers appoint the Manager to act as the Growers sole and exclusive agent to market and sell the grape produce from the Allotments. Each Grower will be entitled to a pro-rata share of the proceeds arising from the sale of the grapes produced from the Project in accordance with clause 7.(c).

36. During the first 12-month period the Manager will be responsible for the establishing the vineyard on each allotment as outlined in the Management Agreement. In consideration of payment by the Grower of the Project Management Fees the Manager will provide both Vineyard Establishment Services and Management Services (cl 2). Commencement of the Vineyard Establishment Services will be on the date set out in Item 4 of the Schedule which details the commencement date of the Management Agreement. The Manager undertakes to use its best endeavours to complete the Vineyard Establishment Services within two weeks from that date.

37. Under clause 1(b) Vineyard Establishment Services are defined to mean, planting with vine rootlings in accordance with good viticultural practice and, without limiting the generality of the foregoing, includes the following:

- the supply and planting of healthy vine rootlings to an average density of approximately 600 vines per 0.25 hectare;
- supply and installation of irrigation equipment; and
- supply and installation of vineguards.

38. The Project Management Fee for the first 12 month period of the Project is $14,324 (Item 5 of the Schedule) (cl 10). In subsequent years Growers are liable to pay an Annual Management Fee, as calculated according to Item 6 of the Schedule to the Management Agreement. The Annual Management Fee for each year is payable by the Grower annually in advance (cl 11).

39. The Manager is to be reimbursed for the costs incurred on harvesting and sale of the grapes. This will be deducted from the gross sale proceeds.

Finance

40. A financial institution has indicated to the Manager that finance may be available to Growers to meet all or part of the Lease and Management Fees per Allotment per Grower in respect of year 1 of the project.

41. Alternatively, Growers may seek to finance their investment from other lenders. This ruling only applies where loan transactions exhibit the following features:

- all loan terms will be of an arm's length nature;
- borrowers will remain fully liable for the balance of the loan outstanding at any time, and the lender will take full legal action against defaulting borrowers;
- none of the funds lent will be transferred back to the lender, or any associate, as part of any 'round robin' or equivalent transaction;
- the loan will not be a 'split-loan', of the type described in Taxation Ruling TR 98/22;
- there will be no indemnity, or equivalent agreement, to reduce the borrower's liability; and
- repayment of principal and payment of interest will not be linked to deriving income from the Project, and will be made regularly, commencing from or about, the time of the making of the loan.

42. There is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or

other institution for the provision of any finance to the Grower for any purpose associated with the Project.

Derivation of income

43. The first harvest from the Project is expected in the year ending 30 June 2003. The Manager has obtained letters of intent from Granite Hills and Hanging Rock Winery to collectively acquire all of the grapes harvested up to year five of the project and for at least 60% thereafter. The pooled proceeds will be evenly allocated to the Growers based on the number of Allotments held. Under the Management Agreement, all harvestable grapes grown on each Allotment are to be severed from the vines each year. These grapes are to be delivered by the Manager to purchasers on or before 30 June of each year of harvest.

44. Subject to any lien the Manager may have over the grape sale proceeds because of monies owing under the Lease Agreement or Management Agreement, the Manager will pay from the sale proceeds to Growers within 21 days of receiving those proceeds.

Fees

45. Growers are required to make the following payments for a per Allotment:

- $938 Lease Fee for year 1 of the project. The payment being due on the Grower entering into the Lease Agreement;
- $14,324 Project Management Fee for year 1 of the project. The payment being due on the Grower entering into the Management Agreement.

46. In year 2 of the project, the Annual Management Fee per Allotment will be $1,875. The Annual Management Fee for each year will be paid prior to the commencement of the 12 month period. The Annual Management Fee for year 3 and each subsequent year will be based on the Annual Management Fee for the proceeding year increased by the greater of 2% or movements in the Consumer Price Index.

47. In year 2 and each subsequent year of the project, the Lease Fee per Allotment will be $938 per Allotment per annum. The Lease Fee for each year will be paid prior to the commencement of the 12 month period.

Ruling

Section 6-5 – Assessability of income from the Project

48. 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.

Goods and Services Tax

49. The Goods and Service Tax will be applicable to services provided by the Project Manager on or after 1 July 2000 and, in accordance with the documentation for the arrangement, should be added to the amount of fees detailed below for such services. Also, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any deduction allowable to a Grower 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.

Allowable deductions

50. The deduction available to a Grower for the prepaid management fee or the prepaid lease fee will depend upon when the fee is incurred and, in some cases, whether or not the Grower is a 'small business taxpayers'.

IMPORTANT: Paragraph 52 and 53 (relating to 'small business taxpayers') and paragraphs 54 to 59 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Growers are advised to carefully examine the information contained in paragraphs 61 to 70 relating to proposed changes. Paragraphs 74 to 77 explain the meaning of 'small business taxpayer' for the purposes of this ruling.

51. Under section 8-1 of the ITAA 1997 no deduction is allowable to a Grower for the acquisition of shares in Loxley Vineyard Holdings Limited. The cost of the shares is a capital outgoing and is excluded from deductibility by subsection 8-1(2).

Growers who are 'small business taxpayers'

52. For a Grower who is a **'small business taxpayer'** and participates in the Project **on or before 30 June 2000**, subject to any effect of the Goods and Service Tax (refer to paragraph 49 above) the deductions shown in the Table below will be available for the years ended 30 June 2000 to 30 June 2002.

	Deductions for small business taxpayers only per Leased Allotment				
Fee Type	**ITAA 1997**	**Refer Note**	**Year 1 30 June 2000**	**Year 2 30 June 2001**	**Year 3 30 June 2002**
Management services fee	8-1	**See note (i) below**	$7,146	0	0
Annual management fee	8-1		0	$1,875	$1,913 **estimated**
Lease fee	8-1		$938	$938	$938
Vineguards	42-15	**See note (ii) below**			
Irrigation costs	387-125	**See note (iii) below**	$1,385	$1,385	$1,385
Horticultural plant expenditure	387-165	**See note (iv) below**	0	0	0
Loan interest	8-1		As incurred	As incurred	As incurred

(All figures shown are exclusive of GST)

Notes:

(i) Legislative change means that the full deduction will not be allowed in the years ended 30 June 2000 for Growers who are not 'small business taxpayer'. See paragraphs 54 to 59 and Example in paragraph 130.

(ii) For Growers who are 'small business taxpayers' and who comply with the conditions in section 42-345, the deduction for depreciation of vineguards 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'. For a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, a deduction in full is available for vineguards costing $3.45 each as items of plant costing $300 or less (section 42-167). The deduction arises at the time the items are installed ready for use (section 42-170). Manager is to advise any affected Growers of relevant details of their depreciation deductions.

(iii) A deduction is allowable under section 387-125 for capital expenditure representing the cost for the establishment of the irrigation system paid by the Grower. A deduction for the irrigation system 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 two years; and

(iv) The vine planting expenditure of $950 comprising the cost of the vine rootling and planting costs, are attributable to the establishment of horticultural plants. The deduction is allowed when the grapevines, as horticultural plants, enter their first commercial season. In calculating the deduction, a Grower must use section 387-175, and 387-185 to determine the 'effective life' of the grapevines. The Manager will inform each Grower when the vines enter their first commercial season, which is expected to be in the income year ending 30 June 2003.

53. For a Grower who is a **'small business taxpayer'** and begins to participate in the Project **after 30 June 2000 and on or before 30 June 2001**, subject to any effect of the Goods and Service Tax (refer to paragraph 49 above) the deductions shown in the Table below will be available for the years ended 30 June 2001 to 30 June 2003.

	Deductions for small business taxpayers only Per Leased Allotment				
Fee Type	**ITAA 1997**	**Refer Note**	**Year Ending 30 June 2001**	**Year Ending 30 June 2002**	**Year Ending 30 June 2003**
Management services fee	8-1	**See note (v) below**	$7,146	0	0
Annual management fee	8-1		0	$1,875	$1,913 **estimated**
Lease fee	8-1		$938	$938	$938
Vineguards	42-15	**See note (ii) above**			
Irrigation costs	387-125	**See note (iii) above**	$1,385	$1,385	$1,385
Horticultural plant expenditure	387-165	**See note (iv) above**	0	0	$124
Loan interest	8-1		As incurred	As incurred	As incurred

(All figures shown are exclusive of GST)

Note:

(v) Legislative change means that the full deduction will not be allowed in the years ended 30 June 2001 for Growers who are not 'small business taxpayers'. See paragraphs 54 and 59 and Example in paragraph 130.

Growers who are not 'small business taxpayers'

54. For a Grower who commences to participate in the Project **on or before 30 June 2000** who is **not a 'small business taxpayer'** and is carrying on a business, the deduction available in respect of the Project Management Fee is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5). (Example at paragraph 130 illustrates the application of this method).

55. In calculating the deductions available for a Grower described in the preceding paragraph, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 whose 'eligible service period' ends not more than 13 months after it is incurred by the taxpayer. The 'eligible service period' (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

56. The Manager will inform affected Growers of the number of days in the eligible service period in the expenditure year. This figure is necessary for the deduction for the Project Management Fee to be calculated.

57. The calculation of the deduction for the Project Management Fee for a Grower who is **not 'a small business taxpayer'** is as follows:

<u>Year 1: Expenditure incurred before 30 June 2000</u>

Available deduction = A + B

<u>Where</u>:

= Expenditure X $\dfrac{\text{Number of days of eligible service period in A the expenditure year}}{\text{Total number of days of the eligible service period}}$

B = (Expenditure *less* A) x 80%

<u>Year 2: Expenditure is incurred after 1 July 2000 and before 30 June 2001</u>

Available deduction = A + B + C

<u>Where</u>:

A = Expenditure X $\dfrac{\text{Number of days of eligible service period in A the expenditure year}}{\text{Total number of days of the eligible service period}}$

B = (Expenditure *less* A) x 60%

C = balance of the Year 1 expenditure not previously deducted

Year 3: Expenditure incurred after 1 July 2001 and before 30 June 2002

Available deduction = A + B + C

Where:

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

B = (Expenditure *less* A) x 40%

C = balance of the Year 2 expenditure not previously deducted.

58. For a Grower who commences to participate in the Project **on or before 30 June 2000** who is **not a 'small business taxpayer'** and is carrying on a business, subject to any effect of the Goods and Service Tax (refer to paragraph 49 above) the deductions other than the first year project management fee are shown in the Table below.

	Deductions for taxpayers who are not small business taxpayers and are carrying on a business. Per Lease Allotment.				
Fee Type	**ITAA 1997**	**Refer Note**	**Year Ending 30 June 2000**	**Year Ending 30 June 2001**	**Year Ending 30 June 2002**
Management services fee	8-1		**See paragraph 54 to 57**		
Annual management fee	8-1		0	$1,875 **See note (vi) below**	$1,913 **estimated See note (vi) below**
Lease fee	8-1	**See note (vii) below**	$938	$938	$938
Vineguards	42-15	**See note (viii) below**			
Irrigation costs	387-125	**See note (iii) above**	$1,385	$1,385	$1,385
Horticultural plant expenditure	387-165	**See note (iv) above**	0	0	0
Loan interest	8-1		As incurred	as incurred	as incurred

(All figures shown are exclusive of GST)

Notes:

(vi) Legislative change means that the full deduction will not be allowed in the years ended 30 June 2001 or 2002 for Growers who are **not 'small business taxpayers'**. The deduction available in respect of the prepaid Annual Management fee will depend upon the date that the investment is made and is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5).

(vii) Amounts of less than $1,000 will be 'excluded expenditure' as defined in section 82KZL(1) and are deductible in full in the year in which they are incurred. Where these amounts exceed $1,000, as may be the case where a Grower has more than one interest in the Project, deductions are determined on the same basis as shown above for prepaid project management fees in paragraph 54 to 57.

(viii) A deduction for depreciation is allowable for capital expenditure incurred for vineguards. For Growers who are not 'small business taxpayers' the deduction for depreciation of vineguards is determined using the formula in either subsection 42-160(3), 'Diminishing value method', or subsection 42-165(2A), 'Prime cost method'. Those formulae use 'effective life' to determine the deduction for depreciation. For the year ended 30 June 2000 the deduction will depend upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the vine guards. Depreciation of vineguards will be an allowable deduction for the year ending 30 June 2000 to the Growers at a rate (determined under section 42-125) of 100%, if the vineguards are first used for the purpose of producing assessable income before 1 July 2000. The Manager will advise the Grower of the date the vineguards are installed ready for use in the year ended 30 June 2000.

59. For a Grower who commences to participate in the Project **after 30 June 2000 and on or before 30 June 2001** who is **not a 'small business taxpayer'** and is carrying on a business, deductions other than the first year project management fee are shown in the Table below.

	Deductions for taxpayers who are not small business taxpayers and are carrying on a business. Per Lease Allotment.				
Fee Type	**ITAA 1997**	**Refer Note**	**Year Ending 30 June 2001**	**Year Ending 30 June 2002**	**Year Ending 30 June 2003**
Management services fee	8-1		**See note (ix) below**		
Annual management fee	8-1		0	$1,875 **See note (ix) below**	$1,913 **estimated See note (ix) below**
Lease fee	8-1	**See note (x) below**	$938	$938	$938
Vineguards	42-15	**See note (xi) below**			
Irrigation costs	387-125	**See note (iii) above**	$1,385	$1,385	$1,385
Horticultural plant expenditure	387-165	**See note (iv) above**	0	0	$124
Loan interest	8-1		as incurred	as incurred	as incurred

(All figures shown are exclusive of GST)

Notes:

(ix) Legislative change means that the full deduction will not be allowed in the years ended 30 June 2001 or 2002 for Growers who are not 'small business taxpayer'. The deduction available in respect of the prepaid Management fee will depend upon the date that the investment is made and is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5).

(x) Amounts of less than $1,000 will be 'excluded expenditure' as defined in section 82KZL(1) and are deductible in full in the year in which they are incurred. Where these amounts exceed $1,000, as may be the case where a Grower has more than one interest in the Project, deductions are determined on the same basis as shown above for prepaid project management fees in paragraph 54 to 57.

(xi) A deduction for depreciation is allowable for capital expenditure incurred for vineguards. For Growers who are not 'small business taxpayers' the deduction for depreciation of vineguards is determined using the formula in either subsection 42-160(3), 'Diminishing value method', or subsection 42-165(2A), 'Prime cost method'. Those formulae use 'effective life' to determine the deduction for depreciation. For the year ended 30 June 2001 the deduction will depend upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the vineguards. Depreciation of vineguards will be an allowable deduction to the Growers in the year ended 30 June 2001 at a rate (determined under section 42-125) of 100%, from the time the vineguards are first used for the purpose of producing assessable income within the year ended 30 June 2001. The Manager will advise the Grower of the date the vine guards are installed ready for use. **Paragraphs 68 and 69 contain information relating to proposed changes to apply from 1 July 2000. These changes, if implemented, will affect deductions in respect of expenditure on vineguards for non-small business taxpayers.**

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

60. The following provisions have application for a Grower as indicated:

- section 82KL does not apply to deny the deductions otherwise allowable;
- expenditure by Growers who are small business taxpayers for things to be wholly done within 13 months of the expenditure being incurred is not within the scope of section 82KZM;
- section 82KZMB applies to expenditure by Growers who are not small business taxpayers and are carrying on a business; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Proposed new laws

Proposed changes to prepayment rules

61. On 11 November 1999, the Government announced a number of changes to the deductibility of certain prepaid expenditure incurred in respect of certain agreements. Legislation introduced into Parliament, but not yet enacted provides that these changes will not

apply if the relevant expenditure falls within one of the Exceptions to the proposed provisions. Provided the provisions are enacted as introduced, expenditure incurred by Growers in this Project will be within Exception 5 of the proposed section 82KZME.

62. Where Exception 5 applies to expenditure that has an 'eligible service period' ending not more than 13 months after the expenditure is incurred and is deductible under section 8-1:

- deductions for 'small business taxpayers' will be allowable in full in the year that the expenditure is incurred; and
- the amount and timing of deductions for taxpayers who are not 'small business taxpayers' will be determined under sections 82KZMB and 82KZMC of the ITAA 1936.

63. The practical effect of expenditure being within Exception 5 is that the deductions described in paragraphs 51 to 59 of this Product Ruling will not be affected by the proposed changes to the prepayment rules.

Losses from non-commercial business activities

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

65. Under proposed subsection 35-10(2), where an individual taxpayer's business activity does not met 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 the 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.

66. 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).

67. 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 111 and 112), Growers can deduct losses arising from their interest(s) they hold in the Project in the years that such losses arise.

Proposed changes to the tax treatment of low cost plant

68. Provided the proposed changes are enacted as announced, the immediate 100% depreciation deduction for plant costing $300 or less will be abolished from 1 July 2000 for all taxpayers except small business taxpayers. The immediate deduction will be replaced by a low value pool arrangement.

69. Under proposed section 42-455(1), a Grower, who is not a small business taxpayer, would be able to choose to allocate the cost of all newly acquired plant costing less than $1,000 each to a low value pool in the year of acquisition. Once the choice is made to allocate low cost plant to the pool, all low cost plant acquired in that income year and subsequent years must be included in the pool (section 42-460 (1)). The pool is to be depreciated using a diminishing value rate of 37.5%. The value of plant included in or disposed of from the pool will be added to or subtracted from the value of the pool.

Note to promoters and advisers

70. 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 Australian Taxation Office suggests that promoters and advisers ensure that potential Growers are fully informed of the announcement requiring prepayments in respect of some 'tax shelter' arrangements to be deductible over the period services are provided. Such action should minimise suggestions that potential Growers have been negligently or otherwise misled.

Explanations

Section 6-5 – assessability of income from the Project

71. 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.

Sections 27-5 and 27-30 - Goods and Services Tax

72. Section 27-30 operates to deny a deduction, that would be otherwise available under section 8-1, for the year ended 30 June 2000 to the extent that the loss or outgoing (incurred after 30 November 1999 and before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled after 1 July 2000.

73. 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.

Subdivision 960-Q - small business taxpayers

74. In this product ruling the term ‘small business taxpayer’ is relevant for the purposes of certain prepaid expenditure and depreciation of vineguards.

75. Whether a Grower is a ‘small business taxpayer’ depends upon the individual circumstances of each Grower and is beyond the scope of this product ruling. It is the individual responsibility of each Grower to determine whether or not they are within the definition of a ‘small business taxpayer’.

76. 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 of the ITAA 1997 is less than $1,000,000.

77. ‘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 of the ITAA 1997).

Section 8-1 - allowable deductions

78. Consideration of whether the management and lease fees are deductible under section 8-1 begins by examining paragraph 8-1(1)(a). This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under paragraph 8-1(1)(b) if they are incurred when the business has not commenced; and
- where a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

79. An outgoing or a loss incurred in carrying on a business for the purpose of gaining or producing assessable income is deductible under the general provisions of section 8-1, provided it is not a loss of capital or expenditure of a capital, domestic or private nature. A business includes a 'primary production business', which is defined under subsection 995-1(1) to include a business of propagating and cultivating plants. Where there is a business, or a future business of growing grapes for sale at a profit, the gross sale proceeds from the sale of grapes from the Project will constitute gross assessable income under section 6-5. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, and maintaining of grapevines and the harvesting of the grapes.

80. Under the Management Agreement, a Grower engages the Manager to grow and harvest grapes from the Grower's vineyard. The Manager may pool the grapes produced by the Project and sell them at its discretion. Under this Agreement, the Growers consent to the proceeds from such sales being held by the Manager in Trust and distributed to them in accordance with their interests in the Project. The purpose for which the Manager, on behalf of the Growers, utilises the grapes will be a determining factor as to whether the amounts incurred on any management fee will be an allowable deduction.

81. This Ruling applies only to those Growers engaging the Manager to provide management services, including the harvesting of the grapes and the selling of the grapes to the Winery, according to the terms of the Grape Purchase Agreement.

Is the Grower in business?

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

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

83. By weighing up all of the attributes of the Project, it is accepted that Growers in the Project will be in a business of primary production from the date that 'business operations' are first commenced on their behalf. 'Business operations', in this context, means such things as planting of vines, installation of vineguards and irrigation as part of a coordinated and concerted plan to grow and harvest grapes for sale at a profit

84. Growers entering into this Project have, under the Lease and Management Agreements, 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 these agreements Growers appoint the Manager, to provide services such as planting tending, pruning, training, fertilising, replanting, spraying, maintaining and otherwise caring for the grapevines. The Manager in the establishment period (12 months from date of entrance to the arrangement) will provide the following services, by engaging such contractors as are necessary:

- obtaining and planting healthy grapevine rootlings;
- install vineguards;
- install irrigation equipment; and
- spacing and trellising each grape vine rootling so that it may be harvested commercially.

85. The Manager is also responsible for the harvesting, marketing and sale of the produce from the grapevines.

86. The Lease Agreement provides the Growers with rights to use land to establish a vineyard. In addition the Growers have a legal interest in the land by virtue of the Lease Agreement.

87. Growers have the right to use the land in question for horticultural purposes and to have the Manager come onto the land to carry out its obligations under the Lease and Management Agreements. The Growers' degree of control over Sandhurst

Nominees (Vic) Limited, as evidenced by the agreements is sufficient. Under the Project, Growers are entitled to receive a yearly account for the proceeds of the sale of grapes, as well as regular reports of, the activities. Growers are able to terminate arrangements with Sandhurst Nominees (Vic) Limited in certain instances, such as cases of default or neglect. The activities described in the Lease and Management Agreements are carried out on the Growers' behalf.

88. The general indicators of the business, as used by the courts are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangements description for all the indicators discussed in that Ruling. The viticultural report indicates that the site is suitable for vine planting and the directors have indicated subject to market conditions that Growers will earn assessable income from the project. Projections contained in the unregistered draft prospectus suggest that the project should return a before tax profit to Growers after the first three years.

89. Growers will engage the professional services of a Manager with the appropriate credentials. Each Grower will have a specific interest in an identifiable area denoted by lot number. The services rendered by the Manager are in line with good viticultural practices and are of the type ordinarily found in viticultural ventures that would commonly be said to be businesses.

90. Growers have a continuing interest in the vines designated on their lot from their planting until the termination of the Lease Agreement following the harvest of the grapes in Autumn of 2016. The viticultural activities, and hence the fees associated with their procurement, are consistent with the commencement of regular activities that are permanent. The Growers viticultural activities will constitute the carrying on of a business.

91. The fees associated with the viticultural activities will relate to the gaining of income from this business and hence, have a sufficient connection to the operations by which this income (sale of grapes) is to be gained. 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. No capital component of the Grower is identifiable from the arrangement apart from the Vineyard Establishment Fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Section 82KL - recouped expenditure

92. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer.

Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

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

94. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Here, there may be a loan provided to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Section 82KZM - prepaid expenditure for small business taxpayers

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

96. Under the Management Agreement the Project Management Fee will be incurred upon execution of the Agreement. This fee is charged for providing services to Growers for the period of 12 months from the date of execution of the Agreement. For this Ruling's purposes, no explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years. The fee is expressly stated to be for a number of specified services. There is evidence this fee is for services to be provided within 12 months of the fee being incurred.

97. Thus, for the purposes of this Ruling, it is accepted that no part of the Project Management Fee is for the Manager to do 'things' that are not to be wholly done within 13 months of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure for the Management fee by Growers who are 'small business taxpayers'.

Sections 82KZMA - 82KZMD - prepaid expenditure for taxpayers other than small business taxpayers

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

99. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. The transitional treatment applies to prepayments initially incurred in the 1999/2000 income year. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service period ends more than 13 months after the date the expenditure was incurred, and does not apply to this Project.

100. The deduction available to Grower who satisfies subsection 82KZMA(1) for the Project Management Fee and the Lease Fee will be determined in accordance with the rules contained in section 82KZMB. Because the quantum of both the Annual Management Fee is lower in the second and subsequent years, the capping provisions contained in section 82KZMC will have no practical effect on the deduction available.

101. During the transitional period the amount of the deduction available to such a Grower is determined using the formula in subsection 82KZMB(3) and the percentages shown in the table in subsection 82KZMB(5).

Proposed changes to prepayment rules

102. The changes announced by the Government, but not yet enacted, to apply from 11 November 1999 will affect all taxpayers that participate in certain agreements and prepay expenditure for up to 13 months. It is proposed that deductions otherwise allowable under section 8-1 of the ITAA 1997 will be spread over the period to which the prepayment relates. Under the proposed changes, there will be no exemption for small business taxpayers and no transitional rules will apply.

103. However, those changes will not apply where the expenditure incurred under the agreement is within one of the Exceptions to the proposed provisions.

104. Exception 5 provides that the expenditure must not be under an agreement to which a product ruling applies, describing expenditure under the agreement as being allowable as a deduction. The product ruling must be made:

(a) on or before 1 pm (by legal time in the Australian Capital Territory) on 11 November 1999; or

(b) in response to an application for a product ruling where:

 (i) the application was received by the Commissioner on or before the time specified in paragraph (a); and

 (ii) the Commissioner acknowledged receiving the application.

105. This product ruling is made in response to an application received by the Commissioner on or before 1 pm on 11 November 1999 and acknowledged. Expenditure incurred by Growers in the Project will, therefore, be within Exception 5 if the proposed new law is enacted as introduced into parliament.

Proposed changes to losses from non-commercial business activities

106. 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.

107. 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 35-45).

108. 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.

109. 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.

110. 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).

111. 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.

112. 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.

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

Section 42-15 - vineguard expenditure

114. Growers will incur expenditure on vineguards on which the vines are grown, to be used on the Grower's behalf in the operation of the vineyard business.

115. Vineguards are plant for the purposes of section 42-18. Under section 42-15 taxpayers can claim a deduction for depreciation on an item of plant used for the purposes of producing assessable income where they are the owners or quasi-owners of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, and absolutely, owned by the owner of the land.

116. However, it is accepted in certain circumstances that lessees are entitled to claim depreciation where they are considered to be the owners of those improvements. Taxation Ruling IT 175 sets out the ATO's views on this issue. Where lessees are considered to own the improvements under a state law 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. A deduction for depreciation is allowable on plant from the date it is installed and ready for use.

117. Growers accepted into the Project enter into a Management Agreement to occupy certain land upon which they are entitled to grow vines to conduct a business of a vineyard The Grower's expenditure attributable to the acquisition and installation of vineguards on the vines has been identified as $2,072 per Allotment.

118. Under section 42-15 Growers are entitled to depreciation deductions for expenditure relating to the acquisition and installation of vineguards. The deduction commences at the date on which the vineguards are installed and begins to be used for the purpose of producing assessable income. The Manager has given an undertaking to the ATO to advise Growers of the date of installation. The deduction available, however, will depend on whether or not the

Grower is a 'small business taxpayer' as defined in section 960-335 and, if so, whether the Grower complies with the conditions contained in section 42-345.

119. Growers entering into this Project before 30 June 2000, and incur the capital costs of purchasing the vineguards and which have been them installed ready first use for producing assessable income before 1 July 2000 will obtain a 100% deduction for depreciation of plant and articles under section 42-15 of the ITAA 1997. The vineguards have an effective life of less than 3 years and/or have an individual unit cost of no more than $300. **Paragraphs 68 to 69 contain information relating to proposed changes to apply from 1 July 2000. These changes, if implemented, will affect deductions in respect of expenditure on low cost plant, acquired by other than 'small business taxpayers', after 1 July 2000 and will apply to both trellising and vineguards.**

Subdivision 387-B - irrigation expenditure

120. 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 by this Project would be covered by Subdivision 387-B.

121. The growing of wine grapevines to produce wine grapes for commercial exploitation is considered to be a primary production business, provided the taxpayer is actually carrying on a business. The Growers of the Project satisfy the requirements of section 387-125. According, the irrigation costs totalling $4,156 per Allotment, are deductible in equal amounts over three (3) years of income, commencing in the year of income the Grower incur that expenditure.

Subdivision 387-C - horticultural plant expenditure

122. 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.

123. 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 has been identified as $950 per Allotment.

124. 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).

125. 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). The Manager 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. The Growers cost of vine establishment will be eligible for write-off deductions at a rate of 13% from this date.

126. The Manager 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 - general tax avoidance provisions

127. 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).

128. The Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 51-59, that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

129. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of grapes. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

130. Obligation to prepay expenditure arising on or after 21 September 1999– applies to taxpayers who are not small business taxpayers and are carrying on a business

Joseph Gardener has extensive business interests and his turnover for the 1999/2000 income year exceeds $1 million. Therefore, he is not a small business taxpayer and is subject to the 21 September 1999 changes to the tax laws relating to prepaid expenditure. Joseph enters into a contract with Pinetree Pty Ltd to manage his one hectare interest in the No 2 Pine Plantation. Joseph's management contract is executed on 20 October 1999 for management services to be provided from 1 June 2000. Under the contract, the first five year's management fees, payable 12 months in advance on 1 June each year, are $6,000 in the first year and $1,200 for each of the following four years.

Joseph is unable to deduct the whole of his prepaid management fees in the years in which they are incurred. The fees are instead deductible over the eligible service period over which the management services will be provided. However, as the law currently stands, Joseph is able to take advantage of certain transitional rules that 'shade-in' the effect of the changes to the prepayment laws.

For 1999/2000 Joseph can claim a deduction of $4,771 for expenditure incurred before 30 June 2000 on management fees. This amount is A + B where:

$$A = \text{Management fee X} \quad \frac{\text{Number of days of eligible service Period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$A = \$6{,}000 \text{ X } \frac{30}{365} = \$493$$

B = (Management fee *less* A) X 80%

B = ($6,000 - $493) X 80% = $4,406

The balance of the $6,000 management fees that were prepaid on 1 June 2000 (i.e. $1,229) is carried forward and can be claimed as a deduction in the 2000/2001-income year. For 2000/2001, Joseph can claim a deduction of $1989 for expenditure incurred after 1 July 2000 and before 30 June 2001 on management fees. This amounts is calculated as A + B + C where:

$$A = \$1{,}200 \text{ X } \frac{30}{365} = \$99$$

B = ($1,200 - $99) X 60% = $661

C = $1,229

Note: that the third component (Part C) is the amount carried forward from 1999/2000. As in the first year, the balance of the $1,200 management fees prepaid on 1 June 2001 (i.e., $440) is carried forward and can be claimed as a deduction in the 2001/2002-income year. It should also be noted that in certain circumstances, not present in most projects with product rulings, 'capping provisions' will apply in the second and subsequent transitional years. These are complex and are not explained in this example.

Similarly, For 2001/2002, Joseph can claim a deduction of $980 for expenditure incurred after 1 July 2001 and before 30 June 2002 on management fees.

This amounts is calculated as A + B + C where:

$$A = \$1,200 \ \mathrm{X} \ \frac{30}{365} = \$99$$

B = ($1,200 - $99) X 40% = $441

C = $440

Note: that the third component (Part C) is again the amount carried forward from 2000/2001. As in the first two years, the balance of the $1,200 management fees prepaid on 1 June 2002 (i.e., $660) is carried forward and can be claimed as a deduction in the 2002/2003-income year.

Detailed contents list

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

Commissioner of Taxation
28 June 2000

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Related Rulings/Determinations:
IT 175; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TD 93/34; TR 98/22; PR 1999/95

Subject references:
- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

Legislative references:
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- ITAA 1936 82KH(1)
- ITAA 1936 82KH(1F)(b)
- ITAA 1936 82KL
- ITAA 1936 82KL(1)
- ITAA 1936 82 KZL
- ITAA 1936 82KZM
- ITAA 1936 90
- ITAA 1936 92
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 8-1(2)(a)
- ITAA 1997 27-5
- ITAA 1997 27-30
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- ITAA 1997 42-118
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- ITAA 1997 42-160
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- ITAA 1997 42-345
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- ITAA 1997 387-55
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- ITAA 1997 387-125
- ITAA 1997 387-130
- ITAA 1997 387-150
- ITAA 1997 Subdiv 387-C
- ITAA 1997 387-165
- ITAA 1997 387-170(3)
- ITAA 1997 387-175
- ITAA 1997 387-185
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