PR 2001/40 - Income tax: Mount Bellarine Vineyard Project

Product Ruling
Income tax: Mount Bellarine Vineyard Project

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 this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Mount Bellarine Vineyard Project, or simply as 'the Project'.

Tax law(s)

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

- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997)
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Section 42-15 (ITAA 1997);
- Section 387-55 (ITAA 1997);
- Section 387-125 (ITAA 1997);
- Section 387-165 (ITAA 1997);
- Section 388-55 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KZL (ITAA 1936);
- Section 82KZME (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936)

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered for GST and hold a valid tax invoice.

Business Tax Reform

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

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

Note to promoters and advisers

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

Class of persons

7. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement.. In this Ruling, each of these persons, referred to as 'Growers', will have accepted an offer made under subsections 708(1)-(11) of the Corporations Law.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from the it.

Qualifications

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

10. If the arrangement described in this 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.

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

Date of effect

12. This Ruling applies prospectively from 2 May 2001, 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 taxation dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 5 February 2001;
- Information Memorandum for the Mount Bellarine Vineyard Project, undated;
- **Lease and Management Agreement between Mount Bellarine Vineyard Pty Ltd (the Landowner), Mount Bellarine Vineyard Management Pty Ltd (the Project Manager) and the Grower, undated;**
- **Constitution of the Mount Bellarine Vineyard Project, undated;**
- Grape Purchase Agreements between, Mount Bellarine Vineyard Management Pty Ltd and Chandi No 20 Pty Ltd, Barwon Wines Pty Ltd and Red Hill Wines Pty Ltd;
- Additional correspondence dated 14 February 2001, 15 February 2001, 27 February 2001, 7 March 2001, 13 March 2001, 14 March 2001 30 March 2001, 12 April 2001, 17 April 2001 and 19 April 2001.

Note: certain information received from, Mount Bellarine Vineyard Management Pty Ltd has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

16. In accordance with the above documents, a Grower who participates in the arrangement must have accepted an offer that was made under section 708 of the Corporations Law**. This Ruling does not apply unless the Grower:**

- has accepted a 'personal offer' under subsections 708(1)-(7) of the Corporations Law ; or
- is a 'sophisticated investor' for the purposes of subections 708(8)-(9) of the Corporations Law ; or
- has accepted an offer made by a licenced dealer where the offer meets the requirements of sub-section 708(10) of the Corporations Law ; or
- is a 'professional investor' for the purposes of paragraphs (a), (b) or (h) of subsection 708(11) of the Corporations Law.

17. Each of these categories is explained in paragraphs 49 to 55 in the Explanations area of this Product Ruling.

18. The documents highlighted are those that Growers may 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 a Grower, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows.

Overview

19. This arrangement is called the Mount Bellarine Vineyard Project.

Location	Founds Road, Bellarine Peninsula, Victoria (approx. 2km north-east of Drysdale)
Type of business each participant (Grower) is carrying on	Commercial growing of grapes
The term of the investment in years	20 years
Total number of hectares under cultivation	50 Hectares
Number of Interests	100
Minimum Investment per Grower	5 Interests
Minimum Subscription for Project	50 interests
Size of Leased Area per Interest	Not less than 0.5 Hectares
Number of Vines *per Hectare*	At least 2,667 vines
Expected production *per Hectare*	Year 3 harvest: 5 tonnes Year 4 harvest: 7.5 tonnes Subsequent harvests: 10 tonnes.
Initial Cost per Interest	$38,313
On going costs (from the second year until the end of the term)	Annual Management Fees, Rent and Insurance (where applicable).

20. Growers applying under the Mount Bellarine Vineyard Project Information Memorandum enter into a Lease and Management

Agreement with Mount Bellarine Vineyard Pty Ltd (the Landowner) and Mount Bellarine Vineyard Management Pty Ltd (the Project Manager). The Lease and Management Agreement gives a Grower a lease over an identifiable area of land called an 'Interest' until the Project is terminated on 30 June 2021. The term of the Project is expected to be 20 years. Each Interest Vinelot is at least 0.5 hectares in size.

21. The Project Land is situated approximately two kilometres north east of the township of Drysdale on the Bellarine Peninsula. Mount Bellarine Vineyard Pty Ltd (the Landowner) has entered into a contract for the purchase of the land. Mount Bellarine Vineyard Pty Ltd (the Landowner) will lease the Interests to the Grower for the purpose of carrying on a long-term commercial viticulture project.

22. The minimum investment for each Grower is five Interests. Mount Bellarine Vineyard Management Pty Ltd (the Project Manager) will plant approximately 1,334 vines per Interest (approximately 2,667 vines per hectare) during the year ended 30 June 2002 following the execution of the Lease and Management Agreement.

Constitution

23. The Constitution establishes the project and sets out the terms and conditions under which Mount Bellarine Vineyard Management Pty Ltd (Project Manager) agrees to act on behalf of the Growers and to manage the Project. The Project Manager:

- ensures that Application Funds are not released until appropriate conditions are met and the proper agreements are in place;
- arranges funds to be placed in Proceeds Fund
- keeps a register of Growers;
- procures a written report to Growers from an Independent Viticulturist each year; and
- distributes profits from the Proceeds Fund.

Lease and Management Agreement

24. A Lease and Management Agreement is entered into between the Project Manager (Mount Bellarine Vineyard Management Pty Ltd), the Landowner (Mount Bellarine Vineyard Pty Ltd) and the Grower.

25. A lease is granted by the Landowner (Mount Bellarine Vineyard Pty Ltd) to each Grower under the terms of the Lease and Management Agreement. Growers must pay rent annually to the

Mount Bellarine Vineyard Pty Ltd for the term of the lease which is from the Commencement Date until 30 June 2021.

26. Growers contract with the Project Manager to plant, develop, manage and maintain the vines. Growers pay an Initial Management Expenditure on application. Management fees and Rent are payable annually thereafter.

27. The Project Manager will carry out establishment services and ongoing annual services including:

(a) Establishment Services:

- obtaining all relevant Government approvals for the Vineyard;
- finalising and marking out Vineyard Layout;
- removing internal fencing and remnant vegetation;
- eradicating weeds, pests and vermin from the Vinelots;
- preparing the land;
- establishing a cover crop;
- establishing drainage
- establishing an irrigation system; and
- providing supervision and management of the above activities
- plant suitable vine rootlings (or cuttings) on the Interests on the leased area.

(b) Ongoing Services

- cultivate, tend, train, prune, fertilise, spray, and otherwise care for the vines as and when required;
- use all reasonable measures to keep the Interests free of, and protect the Land Produce from, vermin, noxious weeds, pests and diseases;
- erect and maintain suitable trellising systems to support the vines;
- maintain a trickle irrigation system to the vines in the Interests;
- maintain in good repair and condition adequate firebreaks in and around the Vinelots;

- maintain the Interests according to good viticultural practices;
- keep in good repair access laneways within the Interest;
- Replace any vines that fail to establish or that die during the first three years of the project; and
- harvest all grapes grown on the Interests and deliver them for sale.

28. Planting will take place in November in accordance with good viticultural practice. Six different varieties of grapes will be planted on the available project land (50 Hectares). After planting, the Project Manager will maintain the vineyard (which may include sub-contracting the services) and provide ongoing reports as required by the Lease and Management Agreement.

29. The Project Manager will be responsible for the harvesting of the grape produce grown on the vineyard. The Harvest will commence from the date of the first commercially harvestable grape crop from the vineyard at such time or times as, in the opinion of the Project Manager, will maximise the price receivable for such grape produce for the purpose of making quality wines. The first commercial harvest is expected in the year ended 30 June 2004. Growers can elect to collect the produce that is in their Interest. The receipts from the sale of any grape produce will be paid into the Proceeds Fund established by the Project Manager.

30. The Project Manager, on behalf of Growers, will endeavour to organise insurance of the Vineyard against destruction or damage by fire or other usual risks to the vineyard, property and produce at the expense of the Grower. The Growers will be required to pay insurance where applicable, for the following year each year in advance.

31. The termination of the Project is the date of payment of the final distribution from the proceeds from the final harvest in 2021.

Fees

32. The following fees are payable by each Grower:

Type of fee payable	Payable by 1 October 2001 in respect of Year Ended 30 June 2002	Payable by 30 June 2002 in respect of Year Ended 30 June 2003	Payable by 30 June 2003 in respect of Year Ended 30 June 2004
Annual Management Expenditure	18,712	6,303	6,963
Rent	737	737	737
Vine Establishment	6,992	0	0
Irrigation	5,633	0	0
Trellising	6,239	0	0
Total Payable	**$38,313**	**$7,040**	**$7,700**

33. Annual Rent payable to the Lessor (Mount Bellarine Vineyard Pty Ltd) is charged on the lease of the land. The rental fee is $737 each year with no adjustment for the Consumer Price Index.

34. Fees are also associated with planting activities. Trellising costs amounting to $6,239 are included in the initial fee.

Finance

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

36. 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;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;

- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, are involved or become involved, in the provision of finance to Growers for the Project.

Ruling

Assessable income

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

Minimum subscription

38. A Grower will not incur the fees shown in the Table(s) below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted (the date the investment is made). Under the Information Memorandum, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 50 interests is achieved. Tax deductions are not allowable until these requirements are met. If the Project's minimum subscription requirements (described above) are reduced or altered in any way (for example, through the issue of a supplementary prospectus), this Product Ruling, including the deductions it describes, will have no application to any Grower.

Section 8-1

Deductions where a Grower is <u>not</u> registered nor required to be registered for GST

39. Expenditure incurred by a Grower who participates in the Project is subject to the prepayment rules contained in sections

82KZME and 82KZMF. Therefore, a Grower who prepays fees that are otherwise allowable under section 8-1 cannot claim a tax deduction of the fees in the year in which the expenditure is incurred unless it is 'excluded expenditure' (see note (ii) below). The amount and timing of tax deductions allowable each year for such fees must be determined using the formula in subsection 82KZMF(1). In that formula, which is shown below, the 'eligible service period' means, generally, the period over which the services are to be provided.

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

40. In this Project, the tax deductions allowable for the Management Fees (detailed at paragraph 32 in the Arrangement) for payments made by 30 June of any year for services after that date are calculated by applying the formula to the amount incurred each year by the Grower. The application of this method is shown in the Examples at paragraphs 119 and 120. The 'eligible service period' for a payment made by 30 June 2001 is 1 July 2001 to 30 June 2002. The 'eligible service period' for payments made by 30 June 2002 for services after that date is 1 July 2002 to 30 June 2003. The 'eligible service period' for payments made by 30 June of subsequent years is 1 July to 30 June of the financial year following the date of the payment. Accordingly, a Grower may claim tax deductions in the Table(s) below where the Grower

- participates in the Project by 1 October 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 32; and
- is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year ended 30 June 2001 deductions	Year ended 30 June 2002 deductions	Year ended 30 June 2003 deductions	Year ended 30 June 2004 deductions
Management Fee	8-1		$18,712 – See Note (i) (below)	$6,303 – See Note (i) (below)	$6,963 – See Note (i) (below)
Lease Fee (Rent)	8-1	$737 – See Note (ii) (below)	$737 – See Notes (i) and (ii) (below)	$737 – See Notes (i) and (ii) (below)	$737 – See Notes (i) and (ii) (below)
Interest			See Note (iii) (below)	See Note (iii) (below)	See Note (iii) (below)

Notes:

(i) Where a Grower **chooses** to prepay fees beyond 13 months, sections 82KZME and 82KZMF will not

apply to set the amount and timing of that Grower's tax deductions. Instead, unless the expenditure is 'excluded expenditure', the amount and timing of the tax deductions is determined under either subsection 82KZM(1) or subsection 82KZMD(2) (see paragraphs 75 to 76). To apportion the expenditure over the eligible service period, these provisions, which apply respectively to 'small business taxpayers' and taxpayers who are not 'small business taxpayers', effectively use the same formula as that shown above.

(ii) Amounts of less than $1,000 will be 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (See Example 3 at paragraph 120). Accordingly, growers whose applications to participate in the Project are accepted by 30 June 2001 who incur rental expenses less than $1000 by that date, may claim a deduction in the year ended 30 June 2001 for the amount incurred. Deductibility of amounts of $1,000 or more, such as may occur where a Grower acquires a number of interests in the Project, will be determined on the same basis as the prepaid Management fees, i.e., using the formula shown above (in paragraph 39).

(iii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraph 71 to 73 below as those rules may be applicable if interest is prepaid.

Tax deductions for capital expenses

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

Fee type	ITAA 1997 section	Year ended 30 June 2001 deductions	Year ended 30 June 2002 deductions	Year ended 30 June 2003 deductions	Year ended 30 June 2004 deductions
Trellising	42-15	Must be calculated - See note (iv) below	Must be calculated - See note (iv) below	Must be calculated - See note (iv) below	Must be calculated - See note (iv) below
Vineguards	42-15	See note (iv) below	See note (iv) below	See note (iv) below	See note (iv) below
Irrigation costs	387-125	see notes (v) and (vi) below	$1,878 - see notes (v) and (vi) below	$1,878 - see notes (v) and (vi) below	see notes (v) and (vi) below
Establishment of horticultural plants	387-165	Nil - see note (vii) below	Nil - see note (vii) below	Nil - see note (vii) below	Nil - see note (vii) below

Notes:

(iv) The tax deduction for depreciation of trellising will depend upon whether or not the Grower is a 'small business taxpayer' (see paragraphs 84 to 86 below).

For a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the tax deduction for depreciation of **trellising** is determined using the rates in section 42-125 and the formula in either subsection 42-160(1) ('diminishing value method') or subsection 42-165(1) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising and the extent to which the trellising is installed ready for use during the year. The Project's manager is to advise Growers of relevant details to calculate their depreciation deductions. Depending upon the method the Grower elects to use, the rate for calculating the tax deduction will be 13% prime cost method or 20% diminishing value method.

Note: The depreciation deductions for 'small business taxpayers' discussed above apply until the introduction of the Simplified Tax System on 1 July 2001 (see paragraphs 81 to 83).

For a Grower who is NOT a 'small business taxpayer' or who is a 'small business taxpayer' who does not

satisfy the conditions in section 42-345, the tax deductions for depreciation of **trellising** is determined using the formula in either subsection 42-160(3) ('diminishing value method') or subsection 42-165(2A) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising and the extent to which each is installed ready for use during the year. The formulae use 'effective life' rather than rate to determine the deduction for depreciation. The Project's manager is to advise Growers of relevant details to calculate their depreciation deductions.

Note: this is only applicable to plant acquired after 21 September 1999 (see paragraphs 81 to 83).

(v) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income. Accordingly, growers whose applications to participate in the Project are accepted by 30 June 2001 may claim a deduction of $1,878 in each of the years ended 30 June 2001, 2002 and 2003 and growers whose applications to participate in the Project are accepted between 1 July 2001 and 1 October 2001 may claim a deduction of $1,878 in each of the years ended 30 June 2002, 2003 and 2004.

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

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

Project's manager will inform Growers of when the grapevines enter their first commercial season.

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

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

- participates in the Project by 1 October 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 32; and
- is entitled to an input tax credit for the fees

then the tax deductions shown in the Table(s) above will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). See Example 1 at paragraph 118.

Division 35 – deferral of losses from non-commercial business activities

Section 35-55 – Commissioner's discretion

43. For a Grower who is an individual and who enters the Project by 1 October 2001 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2003 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies (see paragraph 104 in the Explanations part of this ruling, below)

For the year ended 30 June 2004, income from grape sales is projected to exceed $20,000 for 5 lots. The objective test in section 35-30 will therefore be satisfied.

45. Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any

deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

46. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from this perspective has not been made.

Sections 82KL and Part IVA

47. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Lease Agreement the following provisions of the ITAA 1936 have application as indicated:

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 708 of the Corporations Law

48. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by the Grower under one of four categories in subsections 708(1)-(11) of the Corporations Law. These provisions set out situations where a prospectus or similar disclosure document is not required.

49. Under subsections 708(1)-(7) a Grower may participate in the project by accepting a 'personal offer' for an interest in the project . Offers under these provisions cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than $2 million dollars.

50. An offer will be a personal offer only where if it can be accepted by the person it is made to, and if the person is likely to be interested in the offer because of any previous contact, professional or other connection to the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 708(2)).

51. Offers made under other exclusions in section 708 (see below) are not counted for the purposes of the 20 investors limit.

52. Alternatively, a Grower who is a 'sophisticated investor' may accept an offer for interests in the project under subsections 708(8)-(10). Under subsection 708(8), an investor in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will be a 'sophisticated investor' where :

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least $500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least $500,000; or
- it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made that the person to whom the offer is made:
  - (i) has net assets of at least $2.5 million; or
  - (ii) has a gross income for each of the last 2 financial years of at least $250,000 a year.

53. A Grower may also participate in the project where the offer is made by a licensed dealer under subsection 708(10). Under this provision the dealer must be satisfied that the person to whom the offer is made has previous experience in investing which allows them to assess the merits of the offer, the value of the interests in the project, the risks involved in accepting the offer, their own information needs and the adequacy of the information provided.

54. The licensed dealer must provide a written statement of reasons for being so satisfied. Where a Grower is accepted into the project under this provision he or she must sign an acknowledgment that they did not receive a prospectus in relation to the offer.

55. Under subsection 708(11) an offer may be made to and accepted by a person who is considered to be a professional investor. Growers who participate in the project under this provision will be, at the time the offer is made :

- a person who is a licensed or exempt dealer and who is acting as a principal;
- a person who is a licensed or exempt investment adviser and who is acting as a principal; or
- a person who controls at least $10 million for the purposes of investment in securities.

Section 8-1

56. Consideration of whether the management fees and the lease 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 outgoings 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.

Is the Grower carrying on a business?

57. 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 vinelots 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 outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the grapes each year from the vinelot. 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.

58. For this Project, Growers have rights under of the Lease and Management 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 Lease and Management Agreement, Growers engage the Project Manager 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 are considered to have control of their operations.

59. The Lease and Management 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.

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

61. 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.

62. 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.

63. 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.

64. 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.

Sections 82KZME and 82KZMF – prepaid fees

65. Expenditure prepaid by Growers for management fees and lease fees meets the requirements of subsections 82KZME(1) and (2) and the expenditures are incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies to the expenditures, the amount and timing of tax deductions for those expenditures are determined under section 82KZMF.

66. In relation to the requirements of subsection 82KZME(1) and (2), the prepaid management and lease fees incurred by a Grower who participates in the Project:

- are otherwise deductible under section 8-1; and
- have 'eligible service periods' (for each of the fees) that end not more than 13 months after the Grower incurs the expenditure; and
- are incurred in return for the doing of a thing under the agreement that is not wholly to be done within the expenditure year.

The 'eligible service period' (defined in subsections 82KZL(1)) means, generally, the period over which the services are to be provided.

67. In relation to an 'agreement' referred to in subsection 82KZME(3), the Project is an 'agreement' (this being a broad concept under subsection 82KZME(4)), where, during the term of this Product Ruling:

- the Grower's allowable deductions attributable to the Project for each expenditure year exceeds the Grower's assessable income from the Project (if any) for the expenditure year; and
- the Grower does not have day-to-day control over the operation of the Project; and

- there is more than one Grower participating in the Project.

68. The prepaid management fees incurred by Growers do not fall within any of the 5 exceptions to section 82KZME and therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF overrides section 8-1 and apportions the management fees over the period that the services for which the prepayment is made are performed.

69. The prepaid lease fees, being amounts of less than $1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is not subject to section 82KZMF and is, therefore, deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of prepaid lease fees is $1,000 or more, then the deduction allowable for those amounts will also be subject to apportionment under section 82KZMF.

70. In this Project, the Management Fee of $18,712 and a Lease Fee of $737 per Interest will be incurred on execution of the Lease and Management Agreement for providing management services or leasing land to a Grower between 1 July 2001 or the date of execution of the Agreements, whichever is later, and 30 June 2002. Subsequent payments under the Lease and Management Agreements are charged for providing management services or leasing land to a Grower in the financial year following the date of payment. For these subsequent payments, the 'eligible service period' for a payment made by 30 June is 1 July to 30 June of the financial year following the date of the payment.

Interest deductibility

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

72. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in sections 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass activities not described in the Arrangement or otherwise dealt with in

the Product Ruling, such as a loan to finance participation in the Project.

73. Therefore, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. The relevant formula is shown above in paragraph 39 and the method is explained in the Examples at paragraphs 119 and 120.

Growers who choose to pay fees for a period in excess of that required by the Project's agreements

74. Although not required under the Arrangement described in this Product Ruling, some Growers may choose to prepay some or all of their fees for periods longer than the agreements require. Specifically, this will occur when the 'eligible service period' relating to the prepaid amount ends more than 13 months after the Grower incurs the expenditure. Where the 'eligible service period' exceeds 13 months sections 82KZME and 82KZMF will not apply, as the requirement of paragraph 82KZME(1)(b) is not met.

75. Instead, for a Grower who is a 'small business taxpayer' (see paragraphs 84 to 86) subsection 82KZM(1) applies to apportion the expenditure and determine the amount and timing of the deductions. Alternatively, for a Grower who is not a 'small business taxpayer' subsection 82KZMD(2) applies to apportion the expenditure and determine the amount and timing of the deductions.

76. Both of these provisions, although slightly different in form, apportion deductible expenditure over the 'eligible service period' in the same way as the formula contained in paragraph 39 (above). However, expenditure, which is 'excluded expenditure', is an exception to both provisions (subparagraph 82KZM(1)(b)(ii) and subsection 82KZMA(4) respectively). A tax deduction for 'excluded expenditure' can be claimed in full in the year in which the expenditure is incurred.

Expenditure of a capital nature

77. Any part of the expenditure of a Grower entering into a viticultural business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, the costs of , trellising, vineguards, irrigation, and the establishment of horticultural plants are considered to be capital in nature. The fees for these expenditures are not deductible under

section 8-1. However, this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

Section 42-15: depreciation of trellising and vineguards

78. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose or purposes of producing assessable income where they are the owner or quasi-owner of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally, absolutely owned by the owner of the land.

79. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. Taxation Ruling IT 175 sets out the views of the Tax Office on this issue. Where a lessee is considered to own the improvements under a state law, as detailed in the Ruling, or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the lessee is entitled to claim depreciation for the fixture.

80. Under section 42-15 Growers in the Project are entitled to depreciation deductions for capital expenditure in relation to the acquisition and installation of trellises on the land. The deduction available, however, will depend upon the date the investment is made, when the plant is installed ready for use and whether or not a Grower is a 'small business taxpayer' (see paragraphs 84 to 86).

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

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

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

Small business taxpayers

84. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either

their 'average turnover' for the year is less than $1,000,000 or their turnover recalculated under section 960-350 is less than $1,000,000.

85. '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).

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

Depreciation deductions for Growers who are 'small business taxpayers'

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

88. The deduction is calculated using a rate of 13% prime cost or 20% diminishing value. These accelerated rates of depreciation are shown in section 42-125 and apply to plant with an effective life of between 13 and 30 years. The Project Manager will advise Growers of the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

89. Until the introduction of the proposed Simplified Tax System on 1 July 2001, under section 42-167, a Grower who is a 'small business taxpayer' is entitled to a 100% depreciation deduction for expenditure on **vineguards**, being items of plant with a cost of $300 or less.

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

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

91. The deduction depends on the cost of the plant, the number of days the plant was owned by the Grower during the income year and the 'effective life' of the plant. It also depends upon the extent to which the plant is installed ready for use during the year. The Project Manager will advise Growers of the date that the trellising and vineguards are installed and begin to be used for the purpose of producing assessable income.

Determination of effective life

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

Low value pool option

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

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

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

Subdivision 387-B – irrigation expenditure

96. Section 387-125 allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three-year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed would be covered by this Subdivision.

97. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or licensee who is conducting a primary production business on land in Australia, a deduction would be available to a Grower in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

98. However, a deduction under section 387-125 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Grower can only choose a water facility tax offset where:

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

Subdivision 387-C - vines and horticultural provisions

99. Section 387-165 allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. A lessee or licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land (section 387-210).

100. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant, such as the grapevines in this Project, with an effective life of 13 to fewer than 30 years, that rate is 13%.

Division 35 – deferral of losses from non-commercial business activities

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

- the 'Exception' in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or

- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

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

103. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity, or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

104. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than $40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

105. In broad terms, the objective tests require:

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

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

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

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

106. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of five interests in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2004. Growers who acquire five or more interests in the Project are expected to have at least $20,000 of assessable income in the income year ended 30 June 2004 from the business

activity, thereby passing the objective test at section 35-30 (see paragraph 105(a) above).

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

108. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires the minimum 5 interests in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the income years ending 30 June 2001 to 30 June 2003.

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

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

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

110. 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 (see paragraph 43), in the manner described in the Arrangement (see paragraphs 15 to 36), the Commissioner's discretion will not have been exercised, because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

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

- the report of the independent Viticultural Consultant
- additional expert evidence provided with the application by the Responsible Entity;
- the binding Grape Sale contracts with Chandi No 20 Pty Ltd, Barwon Wines Pty Ltd and Red Hill Wines Pty Ltd 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.

Section 82KL - recouped expenditure

112. 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'.

113. '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.

114. 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.

Part IVA - general tax avoidance provisions

115. 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).

116. The Mount Bellarine Vineyard Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 40 to 41 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.

117. 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 the 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 at 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.

Examples

Example 1 – entitlement to 'input tax credit'

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

1/11 x $5,500 = $500

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

Example 2 – prepaid expenditure and the apportionment of fees

119. Murray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are $5,000 in the first year and $1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Murray that the minimum subscription has been

reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

Management fee x Number of days of eligible service period in the year of income / Total number of days of eligible service period

$5,000 X 26 / 365

= **$356** (this is Murray's total tax deduction in 2001 for the Year 1 prepaid management fees of $5,000. It represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$5,000 X 339 / 365

= **$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2002 income year).

$1,200 X 26 / 365

= **$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2002 income year).

$4,643 + $85 = $4,728 (The sum of these two amounts is Murray's total tax deduction for management fees in 2002).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

Example 3 – apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'

120. On 1 June 2001 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin

pays the first year management fee of $3,600 and first year lease fee of $500 on 15 June 2001.

Kevin, who is not registered nor required to be registered for GST calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

Management fee

Even though he paid the $3,600 in the 2001 income year, because there are no 'days of eligible service period' in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2001.

Lease fee

Because the $500 lease fee is less than $1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2001.

In the **2002 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\$3{,}600 \times \frac{365}{365}$$

= **$3,600** (this represents the whole of the first year's management fee prepaid in the 2001 income year but not deductible until the 2002 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

Detailed contents list

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

Commissioner of Taxation
2 May 2001

Previous draft:
Not previously issued in draft form

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

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

Legislative references:
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40

- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 Subdiv 42-C
- ITAA 1997 42-15
- ITAA 1997 42-118
- ITAA 1997 42-125
- ITAA 1997 42-160
- ITAA 1997 42-160(1)
- ITAA 1997 42-160(3)
- ITAA 1997 42-165(1)
- ITAA 1997 42-165(2A)
- ITAA 1997 42-167
- ITAA 1997 42-345
- ITAA 1997 42-455(1)
- ITAA 1997 42-460(1)
- ITAA 1997 Subdiv 387-B
- ITAA 1997 Subdiv 387-C
- ITAA 1997 387-55
- ITAA 1997 387-125
- ITAA 1997 387-165
- ITAA 1997 387-185
- ITAA 1997 387-210
- ITAA 1997 388-55
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
- ITAA 1936 82KH(1)
- ITAA 1936 82KH(1F)(b)
- ITAA 1936 82KL
- ITAA 1936 82KL(1)
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZM(1)(b)(ii)
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(1)(b)
- ITAA 1936 82KZME(2)
- ITAA 1997 960-345
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1936 Part IVA
- Corporations Law 708(1)
- Corporations Law 708(2)
- Corporations Law 708(3)
- Corporations Law 708(4)
- Corporations Law 708(5)
- Corporations Law 708(6)
- Corporations Law 708(7)
- Corporations Law 708(8)
- Corporations Law 708(9)
- Corporations Law 708(10)
- Corporations Law 708(11)
- Corporations Law 708(11)(a)
- Corporations Law 708(11)(b)
- Corporations Law 708(11)(h)

ATO references:
NO 2000/008926
BO
FOI number: I 1025336
ISSN: 1441 1172