PR 2001/69 - Income Tax: Brokkensted Vineyard Project

Product Ruling
Income tax: Brokkensted 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 these products as investments. Further, we give no assurance that the products are commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

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

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

If the 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 Brokkensted 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);
- section 35-55 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-305 (ITAA 1997);
- section 388-55 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- section 82KZM (ITAA 1936);
- section 82KZMB - 82KZMD (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 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.

Date of effect

12. This Ruling applies prospectively from 23 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 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 upon the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, the product ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect on 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 the 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

15. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents or parts of documents lodged with the Tax Office:

- Application for Product Ruling for Brokkensted Vineyard Project dated 21 February 2001;
- Draft Information Memorandum for the Brokkensted Vineyard Project;
- **Draft Vineyard Management Agreement** between Vinescape Management Services Pty Ltd ('the Vineyard Manager') and Mark Trevor Jackson trading as Jackson Vineshare Management ('the Project Business Manager') and Highgrove Management Services Pty Ltd ('the Promoter') and Benudo Project Management Pty Ltd ('Benudo') and each Lot Owner ('Grower');
- **Draft Contract for Sale and Purchase of Land** (**'Land Contract'**)between Benudo being the Vendor and a Grower being the Purchaser;
- Draft Water Supply Agreement between Alexandrina Water Pty Ltd being the Supplier and the Promoter being the Client;
- **Draft Community Titles Act, 1996 Management By-Laws**;
- Grape Supply Agreement between the Vineyard Manager and the Grape Purchaser, executed on 16 March 2001; and
- Correspondence and attachments from the Tax Adviser dated 5 April 2001and 3 May 2001.

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

16. The documents highlighted are those Growers enter into or become a party to. 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, to which the Grower, or an associate of the Grower, will be a party to. The effect of these agreements may be summarised as follows.

17. 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 subsections 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.

18. Each of these categories is explained in paragraphs 52 to 59 in the Explanations area of this Product Ruling.

Overview of the Project

19. This arrangement is called the Brokkensted Vineyard Project. The salient features of the Project are shown in the table below.

Location	Langhorne Creek in South Australia
Type of business each participant is carrying on	Viticulture
Number of hectares under cultivation	The Project involves 48 hectares under cultivation.
Product Name	Brokkensted Vineyard Project
Number of Lots for sale	10
Minimum subscription	15 hectares by 7 June 2001
Size of each Lot for sale	2 3.0 hectare lots 1 4.7 hectare lot 4 5.0 hectare lots 1 5.5 hectare lot 1 5.7 hectare lot 1 6.3 hectare lot
Term	Growers have freehold title over their land and a 12 year Vineyard Management Agreement with options for a further 5 year term and a further 3 years.
Initial cost per hectare (see paragraphs 27 to 29)	$44,806

Ongoing Costs (see paragraph 30)	Growers are liable to pay an annual fee to each of the Vineyard Manager and the Project Business Manager. Growers are also required to reimburse the Vineyard Manager and the Project Business Manager their share of all out of pocket costs incurred by the Vineyard Manager and the Project Business Manager. Growers may also be required to contribute money to pay the Project Expenses.

The Project Land

20. A Grower will enter into a Land Contract to buy a Freehold Title of between 3 hectares and 6.3 hectares depending on the lot size chosen. These Freehold Titles will be subject to Community Title. The land will require ripping and fertilising as an initial preparation of the Project land. Under the terms of the Community Corporation By Laws, the land is to be used to establish a vineyard.

21. The Community Title associated with the vineyard is governed by the South Australian Community Titles Act 1996 as amended. Under this Act, the owner of a community lot owns all of the improvements on that lot and the common property is vested in the owners of the community lots as tenants in common. The community corporation is responsible for the maintenance, administration, management and control of the common property.

22. The Promoter will assign the Water Supply Agreement to the Community Corporation at its first annual general meeting. Upon assignment, the water for irrigation as contemplated Water Supply Agreement and is subject to a water licence will be acquired and held by the Community Corporation.

Vineyard Management Agreement

23. Under the Vineyard Management Agreement, a Grower appoints the Vineyard Manager and the Project Business Manager. This agreement will commence on execution and will expire on 30 June 2013, subject to earlier termination as provided in this agreement (cl. 2.1). The continuing operation of this agreement is also subject to each of the conditions referred to in clauses 25 and 26 of the Land Contract and if any of the conditions is not satisfied by the relevant date this agreement shall terminate immediately (cl 2.2). The

Vineyard Manager has the option to enter into a new agreement for a further 5 year term and a further 3 years (cl. 22).

24. It is contemplated by the Vineyard Management Agreement that a Grower who becomes registered or entitled to be registered as the proprietor of a Lot prior to 1 November 2001 will have that Grower's Lot established on or before 15 November 2001 and thereafter, develop and maintain that Grower's vineyard. The Vineyard Manager shall, among others, provide the following services:

- plan, design, co-ordinate and administer all vineyard development and operational functions;
- supervise all vineyard related functions ensuring that they are carried out to acceptable standards;
- install and maintain irrigation systems;
- monitor the vineyard for pest, disease, nutritional defects and other causes or symptoms requiring attention and forthwith act to rectify the same;
- provide vine root stocks, labour, plant and equipment to enable planting and land preparation, weed control, pest and disease control, vine training, pruning, watering and fertilising of vines, canopy management and land maintenance;
- attend to vine establishment, machine harvesting, hand harvesting, trellising and irrigation and reticulation installation;
- co-ordinate persons and corporations sub-contracting to the Vineyard Manager; and
- pay (without deduction or abatement) the pooled proceeds from the sale of grapes produced on the Lot to the Project Business Manager (cl 7.2(a)).

25. Through the Vineyard Management Agreement, the Vineyard Manager is also appointed as Attorney of the Grower to facilitate the sale of grapes produced from the Lot (cl. 9). Consistent with this provision, the Vineyard Manager has entered into a Grape Supply Agreement whereby the Grape Purchaser will buy from the Vineyard Manager "all the Sound Grapes for the period commencing from the Vintage 2004 and expiring 30 June 2013" and will have an option to purchase "downgraded" and "reject" grapes.

26. Growers also appoint a Project Business Manager, for a period of 12 years, to manage and conduct the business and affairs of the Project (cl. 12). This role will be performed by Mark Trevor Jackson trading as Jackson Vineshare Management. It is envisaged that the

Project Manager will be appointed Community Corporation Manager by the Community Corporation to be responsible for administering the Community Corporation's affairs.

Project Fees

Note: All amounts shown below are on a cost per hectare basis.

27. Upon execution of the Land Contract, a Grower will be liable to pay a deposit of 10% of the purchase price. On a cost per hectare basis, the deposit will be $1,293.

28. Upon settlement of the Land Contract, a Grower will be liable to pay the expenditures shown in the table below.

Operating expenses	$5,016
Vineyard Management Fee	$3,190
Project Management Fee	$303
Balance of a Lot's purchase price	$11,633
Soil Preparation	$1,160
Landcare	$1,732
Irrigation	$8,187
Trellis	$7,645
Roads and Headlands	$220

29. A Grower will also be liable to pay the following establishment costs. The date these expenditures will become due and payable depends on a Grower's settlement date. If a Grower settles on or before 1 August 2001, it will payable on or before 1 August 2001. If a Grower settles after 1 August 2001 but before 1 November 2001, it will payable at the time of settlement.

Trellis	$962
Vines and Planting	$3,465

30. From 1 July 2001, a Grower will be liable to pay an annual fee to each of the Vineyard Manager and the Project Business Manager. In addition, the Project Business Manager may make a Call on each Grower to contribute money for operating expenses. These fees will be paid by equal quarterly instalments in advance, the first of such instalment falling due and becoming payable on 1 July 2001. If the settlement occurs after a Call has been made, then that Call will become payable at settlement. The amounts payable are shown in the table below.

Fee type	30 June 2002	30 June 2003	30 June 2004
Vineyard Management Fee	$3,190	$3,190	previous year's fee indexed
Project Management Fee	$303	previous year's fee indexed	previous year's fee indexed
Estimated operating expenses	$7,031	$10,296	$5,949

Finance

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

32. A financial broker will be made available to Growers in arranging loans from independent financiers to cover the fees payable to the Project. Information provided with the Product Ruling Application indicates that the financial broker is neither an associate of the Promoter or any associates of the Promoter nor has financial interest in the Project.

33. 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

34. 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

35. A Grower will not incur the fees shown in paragraphs 27 to 30 above before the conditions in the Land Contract are satisfied and the Grower's application to enter into the Project is accepted (the date the investment is made). These conditions include Development Assessment approval, the depositing of the Community Plan with the Land Titles Registration Office and minimum subscription equivalent to 15 hectares. These conditions must be satisfied on or before 7 June 2001. Tax deductions are not allowable until these requirements are met.

Section 8-1

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

36. A Grower may claim tax deductions shown in the table below for the years ending 30 June 2001 to 30 June 2004 where a Grower:

- settles the Land Contract prior to 15 June 2001;
- incurs the fees shown in in paragraphs 27 to 30; and
- is not registered nor required to be registered for GST.

Fee type	**ITAA 1997**	**Year 1**	**Year 2**	**Year 3**	**Year 4**
	section	**30/6/2001**	**30/06/2002**	**30/06/2003**	**30/06/2004**
Vineyard Management Fee	8-1	$3,190	$3,190	$3,190	As incurred
Project Management Fee	8-1	$303	$303	As incurred	As incurred

Estimated operating expenses	8-1	$5,016	$7,031	$10,296	$5,949

37. Where a Grower:

- settles the Land Contract between 15 June 2001 and 30 June 2001;
- incurs the fees shown in paragraphs 27 to 30; and
- is not registered nor required to be registered for GST;

then that Grower will not be able to claim in the year ending 30 June 2001, the Vineyard Management Fee, the Project Management Fee and operating expenses that will be payable on settlement. Instead, the amount and timing of the deduction for these fees will be subject to the prepayment rules contained in sections 82KZME and 82KZMF.

38. The amount and timing of tax deductions allowable 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.

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

39. The application of this method is shown in the Examples at paragraphs 123 and 124.

40. Information provided with the Product Ruling Application indicates that all the services in respect of these fees will be provided in the year ending 30 June 2002. In view of this, the Vineyard Management Fee, the Project Management Fee and operating expenses incurred on settlement will be deductible in the year ending 30 June 2002. The table in paragraph 41 below shows the amount deductible.

41. Where a Grower:

- settles the Land Contract after 30 June 2001 but prior to 1 November 2001;
- incurs the fees shown in paragraphs 27 to 30; and
- is not registered nor required to be registered for GST;

then that Grower may claim tax deductions shown in the table below.

Fee type	**ITAA 1997**	**Year 1**	**Year 2**	**Year 3**	**Year 4**
	section	**30/6/2001**	**30/06/2002**	**30/06/2003**	**30/06/2004**
Vineyard Management Fee	8-1	nil	$6,380 – see Note (i) below	$3,190	As incurred
Project Management Fee	8-1	nil	$606 – see Note (ii) below	As incurred	As incurred
Estimated operating expenses	8-1	nil	$12,047 – see Note (iii) below	$10,296	$5,949

Notes:

(i) $3,190 payable on settlement + $3,190 annual fee

(ii) $303 payable on settlement + $303 annual fee

(iii) $5,016 payable on settlement + $7,031

Prepayments where the eligible service period exceeds 13 months

42. 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 76 to 78). 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 in paragraph 38 above.

Interest expense

43. 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 paragraphs 73 to 75 below as those rules may be applicable if interest is prepaid.

Tax deductions for capital expenses

44. A Grower who settles the Land Contract on or before 30 June 2001 will also be entitled to the following tax deductions.

Fee type	ITAA 1997 section	Year 1 30/6/2001	Year 2 30/06/2002	Year 3 30/06/2003	Year 4 30/06/2004
Trellising	42-15	nil - see note (iv) below	Amount must be calculated - see note (iv) below	Amount must be calculated - see note (iv) below	Amount must be calculated - see note (iv) below
Landcare operations	387-55	$1,732 - see note (v) & (vii) below			
Irrigation costs	387-125	$2,729 - see note (vi) & (vii) below	$2,729 - see note (vi) & (vii) below	$2,729 - see note (vi) & (vii) below	
Establishment of horticultural plants	387-305	Nil - see note (viii) below	$505 - see note (viii) below	$867 - see note (viii) below	$867 - see note (viii) below
Soil preparation	387-305	Nil - see note (viii) below	$169 - see note (viii) below	$290 - see note (viii) below	$290 - see note (viii) 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 79 to 81 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 Vineyard Manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2002. 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 84 to 86).

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 specific rates to determine the deduction for depreciation. The Vineyard Manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2002. Note: This is only applicable to plant acquired after 21 September 1999 (see paragraphs 90 to 91).

In certain circumstances, a Grower who is NOT a 'small business taxpayer' is able to allocate plant to a 'low value pool' (see paragraphs 92 to 96 below). **Note:** This choice is only available from 1 July 2000.').

(v) A deduction is allowable under section 387-55 for capital expenditure incurred for Landcare operations. The deduction is allowed in the year that the expenditure is incurred.

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

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

(viii) A deduction is allowable under section 387-305 for the cost of establishing the vines. The amount deductible is worked out by the formula at subsection 387-305(2).

Deductibility is allowed on the basis of the vines being planted by 15 November 2001.

45. For a Grower who settles the Land Contract after 30 June 2001 but prior to 1 November 2001 the tax deduction for Landcare and Irrigation will be available as follows:

- for Landcare, the deduction is available in the year ending 30 June 2002; and
- for Irrigation, the write-off commences in the year ending 30 June 2002.

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

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

- settles the Land Contract prior to 1 November 2001;
- incurs the fees shown in paragraphs 27 to 30; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the tables in paragraphs 36, 41 and 44 above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 122.

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

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

48. 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 110 in the Explanations part of this Ruling, below).

49. 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 excess of 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.

50. 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 subsection 35-55(1) 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 82KZM, 82KZMB - 82KZMD, 82KL and Part IVA

51. For a Grower who participates in the Project and incurs expenditure in accordance with the Vineyard Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

(i) the expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs 76 to 78);

(ii) the expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 76 to 78);

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

(iv) the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 708 of the Corporations Law

52. 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.

53. 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.

54. 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)).

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

56. 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.

57. A Grower may also participate in the project where the offer is made by a licenced 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.

58. The licenced 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.

59. 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

60. Consideration of whether the Vineyard Management Fee, Project Management Fee and project operating expenses 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?

61. 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 the Lots 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 Lots.

62. 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.

63. For this Project, Growers will acquire freehold title to the land with the intention to carry on a business of growing vines. Under the Vineyard Management Agreement, Growers engage the Vineyard Manager to acquire vine seedlings and plant out the seedlings on the land and to provide ongoing services to care and maintain the vines. Growers are considered to have control of their operations. Growers will also have ownership of the vineyard assets.

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

65. 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 Information Memorandum 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. Grower's will engage the professional services of a manager with appropriate credentials. There is a means to identify which vines Grower's 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.

66. 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.

67. The Vineyard Management Fee, Project Management Fee and project operating expenses 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 Vineyard 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

68. Expenditure prepaid by Growers who settles the Land Contract between 15 June 2001 and 30 June 2001 for the Vineyard Management Fee, Project Management Fee and project operating expenses meet 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.

69. In relation to the requirements of subsection 82KZME(1) and (2), the prepaid Vineyard Management Fee, Project Management Fee and project operating expenses 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.

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

71. 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.

72. These prepaid 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 these fees over the period that the services for which the prepayment is made are performed.

Interest deductibility

73. 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.

74. 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.

75. 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 38 and the method is explained in the Examples at paragraphs 123 and 124.

Prepayments where the eligible service period exceeds 13 months

76. 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.

77. Instead, for a Grower who is a 'small business taxpayer' (see paragraphs 79 to 81) 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.

78. 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 38 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.

Small business taxpayers

79. 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.

80. '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).

81. 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'.

Expenditure of a capital nature

82. 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 expenditure for trellising, Landcare operations, irrigation and establishing grapevines are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, these expenditure fall for consideration under specific write-off provisions of the ITAA 1997.

Section 42-15: depreciation of trellising

83. 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.

84. 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 is a 'small business taxpayer' (see paragraphs 79 to 81).

85. For plant acquired or constructed after 11:45am 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.

86. 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.

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

Depreciation deductions for Growers who are 'small business taxpayers'

88. 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.

89. 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 Vineyard Manager will advise Growers of the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

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 (see paragraph 92). It also depends upon the extent to which the plant is installed ready for use during the year. The Vineyard Manager will advise Growers of the date that the trellising 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.

96. Under the Vineyard Management Agreement, a Grower incurs expenditure of $8,607, on a cost per hectare basis, for trellising and will first be entitled to claim a deduction for depreciation in the year ended 30 June 2002.

97. As the cost of trellising exceeds $1,000 it will not qualify as 'low cost plant'. However, provided the Grower uses the diminishing value method to depreciate the trellising, the plant can be allocated to a 'low value pool' after it has been depreciated below $1,000 (paragraph 42-455(3)(b)).

Subdivision 387-A - Expenditure for Landcare operations

98. Section 387-55 allows a taxpayer a deduction for capital expenditure incurred on a Landcare operation for land used to carry on a primary production business.

99. Landcare operation for land includes work on erecting fences primarily and principally for the purpose of excluding animals from an area affected by land degradation to prevent or limit extension of that degradation and to help reclaim the area. It also includes work on constructing drainage works primarily and principally for the purpose of controlling salinity or assisting in drainage control, and work primarily and principally for the purpose of eradicating pests and plants detrimental to the land.

100. Under the Vineyard Management Agreement a Grower incurs expenditure for Landcare on the Lot. In this Project there will be no delay between the execution of the relevant agreements and the commencement of 'business operations' on the Growers behalf. Accordingly, a Grower's primary production business will have commenced at the time the expenditure in question has been incurred, and the requirements of section 387-55 will have been satisfied.

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

- had the chosen a deduction instead of the tax offset, the Growers 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-B – Irrigation expenditure

102. 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. 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.

103. However, a deduction under section 387-125 is denied where the 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 chosen a deduction instead of the tax offset, the Growers 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.

Cost of Establishment of Grapevines – Subdivision 387-D, ITAA 1997

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

105. The write-off commences from the time the vines are planted in the ground by the Grower. The write-off rate is 25% per annum, over four years, of the establishment expenditure. This amount must be apportioned, based on the number of days in the year in which the vines are owned by the Grower. Thus, where the vines are planted part-way through the income year, the write-off period will extend over five income years, with the deduction being pro-rated in the first and last years.

106. The costs of establishing grapevines may include the cost of acquiring the plants, the cost of establishing the plants, and the costs of ploughing, contouring, top dressing and fertilising the land. Expressly excluded is expenditure incurred on draining swamps or the clearing of land (see section 387-310).

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

107. 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.

108. 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.

109. 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.

110. 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.

111. 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).

112. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the Product Ruling Application indicates that a Grower who acquires a Lot in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2004.

113. 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.

114. 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 an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the income years ending 30 June 2001 to 30 June 2003.

115. 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.

116. 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 47), in the manner described in the Arrangement (see paragraphs 15 to 33), 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.

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

- the independent expert report provided with the Product Ruling application; and
- independent, objective, and generally available information relating to the industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application.

Section 82KL

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

Part IVA - general tax avoidance provisions

119. 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).

120. This 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 36, 41 and 44 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.

121. 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'

122. 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

123. 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:

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

$$\$5{,}000 \quad \text{X} \quad \frac{26}{365}$$

= **$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:

$$\$5{,}000 \times \frac{339}{365}$$

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

$$\$1{,}200 \times \frac{26}{365}$$

= **$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'

124. 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:

$$\$3{,}600 \quad \text{X} \quad \frac{365}{365}$$

= **$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

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

Commissioner of Taxation
23 May 2001

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 97/11; TR 97/16; TR 92/20; TR 98/22; IT 175; IT 333; TD 93/34

Subject references:

- carrying on a business
- commencement of a business
- interest expenses
- harvesting expenses
- management fees
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- tax benefits
- horticultural expenses

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(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(1)
- ITAA 1997 42-160(3)
- ITAA 1997 42-165(1)
- ITAA 1997 42-165(2A)
- ITAA 1997 42-345
- ITAA 1997 42-455(1)
- ITAA 1997 42-460(1)
- ITAA 1997 42-470
- ITAA 1997 387-55
- ITAA 1997 387-60
- ITAA 1997 387-60(2)
- ITAA 1997 387-125
- ITAA 1997 387-185
- ITAA 1997 387-305
- ITAA 1997 Subdiv 387-A
- ITAA 1997 Subdiv 387-B
- ITAA 1997 Subdiv 387-C
- ITAA 1997 388-55
- ITAA 1997 Subdiv 960-Q
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
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