PR 2001/93 - Income tax: Coonawarra Wine Grape Project

Product Ruling
Income tax: Coonawarra Wine Grape Project

Contents Para

What this Product Ruling is about	**1**
Date of effect	**12**
Withdrawal	**14**
Arrangement	**15**
Ruling	**40**
Explanations	**50**
Example	**125**
Detailed contents list	**126**

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 Coonawarra Wine Grape 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 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 82KZM (ITAA 1936);
- sections 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 Farmer) 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.

4. For a Farmer who invests in this Project, Division 27 of the ITAA 1997 would apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Farmer might be entitled. Note that any entitlement to GST credits would be dependent on the Farmer carrying on an enterprise, and making creditable acquisitions, within the meaning of the GST law.

Business Tax Reform

5. 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.

6. 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

7. 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

8. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires) and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as ‘Farmers’.

9. 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

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

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- the Ruling will be withdrawn or modified.

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 part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

12. This Ruling applies prospectively from 20 June 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 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 2003. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who

enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Re-Issue of Product Ruling dated 28 March 2001;
- Application for Product Ruling dated 16 April 1999;
- The Coonawarra Winegrape Project Investment Prospectus 2 dated 29 May 2001 ('the Prospectus');
- Supplementary Prospectus dated 8 June 2001;
- The Coonawarra Winegrape Project Investment Prospectus dated 11 June 1999 ;
- First Supplementary Prospectus dated 11 June 1999;
- Second Supplementary Prospectus dated 17 April 2000;
- Third Supplementary Prospectus, undated;
- Fourth Supplementary Prospectus dated 10 July 2000;
- Draft copy of a Managed Investment Scheme Constitution between the Manager, Australian Hardwood Management Limited (AHML) and the landowner CPHL and the Farmer, which also incorporates a Joint Venture Agreement between AHML, CPHL and each Farmer received by the ATO on 20 April 1999;
- Draft Joint Venture Agreement between AHML, CPHL and each Farmer enclosed with Application for re-issue of Product Ruling dated 28 March 2001;
- Draft Loan Deed between the Lender and the Borrower enclosed with Application for Re-Issue of Product Ruling dated 28 March 2001;
- Draft Deposit Agreement between the Contractor, Koonarra Management Pty Limited (KMPL) and the Lender received by the ATO on 26 May 1999;

- Draft Lease Agreement between CPHL and the Custodian, Australian Rural Group Limited (ARGL) as agent for AHML received by the ATO on 26 May 1999;
- Sub-Contract Agreement between AHML and Koonara Management Pty Limited enclosed with Application for Re-Issue of Product Ruling dated 28 March 2001;
- Correspondence dated 31 August 1999, 8 September 1999, 20 September 1999, 7 December 1999, 8 December 1999, 10 April 2001, 11 May 2001, 1 June 2001 and 8 June 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 arrangement is called the 'Coonawarra Wine-Grape Project Investment' and is registered as a managed investment scheme under the Corporations Law.

Overview

Location	South Australia, north east of the township of Coonawarra. Sections 226, 227, 228 and 235 in the Hundred of Comaum.
Type of business each participant is carrying on	Viticulture, wine processing and production
Number of hectares under cultivation	180 hectares
Maximum number of participants	900
Size of participation	0.2 hectares
Number of vines per hectare	1840
Number of vines per participation	368
The term of the investment	21 years

Initial cost	$17,300 on settlement, $5,309 one year after settlement and $5,318 two years after settlement
Initial cost on a per hectare basis	$139,635 for the first three years
Ongoing costs	From year three management fees of $1,300 increased yearly by the greater of the CPI (All Groups) Adelaide or 3% and Lease Rent of $318 increased yearly by the greater of the CPI (All Groups) Adelaide or 3%
Other aspects	No sales agreements are in place for the grapes and/or wine that is harvested / produced

17. Farmers enter into a Joint Venture Agreement with AHML (the Manager), CPHL (the Landowner) and other Farmers whereby AHML will be engaged to manage the Joint Venture and the Farmers' interest in it until 30 June following the twenty-first anniversary of the Agreement.

18. Each farmer has a proportionate interest in the income of the scheme project. **The Joint Venture is a partnership for tax law purposes and the Joint Venture will prepare a partnership tax return.**

19. The Project aims to establish a vineyard of up to 180 hectares and has up to 900 interests in the Joint Venture on offer. The minimum subscription, set at 100 Joint Venture participations, has been met . A Farmer's minimum investment in the Project is the purchase of one 'Joint Venture Participation'.

20. The Prospectus will expire on the 29 May 2002 unless extended by authority of the ASIC.

21. Grape vines will be planted on the property which is part of a larger holding managed by the Vineyard Manager. Sections 226, 227 and 228 of the property are presently owned by Trevor Stanley Reschke and section 235 is owned by Trevor Reschke Nominees Pty Ltd. CPHL has an option to purchase this land from both owners and will be the landowner. Pending exercise of the option Trevor Reschke and Trevor Reschke Nominees Pty Ltd have leased the land to CPHL.

22. CPHL will lease the Project land to ARGL (Custodian) as agent for the Manager (AHML). The Manager will hold the interest in the land, being the lease, on behalf of the Joint Venture of Farmers to enable the vineyard to be planted out with grape vines.

23. The Manager will plant the Project's land, a total of 180 hectares, with 368 vines per 0.2 ha interest within the first 13 months of the date of acceptance of an investor's application.

Constitution and Joint Venture Agreement

24. In respect of the project, a Farmer has an interest in specific property comprising the managed investment scheme ("Scheme") property which is defined in the Constitution. There will be a Custodian of the Project for the Joint Venture Farmers. Farmers execute a power of attorney enabling AHML to act on their behalf as required.

25. Farmers do not have any right to withdraw from the Scheme nor do they have a right to require their interest in the Scheme to be bought by the Manager or any other person or to have their interest in the Scheme redeemed (Clause 11, Constitution). A Farmer's / Member's Scheme interest may be transferred provided such transfer is a transfer of the entire unencumbered interest in the Scheme (Clause 16, Constitution). AHML keeps a register of Farmers.

26. The Farmers will remain Scheme members until the Scheme is determined on 30 June 2022, unless it is wound up earlier (Clause 7, Constitution). The Farmers will each enter into a Joint Venture Agreement to carry out the Project as a Joint Venture and to appoint AHML to manage the Joint Venture.

27. Upon termination of the Joint Venture trellises will be valued at market value on the assumption they have been removed as tenants' fixtures. The Land Owner will pay this amount to the Manager on behalf of the Joint Venturers (clause 15.1).

Management Services

28. The services to be provided by AHML to the Joint Venture are specifically set out in clause 1.1 of the Joint Venture Agreement and include:

(a) cultivating, fertilising and planting out the vineyard with rootstock in a healthy condition;

(b) prune and/or train, string up, de-shoot and/or take other measures that may be necessary in accordance with good viticultural practice to properly manage the growth of the grape vines to and along the trellises and to optimise as far as is reasonably possible in the circumstances the quality of the grapes produced therefrom;

(c) taking such reasonable measures as may be required to control the growth of weeds and other vegetable pests on the vineyard upon which the vines are growing;

(d) taking all reasonable measures in accordance with the principles of good viticulture practice and to the extent reasonably possible to deter and eradicate any insect, bird or animal pests from the vineyard which may detract from the health and vigour of the grape vines or yield thereof;

(e) taking representative soil samples from the vineyard from time to time and arranging to have those samples analysed by an accredited soil analysis laboratory and having regard to the results and recommendations of any soil analysis undertaken, supply suitable fertiliser and apply it to the vineyard in accordance with the principles of good viticulture practice and in such quantities as may be required to promote healthy plant growth and yield;

(f) replacing at the Farmers' expense any grape vines which die or become unproductive with juvenile grape vines of the same variety as those which die or have become unproductive;

(g) repairing and maintaining in a good condition all fences, trellises, accessways and other structural improvements and irrigation plant and equipment on the vineyard;

(h) arranging sales of the wine grapes and/or bottled wine from the vineyard including entering into a contract or contracts to supply grapes harvested from the vineyard or bulk wine produced therefrom;

(i) harvesting the wine grapes from the vineyard;

(j) effecting the insurances referred to in the Agreement;

(k) employing such staff and labour and engaging such contractors to assist the manager to carry out its obligations under the Agreement;

(l) carrying out the accounting, financial control and reporting needs and functions of the Joint Venture;

(m) keeping of proper books of account for the Joint Venture; and

(n) doing all other things that are necessary or incidental to the carrying out of the Project to produce a viable business of growing, marketing and sale of wine grapes and/or bulk wine.

29. The Vineyard Establishment Fee payable by each Farmer to the Manager is to cover the purchase of the cuttings or rootings and the costs of vine establishment, land care, trellising and irrigation establishment being the amounts referred to in clause 7 of the Joint Venture Agreement.

30. The Manager is entitled to engage contractors and in this respect it will sub-contract all proposed vineyard establishment and maintenance functions to Koonara Management Pty Limited.

31. Clause 18.1 of the Constitution provides that gross income be paid by the Manager into the 'Scheme Bank Account'. There are no agreements for the allocation of product between Farmers and/or the pooling for sale of produce.

32. Members to the Constitution referred to as Farmers in the Joint Venture Agreement have the power to remove the Manager in accordance with the Constitution (clause 23.5 of the Constitution).

Other undertakings by the manager

33. The Manager has provided the ATO with the following undertakings:

- to contact the Farmers and provide them with the correct date of commencement of the vines' first commercial season; and
- to contact the Farmers and provide them with the correct date of trellising installation for purposes of calculating the depreciation deduction.

Fees

34. Farmers must pay the following subscription fees per Joint Venture interest:

	On settlement	**One year after settlement**	**2 years after settlement**
Management fee	$13,430	$5,000	$5,000
Lease rent contribution fee	$300	$309	$318
Establishment fees	$3570		
Total	$17,300	$5,309	$5,318

35. Subsequent fees until 30 June 2022 will be as follows:

- **Management fees:** The annual fee for year 3 and subsequent years will be calculated on the basis of $1,300 for the 3rd year and then increased by the greater of the Consumer Price Index (All Groups) Adelaide or 3%, in accordance with the formula in clause 5.1 of the Joint Venture Agreement. Fees are payable until there is sufficient funds from income of the Joint Venture to enable management fees to be payable yearly in advance from those funds.
- **Lease Rent Contribution fees:** the fee for each year is equal to the fee of the previous year indexed by the Consumer Price Index (All Groups) Adelaide or 3%, in accordance with the formula in clause 6.1 of the Joint Venture Agreement.

Finance

36. Farmers can fund their investment in the Project themselves, borrow from an independent lender or borrow through the finance option offered by RCFPL ("the Lender").

37. This Ruling does not apply if a Farmer enters into a finance agreement that includes any of the following features:

- split loan features of the type described in Taxation Ruling TR 98/22;
- entities associated with the Project, other than RCFPL, are, or become, involved in provision of the finance;
- indemnity agreements, or equivalent collateral arrangements limiting the borrower's risk;
- non-arms length terms and conditions;

- 'additional benefits', for the purposes of section 82KL are granted to the borrower, or the funding arrangement transforms the Project into a 'scheme' to which Part IVA may be applied;
- repayments of principal and payments of interest are limited to income derived from the Project;
- funds borrowed, in whole or in part, are not available for the conduct of the Project, but are transferred (by any means, and directly, or indirectly) back to the lender, or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers;
- entities associated with the Project other than RCFPL, are involved or become involved, in the provision of finance to Farmers for the Project.

38. RCFPL will, if a loan option is taken, advance funds of $8,000 on the Settlement Date, $2,500 on the first and second anniversary of the Settlement Date, $1,500 on the third anniversary of the Settlement Date and $1,100 on the fourth anniversary of the Settlement Date, for each Joint Venture interest. Security is to be enforced over the Farmer's interest in the Project. An interest rate of 8.5% will be charged, payable yearly in advance for each Joint Venture interest.

39. The loan principal will be repayable by ten (10) annual repayments of $1,560 from the net income of a Farmer's interest in the Joint Venture, commencing on 30 June in Year 5 of the Project until the loan is repaid. If net income is insufficient then the repayments will be met from the Farmers' own funds. The finance is provided as full recourse loans and the Lender will pursue legal action against borrowers to recover any outstanding obligations.

Ruling

Section 8-1

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

40. The Project will be a 'partnership' for the purposes of the definition of this term in section 995-1 of the ITAA 1997. The net income or loss of this partnership is calculated by deducting all its allowable deductions for a year of income from all its assessable income (section 90, ITAA 1936). However, no joint liability arises in respect of this partnership, in relation to expenditure on management

fees, lease rental, horticultural plant establishment, trellising, landcare and irrigation work.

41. Expenditure incurred by a Farmer who participates in this Project that is otherwise deductible under section 8-1 falls within subsections 82KZME(9), (10) and (11). Such expenditure is an exception ('Exception 5') to the prepayment rules contained in sections 82KZME and 82KZMF. Therefore, the amount and timing of tax deductions for such expenditure is determined under section 82KZM where the Farmer is a 'small business taxpayer' (see paragraphs 67 to 69), or under sections 82KZMA - 82KZMD where the Farmer is NOT a 'small business taxpayer'. The following tables set out the deductions for a Farmer, depending on whether or not they are a 'small business taxpayer'.

Tax deductions for a Farmer who is a 'small business taxpayer'

42. A Farmer may claim the tax deductions referred to in the Table below where the Farmer

- is a 'small business taxpayer';
- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 34; 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
Management Fees	8-1	$10,760 – see note (i) below	$5,000– see note (i) below	$5,000– see note (i) below
Lease Rent Contribution Fee	8-1	$548 – see note (i) below	$309 – see note (i) below	$318 – see note (i) below
Interest on RCFPL loan	8-1	As incurred – see note (ii) below	As incurred – see note (ii) below	As incurred – see note (ii) below
Trellising	42-15	Amount must be calculated - See note (iii) below	Amount must be calculated - See note (iii) below	Amount must be calculated - See note (iii) below

Landcare operations	387-55	$316 - see note (iv) & (vi) below		
Irrigation costs	387-125	$1065 - see note (v) & (vi) below	$1065 - see note (v)& (vi) below	$1065 - see note (v) & (vi) below
Establishment of horticultural plants	387-165	see note (vii) below	see note (vii) below	see note (vii) below

Notes:

(i) Where a Farmer who is a 'small business taxpayer' incurs the Management and Lease Fee as required respectively by the Management Agreement and the Lease Agreement those fees are deductible in full in the year incurred. However, if a Farmer **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done within 13 months of the fees being incurred, then the prepayments rules in section 82KZM of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraph 76 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than $1,000, is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred.

(ii) For a Farmer who is a 'small business taxpayer' interest incurred using the finance option offered by RCFPL is deductible in full in the year in which it is incurred.

The deductibility or otherwise of interest arising from agreements that Farmers enter into with financiers other than RCFPL is outside the scope of this Ruling. However, Farmers who are 'small business taxpayers' and who finance their participation in the Project other than with RCFPL should read carefully the discussion of the prepayment rules in paragraph 65 to 66 below as those rules may be applicable if interest is prepaid for a period exceeding 13 months.

(iii) For a Farmer 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 Farmer 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 Farmers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Depending upon the method the Farmer elects to use, the rate for calculating the tax deduction will be 13% prime cost method or 20% diminishing value method.

(iv) 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.

(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.

(vi) 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.

(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 Farmers of when the grapevines enter their first commercial season.

Tax deductions for a Farmer who is NOT a 'small business taxpayer'

43. A Farmer may claim the tax deductions referred to in the Table below where the Farmer

- is NOT a 'small business taxpayer';
- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 34; 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
Management Fees	8-1	Amount must be calculated – See Notes (viii) & (xi) below	Amount must be calculated – See Notes (viii) & (xi) below	Amount must be calculated – See Notes (viii) & (xi) below
Lease Fee	8-1	$548 – See Note (ix) & (xi) below	$309 – See Note (ix) & (xi) below	$318 – See Note (ix) & (xi) below
Interest	8-1	As incurred – See Note (x) & (xi) below	As incurred – See Note (x) & (xi) below	As incurred – See Note (x) & (xi) below
Trellising	42-15	Amount must be calculated – See note (xii) below	Amount must be calculated – See note (xiii) below	Amount must be calculated – See note (xiii) below
Landcare operations	387-55	$316 - see note (iv) & (vi) above		
Irrigation costs	387-125	$1065 - see note (v) & (vi) above	$1065 - see note (v)& (vi) above	$1065 - see note (v) & (vi) above
Establishment of horticultural plants	387-165	Nil - see note (vii) above	Nil	Nil

Notes:

(viii) A Farmer who is NOT a 'small business taxpayer' cannot claim the prepaid Management Fees in full in the years in which the fees are incurred. The tax deduction in each year must be calculated using the formula in subsection 82KZMB(3) (shown below). This formula apportions the tax deduction in each 'expenditure year' (i.e., the year that the fees are incurred) using the number of days in the 'eligible service period'. The 'eligible service period' means, generally, the period over which the management services are to be provided.

$$\text{Managem't Fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of eligible service period}}$$

Because of the operation of the capping provisions in section 82KZMC, there is no additional deductible amount available in the 'expenditure year' from the Table in subsection 82KZMB(5). Instead, the balance of the Management Fee incurred each year is determined under subsection 82KZMC(4) and the formula in subsection 82KZMC(5). These provisions apportion the balance of the prepaid Management Fee incurred each year over the year(s) in which the management services are to be provided (See Example 1 at paragraph 125).

(ix) The Lease Fee, being an amount of less than $1,000 each year constitutes 'excluded expenditure' and is deductible in full in the year in which it is incurred. However, if a Farmer who is NOT a 'small business taxpayer' acquires more than one participation, the quantum of the Lease Fee may be $1,000 or more. Where this occurs, the Farmer must determine the tax deduction that is allowable by using the method shown above for the Management Fee (see Note (viii)).

(x) A Farmer who is NOT a 'small business taxpayer' and who finances participation in the Project using the finance option offered by RCFPL (described in paragraphs 38 to 39) is not required to prepay interest. The interest incurred is, therefore, deductible in full in the year in which it is incurred.

The deductibility or otherwise of interest arising from agreements entered into with financiers other than RCFPL is outside the scope of this Ruling. However, all Farmers who finance their participation in the

Project other than with RCFPL should read carefully the discussion of the prepayment rules in paragraph 70 to 76 below as those rules may be applicable if interest is prepaid.

(xi) A Farmer, who chooses to prepay the Management Fee, and/or the Lease Fee for a period exceeding 13 months, should read carefully the information shown in paragraph 76 below. The tax deductions for prepaid fees with an 'eligible service period' exceeding 13 months must be determined using the formula shown in paragraph 76 unless the expenditure is 'excluded expenditure'.

(xii) For a Farmer 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 Farmer 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 Project's manager is to advise Farmers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Note: This is only applicable to plant acquired after 21 September 1999 (see paragraph 92 to 93).

A Farmer who is NOT a 'small business taxpayer' has the option of allocating the trellising to a 'low value pool' and calculating the depreciation deduction under section 42-470 using the diminishing value method (see paragraph 95 to 97 below). Note: This choice is only available from 1 July 2000.

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

44. Where a Farmer who is registered or required to be registered for GST:

- is NOT a 'small business taxpayer';

- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 34; and
- is entitled to an input tax credit for the fees,

then Division 27 of the ITAA 1997 would apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Farmer might be entitled. Note that any entitlement to GST credits would be dependent on the Farmer carrying on an enterprise, and making creditable acquisitions, within the meaning of the GST law.

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

Section 35-55 – Commissioner's discretion

45. For a Farmer 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 ended 30 June 2001 to 30 June 2005 (for Farmers participating under the 'with finance option') or for the years ended 30 June 2001 to 30 June 2004 (for Farmers participating under the 'without finance option') 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.

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

- a Farmer'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 111 in the Explanations part of this ruling, below).

47. Where, either the Farmer'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 Farmer 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.

48. Farmers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Farmer 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 82KZM, 82KZMB – 82KZMD, 82KL and Part IVA

49. For a Farmer 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:

- expenditure by a Farmer who is a 'small business taxpayer' does not fall within the scope of section 82KZM (but see paragraph 64 to 65);
- section 82KZMB applies to expenditure by a Farmer who is not a 'small business taxpayer' (but see paragraph 74;
- 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 8-1

50. 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 Joint Venture carrying on a business?

51. A viticulture scheme can constitute the carrying on of a business. Where there is a business, or a future business, the Gross Harvest Proceeds each year from grapes from Joint Venture interests 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 Joint Venture interest. Generally, a Farmer will be carrying on a business of viticulture where:

- the Farmer 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 Farmer'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.

52. For this Project Farmers have rights under the Lease Agreement in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing vines. Under the Management Agreement Farmers engage the Project Managers to acquire vine rootlings and plant out the rootlings on the leased land and to provide ongoing services to care and maintain the vines. Farmers are considered to have control of their operations.

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

54. Farmers 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 Management Agreement. The Farmers' degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Farmers are entitled to receive regular progress reports on the Project Manager's activities. Farmers 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 Management Agreement are carried out on the Farmers' behalf.

55. 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. Farmers 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 Farmers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

56. Farmers will engage the professional services of a manager with appropriate credentials. There is a means to identify which vines Farmers 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.

57. Farmers 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 Farmers' viticulture activities will constitute the carrying on of a business.

58. 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 and Exception 5

59. Unless one of the statutory exceptions applies, where the requirements of section 82KZME are met, section 82KZMF operates to set the amount and timing of deductions for expenditure that a taxpayer incurs in a year of income. Effectively, these provisions apportion the allowable tax deductions over the period during which the prepaid benefits will be provided.

60. Product Ruling PR 2000/10 was made in response to an application for a product ruling where the application was received by the Commissioner before 1pm (by legal time in the Australian Capital Territory) on 11 November 1999 and the Commissioner

acknowledged receiving the application. Therefore, the Project is an arrangement to which Exception 5 (subsections 82KZME(9), (10) and (11)) applies. Because Exception 5 applies, sections 82KZME and 82KZMF do not apply to set the amount and timing of expenditure incurred by Farmers who participate in the Project. Expenditure incurred by a Farmer for the doing of a thing not to be wholly done within the expenditure year will therefore, be determined under section 82KZM (for a 'small business taxpayer') or sections 82KZMA – 82KZMD (for a taxpayer who is NOT a 'small business taxpayer').

Section 82KZM - Farmers who are 'small business taxpayers'

61. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred. The term 'small business taxpayer' is explained below in paragraphs 67 to 69.

62. The Management Fee of $13,430 per Joint Venture interest will be incurred on execution of the Joint Venture Agreement. This fee is charged for providing services to a Farmer in the first 13 months of the Project. The fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the arrangement's description that the fee has been inflated to result in reduced fees being payable for subsequent years.

63. There is also no evidence that might suggest the services covered by the fee could not be provided within 13 months of the expenditure in question being incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Manager doing 'things' that are not to be wholly done within 13 months of the day on which the fee is incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure. The Management Fee is therefore deductible in full in the year it is incurred by a Farmer who is a 'small business taxpayer'.

64. A Farmer who is a 'small business taxpayer' also incurs expenditure on Lease Fees. These fees of $300 (indexed) per Joint Venture interest are incurred on or before the 30 June each year for a lease over the land for the following 12 months. Therefore, the basic precondition for section 82KZM is also not satisfied for expenditure for these fees where they are paid annually as required by the relevant agreements. Therefore, Lease Fee are deductible in full in the year in which a Farmer who is a 'small business taxpayer' incurs them.

65. Although not required by either the Management Agreement or the Lease Agreement, some Farmers who are 'small business taxpayers' may choose to prepay fees for periods longer than that required by the Agreements. Where a prepayment is incurred and the 'eligible service period' is greater than 13 months then, contrary to the conclusion reached above, unless the expenditure is 'excluded expenditure' section 82KZM will apply. 'Excluded expenditure' being expenditure of less than $1,000, (subsection 82KZL(1)) is an exception to section 82KZM.

66. Where the 'eligible service period' exceeds 13 months the formula in paragraph 82KZM(1)(c) (shown below) is used to apportion the tax deduction over the period that the benefits relating to the prepaid fees are provided.

$$\frac{\text{Period in year}}{\text{Eligible service period}}$$

Where:

Period in year is the number of days in the whole or the part of the eligible service period in the year of income;

Eligible service period is the number of days in the eligible service period.

Subdivision 960-Q - small business taxpayers

67. 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.

68. '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).

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

Section 82KZMA – 82KZMD – Farmers who are NOT 'small business taxpayers

70. For a Farmer who is NOT a 'small business taxpayer', sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an

agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the 'expenditure year'). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

71. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Farmers investing in the Project transitional treatment applies to prepayments initially incurred in the year ended 30 June 2001. Section 82KZMD governs the deductibility of prepayment expenditure where the eligible service period ends more than 13 months after the date the expenditure was occurred.

72. Under the Management Agreement, the Management Fee is for services to be wholly done within 13 months of the fee being incurred. Therefore, the tax deduction available to a Farmer for the Management Fee will be determined in accordance with the rules contained in section 82KZMB and 82KZMC. The amount of the deduction available to Farmers in the 'expenditure year' (that is, the year ended 30 June 2001) is determined using the formula in subsection 82KZMB(3) and the table in subsection 82KZMB(5).

73. However, section 82KZMB is subject to the capping provisions in section 82KZMC. For Farmers who participate in the Project and incur the Management Fee in the year ended 30 June 2001, the 'later year amount' for the purposes of the table in subsection 82KZMB(5) is nil. Therefore, for the year ended 30 June 2001, the tax deduction for a Farmer who is NOT a 'small business taxpayer' will be the amount determined using the formula in section 82KZMB(3) only. The balance of the tax deduction is then determined under subsection 82KZMC(4) using the formula in subsection 82KZMC(5). For Farmers in this Project, the balance of the 13 month 'eligible service period' will cover the whole of the year ended 30 June 2002 and some of the year ended 30 June 2003, therefore the balance of the Management Fee is apportionable over the period. Example 1 at paragraph 125 demonstrates the application of these provisions.

74. A Farmer who is NOT a 'small business taxpayer' also incurs expenditure on Lease Fees. These fees of $300 (indexed) per Joint Venture interest are incurred on or before the 30 June each year for a lease over the land for the following 12 months. The Lease Fees constitute 'excluded expenditure' for a Farmer who is allocated one per Joint Venture interest in the Project. 'Excluded expenditure' being expenditure of less than $1,000, (subsection 82KZL(1)) is an exception to sections 82KZMB and 82KZMC. The Lease Fees are

therefore deductible in full in the year in which a Farmer who is NOT a 'small business taxpayer' incurs them.

75. However, if a Farmer who is NOT a 'small business taxpayer' acquires more than one per Joint Venture interest in the Project, the quantum of a the Lease Fees may be $1,000 or more. Where this occurs, like the Management Fee discussed above, the amount and timing of the deduction allowable for the Lease Fees must be determined under sections 82KZMB and 82KZMC.

76. Although not required by either the Management Agreement or the Lease Agreement, some Farmers who are NOT 'small business taxpayers' may choose to prepay fees for periods longer than that required by the Agreements. Where a prepayment is made and the 'eligible service period' is greater than 13 months then section 82KZMB and 82KZMC do not apply. Instead, unless the expenditure is 'excluded expenditure' section 82KZMD will apply to apportion the tax deduction over the period that the benefits relating to the prepaid fees are provided. The relevant formula contained in subsection 82KZMD(2) is:

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

Interest deductibility

(i) Farmers who use Rocky Castle Finance Pty Limited (RCFPL) as the finance provider

77. Farmers may finance their participation in the Project through a finance option offered by RCFPL (see paragraphs 38 to 39 above). Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of lease and management fees.

78. The interest incurred for the year ended 30 June 2001 and in subsequent years of income will be in respect of a loan to finance the Project business operations of viticulture and is therefore, directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

79. As the finance option offered by RCFPL does not require a Farmer to prepay interest, section 82KZM or sections 82KZMA - 82KZMD will not apply. The interest will be deductible in full in the year in which it is incurred.

80. However, a Farmer who, contrary to the requirements of the finance option offered by RCFPL, **chooses** to prepay interest will be

required to determine any tax deduction under section 82KZM (for a Farmer who is 'small business taxpayer') or sections 82KZMA - 82KZMD (for a Farmer who is not a 'small business taxpayer') – see discussion above of these provisions.

(ii) Farmers who DO NOT use RCFPL as the finance provider

81. The deductibility of interest incurred by Farmers who finance their participation in the Project through a loan facility with a bank or financier other than RCFPL 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.

82. While the terms of any finance agreement entered into between relevant Farmers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid, relevant Farmers will be required to determine any tax deduction under section 82KZM (for a Farmer who is 'small business taxpayer'), or sections 82KZMA - 82KZMD (for a Farmer who is not a 'small business taxpayer') – see discussion above of these provisions.

Expenditure of a capital nature

83. Any part of the expenditure of a Farmer 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, landcare, 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

84. 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.

85. 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.

86. Under section 42-15 Farmers 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 Farmer is a 'small business taxpayer' (see paragraphs 67 to 69 above).

87. 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.

88. 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.

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

Depreciation deductions for Farmers who are 'small business taxpayers'

90. The depreciation deduction for **trellising** available to a Farmer 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 Farmer during the income year. It also depends on the extent to which the trellising is installed ready for use during the year.

91. 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 Farmers of the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

Depreciation deductions for Farmers who are not small business taxpayers

92. A Farmer 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 Farmer is calculated using the formula in either subsection 42-160(3) or subsection 42-165(2A).

93. The deduction depends on the cost of the plant, the number of days the plant was owned by the Farmer 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 Farmers of the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

Determination of effective life

94. Subdivision 42-C provides the choice of methods for determining the 'effective life' of plant. Farmers 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

95. 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'

96. Under subsection 42-455(1), a Farmer 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, <u>all</u> 'low cost plant' acquired in that income year and subsequent income years must be included in the pool (subsection 42-460(1)).

97. 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-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. Farmers need not own the land to qualify for the deduction, so long as it is used by them to carry on a primary production business.

99. 'Landcare operation for land' includes expenditure that qualifies includes the eradication of animal and vegetable pests and other measures, including fencing, to prevent soil erosion, salinity, and preserve natural vegetation (section 387-60).

100. In order for the expenditure to qualify as a deduction under section 387-55, a business must be being carried on at the time the expenditure was incurred. Under subsection 387-75(3) these deductions are to be disregarded when working out the net income or partnership loss of the Partnership under section 90 of the ITAA 1936. Each Partner claims a deduction as agreed between them or an amount equal to their proportionate interest in the Partnership.

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

- had the Farmer chosen a deduction instead of the tax offset, the Farmer 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.

103. Under subsection 387-150(3) these deductions are to be disregarded when working out the net income or partnership loss of the Partnership under section 90 of the ITAA 1936. Each Partner claims a deduction as agreed between them or an amount equal to their proportionate interest in the Partnership.

104. 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 Farmer in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

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

- had the Farmer chosen a deduction instead of the tax offset, the Farmer'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

106. 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).

107. 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 30 years, that rate is 13%.

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

108. 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.

109. 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.

110. 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.

111. 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 Farmers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

112. 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).

113. A Farmer 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 Farmer who acquires the minimum investment of one Joint Venture interest in the Project is unlikely to pass one of the objective tests, or produce a taxation profit, until the income year ended 30 June 2006 (for Farmers participating under the 'with finance option') or for the years ended 30 June 2005 (for Farmers participating under the 'without finance option'). Farmers who acquire more than one interest

in the Project may however, pass one of the tests in an earlier income year.

114. 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 Farmer's participation in the Project.

115. 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 Farmer who acquires an interest 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 term of this Product Ruling.

116. 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.

117. This Product Ruling is issued on a prospective basis (i.e., before an individual Farmer'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 45), in the manner described in the Arrangement (see paragraphs 15 to 39), 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.

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

Section 82KL - recouped expenditure

119. 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'.

120. '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.

121. 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 Farmer. 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

122. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

123. The Coonawarra Wine Grape Project will be a 'scheme'. A Farmer will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 42 to 43 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.

124. Farmers 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 Farmers 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.

Example

Example 1 - Tax deductions for prepaid expenditure where Exception 5 applies and the Farmer is NOT a 'small business taxpayer'

125. Joseph decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The ABC Pineforest Project lodged an application for a Product Ruling on 20 October 1999 and the Ruling was issued by the Tax Office on 8 January 2000. Accordingly, Exception 5 applies to taxpayers who are accepted into the Project and incur prepaid expenditure under the arrangement.

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. 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. Joseph 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 Joseph that the minimum subscription has been reached and the Project will go ahead. Joseph's agreements are duly executed and management services start to be provided on that date.

Joseph has extensive business interests and his average turnover for the 2000/2001 income year exceeds $1 million. Therefore, he is not a 'small business taxpayer' and must calculate his tax deductions under the prepayment rules in sections 82KZMA-82KZMD.

Joseph, 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:

$$\text{Managem't fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of eligible service period}}$$

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

= **$356** (this is Joseph'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** Joseph 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 Joseph 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 Joseph in the 2002 income year).

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

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

Detailed contents list

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

	Paragraph
What this Product Ruling is about	**1**
Tax law(s)	2
Goods and Services Tax	3
Business Tax Reform	5
Note to promoters and advisers	7
Class of persons	8
Qualifications	10
Date of effect	**12**
Withdrawal	**14**
Arrangement	**15**
Overview	17
Constitution and Joint Venture Agreement	24
Management Services	28
Other undertakings by the manager	33
Fees	34
Finance	36

Ruling **40**

Section 8-1 40

Deductions where a Farmer is <u>not</u> registered nor required to be registered for GST 40

Tax deductions for a Farmer who is a 'small business taxpayer' 42

Tax deductions for a Farmer who is NOT a 'small business taxpayer' 43

Deductions where a Farmer is registered or required to be registered for GST 44

Division 35 – deferral of losses from non-commercial business activities 45

Section 35-55 – Commissioner's discretion 45

Sections 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF, 82KL and Part IVA 49

Explanations **50**

Section 8-1 50

Is the Joint Venture carrying on a business? 51

Sections 82KZME and 82KZMF and Exception 5 59

Section 82KZM - Farmers who are 'small business taxpayers' 61

Subdivision 960-Q - small business taxpayers 67

Section 82KZMA – 82KZMD – Farmers who are NOT 'small business taxpayers' 70

Interest deductibility 77

(i) Farmers who use Rocky Castle Finance Pty Ltd (RCFPL) as the finance provider 77

(ii) Farmers who DO NOT use RCFPL as the finance provider 81

Expenditure of a capital nature 83

Section 42-15: depreciation of trellising 84

Depreciation deductions for Farmers who are 'small business taxpayers' 90

Depreciation deductions for Farmers who are not small business tapayers 92

Determination of effective life 94

Low value pool option 95

Subdivision 387-A - expenditure for landcare operations 98

Subdivision 387-B – irrigation expenditure 102
Subdivision 387-C - vines and horticultural provisions 106
Division 35 – deferral of losses from non-commercial business activities 108
Section 82KL – recouped expenditure 119
Part IVA – general tax avoidance provisions 122
Example **125**
Example 1 – Tax deductions for prepaid expenditure where Exception 5 applies and the Farmer is NOT a 'small business taxpayer' 125
Detailed contents list **126**

Commissioner of Taxation
20 June 2001

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
PR 1999/95; PR 2000/10; TR 92/1; TR 97/11; TR 97/16; TR 92/20; TR 98/22; IT 175; 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

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 42-160(1)
- ITAA 1997 42-160(3)
- ITAA 1997 42-165(1)
- ITAA 1997 42-165(2A)
- ITAA 1997 42-345
- ITAA 1997 42-470
- ITAA 1997 42-455(1)
- ITAA 1997 Subdiv 387-A
- ITAA 1997 Subdiv 387-B
- ITAA 1997 387-55
- ITAA 1997 387-60
- ITAA 1997 387-125
- ITAA 1997 387-150(3)
- 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 1997 Subdiv 960-Q
- ITAA 1997 995-1
- 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
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMB(3)
- ITAA 1936 82KZMB(5)
- ITAA 1936 82KZMC
- ITAA 1936 82KZMC(4)
- ITAA 1936 82KZMC(5)
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(9)
- ITAA 1936 82KZME(10)
- ITAA 1936 82KZME(11)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 90
- ITAA 1936 92
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)

ATO references:
NO T2001/010040
BO
FOI number: I 1024024
ISSN: 1441 1172