



PR 2002/8 - Income tax: Settlers Rise Premium Vineyard Project

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 This document has changed over time. This is a consolidated version of the ruling which was published on *30 January 2002*



Product Ruling

Income tax: Settlers Rise Premium Vineyard Project

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Previous Ruling	14
Arrangement	15
Ruling	35
Explanations	61
Example	117
Detailed contents list	118

Potential participants 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**, **Previous Ruling**, **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. 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 participants 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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants 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, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants 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 laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Settlers Rise Premium Vineyard Project or simply as 'the Project'.

Tax laws

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 8-1 (ITAA 1997);
 - Section 17-5 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - Division 40 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 82KZL (ITAA 1936);
 - Section 82KZME (ITAA 1936);
 - Section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

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

Changes in the Law

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 taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating 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 participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified 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. In this Ruling these persons are referred to as 'Growers'.

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. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

10. 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

11. This Ruling applies prospectively from 30 January 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, 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

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. 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 person's involvement in the arrangement.

Previous Ruling

14. This Ruling replaces Product Ruling PR 2001/67 which is withdrawn on and from the date this Ruling is made (30 January 2002).

Arrangement

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

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

- Application for Product Ruling for Settlers Rise Premium Vineyard;
- Settlers Rise Premium Vineyard Draft Prospectus dated 21 January 2000;
- Settlers Rise Premium Vineyard Prospectus date 20 September 2001;
- Settlers Rise Premium Vineyard Project Supplementary Prospectus dated 19 October 2001;
- Settlers Rise Premium Vineyard Project Supplementary Prospectus dated 4 January 2002;
- **Settlers Rise Premium Vineyard Project Constitution**, as amended at 18 October 2001;
- **Licence Agreement** (Commencement date to 30 June 2007) between Benchmark Farming Australia Limited and The Grower;
- **Licence Agreement** (1 July 2007 to 30 June 2012) between Benchmark Farming Australia Limited and The Grower;
- **Licence Agreement** (1 July 2012 to 30 June 2017) between Benchmark Farming Australia Limited and The Grower;
- Lease Agreement between Woodside Land Holdings Limited and Benchmark Farming Australia Limited;
- Lease Agreement between Woodthall Pty Ltd and Benchmark Farming Australia Limited;
- Grower Agreement between Rosemount Estates Pty Limited and “Settlers Rise” Woodside Vineyards dated 2 February 2001;
- Facsimile from the applicant’s representative dated 22 February 2001;
- Facsimile from the applicant’s representative dated 1 March;
- Correspondence from the applicant’s representative dated 27 March 2001;

- Correspondence from the applicant's representative dated 10 April 2001;
- Correspondence from the applicant's representative dated 19 November 2001;
- Correspondence from the applicant's representative dated 15 January 2002; and.
- Correspondence from the applicant's representative dated 18 January 2002.
- **Note: Certain information received from the applicant has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.**

17. The documents highlighted are those that the Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or an associate of the Grower will be a party to that are part of the arrangement to which this Ruling applies.

18. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

Overview

19. The arrangement is called "Settlers Rise Premium Vineyard Project" and is summarised as follows:

Location	Adelaide Hills Wine Region. Corner of Onkaparinga Valley Road and the main road to Lobethal, approximately 45 minutes from the Adelaide CBD.
Type of business	Viticulture
Number of hectares under cultivation	98 Hectares
Name of development	Settlers Rise Premium Vineyard Project
Size of participation (lot)	0.2 hectares
Number of vines per lot	490 vines
The term of investment	16 years
Nature of the investment	Licences to establish and maintain a vineyard on 0.2 hectare of land, and one share in Woodside Land Holdings Ltd (which holds approximately 50% of the land on which the activities are to be

	carried out).
Initial Costs per participation	<p><u>For Managed Grower Units;</u></p> <p>If application accepted by 15 June 2002: \$13,750 plus \$3,150 per lot for one share in Woodside Holdings Limited.</p> <p>If application accepted after 15 June 2002: \$16,170 plus \$3,150 per lot for one share in Woodside Holdings Limited payable on application or 1 July 2002, whichever is later.</p>
Initial costs per hectare	\$68,750 if application accepted by 15 June 2002 (excluding share acquisition)
Ongoing costs	Management and Licence fees.
Expected Production	Output from each lot is expected to be 2.5 tonnes.
Other aspects	82.16% of grapes are pre-sold until 2008 to 2010 at market prices.

Description of Arrangement: Grower's Participation in Project

20. A Grower will participate in the Project by:

- Purchasing a share in the company Woodside Land Holdings Pty Ltd;
- Being allocated an individually identifiable area of 0.2 hectares of land on which to conduct the growing, cultivating and harvesting of wine grapes for sale;
- Entering into a licence agreement with Benchmark Farming Australia Limited;
- Appointing the Responsible Entity as its agent for the benefit of the Grower until the grapes are delivered for sale. The Responsible Entity as agent for each Grower will enter into a Grape Purchase Agreement with Rosemount Estates Pty Ltd; and
- The first harvest will be in 2004.

Constitution

21. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Responsible Entity will keep a register of Growers. Growers are entitled to assign their Grower's interest (Managed or Self-Managed Grower Unit) in certain circumstances. The Management Agreement is annexed to the Constitution and will be executed on behalf of the Growers following

them signing the Application and a Power of Attorney Form in the Prospectus. All Growers are bound by the Constitution by virtue of their participation in the Project.

22. Growers may elect to subscribe for either a Managed Grower Unit or a Self-Managed Grower Unit. Growers who elect to subscribe for Self-Managed Grower Units are not considered to be included in the class of persons to whom this Ruling applies.

Compliance plan

23. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Law. Under the Compliance Plan, a Compliance Committee will monitor to what extent the Responsible Entity meets its obligations as the Responsible Entity of the Project and the rights of the Growers are protected.

Interest in land

24. Growers participating in the arrangement will enter into three consecutive Licence Agreements between Benchmark Farming Australia Limited (the "Licensor") and the Growers. The first Licence Agreement commences from acceptance of Growers into the Project until 30 June 2007, the second Licence Agreement will be in effect from 1 July 2007 to 30 June 2012 and the third Licence Agreement will be in effect from 1 July 2012 to 30 June 2017. Growers are granted an interest in land in the form of a licence to use their Vineyard Lots for the purpose of conducting their viticulture business.

Licence Agreements

25. Each Grower, whose application is accepted and the agreements executed by 15 June 2002, must pay a Licence fee on application to the Responsible Entity of an amount equal to \$550 per Vineyard Lot for the initial period, from the date of acceptance in the Project until 30 June 2002, and pay \$550 on 1 July 2002 per Vineyard Lot for the period 1 July 2002 to 30 June 2003. Each Grower, whose application is accepted and the agreements executed after 15 June 2002, must pay an amount equal to \$1100 on application or 1 July 2002, whichever is later, per Vineyard Lot for the initial period from 1 July 2002 to 30 June 2003. All Growers must pay Licence fees of the amounts equal to \$550 to the Responsible Entity on 1 July each year thereafter, indexed annually according to CPI after 30 June 2004.

Management Agreement

26. Each Grower who subscribes for a Managed Grower Unit enters into a Management Agreement with the Responsible Entity, contracting the Responsible Entity to establish and maintain the Vineyard Lot. Each Grower entering into the Management Agreement, who is accepted into the Project by 15 June 2002, must pay a Management fee for management services to the Responsible Entity of an amount equal to \$13,200 on application for the period from the date of acceptance into the Project until 30 June 2002, \$1,870 on 1 July 2002 for the financial year ended 30 June 2003, \$1679 on 1 July 2003 for the financial year ended 30 June 2004, \$1501 on 1 July 2004 for the financial year ended 30 June 2005 and on 1 July each year thereafter indexed annually according to CPI.

27. Growers entering into the Management Agreement, who are accepted into the Project after 15 June 2002, will pay on application or 1 July 2002, whichever is later, a Management Fee for management services to the Responsible Entity of an amount equal to \$15,070 for the period from the date of acceptance into the Project or 1 July 2002, whichever is the later, to 30 June 2003. These Growers will pay the same management services amounts for the years following after 30 June 2003 as those Growers who are accepted into the Project by 15 June 2002.

28. The Management Agreement provides that each Grower appoints the Responsible Entity to perform services under the agreement. The Agreement specifies the services to be performed by the Responsible Entity. The Responsible Entity will supervise and manage all viticulture activities on behalf of each Grower and must, along with other duties:

- acquire appropriate dormant rootlings;
- prepare the Vineyard Lot for planting;
- for Growers who are accepted into the Project prior to 15 June 2002, plant no less than 490 of the nominated varieties of rootlings on the land by 30 June 2002;
- for Growers who are accepted into the Project on or after 15 June 2002, plant no less than 490 of the nominated varieties of rootlings on the land by 31 December 2002;
- replace and replant any planting material on the Grower's Vineyard Lot which dies during the first six months, unless in certain circumstances;
- install appropriate trellising and irrigation equipment;

PR 2002/8

- annually or otherwise when required in accordance with good viticultural practices prune the Grapevines to ensure proper growth of the grapevines along the trellising to optimise quality of the grapes produced;
- at appropriate times operate the irrigation system to irrigate the Vineyard Lots in accordance with good viticultural practices; and
- generally maintain the Vineyard Lot according to good viticultural practices.

29. The Responsible Entity will harvest and sell the grapes produced on the Growers behalf, at a price equivalent to the price per tonne likely to be paid for the majority of the grape varieties grown in the area local to the Land and of the same variety, quality and use as the grapes to be sold. The Responsible Entity will recover all costs in relation to the harvest and sale of the grapes, including storage, delivering or weighing of grapes.

Grower Payments

30. For Growers subscribing for Managed Grower Units, whose applications are accepted on or before 15 June 2002, payments are for the following purposes:

Description	Due date for Payment	\$Amount
Payment to acquire share in Woodside P/L	on application	3,150
Management fees: for year ended 30/6/2002	on application	8,976
Horticultural Establishment Expenditure	on application	364
Trellising	on application	1,931
Irrigation	on application	1,277
Horticultural Establishment Expenditure (purchase of root stock)	on application	652
Licence Fee	on application	550
Management fees: for year ended 30/6/2003	on 1/7/2002	1,870
Licence Fees	on 1/7/2002	550
	Total	19,320

31. For Growers subscribing for Managed Grower Units, whose applications are accepted after 15 June 2002, payments are for the following purposes:

Description	Due date for Payment	\$Amount
Payment to acquire share in Woodside P/L	on application	3,150
Management fees: for year ended 30/6/2003	on application	10,846
Horticultural Establishment Expenditure	on application	1,016
Trellising	on application	1,931
Water Facilities	on application	1,277
Licence Fee: for the year ended 30/6/2003	on application	1,100
	Total	19,320

32. Growers are required to make all payments specified. Under the terms of the Constitution, the Responsible Entity is entitled to withhold payment of the proceeds of grape sales from the Grower where the Grower is in arrears of payments due. Despite the circumstance where the proceeds of grape sales are insufficient to meet payment a Grower is still liable for all payments specified.

Finance

33. Growers can fund their investment in the Project themselves, or borrow from an independent lender. Growers are required to obtain their own finance for the development.

34. 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

Application of this Ruling

35. This Ruling applies only to Growers who are accepted to participate in the Project on or before 6 October 2002 and who have executed a Management Agreement and a Licence Agreement before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

36. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 150 interests is achieved.

The Simplified Tax System ('STS')

Division 328

37. For a Grower participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

Qualification

38. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Growers who are not 'STS taxpayers'**Assessable Income****Section 6-5**

39. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

40. The Grower recognises ordinary income from carrying on the business of viticulture at the time that income is derived.

Deductions for Management fees and Licence fees for non-STs taxpayers who are accepted into the Project on or before 15 June 2002**Section 8-1**

41. A Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1	\$8,976 – See Notes (i) & (ii) below	\$1,870 – See Notes (i) & (ii) below	\$1,679– See Notes (i) & (ii) below
Licence Fee (Rent)	8-1	\$550 – See Notes (i) & (ii) below	\$550 – See Notes (i) & (ii) below	\$550 – See Notes (i) & (ii) below

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be

adjusted as relevant for GST (e.g., input tax credits):
Division 27. See example at paragraph 117;

- (ii) The Management fees and the Licence fees shown in the Management Agreement and the Licence Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 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 91 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Deductions for capital expenditure

Division 40

42. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to trellising, water facilities (e.g., irrigation) and grapevines. All deductions shown in the following Table are determined under Division 40.

Fee type	ITAA 1997 section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Trellising	40-25	Must be calculated - See Notes (iii) and (iv) below	Must be calculated - See Notes (iii) and (iv) below	Must be calculated - See Notes (iii) and (iv) below
Water facility (e.g., irrigation, dam, bore, etc)	40-515	\$426 - see Notes (iii) & (v) below	\$426 - see Notes (iii) & (v) below	\$425 - see Notes (iii) & (v) below
Establishment of horticultural plants (grapevines)	40-515	Nil - see Notes (iii) & (vi) below	Nil - see Notes (iii) & (vi) below	See Notes (iii) & (vi) below

Notes:

- (iii) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 117;
- (iv) Trellising is a 'depreciating asset'. Each Grower's interest in the trellising is a 'depreciating asset'. The 'cost' of the asset is the amount paid by each Grower. The decline in value of the asset is calculated using the formula in either subsection 40-70(1) ('diminishing value method') or subsection 40-75(1) ('prime cost method'). Both formulas rely on the 'effective life' of the trellising.

Growers can either self-assess the 'effective life' (section 40-105) or use the Commissioner's determination of 'effective life' (section 40-100). The Commissioner has determined that trellising has an 'effective life' of 20 years. Trellising will be installed and first used during the year ended 30 June 2002. The Project Manager will advise Growers when that occurs to enable Growers to calculate the deduction for the decline in value;

- (v) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540);
- (vi) As grapevines are affixed to land which the Grower does not own, they are not owned by the Grower, the conditions in subsection 40-525(3) cannot be met, and the grapevines are not eligible for the 4 year write-off under section 40-550. However, grapevines are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable

to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530, item 2). The Project Manager will inform Growers of when the grapevines enter their first commercial season.

Deductions for Management fees and Licence fees for non-STS taxpayers who are accepted into the Project after 15 June 2002

Section 8-1

43. A Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1	\$10,846 – See Notes (i) & (ii) above	\$1,679 – See Notes (i) & (ii) above
Licence Fee (Rent)	8-1	\$1,100 – See Notes (i) & (ii) above	\$550 – See Notes (i) & (ii) above

Deductions for capital expenditure

Division 40

44. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to trellising, water facilities (e.g., irrigation) and grapevines. All deductions shown in the following Table are determined under Division 40.

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004
Trellising	40-25	Must be calculated - See Notes (iii) above and (vii) below	Must be calculated - See Notes (iii) above and (vii) below
Water facility (e.g. irrigation, dam, bore, etc.)	40-515	\$426 - see Notes (iii) & (v) above	\$426 - see Notes (iii) & (v) above

Establishment of horticultural plants (grapevines)	40-515	Nil - see Notes (iii) & (vi) above	See Notes (iii) & (vi) above
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Notes:

- (vii) Trellising is a ‘depreciating asset’. Each Grower’s interest in the trellising is a ‘depreciating asset’. The ‘cost’ of the asset is the amount paid by each Grower. The decline in value of the asset is calculated using the formula in either subsection 40-70(1) (‘diminishing value method’) or subsection 40-75(1) (‘prime cost method’). Both formulas rely on the ‘effective life’ of the trellising.

Growers can either self-assess the ‘effective life’ (section 40-105) or use the Commissioner’s determination of ‘effective life’ (section 40-100). The Commissioner has determined that trellising has an ‘effective life’ of 20 years. Trellising will be installed and first used during the year ended 30 June 2003. The Project Manager will advise Growers when that occurs to enable Growers to calculate the deduction for the decline in value.

Tax outcomes for Growers who are ‘STS taxpayers’**Assessable Income****Section 6-5**

45. That part of the gross sales proceeds from the Project attributable to the Grower’s produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

46. The Grower recognises ordinary income from carrying on the business of viticulture at the time the income is received (paragraph 328-105(1)(a)).

**Deductions for Management fees and Licence fees for
STS taxpayers who are accepted into the Project on or before
15 June 2002**

Section 8-1 and section 328-105

47. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1 & 328-105	\$8,976 – See Notes (viii), (ix) & (x) below	\$1,870 – See Notes (viii), (ix) & (x) below	\$1,679 – See Notes (viii), (ix) & (x) below
Licence Fee (Rent)	8-1 & 328-105	\$550 – See Notes (viii), (ix) & (x) below	\$550 – See Notes (viii), (ix) & (x) below	\$550 – See Notes (viii), (ix) & (x) below

Notes:

- (viii) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 117;
- (ix) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Grower. Any amount or part of an amount shown in the Table above which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid;
- (x) Where a Grower who is an 'STS taxpayer', pays the Management fees and the Rent in the relevant income years shown in the Licence and Management Agreements, those fees are deductible in full in the year that they are paid. However, if a Grower chooses to prepay fees for the doing of a thing (e.g., the provision of management services or the licensing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA may apply to apportion those fees (see paragraphs 85 to 96). In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 91, unless the expenditure is 'excluded expenditure'.

‘Excluded expenditure’ is an ‘exception’ to the prepayment rules, and is deductible in full in the year in which it is incurred. For the purpose of this Ruling ‘excluded expenditure’ refers to an amount of expenditure of less than \$1,000.

Deductions for capital expenditure

Subdivision 328-D and Subdivisions 40-F

48. A Grower who is an ‘STS taxpayer’ will also be entitled to tax deductions relating to trellising, water facilities (e.g., irrigation) and grapevines. Deductions relating to the ‘cost’ of trellising must be determined under Division 328. An ‘STS taxpayer’ may claim deductions in relation to water facilities under Subdivision 40-F. If the ‘water facility’ expenditure is on a ‘depreciating asset’ used to carry on the business, they may choose to claim deductions under Division 328. Deductions for the grapevines must be determined under Subdivision 40-F.

49. The deductions shown in the Tables assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities under Subdivisions 40-F and not under Division 328. If the expenditure has been incurred on ‘depreciating assets’ and is claimed under Division 328, the deduction is determined as discussed in Notes (xi) and (xiii) below.

50. Under Division 328, if the ‘cost’ of a ‘depreciating asset’ at the end of the income year is less than \$1000 (a ‘low-cost asset’), it can be claimed as an immediate deduction when first used or ‘installed ready for use’. This is so provided the Grower is an ‘STS taxpayer’ for the income year in which it starts to ‘hold’ the asset and the income year in which it first uses the asset or has it ‘installed ready for use’ to produce assessable income.

Fee type	ITAA 1997 section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Trellising	328-185 & 328-190	\$290 - See Notes (xi) & (xii) below	\$492 - See Notes (xi) & (xii) below	\$345 - See Notes (xi) & (xii) below
Water facility (e.g., irrigation, dam, bore, etc.)	40-515	\$426 - see Notes (xi) & (xiii) below	\$426 - see Notes (xi) & (xiii) below	\$425 - see Notes (xi) & (xiii) below

Establishment of horticultural plants (grapevines)	40-515	Nil - see Notes (xi) & (xiv) below	Nil - see Notes (xi) & (xiv) below	See Notes (xi) & (xiv) below
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Notes:

- (xi) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See example at paragraph 117;
- (xii) Trellising is a 'depreciating asset'. Each Grower's interest in the trellising is a 'depreciating asset', which can be allocated to a 'general STS pool'. The 'cost' of the asset is the amount paid by each Grower. The tax deduction allowable is determined in the year ended 30 June 2002 by multiplying the 'cost' of the interest by half the 'general STS pool rate, i.e., by 15%. Each Grower's interest in the trellising is allocated to their 'general STS pool' at the end of the year ended 30 June 2002 and that part of the 'cost' not deducted in the first year is added to the pool balance. In subsequent years, the full pool rate of 30% will apply;
- (xiii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2002 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the

expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540);

- (xiv) As grapevines are affixed to land which the Grower does not own, they are not owned by the Grower, the conditions in subsection 40-525(3) cannot be met, and the grapevines are not eligible for the 4 year write-off under section 40-550. However, grapevines are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530(2)). The Project Manager will inform Growers of when the grapevines enter their first commercial season.

Deductions for Management fees and Licence fees for STS taxpayers who are accepted into the Project after 15 June 2002

Section 8-1 and section 328-105

51. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Fee Type	ITAA 1997 Sections	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1 & 328-105	\$10,846 – See Notes (viii), (ix) & (x) above	\$1,679 – See Notes (viii), (ix) & (x) above
	8-1 &	\$1,100 – See Notes (viii), (ix) & (x)	\$550 – See Notes (viii), (ix) & (x)

Licence Fee (Rent)	328-105	above	above
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Deductions for capital expenditure**Subdivision 328-D and Subdivisions 40-F**

52. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to trellising, water facilities (e.g., irrigation) and grapevines. Deductions relating to the 'cost' of trellising must be determined under Division 328. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F. If the 'water facility' is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328. Deductions for the grapevines must be determined under Subdivision 40-F.

53. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities under Subdivisions 40-F and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Notes (xi) and (viii) above.

54. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

Fee type	ITAA 1997 section	Year ended 30 June 2003	Year ended 30 June 2004
Trellising	328-185 & 328-190	\$290 - See Notes (xi) above & (xii) below	\$492 - See Notes (xi) & (xii) below
Water facility (e.g., irrigation, dam, bore, etc.)	40-515	\$426 - see Notes (xi) above & (xv) below	\$426 - see Notes (xi) above & (xv) below
Establishment of horticultural plants (grapevines)	40-515	Nil - see Notes (xi) & (xiv) above	See Notes (xi) & (xiv) above

Notes:

- (xv) Trellising is a 'depreciating asset'. Each Grower's interest in the trellising is a 'depreciating asset', which can be allocated to a 'general STS pool'. The 'cost' of the asset is the amount paid by each Grower. The tax deduction allowable is determined in the year ended 30 June 2003 by multiplying the 'cost' of the interest by half the 'general STS pool rate, i.e., by 15%. Each Grower's interest in the trellising is allocated to their 'general STS pool' at the end of the year ended 30 June 2003 and that part of the 'cost' not deducted in the first year is added to the pool balance. In subsequent years, the full pool rate of 30% will apply.

Tax outcomes that apply to all Growers

55. The deductibility or otherwise 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. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 85 to 96 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower's choice.

Division 35 – Deferral of losses from non-commercial business activities**Section 35-55 – Commissioner's discretion**

56. For a Grower who is an individual and who enters the Project during the years ended 30 June 2002 or 30 June 2003 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 2002 to 30 June 2004 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.

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

- the 'exception' in subsection 35-10(4) applies (see paragraph 105 in the Explanations part of this ruling, below); or

- a Grower's business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the Grower's business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

58. Where, the exception in subsection 35-10(4) applies, the Grower's business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, 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.

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

Sections 82KZME – 82KZMF, 82KL and Part IVA

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

- expenditure by a Grower does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 85 to 96);
- 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

Is the Grower carrying on a business?

61. For the amounts set out in the Tables above to constitute allowable deductions the Grower's viticulture activities as a participant in the Settlers Rise Premium Vineyard Project must amount to the carrying on of a business of primary production. These viticulture activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

62. For schemes such as that of the Settlers Rise Premium Vineyard Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929.

63. Generally, a Grower will be carrying on a business of viticulture, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's grapevines are established;
- the Grower has a right to harvest and sell the grapes each year from those grapevines;
- the viticulture activities are carried out on the Grower's behalf;
- the viticulture activities of the Grower are typical of those associated with a viticulture business; and
- the weight and influence of general indicators point to the carrying on of a business.

64. In this Project, each Grower enters into a Management Agreement and a Licence Agreement.

65. Under the Licence Agreement each individual Grower will have rights over a specific and identifiable area of land. The Licence Agreement provides the Grower with an ongoing interest in the specific grapevines on the licensed area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out viticulture activities and for no other purpose. The licence allows the Project Manager to come onto the land to carry out its obligations under the Management Agreement.

66. Under the Management Agreement the Project Manager is engaged by the Grower to establish and maintain a Vineyard Lot on the Grower's identifiable area of land during the term of the Project. The Project Manager has provided evidence that it holds the

appropriate professional skills and credentials to provide the management services to establish and maintain the Vineyard Lot on the Grower's behalf.

67. In establishing the Vineyard Lot, the Grower engages the Project Manager to purchase and install trellising and water facilities (e.g., irrigation) and to acquire and plant vine rootlings on the Grower's Vineyard Lot. During the term of the Project, these assets will be used wholly to carry out the Grower's viticulture activities. The Project Manager is also engaged to harvest and sell, on the Grower's behalf, the grapes grown on the Grower's Vineyard Lot.

68. 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 Project's description for all the indicators.

69. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of its grapes that will return a before-tax profit, i.e., a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

70. The pooling of grapes grown on the Grower's Vineyard Lot with the grapes of other Growers is consistent with general viticulture practices. Each Grower's proportionate share of the sale proceeds of the pooled grapes will reflect the proportion of the grapes contributed from their Vineyard Lot.

71. The Project Manager's services and the installation of assets on the Grower's behalf are also consistent with general viticulture practices. The assets are of the type ordinarily used in carrying on a business of viticulture. While the size of a Vineyard Lot is relatively small, it is of a size and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

72. The Grower's degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Vineyard Lot and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect.

73. 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. For the purposes of this Ruling, the Growers' viticulture activities in the Settlers Rise Premium Vineyard Project will constitute the carrying on of a business.

The Simplified Tax System**Division 328**

74. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

75. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of management fees and licence fees**Section 8-1**

76. Consideration of whether the initial management fees and licence 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 is contractually committed 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.

77. The management fees and licence fees associated with the viticulture activities will relate to the gaining of income from the Grower's business of viticulture (see above), 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.

Possible application of prepayment provisions

78. Under the Management Agreement and the Licence Agreement neither the management fees nor the licence fees are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

79. However, where a Grower chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 85 to 96) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Timing of deductions

80. In the absence of any application of the prepayment provisions, the timing of deductions for the management fees or the licence fees will depend upon whether a Grower is an 'STS taxpayer' or is not an 'STS taxpayer'.

81. If the Grower is not an 'STS taxpayer', the management fees and the licence fees are deductible in the year in which they are incurred.

82. If the Grower is an 'STS taxpayer' the management fees and the licence fees are deductible in the income year in which they are paid, or are paid for the Grower (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Grower.

Interest deductibility**Section 8-1**

83. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or 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.

84. 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. Alternatively, a Grower may choose to prepay such interest. Unless such prepaid interest is ‘excluded expenditure’ any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 85 to 96).

Prepayment provisions

Sections 82KZL to 82KZMF

85. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

86. For this Project only section 82KZL (an interpretative provision) and sections 82KZME and 82KZMF are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to ‘STS taxpayers’ because there is no specific exclusion contained in section 82KZME that excludes ‘STS taxpayers’ from the operation of section 82KZMF.

Sections 82KZME and 82KZMF

87. Where the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the ‘expenditure year’ (subsection 82KZME(1)).

88. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer’s allowable deductions under the agreement for the ‘expenditure year’ exceed any

assessable income attributable to the agreement for that year; and

- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either :
 - a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

89. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

90. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

91. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

92. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later,

and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Application of the prepayment provisions to this Project

93. In this Project, an initial management fee of \$8,976 and an initial licence fee of \$550 per Vineyard Lot for Growers accepted into the Project on or before 15 June 2002, or an initial management fee of \$10,846 and an initial licence fee of \$1,100 per Vineyard Lot for Growers accepted into the Project after 15 June 2002, will be incurred on execution of the Management Agreement and the Licence Agreement. The management fee and the licence fee are charged for providing management services or licensing land to a Grower by 30 June of the year of execution of the Agreements. Under the Agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

94. In particular, the management fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the initial management fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

95. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee, and the fees for subsequent years, is for the Project Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Licence Agreement, licence fees are payable annually in advance for the license of the land during the expenditure year.

96. On this basis, provided a Grower incurs expenditure as required under the Project agreements, as set out in paragraphs 25, 26, 27, 30 and 31, then the basic precondition in subsection 82KZME(2) is not satisfied and, in these circumstances, section 82KZMF will have no application.

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

97. Although not required under either the Management Agreement or the Licence Agreement, a Grower participating in the Project may **choose** to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers may either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 96 above, section 82KZMF

will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

98. For these Growers, the amount and timing of deductions for any relevant prepaid management fees, prepaid licence fees, or prepaid interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

Expenditure of a capital nature

Division 40 and Division 328

99. Any part of the expenditure of a Grower 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, expenditure attributable to trellising, water facilities and the establishment of the grapevines is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

100. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

101. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 42, 44, 50 and 54 (above) in the Tables and the accompanying Notes.

Deferral of losses from non-commercial business activities

Division 35

102. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2), a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

- the exception in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

103. 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.

104. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

105. For the purposes of applying Division 35, 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.

106. In broad terms, the 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, or an interest in real property, (excluding any private dwelling) 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 (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

107. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of one Vineyard Lot in the Project is unlikely to have their activity pass one of the tests until the income year ended 30 June 2007. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

108. 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.

109. 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, 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;
- (ii) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

110. Information provided with this Product Ruling indicates that a Grower who acquires the minimum investment of one Vineyard Lot in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2005. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2004. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

111. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 56), in the manner described in the Arrangement (see paragraphs 15 to 34). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

112. 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 consultant Dr Ben Robinson of Scholfield Robinson Horticultural Services Pty Ltd dated 9 January 2001 provided with the application by the applicant's representative; and
- the binding Grape Sale contract(s) with Rosemount Estates Pty Ltd (winemaker) for the sale of the grapes setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the grapes are grown.

Section 82KL - recouped expenditure

113. 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

114. 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).

115. The Settlers Rise Premium Vineyard Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 41 to 54 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.

116. 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 their 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 at arm's length or, if any parties are not dealing 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**Entitlement to GST input tax credits**

117. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

PR 2002/8

Management fee for period 1/1/2002 to 30/6/2002	\$4 400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2 200*</u>
Total due and payable by 1 January 2002 (includes GST of \$600)	<u>\$6 600</u>

*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

$$1/11 \times \$4400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4400 *less* \$400, or \$4000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

$$1/11 \times \$2200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2200 *less* \$200, or \$2000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4000 (not \$4400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10-year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2000 only, not one tenth of \$2200).

Detailed contents list

118. 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
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9

Date of effect	11
Withdrawal	13
Previous Ruling	14
Arrangement	15
Overview	19
Description of arrangement: Grower's Participation in Project	20
Constitution	21
Compliance Plan	23
Interest in land	24
Licence Agreements	25
Management Agreement	26
Grower Payments	30
Finance	33
Ruling	35
Application of this Ruling	35
Minimum subscription	36
The Simplified Tax System ('STS')	37
Division 328	37
Qualification	38
Tax outcomes for Growers who are not 'STS' taxpayers	39
Assessable Income	39
Section 6-5	39
Deductions for Management fees and Licence fees for non-STS taxpayers who are accepted into the Project on or before 15 June 2002	41
Section 8-1	41
Deductions for capital expenditure	42
Division 40	42
Deductions for Management fees and Licence fees for non-STS taxpayers who are accepted into the Project after 15 June 2002	43
Section 8-1	43
Deductions for capital expenditure	44
Division 40	44

PR 2002/8

Tax outcomes for Growers who are ‘STS’ taxpayers	45
Assessable Income	45
Section 6-5	45
Deductions for Management fees and Licence fees for STS taxpayers who are accepted into the Project on or before 15 June 2002	47
Section 8-1 and section 328-105	47
Deductions for capital expenditure	48
Subdivision 328-D and Subdivisions 40-F	48
Deductions for Management fees and Licence fees for STS taxpayers who are accepted into the Project after 15 June 2002	51
Section 8-1 and section 328-105	51
Deductions for capital expenditure	52
Subdivision 328-D and Subdivisions 40-F	52
Tax outcomes that apply to all Growers	55
Division 35 - Deferral of losses from non-commercial business activities	56
Section 35-55 – Commissioner’s discretion	56
Sections 82KZME - 82KZMF, 82KL and Part IVA	60
Explanations	61
Is the Grower carrying on a business?	61
The Simplified Tax System	74
Division 328	74
Deductibility of Management fees and Licence fees	76
Section 8-1	76
<i>Possible application of prepayment provisions</i>	78
<i>Timing of deductions</i>	80
Interest deductibility	83
Section 8-1	83
Prepayment provisions	85
Sections 82KZL to 82KZMF	85
<i>Sections 82KZME and 82KZMF</i>	87
<i>Application of the prepayments provisions to this Project</i>	93

<i>Growers who <u>choose</u> to pay fees for a period in excess of that required by the Project's agreements</i>	97
Expenditure of a capital nature	99
Division 40 and Division 328	99
Deferral of losses from non-commercial business activities	102
Division 35	102
Section 82KL - recouped expenditure	113
Part IVA - general tax avoidance provisions	114
Example	117
Entitlement to GST input tax credits	117
Detailed contents list	118

Commissioner of Taxation

30 January 2002

<i>Previous draft:</i>	- trading stock
Not previously issued in draft form	<i>Legislative references:</i>
<i>Related Rulings/Determinations:</i>	- ITAA 1997 6-5
TR 92/1; TR 92/20; TD 93/34;	- ITAA 1997 8-1
TR 97/11; TR 97/16; TR 98/22;	- ITAA 1997 17-5
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	- ITAA 1997 35-10
<i>Subject references:</i>	- ITAA 1997 35-10(2)
- carrying on a business	- ITAA 1997 35-10(3)
- commencement of business	- ITAA 1997 35-10(4)
- crops as trading stock	- ITAA 1997 35-30
- fee expenses	- ITAA 1997 35-35
- horticulture	- ITAA 1997 35-40
- irrigation expenses	- ITAA 1997 35-45
- management fees expenses	- ITAA 1997 35-55
- plantation forestry	- ITAA 1997 35-55(1)
- primary production	- ITAA 1997 35-55(1)(a)
- primary production expenses	- ITAA 1997 35-55(1)(b)
- primary production income	- ITAA 1997 35-55(2)
- producing assessable income	- ITAA 1997 Div 40
- product rulings	- ITAA 1997 Subdiv 40-F
- public rulings	- ITAA 1997 40-25
- schemes and shams	- ITAA 1997 40-70(1)
- tax administration	- ITAA 1997 40-75(1)
- tax avoidance	- ITAA 1997 40-100
- tax benefits under tax avoidance	- ITAA 1997 40-105
schemes	- ITAA 1997 40-515
- tax shelters	- ITAA 1997 40-515(1)(a)
- tax shelters project	- ITAA 1997 40-515(1)(b)
	- ITAA 1997 40-520(1)

PR 2002/8

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| - ITAA 1997 40-525(2) | - ITAA 1936 82KZL(1) |
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| - ITAA 1997 40-535 | - ITAA 1936 82KZME(3) |
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| - ITAA 1997 Div 328 | - ITAA 1936 82KZMF(1) |
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| - ITAA 1997 Subdiv 328-F | - ITAA 1936 177A |
| - ITAA 1997 Subdiv 328-G | - ITAA 1936 177C |
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| - ITAA 1997 328-105(1)(a) | - ITAA 1936 177D(b) |
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| - ITAA 1997 328-190 | <i>Case references:</i> |
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Subdiv-H | - FCT v. Lau 84 ATC 4929 (1984) |
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