

# ***PR 2004/63 - Income tax: National Viticultural Fund of Australia Project No. 3***

 This cover sheet is provided for information only. It does not form part of *PR 2004/63 - Income tax: National Viticultural Fund of Australia Project No. 3*

 This document has changed over time. This is a consolidated version of the ruling which was published on *19 May 2004*



## Product Ruling

### Income tax: National Viticultural Fund of Australia Project No. 3

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#### **Preamble**

*The number, subject heading, **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. 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.

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.

## What this Product Ruling is about

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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 'National Viticultural Fund of Australia Project No. 3', or just simply as 'the Project'.

### Tax law(s)

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 70 (ITAA 1997);
- Division 328 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Section 82KZL (ITAA 1936);
- Sections 82KZME - 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

### Goods and Services Tax

3. All fees and expenditure referred to in this Ruling include the 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. Although this Ruling deals with the laws 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 potential 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 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 (that is being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Growers'.

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.

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## Date of effect

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11. This Ruling applies prospectively from 19 May 2004, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. 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 persons' involvement in the arrangement.

## Arrangement

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

- Application for Product Ruling dated 20 February 2004 and additional correspondence between the ATO and the Applicant dated 5 April 2004, 13 April 2004, 28 April 2004, 30 April 2004, 5 May 2004 and 10 May 2004;
- Draft PDS for the National Viticultural Fund of Australia Project No. 3, received 5 May 2004;
- Draft **Constitution** of the National Viticultural Fund of Australia Project No. 3, received 28 April 2004;
- Draft **Management Agreement** between Food and Beverage Australia Ltd (the 'Responsible Entity') and the Grower, received 5 May 2004;

- Draft **Licence Agreement** between National Vineyard Fund of Australia (No.3) Ltd (the Land Owner), Food and Beverage Australia Ltd (the 'Responsible Entity') and the Grower, received 5 May 2004;
- Draft Compliance Plan for the National Viticultural Fund of Australia Project No. 3, received 26 February 2004;
- Custodian Agreement between Food and Beverage Australia Ltd (the 'Responsible Entity') and National Viticultural Fund of Australia Pty Ltd, received 28 April 2004; and
- Draft Grape Purchase Agreement between Orlando Wyndham Group Pty Ltd and National Viticultural Fund of Australia, received 26 February 2004.

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

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

16. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

### Overview

17. The salient features of the National Viticultural Fund of Australia Project No. 3 are as follows:

Location	The Barossa Valley region of South Australia.
Type of business each participant is carrying on	Commercial growing of Wine grapes.
Number of hectares offered for cultivation	80
Size of each Vinelot	0.33 hectares
Number of vines per hectare	1,667
Term of the Project	16 years
Initial cost	\$8,298 plus \$4,500 for shares

Initial cost per hectare	\$24,894
Ongoing costs	<ul style="list-style-type: none"> <li>• Management and Administration fees of \$3,318 in Year 2 and \$2,930 in Year 3 and ongoing costs for the Years 4 to 16;</li> <li>• Licence fees of \$1,903 in Year 2, \$2,023 in Year 3 and ongoing costs for Years 4 to 16.</li> <li>• Capital costs for Planting, Vineyards, Road Works and Site Clearing of \$1,475 in Year Two and \$669 in Year Three.</li> <li>• Balance of Shares cost of \$1,750 in Year 2.</li> </ul>
Other costs	Growers will be charged for the cost of all insurance except Public Liability Insurance.

18. Under this Product Disclosure Statement, Food and Beverage Australia Ltd proposes to offer 240 interests called 'Allotments' of 0.33 hectares. The Project is registered as a Managed Investment Scheme under the Corporations Act. The Responsible Entity for the Project is Food and Beverage Australia Ltd (FABAL). For each interest acquired in the Project, a Grower is required to subscribe to 100 Ordinary Shares in the Land Owning Company also. Upon application, Growers will execute a Power of Attorney enabling FABAL to act on their behalf as required.

19. The land for the Project has been purchased by National Vineyard Fund of Australia (No.3) Ltd (the Land Owner) which will lease the land to National Viticultural Fund of Australia Pty Ltd (the Custodian) which will then sublease the land back to the Land Owner. The Land Owner will grant a licence to the Growers to use and occupy the Allotment for the planting, growing and harvesting of grapes. There is a minimum subscription of 40 interests for this Project.

20. Growers enter into a Management Agreement with FABAL to manage their Allotments for the eventual harvest and sale of their grape produce. FABAL will manage and cultivate the vines and be responsible for harvesting and selling the grapes. FABAL has entered into an arrangement to pre-sell 100% of the growers wine grapes for this Project to Orlando Wyndham Group Pty Ltd.

21. Under the Product Disclosure Statement offer, Growers can enter the Project during the period up to 15 June 2004 (2004 Growers) or during the period 16 June 2004 to 31 October 2004 (2005 Growers). Applications from Growers who

apply to enter the Project during the period 16 June 2004 to 30 June 2004 will not be accepted until 1 July 2004.

### **Constitution**

22. The Constitution establishes the Project and operates as a deed binding on all of the Project's Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which FABAL agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 14 of the Constitution, the Responsible Entity will keep a register of Growers.

23. Under the terms of the Constitution, all moneys received from applications shall be paid to the Responsible Entity which will deposit those moneys into an Application Fund in the name of the Responsible Entity. The application moneys will be released by the Responsible Entity when it is reasonably satisfied that certain specified criteria in the Constitution have been met (clause 15).

### **Compliance plan**

24. As required by the Corporations Law, a Compliance Plan has been adopted by FABAL for the Project. The purpose of the Compliance Plan is to ensure that FABAL manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

### **Management Agreement**

25. Growers participating in the arrangement will enter into a Management Agreement (MA) between FABAL and the Grower.

26. The Management Agreement provides that each Grower appoints FABAL to perform services under the agreement from the date FABAL accepts the Grower's Application. FABAL will manage all viticultural activities on behalf of the Grower. The services to be performed are specified in Clause 4 of the Agreement.

27. The Grower appoints the Responsible Entity to provide the Primary Services for the Grower in Year 1 of the Project. The services to be provided consist of maintaining the Allotment free of weeds, pests and other vermin and all administrative, technical and compliance duties.

28. In addition to the duties specified above, the Responsible Entity will also arrange for the following services to be carried out on or in respect of the Allotment:

- (a) establishment of an irrigation system on Grower Allotments;

- (b) preparation for, and planting of, rootlings or cuttings on Grower Allotments; and
- (c) establishing a cover crop on the Allotment.

29. The Grower appoints the Responsible Entity to manage and maintain the Grower Allotment(s) following the establishment of the Allotment. The Responsible Entity must perform these services in accordance with sound viticultural, environmental and industry practises. These duties include, but are not limited to:

- (a) as and when reasonably required, irrigate the Allotment in order to maintain the Grower's Vines in a healthy condition;
- (b) as and when required, but no less than once in each Year after the planting of Vines, prune and/or train and/or take other measures that may be reasonably necessary, in accordance with best viticultural practice, to properly manage the growth of the Vines to and along the trellises on the Allotment and to optimise as far as possible the quality of the grapes on the Grower's Allotment;
- (c) take such reasonable measures as may be required to control the growth of the weeds and other vegetable pests on the Allotment;
- (d) take all reasonable measures to prevent and control the outbreak and spreading of disease on the Allotment which may affect the health and vigour of the Vines or yield of the Vines;
- (e) take all reasonable measures, in accordance with best viticultural practice, to deter and control any declared insect, bird or animal pests from the Allotment which may detract from the health and vigour of the Vines or yield of the Vines;
- (f) conduct regular tests for evidence of ill health or other disease and recommend any remedial procedures considered necessary;
- (g) take representative soil samples from the Allotment as required and have those samples analysed by an accredited soil analysis laboratory and, having regard to the results and recommendations of any soil analysis undertaken, apply suitable fertiliser and other recommended soil additives to the Allotment in such quantities as may be required to promote healthy vine growth and yield;
- (h) replace any vines which die or become unproductive within the first 13 months after planting with juvenile grape vines of the same variety;

- (i) slash, mow or otherwise control the growth of native pasture grasses, vegetation or introduced pasture species on the Allotment, as required to minimise fire risk or fire hazard to the extent reasonably possible and in accordance with sound viticultural practice;
- (j) subject to any grape supply agreement the Responsible Entity has negotiated, use its reasonable endeavours to commence harvesting the grapes from the Vines at the time it regards as the optimum time for the purposes of obtaining grapes of optimum quality for the making of premium quality table wine;
- (k) market and sell the grapes attributable to the Grower's Allotment for the maximum price available having regard to the long term nature and security of any grape supply agreement which the Responsible Entity has negotiated; and
- (l) carry out all administration and compliance duties in respect of the Allotment and the other services provided under this Agreement.

30. Growers who enter the Project during the period up to 15 June 2004 will have their Primary Services carried out by 30 June 2004. For Growers entering during the period 1 July 2004 to 31 October 2004, the Primary Services will be carried out by 31 December 2004. The Responsible Entity will complete the planting for all Growers by 31 December 2004.

### **Licence Agreement**

31. Growers participating in the Project will, pursuant to the terms of the Licence Agreement, be granted an interest in the Allotment by the Land Owner in the form of a licence to use their Allotment for the purpose of conducting their viticultural business.

32. The Licence Agreement gives the Grower a licence over an identifiable area of land for a period of 16 years ending on 30 June 2019 or until the termination of the Grower's Interest.

33. Each Grower must pay the amount of Rent to the Land Owner as specified in clause 6.1 of the Licence Agreement. In return for payment of this rent, the Land Owner agrees to grant the Grower licences to:

- (a) use and occupy the Grower's Allotment for the purpose only of developing, planting, growing, maintaining and harvesting vines;
- (b) draw water supplied by the Land Owner to the extent necessary and for the purpose of irrigating the Allotment and Vines;
- (c) use the trellising to be installed on the Grower's Allotment;

- (d) use the Land Owners plant and equipment for the purposes of carrying out maintenance on the Allotment, and
- (e) use in common with all other Growers the viticultural infrastructure on the Land required for the Project.

34. Under the agreement, the Grower agrees, amongst other things, to:

- (a) use the Allotment solely for the purpose of developing, planting, growing, maintaining and harvesting the grapes from the vines;
- (b) comply with sound agricultural and environmental practices;
- (c) promptly repair any damage caused by the Grower or its employees, agents or contractors to any roads, tracks or fences on the Allotment or on any neighbouring land;
- (d) not store any chemical, flammable, noxious or dangerous substances in a manner which is likely to result in damage to vegetation, livestock, crops or water resources on any neighbouring land;
- (e) take all reasonable measures to prevent and combat land degradation on the allotment;
- (f) permit the land owner and its employees, agents and contractors to enter upon the Allotment from time to time with or without equipment for the purpose of performing the Responsible Entity's obligations under this agreement and the Grower's Management Agreement;
- (g) not erect any buildings structures or dwellings or use any caravans on the Allotment for accommodation purposes except to the extent that such facilities are reasonably required by the Grower for the bona fide management of the Vines; and
- (h) comply or procure compliance with the provisions of the Grower's Management Agreement.

35. The Land Owner will establish water pipeline infrastructure for the purpose of servicing the Allotment and then maintain that infrastructure as necessary for the term of the Agreement and install and maintain the trellising on the Allotment.

## **Grape Purchase Agreement**

36. Pursuant to a Grape Purchase Agreement, Orlando Wyndham Group Pty Ltd has agreed to purchase Grapes from the Grower.

37. The proceeds of the sale are to be paid to the Responsible Entity as agent for each Grower. Clause 6 of the draft Grape Purchase Agreement sets out the payment schedule.

### **Fees – Years 1 to 3**

38. The fees payable by a Grower in the Project in the first three years of the Project are as set out in the Table below for one Allotment:

	<b>Year 1 Payable On Application</b>	<b>Year 1 Payable by 15 June</b>	<b>Year 2 Payable by 31 July</b>	<b>Year 3 Payable by 31 July</b>
<b>Management Agreement Fees</b>				
Installation of irrigation		3,389		
Pre-planting activities		721		
Primary Services	1,124	1,614		
Supply and planting of rootlings		1,085	59	54
Vineguards			1,276	512
Administration costs			331	249
Ongoing management fees			2,987	2,681
Site Clearing			31	
Road construction			109	103
<b>Licence Agreement Fees</b>				
Water Licence		295	576	500
Land licence		42	519	649
Plant & Equipment Rental		28	479	537
Trellis Rental			329	337

39. For a 2004 Grower who enters the Project on or before 15 June 2004, a reference to 'Year 1' means the period from the date the Grower enters the Project to 30 June 2004, 'Year 2' means the

period 1 July 2004 to 30 June 2005 and 'Year 3' means the period 1 July 2005 to 30 June 2006.

40. For a 2005 Grower who enters the Project during the period 1 July 2004 to 31 October 2004, a reference to 'Year 1' and 'Year 2' each means the period 1 July 2004 to 30 June 2005 and 'Year 3' means the period 1 July 2005 to 30 June 2006.

41. For a 2005 Grower who enters the Project before 31 July 2004, the Year 1 fees will be payable on application. For 2005 Growers who enter on or after 31 July 2004, the Year 1 and Year 2 fees will be payable on application.

42. A Grower is required to pay ongoing management fees and administration fees and Licence fees for each of the Years 4 through to 16 in the amounts set out in the Licence Agreement and the Management Agreement.

## **Call for Funds**

43. The Responsible Entity is entitled to make a call on Growers of up to \$4,217 in any year for a contribution to the expenses of the Project.

## **Harvesting and Sale**

44. Subject to any grape supply agreement negotiated, the Responsible Entity must use its reasonable endeavours to commence harvesting the grapes from the Vines at the time it regards as the optimum time for the purposes of obtaining grapes of optimum quality for the making of premium quality table wine.

45. The Grower has appointed FABAL to market and sell the Grapes Attributable to the Grower's Allotment for the maximum price available having regard to the long term nature and security of any grape supply agreement which the Responsible Entity has negotiated (clause 4.4 of the Management Agreement).

46. At all times, the Grower has full right, title and interest in the Grapes Attributable to the Growers Allotment and the right to harvest and sell the Grapes Attributable to the Grower's Allotment (clause 2.3 of the Licence Agreement).

47. FABAL will ensure that the proceeds from the sale of Grapes Attributable to the Grower's Allotment, after payment of any costs and expenses in relation to the harvest, will be paid into the Proceeds Fund trust bank account. A Grower is entitled to the money in the Proceeds Fund which represents the gross income from that Grower's Grapes Attributable to the Grower's Allotment for a particular period less:

- (a) all fees payable under the Grower's Management Agreement;

- (b) all fees payable under the Grower's Licence Agreement;
- (c) any other amounts payable by the Grower under this Constitution, the Grower's Licence Agreement and Management Agreement; and
- (d) any amounts which the Responsible Entity reasonably considers will be required to meet operating expenses in future years.

48. The surplus available for each Grower after all deductions are made by the Responsible Entity must be paid by the Responsible Entity to the relevant Grower within 5 months after 30 June each Year. The terms 'Proceeds Fund' and 'Grapes Attributable to a Grower's Allotment' are defined in Schedule 1 to the Constitution.

### **Finance**

49. Growers can fund their participation in the Project themselves or borrow from an independent lender.

50. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- entities associated with the Project are involved in the provision of finance for the Project;
- 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' 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 terms or rate of interest are of a non-arm's length nature;
- repayments of the principal and 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) 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.

## Ruling

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### Application of this Ruling

51. This Ruling applies only to Growers who are accepted to participate in the Project:

- on or before 15 June 2004 where the Grower has executed a Licence Agreement and a Management Agreement on or before that date (2004 Growers), or
- during the period 1 July 2004 to 31 October 2004, where the Grower has executed a Licence Agreement and a Management Agreement (2005 Growers).

52. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

53. This ruling does not apply to Growers who have their Agreements executed during the period 16 June 2004 to 30 June 2004.

### Minimum subscription

54. 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 Product Disclosure Statement, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 40 Interests is achieved.

### The Simplified Tax System ('STS')

#### Division 328

55. For a Grower participating in the Project, the recognition of income and the timing of tax deductions 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

56. 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.

### **Prepaid expenditure for Management Fees and Licence Fees**

#### **Sections 82KZME and 82KZMF**

57. The following expenditure incurred by a Grower who is accepted into this Project is subject to the prepayment rules in sections 82KZME and 82KZMF:

- \$862 of the Year 2 Management Fee which is paid in advance for services to be provided in Year 3;
- \$699 of the Year 3 Management Fee which is paid in advance for services to be provided in Year 4; and
- \$116 of the Year 3 Licence Fee which is paid in advance for the licence of land in Year 4.

58. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Note (iii)).

59. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' 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.

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

60. Sections 82KZME and 82KZMF are discussed in greater detail at paragraphs 99 to 106.

### **Assessable Income**

#### **Section 6-5 and section 328-105**

61. 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.

62. A Grower who is not an 'STS taxpayer' recognises ordinary income from carrying on the business of viticulture at the time that income is derived.

63. A Grower who is an 'STS taxpayer' recognises ordinary income from carrying on a business of viticulture at the time that income is received (paragraph 328-105(1)(a)).

## **Trading Stock**

### ***Section 70-35***

64. A Grower who is not an 'STS taxpayer' may, in some years, hold grapes that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Grower must include the amount of that excess in assessable income.

65. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Grower may claim the amount of that excess as an allowable deduction.

### ***Section 328-285***

66. A Grower who is an 'STS taxpayer' may, in some years, hold grapes that will constitute trading stock on hand. Where, for such a Grower, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than \$5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

67. Alternatively, a Grower who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

## ***Deductions for Management fees and Licence fees***

### ***Section 8-1 and section 328-105***

68. A Grower may claim tax deductions for the following revenue expenses on a per 'Allotment' basis:

**2004 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30 June 2004 Year 1</b>	<b>Year ended 30 June 2005 Year 2</b>	<b>Year ended 30 June 2006 Year 3</b>
<b>Management Fee</b>	8-1	\$2,738 – See Note (i)	\$2,456 – See Notes (i), (ii) & (iii)	\$2,231 – See Notes (i), (ii) & (iii)
<b>Prepaid Management Fee</b>	8-1	Nil	Amount must be calculated – See Notes (i) & (iv)	Amount must be calculated – See Notes (i) & (iv)
<b>Land Licence Fee (Rent)</b>	8-1	\$42 – See Notes (i) & (iii)	\$519 – See Notes (i) & (iii)	\$533 – See Notes (i) & (iii)
<b>Prepaid Land Licence Fee</b>	8-1	Nil	Nil	Amount must be calculated – See Notes (i) & (iv)
<b>Water Licence Fee</b>	8-1	\$295 – See Notes (i) & (iii)	\$576 – See Notes (i) & (iii)	\$500 – See Notes (i) & (iii)
<b>Trellis Rental</b>	8-1	Nil	\$329 – See Notes (i) & (iii)	\$337 – See Notes (i) & (iii)
<b>Plant &amp; Equipment Rental</b>	8-1	\$28 – See Notes (i) & (iii)	\$479 – See Notes (i) & (iii)	\$537 – See Notes (i) & (iii)

**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 (for example input tax credits): Division 27. See example 1 at paragraph 119.
- (ii) The ongoing Management fees contain amounts of \$140 in Year 2 and \$103 in Year 3. These outgoings are expenditure of a capital nature and are not deductible under section 8-1.
- (iii) The Management fees and the licence fees shown in the Table above, excluding prepaid Management Fees and prepaid Land Licence Fees, are deductible in the year that they are incurred (where the Grower is NOT an 'STS taxpayer' or, under paragraph 328-105(1)(b) in the year in which they are paid (where the Grower is an 'STS taxpayer'). However, although not required under the Management Agreement or Licence, if a Grower chooses to prepay these fees for the doing of a

thing (for example the provision of management services or the licencing 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 formulae shown in paragraph 59 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 purposes of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

- (iv) The Management Agreement and the Licence require the following amounts to be prepaid:
- \$862 of the Year 2 Management Fee which is paid in advance for services to be provided in Year 3;
  - \$699 of the Year 3 Management Fee which is paid in advance for services to be provided in Year 4; and
  - \$116 of the Year 3 Licence Fee which is paid in advance for the licence of land in Year 4.

For a Grower who acquires the minimum allocation of 1 Allotment the prepaid Management fee and prepaid Land Licence fee is less than \$1,000, and is therefore deductible in the year it is incurred as it qualifies as 'excluded expenditure'.

However, where a Grower acquires more than 1 Allotment, the amount of either or both of these prepaid fees may be \$1,000 or more. Where this occurs, such Growers **MUST** determine the relevant deduction for the prepaid Management fees and prepaid Licence fee, using the formulae shown in paragraph 59.

**2005 Growers**

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30 June 2004 Year 1</b>	<b>Year ended 30 June 2005 Year 2</b>	<b>Year ended 30 June 2006 Year 3</b>
<b>Management Fee</b>	8-1	Nil	\$5,194 – See Notes (i), (ii) & (iii)	\$2,231 – See Notes (i), (ii) & (iii)
<b>Prepaid Management Fee</b>	8-1	Nil	Amount must be calculated – See Notes (i) & (iv)	Amount must be calculated – See Notes (i) & (iv)
<b>Land Licence Fee (Rent)</b>	8-1	Nil	Amount must be calculated– See Note (v)	\$533 – See Notes (i) & (iii)
<b>Prepaid Land Licence Fee</b>	8-1	Nil	Nil	Amount must be calculated – See Notes (i) & (iv)
<b>Water Licence Fee</b>	8-1	Nil	Amount must be calculated– See Note (vi)	\$500 – See Notes (i) & (iii)
<b>Trellis Rental</b>	8-1	Nil	Amount must be calculated– See Note (vii)	\$337 – See Notes (i) & (iii)
<b>Plant &amp; Equipment Rental</b>	8-1	Nil	Amount must be calculated – See Note (viii)	\$537 – See Notes (i) & (iii)

- (v) For 2005 Growers accepted into the Project after 1 July 2004 and on or before 31 October 2004, the deduction for the Land Licence fee is \$43.25 per month for each month that the Grower holds the licence over the land. This will mean that for 2005 Growers accepted after 1 July 2004, the full \$519 payable for the year ended 2005 will not be deductible. See paragraphs 97 and 98.
- (vi) For 2005 Growers accepted into the Project after 1 July 2004 and on or before 31 October 2004, the deduction for the Water Licence Fee is \$48 per month for each month that the Grower holds the water licence. This will mean that for 2005 Growers accepted after 1 July 2004, the full \$576 payable for the year

ended 2005 will not be deductible. See paragraphs 97 and 98.

- (vii) For 2005 Growers accepted into the Project after 1 July 2004 and on or before 31 October 2004, the deduction for the Trellis Rental fee is \$27.42 per month for each month that the Grower is in the Project. This will mean that for 2005 Growers accepted after 1 July 2004, the full \$329 payable for the year ended 2005 will not be deductible. See paragraphs 97 and 98.
- (viii) For 2005 Growers accepted into the Project after 1 July 2004 and on or before 31 October 2004, the deduction for the Plant and Equipment Rental fee is \$39.92 per month for each month that the Grower is in the Project. This will mean that for 2005 Growers accepted after 1 July 2004, the full \$479 payable for the year ended 2005 will not be deductible. See paragraphs 97 and 98.

### ***Deductions for capital expenditure***

#### ***Division 40***

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

#### **2004 Growers & 2005 Growers**

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year ended 30 June 2004 Year 1</b>	<b>Year ended 30 June 2005 Year 2</b>	<b>Year ended 30 June 2006 Year 3</b>
Vineyards	40-25	Nil	Amount must be calculated – See Notes (ix) & (x)	Amount must be calculated – See Notes (ix) & (x)
Water facility (eg dam, irrigation, bore, etc)	40-515	\$1,130 – See Notes (ix), (xi) & (xii)	\$1,130 – See Notes (ix) & (xi)	\$1,130 – See Notes (ix) & (xi)
Establishment of horticultural plants (grapevines)	40-515	Nil – See Notes (ix) & (xiii)	Nil – See Notes (ix) & (xiii)	Nil – See Notes (ix) & (xiii)

**Notes:**

- (ix) 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 (for example input tax credits): Division 27. See example 1 at paragraph 119.
- (x) A vineyard is a 'depreciating asset'. Each Grower holds an interest in each vineyard which is a 'low-cost asset' and can be allocated to a 'low-value pool'. Once any 'low-cost asset' of a Grower is allocated to a 'low-value pool', all other 'low-cost assets' the Grower start to 'hold' in that year or a later year must be allocated to that pool. If the Grower has already allocated an asset to a 'low-value pool', the vineyard assets would also have to be allocated to that pool. Otherwise, the Grower must decide whether to create a 'low-value pool'. If the assets are allocated to a 'low-value pool', the capital expenditure on the vineyards will be deducted under the diminishing value methodology of the pool based on a rate of 18.75% in the year the vineyards are first used and a rate of 37.5% in subsequent years (section 40-440). If the assets are not allocated to a 'low-value pool', they can be written off based on the 'effective life' of the vineyards. As there has been no determination of the 'effective life' of a vineyard by the Commissioner, Growers must self-assess an 'effective life'. Vineyards are not installed until after the grapevines are planted and no deduction for the decline in value is available until this installation occurs. The Project Manager will advise Growers of that date to enable them to calculate the deduction.
- (xi) 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).
- (xii) For 2005 Growers, the capital expenditure is incurred in the year ended 30 June 2005 and no deduction is available for the 2004 year. One third of the expenditure is available as a deduction in the 2005 year and one third in each of the following two years.
- (xiii) 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 40-520(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.

***Subdivision 328-D and Subdivisions 40-F and 40-G***

70. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to vineyards, water facilities (for example irrigation) and grapevines. Deductions relating to the 'cost' of vineyards 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.

71. 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 Subdivision 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 Note (xvi).

72. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1,000 (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.

**2004 Growers and 2005 Growers**

<b>Fee Type</b>	<b>ITAA 1997 section</b>	<b>Year ended 30 June 2004 Year 1</b>	<b>Year ended 30 June 2005 Year 2</b>	<b>Year ended 30 June 2006 Year 3</b>
Vineyards	328-180	Nil	\$1,276 – See Notes (xiv) & (xv)	\$512 – See Notes (xiv) & (xv)
Water facility (eg irrigation, dam, bore, etc)	40-515	\$1,130 – see Notes (xiv), (xvi) & (xvii)	\$1,130 – see Notes (xiv) & (xvi)	\$1,130 – see Notes (xiv) & (xvi)
Establishment of horticultural plants (grapevines)	40-515	Nil	Nil – see Notes (xiv) & (xviii)	Nil – see Notes (xiv) & (xviii)

**Notes:**

- (xiv) 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 (for example input tax credits): Division 27. See example 1 at paragraph 119.
- (xv) A vineyard is a 'depreciating asset'. Each Grower holds an interest in each vineyard which is a 'low-cost asset' as defined in subsection 40-425(2). It cannot be allocated to the 'general STS pool' (section 328-180). A deduction equal to the amount of the Grower expenditure for the vineyards is available in the income year in which they are 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. Vineyards are not installed until after the grapevines are planted. The Project Manager will advise when that has occurred.
- (xvi) 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 \$1,000, 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 2005 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).

- (xvii) For 2005 Growers, the capital expenditure is incurred in the year ended 30 June 2005 and no deduction is available for the 2004 year. One third of the expenditure is available as a deduction in the 2005 year and one third in each of the following two years.
- (xviii) 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 40-520(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.

**Tax outcomes that apply to all Growers**

73. 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 99 to 106 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.

**Amounts not deductible under section 8-1**

74. A Grower in this Project may be required to pay additional funds to meet Project costs at the request of the Responsible Entity. This call for funds is in addition to all other fees described in this ruling and cannot exceed \$4,217 in any year of the Project. Any such amounts incurred (where the Grower is NOT an 'STS Taxpayer') or paid (where the Grower is an 'STS Taxpayer') are capital in nature and will not be deductible under section 8-1 of the ITAA 1997.

**Shares**

75. The shares in National Vineyard Fund of Australia (No. 3) Ltd are CGT assets (section 108-5 of the ITAA 1997) and the amount paid by a Grower to acquire those assets is an outgoing of capital and not allowable as a deduction.

76. The amounts paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)). Any disposal of the shares by a Grower will be a CGT event and may give rise to a capital gain or loss.

**Dividends relating to the shares**

77. Dividends paid out of profits by National Vineyard Fund of Australia (No. 3) Ltd are included in the assessable income of shareholders under subsection 44(1) of the ITAA 1936.

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

78. A Grower who is an individual accepted into the Project in the year ended 30 June 2004 or the year ended 30 June 2005 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the

Commissioner will exercise the discretion in paragraph 35-55(1)(b) for 2004 Growers for the income years ending **30 June 2004 to 30 June 2007** and 2005 Growers for the income years ending **30 June 2005 to 30 June 2007**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

## Section 82KL and Part IVA

79. For a Grower who commences participation in the Project and incurs expenditure as required by the Licence Agreement and the Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

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

## Explanation

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### Is the Grower carrying on a business?

80. For the amounts set out in the Tables above to constitute allowable deductions, the Grower's viticultural activities as a participant in the National Viticultural Fund of Australia Project No. 3 must amount to the carrying on of a business of primary production.

81. Where there is a business, or a future business, the gross proceeds from the sale of the grape produce will constitute 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.

82. For schemes such as those of the National Viticultural Fund of Australia Project No. 3, 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 *Commission of Taxation v Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

83. 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 vines are established;

- the Grower has a right to harvest and sell the grape produce from those vines;
- the viticultural activities are carried out on the Grower's behalf;
- the viticultural activities of the Grower are typical of those associated with a viticultural business; and
- the weight and influence of general indicators point to the carrying on of a business.

84. In this Project, each Grower enters into a Licence Agreement and a Management Agreement. Under the Licence Agreement each individual Grower will have rights over a specific and identifiable area of land. The agreement provides the Grower with an ongoing interest in the specific vines on the leased area for the term of the Project. Under the agreement, the Grower must use the land in question for the purpose of carrying out viticultural activities, and for no other purpose. The agreement allows Food and Beverage Australia Ltd, the Responsible Entity, to come onto the land to carry out its obligations.

85. Under the Management Agreement, the Responsible Entity is engaged by the Grower to maintain an Allotment on the Grower's identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to maintain the Allotment on the Grower's behalf.

86. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the grape produce grown on the Grower's Allotment.

87. 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.

88. 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 the grape produce that will return a before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

89. The pooling of grape produce from vines grown on the Grower's Allotment with the grape produce of other Growers is consistent with general viticultural practices. Each Grower's proportionate share of the sale proceeds of the pooled grape produce will reflect the proportion of the produce contributed from their Allotment(s).

90. The Responsible Entity's services are also consistent with general viticultural practices. They are of the type ordinarily found in viticultural ventures that would commonly be said to be businesses. While the size of an Allotment is relatively small, it is of a size and

scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

92. The viticultural 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' viticultural activities in the Project will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

93. 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.

94. 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**

### ***Section 8-1***

95. Consideration of whether the initial management 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.

96. The management fee and, subject to paragraphs 97 and 98, the rent and licence fees associated with the viticultural activities will relate to the gaining of income from the Grower's business of viticulture (see above), and hence has a sufficient connection to the operations by which income (from the harvesting and sale of grape produce) 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. Subject to paragraphs 97 and 98, there is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. Subject to paragraphs 97 and 98, the exclusions do not apply.

97. One of the exclusions under section 8-1 relates to expenditure that is capital, or is capital in nature. Any part of the expenditure of a Grower entering into a viticulture business which is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and hence will not be deductible under section 8-1. The Commissioner is of the view that depending upon when they are accepted to participate in the Project, a portion of the initial Licence Agreement costs payable by a '2005 Grower' will be capital expenditure. Therefore, the amount allowed as a deduction for Rent and licences under section 8-1 will be allowed as follows.

98. For a '2005 Grower' who enters the Project after 1 July 2004, the initial Water Licence of \$295, Land Licence of \$42 and Plant and Equipment Rental of \$28 will not be deductible. The Water Licence fee of \$576, the Land Licence fee of \$519, the Plant and Equipment Rental of \$479 and the Trellising Rental of \$329 payable on application for the period from the 'Commencement Date' to 30 June 2005 will not be deductible in full. The deductions will be calculated on a pro-rata monthly basis to reflect the period of time the Grower has been a party to the Licence Agreement. Accordingly, the following amounts are deductible for each month or part month that the '2005 Grower' is in the Project for the 2005 Year:

- \$48 per month for the Water Licence;
- \$43.25 per month for the Land Licence;
- \$39.92 per month for the Plant and Equipment Rental; and
- \$27.42 per month for the Trellising Rental.

### **Prepayment provisions**

#### ***Sections 82KZL to 82KZMF***

99. 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 (for example 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.

100. For this Project, only section 82KZL (an interpretive provision) and sections 82KZME and 82KZMF are relevant. If 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) (see paragraph 105). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

### ***Sections 82KZME and 82KZMF***

101. If the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) 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)).

102. 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.

103. 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 an unrelated financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deductions 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.

104. 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.

105. 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.

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

106. 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***

107. Under the Management Agreement and Licence Agreement, a Grower incurs fees which include the following amounts:

- \$862 of the Year 2 Management Fee which is paid in advance for services to be provided in Year 3;
- \$699 of the Year 3 Management Fee which is paid in advance for services to be provided in Year 4; and
- \$116 of the Year 3 Licence Fee which is paid in advance for the licence of land in Year 4.

108. The expenditure incurred by a Grower in the Project for the ongoing management services and licence fees meets the requirements of subsections 82KZME(1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to 82KZME applies, the amount and timing of those deductions for those fees are determined under section 82KZMF.

109. Where a Grower acquires only one Allotment, the prepaid amounts set out in paragraph 107 are less than \$1,000 and constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)), 'excluded expenditure' is specifically excluded from the operation of section 82KZMF. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for the prepaid management fees and licence fee in the income year in which it is paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for the prepaid management fees and licence fee in the income year in which it is incurred.

110. However, where a Grower acquires more than one Allotment in the project, the amount of either or both of these fees may be \$1,000 or more. Where this occurs, such growers **MUST** determine the relevant deduction for the prepaid fees using the formula in subsection 82KZMF(1) shown in paragraph 105.

### **Interest deductibility**

111. 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.

112. 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 relevant prepayments provisions of the ITAA 1936 (see paragraphs 99 to 106).

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

#### ***Section 35-55 – Exercise of Commissioner's discretion***

113. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for 2004 Growers for the income years **30 June 2004 to 30 June 2007** and for 2005 Growers for the income years **30 June 2005 to 30 June 2007**, the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14, *Income tax: Division 35 – non commercial business losses*. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2004 up to and including 30 June 2007 and 30 June 2005 up to and including 30 June 2007:

- it is because of its nature the business activity of a Grower that will not satisfy one of the four tests in Division 35;

- there is an objective expectation that within a period that is commercially viable for the viticultural industry, a Grower's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grower who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

114. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) is conditional on the Project being carried on in the manner described in this Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Ruling, a Grower will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

### **Section 82KL**

115. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(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**

116. 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).

117. The 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 68 to 72 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

118. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the grape produce. 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 are 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

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### Example - Entitlement to GST input tax credits

119. 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 2002, 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:

Management fee for period 1/1/2003 to 30/6/2003	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2003 (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:

$$\frac{1}{11} \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4,400 less \$400, or \$4,000.

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

$$\frac{1}{11} \times \$2,200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2,200 less \$200, or \$2,000.

In preparing her income tax return for the year ended 30 June 2003, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

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 \$2,000 only, not one tenth of \$2,200).

## Detailed contents list

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**Commissioner of Taxation**

19 May 2004

*Previous draft:*

Not previously issued in draft form

- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27

*Related Rulings/Determinations:*

IT 360; TR 92/1; TR 92/20;  
 TR 97/11; TR 97/16; TR 98/22;  
 TR 2000/8; TR 2001/14;  
 TD 93/34, PR 1999/95

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*Subject references:*

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- non-commercial business activities
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

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