

# ***PR 2005/101 - Income tax: Peppermint Springs Vineyard Project (post 30 June 2005 Growers)***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *13 July 2005*



## Product Ruling

# Income tax: Peppermint Springs Vineyard Project (post 30 June 2005 Growers)

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Potential participants may wish to refer to the Tax Office website at [www.ato.gov.au](http://www.ato.gov.au) or contact the Tax Office directly to confirm the currency of this Product Ruling or any other Product Ruling that the Tax Office has issued.

### **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 Tax Office **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 and how the product fits an existing portfolio. 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 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, 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 Tax Office 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

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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.

### 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 of the ITAA 1997;
  - section 17-5 of the ITAA 1997;
  - Division 27 of the ITAA 1997;
  - Division 35 of the ITAA 1997;
  - Division 40 of the ITAA 1997;
  - Subdivision 61-J of the ITAA 1997;
  - Division 328 of the ITAA 1997;
  - section 82KL of the *Income Tax Assessment Act 1936* (of the ITAA 1936);
  - section 82KZL of the ITAA 1936;
  - section 82KZME and 82KZMF of the ITAA 1936; and
  - Part IVA of the 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. 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 (that is 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:

- are accepted to participate in the Project before the date of this Ruling and after 1 October 2005; or
- 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 13 July 2005, 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 2008. 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 received 15 March 2005 as constituted by documents provided on 5 April 2005, 20 April 2005, 28 April 2005, 30 April 2005, 9 May 2005 and 20 May 2005;
- Draft Information Memorandum for Peppermint Springs Vineyard Project, received 20 May 2005;
- Draft **Vineyard Management Agreement** between Peppermint Springs Management Pty Ltd ('the Manager') the Grower, and the Land Owner received 27 June 2005; and
- Draft **Lease of Vineyard Lot** between the Land Owner, Peppermint Springs Management Pty Ltd and the Grower, received 27 June 2005.

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

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 to which this Ruling applies.

16. In accordance with the above documents, a Grower who participates in the arrangement must have accepted a 'personal offer' of a small scale offering for the purpose of the *Corporations Act 2001* (see explanation at paragraphs 66 to 69). 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 below.

### Overview

17. The salient features of the Peppermint Springs Vineyard Project are as follows:

Location	South West region of Western Australia.
Type of business each participant is carrying on	Commercial growing of wine grapes.
Number of hectares offered for cultivation	28
Size of each Vineyard Lot	1 hectare
Minimum interest	2 Vineyard Lots
Number of grapevines per hectare	1666
Term of the Project	Approximately 18 years
Initial cost per Vineyard Lot	Management costs of \$43,450, Rent of \$22.91 per month, and the following capital costs: <ul style="list-style-type: none"> <li>• Irrigation \$7,150;</li> <li>• Trellising \$8,800;</li> <li>• Landcare \$1,650; and</li> <li>• Planting \$3,025.</li> </ul>
Initial cost for minimum interest (2)	\$128,150 plus Rent of \$45.82 per month
Ongoing costs	<ul style="list-style-type: none"> <li>• Management Fees;</li> <li>• Rent;</li> <li>• Project Management Fees; and</li> <li>• Additional Fees for services.</li> </ul>

18. The Project will be offered under an Information Memorandum. The Manager of the Peppermint Springs Vineyard Project is Peppermint Springs Management Pty Ltd. The Project Land of 28 hectares is situated approximately 7 kilometres north-east of Manjimup in the South West region of Western Australia.

19. The term of the Project is approximately 18 years. There is no minimum subscription.

20. Post 30 June 2005 Growers can only enter the Project on or after the date this Ruling is made and before 1 October 2005.

21. Each Grower is required to have a minimum interest of 2 Vineyard Lots. Each Vineyard Lot is 1 hectare in size. Applications for additional Vineyard Lots will be considered after all applicants have been allocated their minimum interest.

22. The Grower will enter into a Lease Agreement and a Management Agreement with both the Land Owner and Peppermint Springs Management Pty Ltd.

23. Under the Lease Agreement the Grower leases identifiable areas of land called Vineyard Lots from the Land Owner for a term of approximately 18 years for the purpose of growing wine grapes.

24. Under the Management Agreement the Grower appoints Peppermint Springs Management Pty Ltd as Manager to establish and manage the Vineyard Lots on the Grower's behalf.

25. The offer under the Information Memorandum is subject to:

- execution of the Grape Sale Agreement with the Grape Purchaser;
- provision of an agreement securing water by the Land Owner at the required rate; and
- receipt of a suitable report by a recognised viticultural consultant of the suitability of the proposed land for propagation of the grape varieties proposed.

## **Lease Agreement**

26. Each Grower participating in the Project will enter into a Lease Agreement with the Land Owner and the Manager to use the Vineyard Lots for the purpose of conducting the Grower's viticulture business upon the terms and conditions as set out in the agreement.

27. The Term of each Lease Agreement is from the Date of Commencement until 31 May 2023 or when the Project is terminated.

28. Each Grower must pay Rent to the Land Owner as specified in the Schedule to the Lease Agreement. In return for payment of Rent, the Land Owner agrees to:

- lease to the Grower the Vineyard Lots on which wine grapes are to be grown; and

- grant a licence to the Grower to use such headlands, trellis, irrigation and access ways adjacent to the Vineyard Lots as are necessary to farm the Vineyard Lots.

29. Under the Lease Agreement, the Grower agrees, amongst other things to:

- engage the Manager to manage the Vineyard Lots in a proper and skilful manner pursuant to the Management Agreement and the Vineyard Plan (clause 9.2);
- grant to the Manager and its Officers or Agents the right to enter the Vineyard Lots at all times (clause 9.3);
- not use or permit other persons to use the Vineyard Lots or any part of it for any purpose other than the cultivation and harvesting of wine grapes (clause 9.5); and
- comply with all laws and regulations relating to the occupancy of the Grower's Vineyard Lots (clause 9.9).

### **Management Agreement**

30. Each Grower participating in the arrangement will enter into a Management Agreement with Peppermint Springs Management Pty Ltd and the Land Owner.

31. Under the Management Agreement the Grower appoints Peppermint Springs Management Pty Ltd to perform the Vineyard Management Services from the Date of Commencement. The Manager may subcontract these Services to another party. The Manager will manage the Vineyard Lots on behalf of the Grower in accordance with recognised viticulture practices. The Vineyard Management Services to be performed are specified in item 5 of the Schedule to the Management Agreement.

32. The Manager will perform the Initial Period Services from the Date of Commencement to 15 October 2005, including:

- controlling diseases;
- removing fences and remnant vegetation;
- fertilising;
- conducting soil analysis to ensure maximum growth of the vineyard;
- weed control;
- general administration services; and
- executing on behalf of the Grower any grape contracts.

33. In addition, the Manager will arrange for the following establishment services to be performed:

- installation of an irrigation system before 30 November 2005, including an in-line dripper system and all necessary pumps, filtration and fertilisation equipment to efficiently operate and monitor the irrigation system;
- landcare services including constructing drainage works, installing sub-surface drainage and constructing fencing required to isolate any areas of the vineyard;
- establishing and planting of rootlings as specified in the Vineyard Plan in the period between 29 October 2005 and 15 November 2005; and
- construction of trellising by 31 October 2005.

34. After provision of the Initial Period Services, the Manager will provide Ongoing Vineyard Management Services for the term of the Project. These services include but are not limited to:

- maintaining a cover crop;
- maintaining all irrigation, trellising, pumping equipment and other assets;
- managing the application of water to the Vineyard Lots and de-ionising ponds or dams;
- controlling weeds and maintaining firebreaks;
- vine training, maintenance and pruning;
- controlling diseases and pests;
- maintaining the fertility of the soil each year at a level conducive to economic wine grape production;
- applying herbicides to the Grower's Vineyard Lots;
- harvesting the grapes by means determined by the Manager at its discretion;
- engaging an independent Viticultural Consultant to provide a report on the Project to the Growers prior to 30 June each year; and
- marketing activities for the sale of the grapes.

35. The Manager must ensure that insurance policies are taken out for the Vineyard Lots and improvements on the Land as well as a public liability insurance policy.

36. The Grower is entitled to terminate the Management Agreement should the Manager breach any term of the Agreement or become insolvent.

37. The Land Owner will use its best endeavours to ensure that there is an adequate water supply for the Vineyard Lots and provide or obtain a ground water licence for approximately two megalitres of water per hectare (clause 14).

### **Pooling and Sale of Grapes**

38. The Grower has appointed Peppermint Springs Management Pty Ltd to market and sell the grapes harvested from the Vineyard Lots.

39. The Management Agreement sets out the circumstances relating to the pooling of Growers' grapes and the distribution of proceeds from that sale. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed grapes from a harvest to the pool making up the proceeds are entitled to benefit from distributions from those proceeds; and
- grapes can only be pooled with the grapes of Growers accepted to participate in the Peppermint Springs Vineyard Project on or before 1 October 2005.

40. The Manager intends to enter into a Grape Sale Agreement on behalf of the Growers to sell all of the grapes produced from the Project (clause 39).

41. Under the Management Agreement the Grower is required to pay the Manager a Project Management Fee of 3.85% of the gross grape revenue to which the Grower is entitled under the Grape Sale Agreement. The balance of the proceeds of sale, net of the Project Management Fees, will be held by the Manager and paid into a separate account. The Grower will be entitled to a distribution of the net sale proceeds based on the percentage that the Grower's Vineyard Lots represent to the total number of vineyard lots harvested in the Project in that season. Only Growers who have contributed grapes from a harvest to the pool are entitled to share in the proceeds of sale.

### **Fees**

42. Under the Management Agreement and the Lease Agreement the fees payable by a Grower in the first three years of the Project for one Vineyard Lot are as set out in the Table below:

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	<b>Year ended 30 June 2006</b>	<b>Year ended 30 June 2007</b>	<b>Year ended 30 June 2008</b>
Management Fees	\$43,450	\$8,800	\$8,800 (indexed)
Installation of irrigation	\$7,150		
Landcare Services	\$1,650		
Trellising	\$8,800		
Planting	\$3,025		
Project Management Fees		3.85% of gross grape revenue	3.85% of gross grape revenue
Rent	\$22.92 per month, or part thereof	\$275 (indexed)	\$275 (indexed)

43. Fees for the year ended 30 June 2006 are payable on application. Thereafter, the Management Fees and Rent will be payable on 31 October of each financial year.

44. From the financial year ended 30 June 2008 until the end of the Project, the Management fees will be the amount paid in the preceding year adjusted to reflect movements in the CPI.

45. The Rent payable in the financial year ended 30 June 2006 will be \$22.92 per month, depending on the Commencement Date. The Rent payable for all Growers for the financial year ended 30 June 2007 will be the amount of \$275 plus an adjustment for the movement in the CPI or similar index. From the financial year ended 30 June 2008 the Rent payable for all Growers will be the annual Rent paid in the preceding year adjusted to reflect movements in the CPI or similar index.

46. From the financial year ended 30 June 2007 until the end of the Project, the Project Management Fees will be an amount equal to 3.85% of the gross grape revenue to which the Grower is entitled under the Grape Sale Agreement. Project Management Fees will be deducted from the proceeds of sale.

47. Additional fees may be payable to the Manager for costs incurred by the Manager for Additional Services to those listed in the Management Agreement, where the services are required by reason of an unforeseen event or a change of a law or a significant change to horticultural practices (clause 18 of the Management Agreement).

**Finance**

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

49. This Ruling does not apply if the finance arrangement entered into by the Grower 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**

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### **Application of this Ruling**

50. This Ruling applies only to Growers who are accepted to participate in the Project on or after the date this Ruling is made and before 1 October 2005. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

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

#### ***Division 328***

51. To be an 'STS taxpayer' a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an 'STS taxpayer'. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different under the STS where the Grower uses the cash accounting method.

## **Qualification**

52. 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.

## **25% Entrepreneurs tax offset**

### *Subdivision 61-J*

53. Subdivision 61-J of the ITAA 1997 provides a tax offset of up to 25% of the income tax liability related to the business income of a business in the STS with annual group turnover of less than \$75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

## **Assessable income**

### **Section 6-5**

54. 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.

55. Other than Growers referred to in paragraph 56, a Grower will be assessable on ordinary income from carrying on their business of viticulture in the income year in which that income is derived.

56. A Grower who is an 'STS taxpayer' using the cash accounting method will be assessable on ordinary income from carrying on their business of viticulture in the income year in which that income is received.

## **Deductions for Management Fees, Project Management Fees and Rent**

### **Sections 8-1 & 328-105**

57. A Grower may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the Table below. The amounts shown are per Vineyard Lot.

58. However, if for any reason, an amount shown or referred to in the Table below is not fully paid in the year in which it is incurred by a Grower who is an 'STS taxpayer' using the cash accounting method, 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 below which is not paid in the year in which it is incurred will be deductible in the year in which it is actually paid.

<b>Fee Type</b>	<b>Year ended 30 June 2006</b>	<b>Year ended 30 June 2007</b>	<b>Year ended 30 June 2008</b>
<b>Management Fees</b>	\$43,450 See Notes (i), (ii) & (iii)	\$8,800 See Notes (i), (ii), (iii) & (iv)	\$8,800 (indexed) See Notes (i), (ii), (iii) & (iv)
<b>Project Management Fees</b>		Amount must be calculated See Notes (i), (ii), (iii) & (iv)	Amount must be calculated See Notes (i), (ii), (iii) & (iv)
<b>Rent</b>	\$22.92 per month or part thereof See Notes (i), (ii) & (iii)	\$275 (indexed) See Notes (i), (ii), (iii) & (iv)	\$275 (indexed) See Notes (i), (ii), (iii) & (iv)

**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 100.
- (ii) Project Management Fees, Management Fees and Rent shown in the Management Agreement and the Lease Agreement are deductible in full in the year that they are incurred where the Grower is not an 'STS taxpayer' or, is an 'STS taxpayer' using the accruals accounting method.
- (iii) Management Fees, Project Management Fees and Rent shown in the Management Agreement and the Lease Agreement are deductible in full in the year that they are paid where the Grower is an 'STS taxpayer' who uses the cash accounting method.

- (iv) This Ruling does not apply to Growers who choose to prepay fees. Amounts that are prepaid for a period that extends beyond the income year in which the expenditure is incurred may be subject to the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936. Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.

## **Deductions for capital expenditure**

### ***Division 40 and Subdivision 328-D***

#### *Non-STs taxpayers*

59. A Grower who is not an 'STs taxpayer' will also be entitled to tax deductions relating to trellising, irrigation, a 'landcare operation' and the establishment and decline in value of grapevines as outlined in the following Table.

#### *STs taxpayers*

60. A Grower who is an 'STs taxpayer' will also be entitled to tax deductions relating to trellising, irrigation, a 'landcare operation' and the establishment and decline in value of grapevines.

61. Deductions relating to the 'cost' of trellising must be determined under Division 328. An 'STs taxpayer' may claim deductions in relation to irrigation under Subdivision 40-F and in relation to a 'landcare operation' under Subdivision 40-G. If the irrigation or 'landcare operation' 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.

62. The deductions shown in the following Table assume that a Grower has either chosen to or can only claim deductions for expenditure on irrigation or a 'landcare operation' under Subdivisions 40-F or 40-G 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 (vii) and (viii).

Fee Type	ITAA 1997 Section	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
<b>Trellising</b>	40-25  <b>STS taxpayers</b> 328-185 & 328-190	Amount must be calculated See Notes (i) & (v)  <b>STS taxpayers</b> \$1,320 See Notes (i) & (vi)	Amount must be calculated See Notes (i) & (v)  <b>STS taxpayers</b> \$2,244 See Notes (i) & (vi)	Amount must be calculated See Notes (i) & (v)  <b>STS taxpayers</b> \$1,571 See Notes (i) & (vi)
<b>Irrigation</b>	40-515	\$2,383 See Notes (i) & (vii)	\$2,383 See Notes (i) & (vii)	\$2,383 See Notes (i) & (vii)
<b>Landcare operations</b>	40-630	\$1,650 See Notes (i) & (viii)	Nil	Nil
<b>Establishment of grapevines</b>	40-515	Nil See Note (ix)	To be calculated See Note (ix)	To be calculated See Note (ix)

**Notes:**

- (v) For non-STS taxpayers trellising is a 'depreciating asset'. Each Grower's interest in the trellising is a 'depreciating asset'. The 'cost' of the asset is the amount of \$8,800 per Vineyard Lot 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. For Growers who enter the Project from the date this Ruling is made, the trellising will be installed and first used during the year ended 30 June 2006. The Manager will advise Growers when that occurs to enable Growers to calculate the deduction for the decline in value.
- (vi) For STS taxpayers, 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 of \$8,800 per Vineyard Lot paid by each Grower. The tax deduction allowable is determined in the year ended 30 June 2006 by multiplying the 'cost' of the interest by half the 'general STS pool' rate, that is 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 2006 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.

- (vii) 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 for water facilities is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one-third of the capital expenditure of \$7,150 per Vineyard Lot 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 40-450).

For STS taxpayers, if the expenditure is on a 'depreciating asset' the Grower may choose to claim the deduction for irrigation expenditure under Subdivision 328-D. The taxation deduction allowable in the year ended 30 June 2006 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the income year, the depreciating asset is allocated to the relevant STS pool and in subsequent years the full pool rate will apply.

- (viii) Capital expenditure of \$1,650 per Vineyard Lot incurred for a 'landcare operation' (as defined in section 40-635) is fully deductible in the year it is incurred under Subdivision 40-G, section 40-630.

For STS taxpayers, if the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim the deduction for landcare operations under Division 328. The tax deduction 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.

- (ix) Grapevines meet the definition of a 'horticultural plant' in subsection 40-520(2). As Growers hold the land under a lease, 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 of \$3,025 per Vineyard Lot 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 Manager will inform Growers of when the grapevines enter their first commercial season.

### **Interest**

63. 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 87 to 90 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 – exercise of Commissioner's discretion***

64. A Grower who is an individual accepted into the Project by 1 October 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 these Growers for the income years ending **30 June 2006 to 30 June 2008**. 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.

### **Sections 82KZME, 82KZMF and 82KL and Part IVA**

65. 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 and 82KZMF (but see paragraphs 87 to 90);
- 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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### Corporations Act 2001

66. For this Ruling to apply, an offer for an interest in the Project must: be an offer which qualifies as a small scale offering as defined in section 1012E of the *Corporations Act 2001*. Small scale offers do not require a prospectus or product disclosure statement.

67. Under section 1012E, a Grower may participate in the project by accepting a 'personal offer' for an interest in the project. Offers made under section 1012E cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than \$2 million dollars (subsection 1012E(2)).

68. An offer will be a 'personal offer' where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 1012E(5)).

### Is the Grower carrying on a business?

69. For the amounts set out in the Tables in paragraphs 58 and 62 to constitute allowable deductions the Grower's viticulture activities as a participant in the Peppermint Springs Vineyard Project must amount to the carrying on of a business of primary production.

70. Where there is a business, or a future business, the gross proceeds from the sale of the grapes will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

71. For schemes such as that of the Peppermint Springs 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 *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

72. 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 from those grapevines;

- 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.

73. In this Project, each Grower enters into a Management Agreement and a Lease Agreement.

74. Under the Lease Agreement each individual Grower will have rights over a specific and identifiable area of land known as Vineyard Lots. The Lease Agreement provides the Grower with an ongoing interest in the specific grapevines on the leased Vineyard Lots for the term of the Lease Agreement. Under the Lease the Grower must use the land in question for the purpose of carrying out viticulture activities, and for no other purpose. The Lease allows the Manager to come on to the land to carry out its obligations under the Management Agreement.

75. Under the Management Agreement the Manager is engaged by the Grower to establish and maintain the vines on the Grower's Vineyard Lots during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the Vineyard Lots on the Grower's behalf.

76. The Manager is also engaged to harvest and sell, on the Grower's behalf, the grapes grown on the Grower's Vineyard Lots.

77. 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.

78. 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 grapes 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.

79. The pooling of grapes grown from the Grower's Vineyard Lots 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 Lots.

80. The Manager's services are also consistent with general viticulture practices. They are of the type ordinarily found in viticulture ventures that would commonly be said to be businesses. While the size of a Vineyard Lot is relatively small, it is of a size and scale to allow it to be commercially viable.

81. The Grower's degree of control over the Manager as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's Vineyard Lots and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

82. 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 Peppermint Springs Vineyard Project will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

83. 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.

84. Changes to the STS rules apply from 1 July 2005. 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, Project Management Fees and Rent**

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

85. Consideration of whether the Management Fees, Project Management Fees and Rent 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.

86. The Management Fees, Project Management Fees and Rent 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 harvesting and 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.

### **Prepayment provisions**

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

87. 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.

#### *Application of the prepayment provisions to this Project*

88. Under the Arrangement to which this Product Ruling applies Management Fees and Rent are incurred annually. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF have no application to this Arrangement. A Grower who is an 'STS taxpayer' and uses the cash accounting method can, therefore, claim a deduction for each of the relevant amounts in the income year in which the amount is paid, or paid on their behalf. Alternatively, a Grower who is not an 'STS taxpayer' using the cash accounting method can claim a deduction for each of the relevant amounts in the income year in which the fee is incurred.

89. However, sections 82KZME and 82KZMF may have relevance if a Grower in this Project prepays all or some of the expenditure payable under the Management Agreement and/or the Lease Agreement or prepays interest under a loan agreement. Where such a prepayment is made these prepayment provisions will also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

90. As noted in the Ruling section above, Growers who prepay fees or interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in this Project.

## **Expenditure of a capital nature**

### ***Division 40 and Division 328***

91. 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, irrigation, a 'landcare operation', 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.

92. 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'.

93. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 62 including the Table and accompanying Notes.

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

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

94. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years 30 June 2006 to 30 June 2008 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 2006 up to and including 30 June 2008:

- it is because of its nature the business activity of a Grower 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 viticulture 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.

95. 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 – recouped expenditure**

96. 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**

97. 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).

98. The Peppermint Springs 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 58 and 62 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.

99. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the grapes. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing 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.

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**Example****Entitlement to GST input tax credits**

100. 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 2004, 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 1/1/2005 to 30/6/2005	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2005 (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 2005, 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**

13 July 2005

*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

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

*Subject references:*

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

*Legislative references:*

- ITAA 1936 82KL  
 - ITAA 1936 Pt III Div 3 Subdiv H  
 - ITAA 1936 82KZL  
 - ITAA 1936 82KZM  
 - ITAA 1936 82KZMA  
 - ITAA 1936 82KZMB  
 - ITAA 1936 82KZMC  
 - ITAA 1936 82KZMD  
 - ITAA 1936 82KZME  
 - ITAA 1936 82KZMF  
 - ITAA 1936 Pt IVA  
 - ITAA 1936 177A  
 - ITAA 1936 177C  
 - ITAA 1936 177D  
 - ITAA 1936 177D(b)  
 - ITAA 1997 6-5  
 - ITAA 1997 8-1  
 - ITAA 1997 17-5  
 - ITAA 1997 Div 27  
 - ITAA 1997 Div 35  
 - ITAA 1997 35-10  
 - ITAA 1997 35-10(2)  
 - ITAA 1997 35-55  
 - ITAA 1997 35-55(1)(b)  
 - ITAA 1997 Div 40  
 - ITAA 1997 40-25  
 - ITAA 1997 40-70(1)  
 - ITAA 1997 40-75(1)  
 - ITAA 1997 40-100  
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  - ITAA 1997 40-530
  - ITAA 1997 40-545
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  - ITAA 1997 40-630
  - ITAA 1997 40-635
  - ITAA 1997 Subdiv 61-J
  - ITAA 1997 Div 328
  - ITAA 1997 328-105
  - ITAA 1997 Subdiv 328-D
  - ITAA 1997 328-185
- ITAA 1997 328-190
  - ITAA 1997 Subdiv 328-F
  - ITAA 1997 Subdiv 328-G
  - TAA 1953 Pt IVAAA
  - Copyright Act 1968
  - Corporations Act 2001
  - Corporations Act 2001 1012E
  - Corporations Act 2001 1012E(2)
  - Corporations Act 2001 1012E(5)

*Case references:*

- Commissioner of Taxation v. Lau (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55

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