



PR 2005/95 - Income tax: Limestone Coast Vignettes Project - 2005 Mature Vignette Owners (to 30 June 2005)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *22 June 2005*



Product Ruling

Income tax: Limestone Coast Vignettes Project – 2005 Mature Vignette Owners (to 30 June 2005)

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Potential participants may wish to refer to the Tax Office website at 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

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the 'Limestone Coast Vignettes Project', or 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 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* (ITAA 1936);
- section 82KZME and 82KZMF of the ITAA 1936; and
- Part IVA of the 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 an Owner) 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 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 'Owners'.

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 the Ruling is made;
- persons who are accepted to participate in the Project after 30 June 2005;
- persons who participate in the Project through offers made other than through the Product Disclosure Statement; and
- 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

11. This Ruling applies prospectively from 22 June 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 that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2007. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

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

- Application for Product Ruling as constituted by documents provided on 5, 7 and 20 April 2005, 13, 18, 20 and 27 May 2005 and 9 June 2005 and additional correspondence dated 6 April 2005, 9, 11, 13, and 18 May 2005 and 9 June 2005;
- Draft Product Disclosure Statement ('PDS'), which includes the **Licence Agreement** and the **Sale Agreement** for the Limestone Coast Vignettes Project, received 9 June 2005;
- Draft **Constitution** of the Limestone Coast Vignettes Project, received 9 June 2005;
- Draft Constitution of LC Land Proprietary Limited, received 5 April 2005;

- Draft Compliance Plan for the Limestone Coast Vignettes Project, received 5 April 2005;
- Draft Custodian Agreement for the Limestone Coast Vignettes Project between Ironstone RE Limited (as Responsible Entity) and the Custodian, received 5 April 2005;
- Draft Resolution Agreement between Ironstone RE Limited and the Joint Venturer, received 5 April 2005;
- Joint Venture Agreement between Ironstone RE Limited and the Joint Venturer, dated 21 May 2004;
- Option Agreement between the Landowner and the Joint Venturer, received 5 April 2005;
- Draft Standby Option Agreement between the Landowner and the Ironstone RE Limited, received 5 April 2005;
- Draft Contract for the Sale and Purchase of Land between the Landowner and the Joint Venturer, received 5 April 2005;
- Draft Nomination Agreement between the Landowner, Joint Venturer and LC Land Proprietary Limited, received 5 April 2005;
- Draft Memorandum of Underlease for the Limestone Coast Vignettes Project between the Lessor and LC Land Proprietary Limited (as Underlessee), received 5 April 2005;
- Draft Community Title documents including the, Scheme Description, By-Laws, Plan of Community Division, Application for Opinion and the Development Contract between Ironstone RE Limited and LC Land Proprietary Limited (as Developer), received on 5 April 2005;
- Draft Grape Purchase Agreement between the Lessor and Ironstone RE Limited, received 27 May 2005; and
- Draft Vineyard Management Agreement between the Vineyard Manager and Ironstone RE Limited, received 9 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 the Freedom of Information legislation.

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

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 main features of Limestone Coast Vignettes Project – 2005 Mature Vignette Owners (to 30 June 2005) are as follows:

Location	Elgin Valley, South East region of South Australia
Type of business to be carried on by each participant	Commercial growing of wine grapes for the purpose of harvesting and selling the produce.
Number of hectares offered for cultivation	21.4
Size of each interest	0.05 hectares
Number of vines per hectare	Approximately 2,020 vines per hectare.
Term of the Project	Indefinite.
Initial cost	\$6,160 (includes an amount for the purchase of land and project management expenses).
Initial cost per hectare	\$123,200
Ongoing costs per Vignette	Annual Operating Costs.

18. The Limestone Coast Vignettes Project is located on the Elgin Valley property, 20 kms east north east of Beachport in South Australia. Each participant in the Project will acquire, after a process of subdivision, an equitable (or legal and equitable) interest in two or more 0.05 hectare community lots ('Vignettes') in a community title scheme for the purpose of commercial growing and sale of wine grapes.

19. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. Ironstone RE Pty Limited ('IRE') has been issued with an Australian Financial Service Licence and will be the Responsible Entity for the Project. The term of the Project is indefinite.

20. An offer to participate in the Project will be made through a Product Disclosure Statement ('PDS') offering 920 'Development Vignettes' and up to 428 'Mature Vignettes' for sale. Participants ('Owners') will be invited to subscribe for the purchase of Development Vignettes and/or Mature Vignettes. Owners must apply to purchase at least 2 Vignettes, whether Development Vignettes or Mature Vignettes, or a combination of both. **This Ruling only applies to participants whose application to purchase a Mature Vignette(s) is accepted on or before 30 June 2005.**

21. To participate in the Project, Owners must complete the Application and Power of Attorney Form in the PDS and pay the 'Application Money'.

22. The minimum subscription required under the PDS is 1,000 Vignettes. If the minimum subscription is not reached within 4 months after the issue of the PDS, IRE will refund the 'Application Money' and the Project will not proceed.

Constitution

23. The Constitution for the Project sets out the general functions, powers and duties under which the Responsible Entity agrees to act for the Owners and to manage the Project. Upon acceptance into the Project, Owners are bound by the Constitution by virtue of their participation in the Project.

24. All scheme property will be held on trust by the Custodian. Scheme property includes the Application Money paid by Owners and proceeds from the sale of grapes pending distribution to the Owners (clause 9 of the Constitution).

25. The Constitution (clauses 35 and 36) and the PDS set out the rules relating to the pooling of Owners' grapes and the distribution of the proceeds from the sale of each pool. The grapes from the Mature Vignettes will only be pooled with the grapes from the Development Vignettes when the Development Vignettes reach their fifth year of development.

26. The net proceeds from each pool will be distributed to the Owners on the last day of the financial year for which the net proceeds were calculated. Owners are entitled to a share of proceeds in each pool to which they have contributed. The Owner's share of the pool, is based on the proportion of the grapes contributed from their Vignettes in relation to the total pool. The Owner's entitlement in relation to the sales proceeds will be reduced accordingly in the event of total or partial destruction of the vines/grapes on their Vignettes.

27. If an Owner fails to contribute to operating expenses or is otherwise in breach of their obligations then IRE may upon written notice to the Owner:

- suspend services to all or any of the Vignettes owned by the Owner;

- recover IRE's time charges for executives at \$100 per hour (subject to CPI increase) and costs necessarily incurred in respect of the forfeiture;
- recover interest on the unpaid amount at the highest overdraft rate then charged by the MIS principal bankers to its customers;
- deduct the contribution and interest from any distribution otherwise payable to the Owner and apply that amount towards satisfaction of the contribution and interest;
- sue for the contribution and interest; and/or
- if the intention has been declared in the written notice, at any time until the matter is rectified declare the interest to be forfeited.

28. After an Interest is forfeited IRE should:

- give to the Owner notice of the forfeiture;
- record the forfeiture and its date in the register of members; and
- either cancel the Interest or sell the Interest to any person willing to purchase at fair market value.

By signing the Application and Power of Attorney Form attached to the PDS, each Owner appoints any director of IRE as their attorney to sell their forfeited Interest.

Compliance Plan

29. The Responsible Entity has prepared a Compliance Plan in accordance with the *Corporations Act 2001*. Under the Compliance Plan, a Compliance Committee will monitor to ensure the Responsible Entity meets its obligations as the Responsible Entity of the Project and the rights of the Owners are protected.

Land and Water Allocation purchase

30. The Project Land is currently owned by the Landowner. The Land is currently leased by the Lessor. IRE has entered into a Joint Venture Agreement with the 'Joint Venturer' to establish the Project. The Joint Venturer has been granted an option to purchase the land and water allocations under an Option Agreement between the Joint Venturer and the Landowner. The option must be exercised before 30 June 2006. Under the Joint Venture Agreement IRE will subdivide the land which will be the subject of a community title scheme under the South Australian *Community Titles Act 1996*.

31. The Joint Venturer will exercise the option to purchase the land upon minimum subscription for the Project being reached. The Joint Venturer has nominated LCL Land Pty Ltd ('LCL') to hold the legal title of the land as bare trustee on trust for the Joint Venturer. The option may be exercised over the whole of the property or a portion thereof. If the option is only exercised over a portion of the property, the Joint Venturer may exercise the option again in relation to the remaining land.

32. After the settlement of the sale of land and water allocations to LCL (as trustee for the Joint Venturer), LCL (as appointed by IRE) will lodge a community plan with the Lands Titles Registration Office (South Australia) and subdivide the portion of the land purchased into:

- Vignettes (community lots) of 0.05 hectares each; and
- appropriate areas of common property, to be used for access roads, water bores and sheds.

33. Owners enter into a Sale Agreement with LCL and the Joint Venturer, on application, to purchase the land comprised in the Vignettes allotted to them. The land sale is subject to, amongst other things, the exclusion of grapes growing on the Vignettes at the date of settlement. The sale will be completed after community titles for the Owners' Vignettes issue from the Land Titles Registration Office. LCL will retain legal title to the land as bare trustee of each Owner separately. However, an Owner may require LCL to transfer the legal title of the land into the Owner's name at any time.

34. In the event that the Joint Venturer does not exercise the option to purchase the land, the Landowner has granted IRE an option to purchase the land under the Standby Option Agreement.

Underlease

35. The Lessor's lease over the Project land will be surrendered when the title of the land is transferred from the Landowner to LCL. The Lessor will grant an Underlease to LCL for the period from minimum subscription being reached until the transfer of the land to LCL.

Licence Agreement

36. Owners participating in the Project will enter into a Licence Agreement with LCL for the period from commencement (the later of minimum subscription or when the Owner's application for land is accepted) to so long as LCL retains title to the land. Under the Licence, Owners are permitted to use their Vignettes for the purpose of conducting their wine grape growing business upon the terms and conditions set out in the Licence.

37. The Licence also includes a right to the benefit of any water allocation held by LCL in connection with the land.

Management Agreement

38. Owners participating in the Project will enter into a Management Agreement between IRE and the Owner. The Management Agreement forms part of the Project's Constitution.

39. Under the Management Agreement, the Owner appoints IRE to perform ongoing management services in respect of their Vignettes. The services commence on the allotment of the Owner's interest in the Project and include:

- procuring insurance against public and product liability;
- if required by an Owner and at the Owners own expense, IRE may also negotiate insurance cover for the loss or destruction of the Owner's vines/grapes;
- manage watering, mulching, pruning, salinity, frost protection, stringing and training and pruning of vines, nutrition of vines, replacement of dead or defective vines and also keep down soil or plant diseases, weeds, pests and fire;
- supply such goods and materials as IRE thinks reasonable;
- pay outgoings for rates, taxes, levies, electricity, water, diesel and other consumables. However, IRE will not pay the municipal council rates for an Owner's Vignettes where the legal title of the Vignettes has been transferred to the Owner's name. In this situation, the Owner will be liable to pay its own municipal council rates;
- harvest grapes;
- (as agent for the Owner) sell grapes harvested in such manner (as grapes or, after processing and storage, as bulk juice or wine) and at such times as IRE thinks desirable in order to increase profits or minimise losses; and
- to any extent not otherwise required by law, give to the Owner at least once each calendar year a report on the management of the vineyard (clause 42 of the Constitution).

40. Under the Vineyard Management Agreement, IRE will engage the Vineyard Manager, to carry out the above services on the terms and conditions contained in the agreement. The Vineyard Manager will be subject to the direction of the IRE in matters relating to the Vineyard Management Services.

41. For the services provided the Owner will contribute the annual 'Vineyard Operating Costs', as described at paragraph 44.

Grape purchase

42. The Lessor owns the grapes growing on the land at the date of the exercise of the Land Option. IRE will enter into agreement with the Lessor to purchase these grapes on behalf of the Owners on the exercise of the Land Option.

43. The Grape Sale Agreement will allow IRE to obtain ownership of the grapes and pass that ownership onto the Owners, so that the Owners will own the grapes growing on their Vignettes from the time they are accepted into the Project. The cost of acquiring the grapes will form part of the 'Vineyard Operating Costs' payable by Owners in the year ended 30 June 2006.

Fees

44. The Owner must pay the following amounts to the IRE for each Vignette:

- **Application Money** of \$6,160 payable on application. This amount will be applied as follows:
 - \$3,845 to purchase the land; and
 - \$2,315 for project management provided in the year ending 30 June 2006.
- **Vineyard Operating Costs** for the year ending 30 June 2006 payable 30 days after IRE notifies the Owner of the estimated costs of that year.

The Vineyard Operating Costs are then due annually in advance on 1 July, commencing on 1 July 2007. Owners will be notified of the estimated costs at about May of each year before each due date.

If the actual costs for a year exceed the estimated costs for the year, IRE may recoup the shortfall in the following year's contribution of Vineyard Operating Costs, or require Owners to pay the shortfall by 30 June. If current year actual costs are less than total estimates, IRE will credit the excess against the next financial year's contribution to operating costs.

Finance

45. Owners can fund their involvement in the Project themselves or borrow from an independent lender. Owners are required to obtain their own finance for the Project.

46. This Ruling also does not apply if an Owner enters into an agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved in the provision of finance to Owners for the Project.

Ruling

Application of this Ruling

47. Subject to paragraph 8, this Ruling applies only to Owners who are accepted to participate in the Project on or before 30 June 2005 and who have been accepted into the Project on or before that date. The Owner's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

48. An Owner is not eligible to claim any tax deductions until the Owner's application to enter the Project is accepted and the Project has commenced. Under the terms of the PDS, an Owner's application will not be accepted until the minimum subscription of 1,000 Interests is achieved.

The Simplified Tax System (STS)***Division 328***

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

Qualification

50. This Product Ruling assumes that an Owner who is an STS taxpayer is so for the income year in which their participation in the Project commences. An Owner may become an STS taxpayer at a later point in time. Also, an Owner 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 Owners that cannot be accommodated in this Ruling. Such Owners can ask for a private ruling on how the taxation legislation applies to them.

25% Entrepreneurs tax offset***Subdivision 61-J***

51. For the first income year starting on or after 1 July 2005, Subdivision 61-J of the ITAA 1997 provides a 25% tax offset of 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 and section 328-105***

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

53. Other than Owners referred to in paragraph 54, for the 2005-06 income year and later years, an Owner will be assessable on ordinary income from carrying on their business of viticulture in the income year in which that income is derived.

54. For the 2005-06 income year and later years, an Owner 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 the Application Money and Vineyard Operating Costs***Section 8-1 and section 328-105***

55. An Owner may claim deductions, on a per Vignette basis, for the revenue expenses in the following Table.

56. 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 an Owner who is an STS taxpayer (for the 2005 income year) or an 'STS taxpayer' using the cash accounting method (for the 2006 and 2007 income years), then the amount is only deductible to the extent to which it has been paid, or has been paid for the Owner. 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.

Fee Type	Year ended 30 June 2005	Year ended 30 June 2006	Year ended 30 June 2007
Land Purchase	Nil – See Note (ii)		
Project management expenses		Nil – See Note (ii)	
Vineyard Operating Costs	Nil	As advised by IRE See Notes (i) & (iii)	As advised by IRE See Notes (i) & (iv)

Notes:

- (i) If the Owner 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 104.
- (ii) The amounts paid on application for the purchase of land, and the Project management expenses are capital in nature and not deductible under section 8-1.
- (iii) The Vineyard Operating Costs notified to the Owner by IRE for the year ending 30 June 2006, are deductible to the extent they are not for the purchase price for unharvested grapes. IRE will advise Owners of the deductible amount, that is, the amount that excludes the purchase price of the grapes.

The amount of the deduction advised by IRE is deductible in full in the year that it is incurred where the Owner is not an STS taxpayer or, is an STS taxpayer using the accruals accounting method.

For an Owner who is an STS Taxpayer who uses the cash accounting method, the amount advised by IRE is deductible in full in the year that it is paid.

- (iv) The Vineyard Operating Costs notified to the Owner by IRE for the year ending 30 June 2007 are deductible in full in the year that they are incurred where the Owner is not an STS taxpayer or, is an STS taxpayer using the accruals accounting method.

For an Owner who is an STS Taxpayer who uses the cash accounting method, the Vineyard Operating Costs are deductible in full in the year that it is paid.

However, if an Owner chooses to prepay fees for the doing of a thing (for example, the provision of management services) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee must be determined using the formula shown in paragraph 85 unless the expenditure is 'excluded expenditure'.

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

Interest

57. The deductibility or otherwise of interest incurred by Owners 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 Owners who borrow funds in order to participate in the Project should read the discussion of the prepayment rules in paragraphs 79 to 86 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 Owner's choice.

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

Section 35-55 – exercise of Commissioner's discretion

58. An Owner who is an individual accepted into the Project by 30 June 2005 may have losses arising from their participation in the Project that must be deferred to a later income year under section 35-10.

59. Under paragraph 35-55(1)(b) the Commissioner may decide that the rule in section 35-10 does not apply to this activity provided that it is because of the nature of the business activity that it has not yet satisfied one of the tests set out in sections 35-30, 35-35, 35-40 or 35-45. However, for this Project, the Commissioner is not satisfied that it is because of the nature of the business activity that it will not satisfy one of those tests. Hence the requirements of subparagraph 35-55(1)(b)(i) are not met.

60. **Therefore, the Commissioner will not exercise the discretion under paragraph 35-55(1)(b) of the Act in relation to this Project for the year ended 30 June 2005. Accordingly a deduction for a loss made by an individual from this Project will not be taken into account in the income year ended 30 June 2005 and is required to be deferred until the activity passes one of the tests referred to in paragraph 59 (see Explanation at paragraphs 90 to 99).**

Section 82KL and Part IVA

61. For an Owner who participates in the Project and incurs expenditure as required by the Constitution 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

Is the Owner carrying on a business?

62. For the amounts set out in the Table in paragraph 56 to constitute allowable deductions the Owner's viticulture activities as a participant in the Limestone Coast Vignettes Project must amount to the carrying on of a business of primary production. These viticulture activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

63. For schemes such as this Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Owner'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.

64. Generally, an Owner will be carrying on a business of viticulture, and hence primary production, if:

- the Owner has an identifiable interest in the land (by lease) or rights over the land (by licence) on which the Owner's vines are established;
- the Owner has a right to harvest and sell the grapes each year from those vines;
- the viticulture activities are carried out on the Owner's behalf;
- the viticulture activities of the Owner 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.

65. In this Project, each Owner enters into a Licence Agreement, Sale Agreement and a Management Agreement.

66. Under the Licence Agreement and Sale Agreement each individual Owner will have rights over the land on which the vines will be planted. The Licence Agreement together with the Sale Agreement provides the Owner with an ongoing right to the vines for the term of the Project. Under the Licence Agreement and Sale Agreement the Owner must use the land in question for the purpose of carrying out viticultural activities and for no other purpose. The agreements allow IRE as Manager to come onto the land to carry out its obligations under the Management Agreement.

67. Under the Management Agreement IRE is engaged by the Owner to maintain a Vignette 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 maintain the Vignette on the Owner's behalf.

68. IRE is also engaged to harvest and sell, on the Owner's behalf, the grapes grown on the Owner's Vignette.

69. 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.

70. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, an Owner in the Project will derive assessable income from the sale of its 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.

71. The pooling of grapes grown on the Owner's Vignette with the grapes of other 'Owners' is consistent with general viticulture practices. Each Owner's proportionate share of the sale proceeds of the pooled grapes will reflect the proportion of the grapes contributed from their Vignette.

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

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

74. 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 Owners viticulture activities in the Limestone Coast Vignettes Project – 2005 Mature Vignette Owners (to 30 June 2005) will constitute the carrying on of a business.

The Simplified Tax System

Division 328

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

76. Changes to the STS rules apply from 1 July 2005. The question of whether an Owner is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Owner 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'.

Deductions for Vineyard Operating Costs

Section 8-1

77. Consideration of whether Vineyard Operating Costs 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.

78. The Vineyard Operating Costs associated with the viticulture activities will relate to the gaining of income from the Owner's business of viticulture (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of grapes) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. Other than the amount paid for unharvested grapes, there is no capital component found in the Vineyard Operating Costs. 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

79. 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.

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

Sections 82KZME and 82KZMF

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

82. 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;
- 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.

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

84. There are a number of exceptions to these rules, but for Owners 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 Owners in this Project, excluded expenditure is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

85. 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.

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

86. 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

87. Where Owners elect to pay the Vineyard Operating Costs in accordance with the relevant agreements or deeds, these amounts are not prepaid. These amounts are charged for management services until 30 June of the year in which the amounts are incurred.

88. Consequently, the Vineyard Operating Costs are deductible in full in the year that they are incurred where the Owner is not an STS taxpayer or, is an STS taxpayer using the accruals accounting method.

89. For an Owner who is an STS taxpayer who uses the cash accounting method, the Vineyard Operating Costs are deductible in full in the year that it is paid.

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

Section 35-55 – exercise of Commissioner's discretion

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

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

91. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

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

93. The 'exception' under subsection 35-10(4) to the general rule in subsection 35-10(2), applies where the loss is from a primary production business activity and is not relevant for the purposes of this Ruling. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

94. An Owner who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that the business activity of an Owner who acquires one Vignette in the Project during the year ending 30 June 2005, is unlikely to pass one of the tests.

95. Therefore, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Owner's participation in this Project.

96. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised where:

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

97. If a business activity does not meet all three requirements above then the Commissioner is not able to exercise the second arm of the discretion in paragraph 35-55(1)(b). The meaning of the phrase 'because of its nature' is discussed in Taxation Ruling TR 2001/14. Paragraph 35-55(1)(b) is intended to cover a business activity that because of its nature has a lead time, usually a number of years, between the commencement of the activity and the production of any assessable income.

98. Where a business activity is by its nature capable of producing income relatively soon after commencing it is generally not possible to conclude that the second requirement is satisfied, and hence, that the business activity is eligible for an exercise of the second arm of the discretion.

99. An initial inability to satisfy one of the tests must be due to an innate or inherent feature of the industry overall, or well recognised segments in it, rather than just isolated business activities within that industry. The viticulture business activity covered by this Ruling is capable of producing assessable income relatively soon after commencing, and therefore does not satisfy subparagraph 35-55(1)(b)(i). **The Commissioner will not exercise the second arm of the discretion in subsection 35-55(1) in relation to the business activity. Accordingly a deduction for a loss made by an individual from this Project will not be taken into account in the income year ended 30 June 2005 and is required to be deferred until the activity passes one of the tests set out above.**

Section 82KL – recouped expenditure

100. 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

101. 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).

102. The Limestone Coast Vignettes Project – 2005 Mature Vignette Owners (to 30 June 2005) will be a 'scheme'. An Owner will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 55 to 56 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.

103. Owners 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 Owners 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.

Examples

Example – entitlement to GST input tax credits

104. 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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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; IT 360

Subject references:

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

Legislative references:

- TAA 1953 Pt IVA
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)

- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 35-55(1)(b)(i)
- ITAA 1997 Div 40
- ITAA 1997 40-535
- ITAA 1997 Subdiv 61-J
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
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- ITAA 1936 82KZMD
- ITAA 1936 82KZME
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- ITAA 1936 Pt IVA
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- ITAA 1936 177D
- ITAA 1936 177D(b)
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- Corporations Act 2001
- Community Titles Act 1996 (SA)

Case references:

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

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