

PR 2006/6 - Adelaide Hills Premium Vineyard Project - Late 2006 Farmers

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 March 2006*



Product Ruling

Income tax: Adelaide Hills Premium Vineyard Project – Late 2006 Farmers

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ⓘ This Ruling provides you with the following level of protection:
This publication (excluding appendices) is a public ruling for the purposes of the *Taxation Administration Act 1953*.
A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.
If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any under-paid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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 scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document.

If the scheme 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 scheme 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 scheme has been implemented as described below and to ensure that the participants in the scheme 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 Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'taxation provision(s)' identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Ruling this scheme is referred to as the 'Adelaide Hills Premium Vineyard Project' or simply as 'the Project'.

Relevant taxation provision(s)

2. The relevant taxation provision(s) 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;
- Part 3-1 of the ITAA 1997;
- section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KL of the ITAA 1936;
- section 82KZL of the ITAA 1936;
- sections 82KZME and 82KZMF of the ITAA 1936; and
- Part IVA of the ITAA 1936.

Class of entities

3. The class of entities to which this Ruling applies is the entities more specifically identified in the Ruling part of this Product Ruling and who enter into the scheme 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 entities are referred to as 'Farmers'.

4. The class of entities to whom this Ruling applies does not include:

- Farmers who intend to terminate their involvement in the arrangement prior to its completion or otherwise do not intend to derive assessable income from it;
- Farmers who participate in the Project through offers made other than through the Product Disclosure Statement;
- Australian Hardwood Management and its associates;
- Farmers who are accepted into the Project after 5 May 2006; or
- Farmers who were accepted into the Project prior to the date of issue of this Product Ruling. This includes Farmers who subscribed for Interests pursuant to a previous prospectus dated 24 May 2001.

Qualifications

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 12 to 50.

6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Goods and Services Tax

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

Date of effect

9. This Ruling applies prospectively from 1 March 2006, 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).

10. 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

11. 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 entities within the specified class who enter into the scheme specified below. Thus, the Ruling continues to apply to those entities, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entities' involvement in the scheme.

Scheme

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

- Application for a Product Ruling as constituted by documents provided on 24 October 2005 and 13 December 2005;

- Product Disclosure Statement & Prospectus 2005 issued on 5 April 2005 for the Adelaide Hills Premium Vineyard Project and Adelaide Hills Investments Limited, received 24 October 2005;
- Draft Supplementary Product Disclosure Statement for the Adelaide Hills Premium Vineyard Project, received 24 October 2005;
- **Fourth Replacement Constitution for the Adelaide Hills Premium Vineyard Project, between Australian Hardwood Management ('Responsible Entity') and each 'Farmer', received 24 October 2005. This includes the Farming Agreement;**
- Instrument Modifying Second Replacement Constitution for the Adelaide Hills Premium Vineyard Project, received 24 October 2005;
- Independent Viticulture Report dated 29 October 2004, received 24 October 2005;
- Deed between Australian Hardwood Management and various parties outlining various land options, received 24 October 2005; and
- Replacement Compliance Plan for The Adelaide Hills Premium Vineyard Project, received 24 October 2005.

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

13. The documents highlighted are those that Farmers 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 Farmer, or any associate of a Farmer, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows.

14. 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.

15. The salient features of the Adelaide Hills Premium Vineyard Project are as follows:

Location	Gumeracha in South Australia
Type of business to be carried on by each participant	A commercial viticulture and wine production business for a period of 17 years.
Number of hectares under cultivation	22.7 hectares
Size of each Farm	0.1 hectares
Number of vines per Farm	247
Initial cost of a Farm	Maximum of \$9,419 (includes prepaid fees)
Subscription for one Share in the Landholder	\$1,600 payable on application with a further \$2,400 payable in 2010
Ongoing costs	Farm Occupation Fee Annual Management Fee
Other costs	Administration Fee Insurance Harvesting costs Grape levy

16. The Project currently has 40 Interests issued to Farmers who subscribed for Interests pursuant to a previous prospectus dated 24 May 2001 equivalent to approximately 16 hectares. These Farmers are the subject of a separate Farming Agreement in the form set out in the Project's Constitution with respect to their allotments.
This Ruling does not apply to these Farmers.

17. The Project is registered as a Managed Investment Scheme under the *Corporations Act 2001*. The Responsible Entity for this Project is Australian Hardwood Management. The Project land is situated in the Adelaide Hills near Gumeracha in South Australia.

18. Under the Supplementary Product Disclosure Statement and the Product Disclosure Statement & Prospectus 2005 (jointly referred to in this Ruling as the 'Offer Documents') applicants are required to apply for a stapled product consisting of an Interest in the Project and 4000 partly paid shares in the landowner, Adelaide Hills Investments Ltd. Upon acceptance applicants (called Farmers) will enter into the Constitution, which includes the Farming Agreement, with the Responsible Entity. The Responsible Entity will grant a licence to the Farmer to enable them to carry on a business of producing wine grapes. Under the Farming Agreement, Farmers licence an area of land called a 'Farm' for a term of approximately 17 years. Each Farm consists of a minimum of one Interest which is 0.1 hectares in size.

19. Under the Farming Agreement, Farmers appoint the Responsible Entity as Manager to manage their Farm. The Manager will perform the services required under the Farming Agreement and will be responsible for the establishment, cultivation, harvesting and sale of the grapes.

20. Under the Offer Documents the Responsible Entity will offer a maximum of 336 Farms. There are 10.9 hectares of Farms that have previously been subscribed for under the Product Disclosure Statement & Prospectus 2005. Farmers who subscribed for these Farms are not the subject of this Product Ruling but may be covered by Product Rulings PR 2005/57 or PR 2005/58 (see below). This Product Ruling only applies to the remaining 227 Farms. The minimum subscription for the Project of 80 Farms was met prior to the issue of this Product Ruling. Each participant may subscribe for one or more Farms at the cost outlined in the table at paragraph 15.

21. Under the Offer Documents participants have entered or may enter the Project between:

- 27 April 2005 and 31 May 2005. Participants may be covered by Product Ruling PR 2005/57;
- 1 July 2005 and 30 November 2005. Participants may be covered by Product Ruling PR 2005/58; or
- between the date of this Ruling and on or before 5 May 2006. Participants may be covered by this Product Ruling.

22. Under the stapled offer, for each Farm subscribed a Farmer must also subscribe for 4000 Ordinary Shares in Adelaide Hills Investments Limited. The shares are required to be partly paid to 40 cents per share with the balance of 60 cents per share payable by 30 June 2010.

Constitution

23. The Constitution establishes the Project and operates as a deed binding on each of the Farmers severally and the Responsible Entity. The Constitution sets out the terms and conditions under which Australian Hardwood Management agrees to act as the Responsible Entity for the Project. The Farming Agreement (included as Schedule 5 of the Constitution) will be executed on behalf of each Farmer following acceptance of the application by the Responsible Entity. Farmers are bound by the Constitution by virtue of their participation in the Project.

24. Under the terms of the Constitution, all monies received from applications shall be paid to the Responsible Entity. The Responsible Entity shall deposit those moneys into an Applications Bank Account held in the name of the Responsible Entity. The application monies will be released by the Responsible Entity into the Project Bank Account if the application is accepted and the minimum subscription of 80 Farms is met (clause 15.7 of the Constitution).

Compliance Plan

25. As required by the Corporations Act, a Compliance Plan has been prepared by Australian Hardwood Management. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Farmers are protected.

Farming Agreement

26. Each Farmer participating in the arrangement will enter into a Farming Agreement with Australian Hardwood Management in its capacity as Responsible Entity of the Project. Under this agreement, Farmers are granted a licence to use their Farm for the purpose of conducting their winegrape growing business subject to certain terms and conditions (clause 3). The licence will commence on the date Farms are allotted to Farmers and will continue until 2022 (clause 2.2). A Farm Occupation Fee is charged to the Farmer for the use of the land for winegrape growing clause 6).

27. Each Farmer appoints the Responsible Entity as manager of their Farming Business to perform the Management Services (clause 4). The Responsible Entity must engage the services of a reputable expert in the field of viticulture and wine production to provide advice and assistance to the Responsible Entity to carry out some or all of these duties (clause 4.8).

28. The Management Services, defined in clause 28.1, include:

- cultivating, fertilising and planting out the Vineyard with cuttings or rootlings in a healthy condition;
- carrying out all work necessary for establishment of the Vineyard to enable the grapes to be grown in accordance with good viticulture practice for the area of the Project including without limitation establishment of any necessary dams or bores, irrigation trellising and land care;
- harvesting the wine grapes from the Vineyard; and
- arranging sales of the wine grapes from the Vineyard including entering into a contract or contracts to supply grapes harvested from the Vineyard.

Pooling of 'Grapes' and distribution of Business Income

29. The Constitution sets out the circumstances relating to the pooling of 'Farmers' Produce and the distribution of the Farmers Business Income. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Farmers who have contributed Produce from a harvest to the pool making up the harvested produce are entitled to benefit from distributions from the business income; and
- Produce can only be pooled with the Produce of Farmers accepted to participate in the Adelaide Hills Premium Vineyard from the date of this Ruling to 5 May 2006.

Fees and other costs

30. The Farming Agreement sets out the Annual Management Fees and Farm Occupation Fee payable during the term of the Project (clauses 5 and 6).

31. On a per Farm basis the components making up the Annual Management Fee, the Farm Occupation Fee and other amounts payable on the Settlement Date are set out in the following table.

Service Period	For	Amount
From the date the application is accepted to 30 June 2006	Initial planting and preparation	\$311.00
	Trellising	\$1,344.00
	Irrigation	\$891.00
	Maintenance of the Farm	\$3,656.00
	Farm Occupation Shares	\$31.17 per month \$1,600.00
From 1 July 2006 to 30 June 2007	Maintenance of the Farm	\$1,623.00
	Planting	\$49.00
From 1 July 2007 to 30 June 2008	Maintenance of the Farm	\$1,421.00

32. On a per Farm basis fees payable on 1 July 2006 are as follows:

Service Period	For	Amount
From 1 July 2006 to 30 June 2007	Administration	\$330.00
From 1 July 2006 to 30 June 2007	Farm Occupation	\$374.00

33. On a per Farm basis fees payable on 1 July 2007 are as follows:

Service Period	For	Amount
From 1 July 2007 to 30 June 2008	Administration	\$385.00
From 1 July 2007 to 30 June 2008	Farm Occupation	\$374.00 indexed

34. From 1 July 2008, the Annual Management Fee will be paid out of the Farmer's Business Income, where applicable. The fee is calculated in direct proportion to the total cost of providing the Management Services by the Responsible Entity (clause 5.1(a)(4) of the Farming Agreement).

35. An amount of \$2,400.00 (60 cents per share) is payable by 30 June 2010 as final payment for the Shares in the Landholding company.

Finance

36. Farmers may fund their participation in the Project themselves or by borrowing from a financier. Financing arrangements are outside the scope of this Ruling but Farmers should note that this Ruling does not apply if a finance arrangement entered into by a Farmer 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 of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 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 Farmers for the Project.

Ruling

Application of this Ruling

37. This Ruling applies only to Farmers who are accepted to participate in the Project from the date of this Ruling to 5 May 2006 inclusive, where the Farmer has executed a Farming Agreement on or before 5 May 2006 and paid the fees set out in paragraph 31 on or before the Settlement Date.

38. The Farmer's participation in the Project must constitute the carrying on of a business of primary production (see Explanation at paragraphs 52 to 64). A Farmer is not eligible to claim any tax deductions until the Farmer's application to enter the Project is accepted and the Project has commenced.

The Simplified Tax System (STS)

39. For a Farmer participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Farmer was an 'STS taxpayer' prior the 1 July 2005 who continues to use the cash accounting method (called the 'STS accounting method' – see section 328-105).

40. For such Farmers only, a reference in this Ruling to an amount being deductible when 'incurred' will mean that amount is deductible when paid and a reference to an amount being included in assessable income when 'derived' will mean that amount is included in assessable income when received.

Qualification

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

25% entrepreneurs tax offset

Subdivision 61-J

42. For the first income year starting on or after 1 July 2005, Subdivision 61-J of the ITAA 1997 provides for a tax offset of up to 25% 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.

Tax outcomes for Farmers

Assessable income

Section 6-5

43. That part of the gross sales proceeds from the Project attributable to the Farmer's produce, less any GST payable on these proceeds (section 17-5 of the ITAA 1997), will be assessable income of the Farmer under section 6-5 of the ITAA 1997.

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

Deductions for Management Fees, Farm Occupation Fee and the Administration Fee***Section 8-1***

45. A Farmer may claim tax deductions for the following revenue expenses on a per Farm basis, as set out in the Table below.

Fee Type	ITAA 1997 Section	30/6/2006 (Initial Period)	30/6/2007 (Second Period)	30/06/2008 (Third Period)
Maintenance of the farm		\$3,656.00 See Note (i)	\$1,623.00 See Notes (i) & (ii)	\$1,421.00 See Notes (i) & (ii)
Farm Occupation Fee		\$31.17 per month See Note (i)	\$374.00 See Note (i)	\$374.00 indexed See Note (i)
Administration Fee			\$330.00 See Note (i)	\$385.00 See Note (i)

Notes:

- (i) If the Farmer 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 of the ITAA 1997.
- (ii) The fees for Maintenance of the Farm paid on the Settlement Date in respect of the financial years ended 30 June 2006 and 30 June 2007 are NOT deductible in full in the year incurred.

Deductions for capital expenditure*Division 40*

46. A Farmer who is **not an 'STS taxpayer'** will also be entitled to tax deductions relating to trellising, water facilities (for example irrigation), and grapevines.

Fee Type	ITAA 1997 Section	30/6/2006 (Initial Period)	30/6/2007 (Second Period)	30/06/2008 (Third Period)
Trellising	40-25	Amounts must be calculated – See Notes (iii) and (iv)	Amounts must be calculated – See Notes (iii) and (iv)	Amounts must be calculated – See Notes (iii) and (iv)
Water facility (e.g. irrigation, dam, bore, etc)	40-515	Amounts must be calculated – See Notes (iii) & (v)	Amounts must be calculated – See Notes (iii) & (v)	Amounts must be calculated – See Notes (iii) & (v)
Establishment of horticultural plants (grapevines)	40-515	Nil – see Notes (iii) & (vi)	Nil – see Notes (iii) & (vi)	Nil – see Notes (iii) & (vi)

Notes:

- (iii) If the Farmer is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (for example input tax credits): Division 27 of the ITAA 1997.
- (iv) Trellising is a 'depreciating asset'. Each Farmer's interest in the trellising is a 'depreciating asset'. The 'cost' of the asset is the amount paid by each Farmer. The decline in value of the asset is calculated using the formula in either subsection 40-70(1) of the ITAA 1997 ('diminishing value method') or subsection 40-75(1) of the ITAA 1997 ('prime cost method'). Both formulas rely on the 'effective life' of the trellising.

Farmers can either self-assess the 'effective life' (section 40-105 of the ITAA 1997) or use the Commissioner's determination of 'effective life' (section 40-100 of the ITAA 1997). The Commissioner has determined that trellising has an 'effective life' of 20 years. Trellising will be installed and first used during the year ended 30 June 2006. The Responsible Entity will advise Farmers when that occurs to enable Farmers to calculate the deduction under subsection 40-25(1) of the ITAA 1997 for the decline in value of their trellising.

- (v) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1) of the ITAA 1997, being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F of the ITAA 1997, paragraph 40-515(1)(a) of the ITAA 1997. This deduction is equal to one third of the capital expenditure incurred by each Farmer on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540 of the ITAA 1997).
- (vi) Grapevines are a 'horticultural plant' as defined in subsection 40-520(2) of the ITAA 1997. As Farmers hold the land under licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) of the ITAA 1997 for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 of the ITAA 1997 and is based on the capital expenditure of \$360 incurred by the Farmer 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 of the ITAA 1997, 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 of the ITAA 1997, item 2). The Responsible Entity will inform Farmers of when the grapevines enter their first commercial season.

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

47. A Farmer who is an '**STS taxpayer**' will also be entitled to tax deductions relating to trellising, water facilities (for example irrigation) and grapevines. Deductions relating to the 'cost' of trellising must be determined under Division 328 of the ITAA 1997. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F of the ITAA 1997. If the 'water facility' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328. Deductions for the grapevines must be determined under Subdivision 40-F.

48. The deductions shown in the following Table assume, for representative purposes only, that a Farmer has either chosen to or can only claim deductions for expenditure on water facilities under Subdivisions 40-F of the ITAA 1997 and not under Division 328 of the ITAA 1997. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Note (ix).

49. The amounts shown in the Table below are on a per Farm basis:

Fee type	ITAA 1997 section	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
Trellising	328-185 & 328-190	\$201.60 – See Notes (vii) & (viii)	\$342.72 – See Notes (vii) & (viii)	\$239.90 – See Notes (vii) & (viii)
Water facility (e.g. irrigation, dam, bore, etc)	40-515	\$297– see Notes (vii) & (ix)	\$297– see Notes (vii) & (ix)	\$297– see Notes (vii) & (ix)
Establishment of horticultural plants (grapevines)	40-515	Nil – see Notes (vii) & (x)	Nil – see Notes (vii) & (x)	Nil – see Notes (vii) & (x)

Notes:

- (vii) If the Farmer is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (for example input tax credits): Division 27 of the ITAA 1997.
- (viii) Trellising is a 'depreciating asset'. Each Farmer's interest in the trellising is a 'depreciating asset' which can be allocated to a 'general STS pool'. The 'cost' of the asset is the amount paid by each Farmer. 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 Farmer'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.
- (ix) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1) of the ITAA 1997, being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Farmer may choose to claim a deduction under either Division 328 of the ITAA 1997 or Subdivision 40-F of the ITAA 1997. For the purposes of Division 328, each Farmer's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1,000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready

for use. This is so provided the Farmer is an 'STS taxpayer' for the income year in which the Farmer starts to 'hold' the asset and the income year in which the Farmer first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2006 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F of the ITAA 1997, Farmers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a) of the ITAA 1997. This deduction is equal to one third of the capital expenditure incurred by each Farmer on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540 of the ITAA 1997).

- (x) Grapevines are a 'horticultural plant' as defined in subsection 40-520(2) of the ITAA 1997. As Farmers hold the land under a licence, one of the conditions in subsection 40-525(2) of the ITAA 1997 is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) of the ITAA 1997 for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 of the ITAA 1997 and is based on the capital expenditure incurred by the Farmer 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 of the ITAA 1997, item 2). The Responsible Entity will inform Farmers of when the grapevines enter their first commercial season.

Shares in Adelaide Hills Investments Limited

Part 3-1

50. Farmers will also acquire Shares in Adelaide Hills Investments Limited. The Shares are CGT assets (section 108-5 of the ITAA 1997) and the amounts payable for the Shares upon subscription constitute an outgoing of capital and are not allowable deductions.

51. The amounts paid for each Share will represent the first element of the cost base of the Share (subsection 110-25(2) of the ITAA 1997). Any disposal of the Shares by a Farmer will be a CGT event and may give rise to a capital gain or loss.

Section 44(1)

52. Any dividends paid to Farmers out of profits by Adelaide Hills Investments Limited will be assessable income of the Farmer under subsection 44(1) of the ITAA 1936.

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

Section 35-55 – exercise of Commissioner’s discretion

53. A Farmer who is an individual accepted into the Project in the year ended 30 June 2006 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10 of the ITAA 1997. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) of the ITAA 1997 for Farmers 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 Farmer’s other assessable income in the income year in which the losses arise.

Section 82KL and Part IVA

54. For a Farmer who commences participation in this Project and incurs expenditure as required by the Lease and Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

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

Appendix 1 – Explanation

❶ ***This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.***

Is the Farmer carrying on a business?

55. For the amounts set out in the Tables above to constitute allowable deductions, the Farmer's viticultural activities as a participant in the Adelaide Hills Premium Vineyard Project must amount to the carrying on of a business of primary production.

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

57. For schemes such as those of the Adelaide Hills Premium Vineyard Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Farmer's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commission of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

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

- the Farmer has an identifiable interest in the land (by lease) or rights over the land (by licence) on which the Farmer's vines are established;
- the Farmer has a right to harvest and sell the grape produce from those vines;
- the viticultural activities are carried out on the Farmer's behalf;
- the viticultural activities of the Farmer are typical of those associated with a viticultural business; and
- the weight and influence of general indicators point to the carrying on of a business.

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

60. Under the Farming Agreement, the Responsible Entity is engaged by the Farmer to maintain a Farm on the Farmer's identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to maintain the Farm on the Farmer's behalf.

61. The Responsible Entity is also engaged to harvest and sell, on the Farmer's behalf, the grape produce grown on the Farmer's Farm.

62. 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.

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

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

65. The Responsible Entity's services are also consistent with general viticultural practices. They are of the type ordinarily found in viticultural ventures that would commonly be said to be businesses. While the size of a Farm is relatively small, it is of a size and scale to allow it to be commercially viable (see Taxation Ruling IT 360).

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

67. The viticultural activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Farmers' viticultural activities in the Project will constitute the carrying on of a business.

The Simplified Tax System

Division 328

68. Subdivision 328-F of the ITAA 1997 sets out the eligibility requirements that a Farmer must satisfy in order to enter the STS and Subdivision 328-G of the ITAA 1997 sets out the rules for entering and leaving the STS.

69. The question of whether a Farmer is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Farmer 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 project fees

Section 8-1

70. Consideration of whether the management fees, rent and interest (the 'project fees') are deductible under section 8-1 of the ITAA 1997 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.

71. The project fees associated with the viticultural activities will relate to the gaining of income from the Farmer's business of viticulture (see above), and hence has a sufficient connection to the operations by which income (from the harvesting and sale of grape produce) is to be gained from this business. It will thus be deductible under the first limb of section 8-1 of the ITAA 1997. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. 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

72. 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.

73. For this Project, only section 82KZL of the ITAA 1936 (an interpretive provision) and sections 82KZME of the ITAA 1936 and 82KZMF of the ITAA 1936 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

74. Where the requirements of subsections 82KZME(2) and (3) of the ITAA 1936 are met, the formula in subsection 82KZMF(1) of the ITAA 1936 (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) of the ITAA 1936).

75. The requirements of subsection 82KZME(3) of the ITAA 1936 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.

76. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4) of the ITAA 1936). This has particular relevance for a Farmer in this Project who, in order to participate in the Project may borrow funds from a financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Farmer prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF of the ITAA 1936.

77. There are a number of exceptions to these rules, but for Farmers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) of the ITAA 1936 is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1) of the ITAA 1936. However, for the purposes of Farmers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

78. Where the requirements of section 82KZME of the ITAA 1936 are met, section 82KZMF of the ITAA 1936 applies to apportion relevant prepaid expenditure.

79. Section 82KZMF of the ITAA 1936 uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

80. In the formula 'eligible service period' (defined in subsection 82KZL(1) of the ITAA 1936) 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

81. The expenditure incurred by a Farmer in the Project for the Management Fees meets the requirements of subsections 82KZME(1) and (2) of the ITAA 1936 and is incurred under an 'agreement' as described in subsection 82KZME(3) of the ITAA 1936. Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF of the ITAA 1936.

82. The prepaid Management Fees incurred by Farmers do not fall within any of the 5 exceptions to section 82KZME of the ITAA 1936. Therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1) of the ITAA 1936. Section 82KZMF will apportion the deduction for prepaid Management fees over the period that the services for which the prepayment is made are provided.

Interest deductibility

83. The deductibility of interest incurred by Farmers who finance their participation in the Project through a loan facility with a bank or financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by, the Tax Office.

84. While the terms of any finance agreement entered into between relevant Farmers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Alternatively, a Farmer may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure', any tax deduction that is allowable will be subject to the relevant prepayments provisions of the ITAA 1936 (see paragraphs 82 to 89).

Expenditure of a capital nature***Division 40 and Division 328***

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

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

87. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 46 and 52 in the Tables and the accompanying Notes.

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

88. In deciding to exercise the discretion in paragraph 35-55(1)(b) of the ITAA 1997 on a conditional basis for Farmers 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 Farmer that will not satisfy one of the four tests in Division 35 of the ITAA 1997;
- there is an objective expectation that within a period that is commercially viable for the viticultural industry, a Farmer's business activity will satisfy one of the four tests set out in Division 35 of the ITAA 1997 or produce a taxation profit; and
- a Farmer who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) of the ITAA 1997 until a later income year is able to offset that loss against their other assessable income.

89. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) of the ITAA 1997 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 Farmer will need to apply for a private ruling on the application of section 35-55 of the ITAA 1997 to those changed circumstances.

Section 82KL

90. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1 of the ITAA 1997.

Part IVA

91. For Part IVA of the ITAA 1936 to apply there must be a 'scheme' (section 177A of the ITAA 1936), a 'tax benefit' (section 177C of the ITAA 1936), and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D of the ITAA 1936).

92. The Project will be a 'scheme'. A Farmer will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 55 and 62 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

93. Farmers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the grape produce. There are no facts that would suggest that Farmers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There are no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) of the ITAA 1936 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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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 360; TR 92/20; TR 97/11;
TR 98/22; TR 2000/8;
TR 2001/14; TD 93/34;
PR 2005/57; PR 2005/58

Subject references:

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

Legislative references:

- ITAA 1936 44
- ITAA 1936 44(1)
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(1)
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
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