PR 2001/5 - Income tax: Tanunda Hill Vineyard Project

Product Ruling
Income tax: Tanunda Hill Vineyard Project

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. 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 investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Tanunda Hill Vineyard Project, or simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:

- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997)
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Section 42-15 (ITAA 1997);
- Section 42-125 (ITAA 1997);
- Section 387-55 (ITAA 1997);
- Section 387-125 (ITAA 1997);
- Section 387-165 (ITAA 1997);
- Section 387-355 (ITAA 1997);
- Section 388-55 (ITAA 1997);
- Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KZL (ITAA 1936);
- Section 82KZM (ITAA 1936);
- Section 82KZMB to 82KZMD (ITAA 1936);
- Section 82KZME (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an

entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered for GST and hold a valid tax invoice.

Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the Ralph *Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing 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 investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires) and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

- the Ruling has no binding effect on the Commissioner as the arrangements entered into are not the arrangements ruled upon; and
- the Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 17 January 2001, the date the Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, the Product 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 2003. 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 specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to

withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for Product Ruling dated 27 October 2000;
- Draft Prospectus of the The Tanunda Hill Vineyard Project dated 8 January 2001;
- Draft Agency Agreement - Custodian of the Tanunda Hill Vineyard Project between Blaxland Vineyards Limited ("BVL", "the Responsible Entity") and Cardinal Financial Securities Limited ("the Custodian") received with the application for Product Ruling;
- Constitution of the Tanunda Hill Vineyard Project received by the ATO on 9 January 2001;
- Constitution of Tanunda Hill Vineyard Limited ("the Land Owner") dated 28 July 2000;
- Compliance Plan of the Tanunda Hill Vineyard Project received with the application for Product Ruling;
- Allotment Agreement of the Tanunda Hill Vineyard Project between the Land Owner and each Grower received by the ATO on 9 January 2001;
- Management Agreement of the Tanunda Hill Vineyard Project between BVL and each Grower received by the ATO on 9 January 2001;
- Draft Contract for the Establishment and Maintenance of a Vineyard received with the application for Product Ruling between BVL and Brian McGuigan Wines Limited ("BMWL") dated 8 January 2001;
- Draft contract for the Sale and Purchase of Wine Grapes between BMWL, BVL, the Land Owner and each several grower received with the application for Product Ruling;
- Letters from the applicant's representative dated 27 November 2000, 15 December 2000, 22 December 2000, 3 January 2001, 5 January 2001, 6 January 2001 and 9 January 2001.

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

Overview

15. This arrangement is called the Tanunda Hill Vineyard Project.

Location	Barossa Valley Region of South Australia near Tanunda.
Type of business each participant is carrying on	A long term commercial viticulture business.
Number of hectares under cultivation	324 hectares
Name used to describe the project	Tanunda Hill Vineyard
Size of each Vinelot	0.6 hectares
Number of vines per hectare	2,025
Expected production	11.7 tonnes/hectare
The term of the investment in years	15 years
Initial cost	$9,202
Initial costs on a per hectare basis	$15,337
2nd years costs	$13,015
3rd years costs	$8,732
Ongoing costs	Ongoing Management Fees, Water Supply and Land Rental.
Cost of stapled investment being shares in Tanunda Hill Vineyard Limited	$9,247

16. Growers applying under the Prospectus, enter into a Management Agreement and an Allotment Agreement. The arrangements are set out in the Constitution for the Project. The Allotment Agreement gives a Grower a licence over an identifiable area of land for the purpose of developing a vineyard until the Project is terminated on 30 June 2016. The term of the Project is expected to be 15 years. Each Vinelot is 0.6 hectares in size, comprising a primary allotment of 0.4 hectares and secondary allotment of 0.2 hectares. The primary allotment will be planted between August and December 2001 and the secondary allotment will be planted between August and December 2002.

17. The Project Land is situated in the Barossa Valley Region of South Australia, near Tanunda. Tanunda Hill Vineyard Limited owns

the land. Growers or their associates will be required to take up shares in Tanunda Hill Vineyard Limited.

18. Tanunda Hill Vineyard Limited will licence a vinelot of 0.6 hectares to the Grower for the purpose of carrying on a long term commercial viticulture project.

19. The minimum subscription is 50 Grower units. Each Grower may subscribe for a minimum of one vinelot. The Responsible Entity will plant approximately 1,215 vines per vinelot (2,025 per hectare) during the planting periods following the execution of the Management Agreement and Allotment Agreement.

20. Growers will execute a power of attorney enabling the Responsible Entity to act on their behalf to execute a Management Agreement and Allotment Agreement.

21. Possible projected returns for Growers are outlined in the Prospectus. The Responsible Entity does not guarantee the success of the vineyard. Investors will be exposed to the usual business risks and agricultural risks inherent in primary production due to matters beyond the control of the Responsible Entity such as adverse weather conditions, insect attacks and variable market conditions. The projected returns are subject to the inherent risks of the long term nature of the venture. BVL has outlined these risks in the Prospectus for the Project. Based on the example set out in the Prospectus, a Grower could expect to achieve a pre-tax internal rate of return of 15.5% per Grower Unit and stapled investment in Tanunda Hill Vineyard Limited.

Constitution

22. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Growers and to manage the Project. The Responsible Entity will keep a register of Growers. The Allotment Agreement and Management Agreement will be executed on behalf of a Grower following the signing of the Application and a Power of Attorney Form attached to the Prospectus. Growers are bound by the Constitution and the Allotment Agreement and Management Agreement by virtue of their participation in the Project.

Interest in land

23. The land owner grants a licence to each Grower under the terms of the Allotment Agreement. Growers are granted an interest in land in the form of a licence to use their vinelot for the purpose of long term viticulture and the Project. Growers must pay rent annually

to the land owner for the term of the Allotment Agreement which is from the Commencement Date until 30 June 2016.

Management Agreement

24. Each Grower enters into a Management Agreement with the Responsible Entity. The termination of the Project is the earlier of the termination of the Grower's Interest and 30 June 2016. Growers contract with the Responsible Entity to carry out the initial services, to plant, develop, manage and maintain the vines. On application, Growers pay the primary services fee and annual management fees thereafter.

25. The Responsible Entity will carry out the following services for the Grower immediately upon entering into the management agreement. These services consist of:

- obtaining all relevant Government approvals for the project;
- developing with consultants an integrated irrigation and drainage plan for the project;
- engaging contractors to develop a soil plan and surveyors to develop contour maps;
- completing an electro magnetic soil survey and establishing GPS points;
- finalising and marking out vineyard layout;
- removing internal fencing and remnant vegetation;
- eradicating weeds, pests and vermin from the vinelot;
- preparing the vinelot;
- establishing a cover crop on the vinelot;
- establishing drainage on the vinelot in accordance with the drainage plan;
- providing supervision and management of the duties in this clause;
- supervising the growing of the rootlings set aside for the Grower in various nurseries;
- developing a management plan for all vinelots in conjunction with the various grape purchasers;
- research and development services on the Vines and grapes;
- all administration and compliance duties.

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

- establish dams surrounding the vinelot;
- establish the Allotment Irrigation System;
- commence the establishment of a trellis system on the vinelot.

27. Growers who join the scheme prior to 22 June 2001 will have their primary services carried out prior to 30 June 2001. Growers who join the scheme after 22 June 2001 will have their primary services carried out in the next financial year and will not be able to claim any tax deductions in the year ended 30 June 2001.

28. The Responsible Entity will pool for sale all produce of each Grower's business with that of each other Grower and will market and sell all such produce. The proceeds of the pooled sales will be paid to the Custodian for crediting to the account of each Grower on a proportional basis. Where the produce from a Grower's Allotment is of sufficient reduced quality or quantity, that Grower's share of the pooled sale proceeds may be reduced. The Responsible Entity is entitled to a fee for each processed tonne of grape attributable to the Grower's Allotment.

29. Income of the Project is to be held on behalf of the Growers by the Custodian and to be applied in payment of the Growers' obligation under the Management Agreement. Any net income remaining after the payment of these fees is to be distributed to Growers after the final payment is received for each sale of produce.

30. The Grower may terminate the Management Agreement in certain instances, including where the Responsible Entity defaults in the performance of its duties.

31. All costs and expenses incurred by the Responsible Entity in carrying out its duties are to be borne by it and the Grower has no obligation to make any payment in addition to the fees prescribed by the various agreements.

32. There will be a Grape Sale Agreement entered into with various contracted grape buyers to purchase 87% of the grapes harvested.

33. The Management Agreement and Project Constitution will bind a participant who enters into the Tanunda Hill Vineyard Project and utilises the services of BVL. These documents detail, among other things, the fees and charges for which an investor is liable. Once a Grower's application has been accepted, the Responsible Entity will be responsible for erecting trellis and irrigation on each allotment prior to 30 June of the financial year in which an application

is accepted. Acceptance of applications received between 22 June 2001 and 30 June 2001 will be deferred until 1 July 2002. The Responsible Entity will advise Growers when certain 'business operations' have been commenced on their behalf, for example, when their vines have been planted.

Vineyard Management Agreement

34. Pursuant to its right to delegate any functions required of it, BVL has contracted with BMWL to undertake the obligations under the Management Agreement to establish the Vineyard and undertake all necessary viticultural work in future years. A Vineyard Management Agreement exists between the manager and BMWL detailing those services to be undertaken by BMWL in each year. BMWL is specifically required to acquire rootlings for the Growers in the Project and install the Irrigation System.

35. BMWL is required to undertake all preplanting activities, establish trellis, plant vines, irrigation and maintenance of the Vineyard and other necessary operations over the life of the Project. BMWL is required to harvest the grapes on behalf of the Growers.

Contract for the Sale and Purchase of Wine Grapes

36. Pursuant to the various Grape Sales Agreements, the contracted grape buyers shall purchase, in each Vintage Year, 87% of the grapes grown on the property. BVL shall process the balance into wine on behalf of the Growers at a cost of $358 per tonne adjusted for CPI from 30 June 2001.

37. The proceeds of the sale are to be paid to the Custodian as agent for BVL. Clause 5 sets out the payment schedule.

Fees

Year 1 to 3 payments:

38. The fees payable by a Grower in the Project in the first three years for one allotment are:

	Year 1 On Application	**Year 1 June 22**	**Year 2 July 31**	**Year 3 July 31**
Installation of Irrigation	$1,122	$302	$2,332	-
Supply & Erection of Trellis	$586	$486	$1,609	$243
Land Improvement	$165	$1,293	$82	-

Pre-Planting Activities	$165	$1,551	$82	-
Primary Service Fee	-	$2,441	-	-
Supply & Planting of Rootlings	-	-	$858	$374
Compliance Costs	$330	-	$337	$346
Research and Development	-	$62	$53	$53
Ongoing Management Fee	-	-	$6,743	$6,540
Power Supply	-	-	$303	-
Dams	$660	-	-	$330
Water Infrastructure Fee			$239	$358
Water Licence Fee			$212	$318
Land Licence Fee		$39	$165	$170
Total	**$3,028**	**$6,174**	**$13,015**	**$8,732**

39. The Year 1 Primary Service fees are only for work to be done up until 30 June 2001, for those Growers accepted into the Project up until 22 June 2001. Acceptance of Applications received between 22 June 2001 and 30 June 2001 will be deferred until 1 July 2001. The term of the Project will be for 15 years from 30 June 2001, at which time Growers will vote to decide on the future of the vineyard. The Project can be renewed or the vineyard sold.

40. For those Growers accepted into the Project from 1 July 2001, the fees payable for both Years 1 and 2 are payable on application.

41. Alternatively, the fees for Years 2 and 3 can be paid by instalments shown in the table below. These instalments include an instalment service fee:

Year	First Instalment by 31 July	Second Instalment by 31 October	Third Instalment by 31 January	Fourth Instalment by 30 April	Total
2	$6,400	$2,250	$2,250	$2,250	$13,150
3	$2,250	$2,250	$2,250	$2,250	$9,000

Finance

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

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

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

Ruling

Assessable Income

44. A Grower's share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

Minimum subscription

45. A Grower will not incur the fees shown in the Table(s) below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted (the date the investment is made). Under the prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 50 interests is achieved. Tax deductions are not allowable until these requirements are met.

Section 8-1

Deductions where a Grower is <u>not</u> registered nor required to be registered for GST

46. A Grower may claim tax deductions in the Table(s) below where the Grower:

- participates in the Project by 22 June 2001 to carry on the business of growing grapes (for Growers who participate in the Project after 22 June 2001, refer to paragraph 48);
- incurs the fees shown in paragraph 38; and is not registered nor required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 deductions	Year 2 deductions	Year 3 deductions
Primary Service Fee	8-1	$2,441 – See Note (i) below		
Ongoing Management Fees	8-1		$6,743 – See Note (i) below	$6,540 – See Note (i) below
Land Licence Fees	8-1	$39 – See Note (i) below	$165 – See Note (i) below	$170 – See Note (i) below
Water Licence Fees	8-1		$212 – See Note (i) below	$318 – See Note (i) below
Water Infrastructure Fees	8-1		$239	$358
Compliance Costs	8-1	$330	$337	$346
Research and Development Costs	8-1	$62	$53	$53
Interest		See Note (ii) (below)	See Note (ii) (below)	See Note (ii) (below)

Notes:

(i) Where a Grower incurs the primary service fee, ongoing management fees, compliance costs and research and development costs as required by the Management Agreement and the water licence fees, water infrastructure fees and land licence fees as required by the Allotment Agreement, those fees are

deductible in full in the year incurred. However, if a Grower **chooses** to prepay fees for the doing of things (e.g., the provision of management services or the leasing of land) that will not be wholly done in the same income year as the fees are incurred, then the prepayments rules of the ITAA may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraphs 108 to 112 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure', being expenditure of less than $1,000, is an 'exception' to any prepayment rules that apply and is deductible in full in the year in which it is incurred.

(ii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraph 113 to 115 below as those rules may be applicable if interest is prepaid.

Tax deductions for capital expenses

47. A Grower who participates in the Project will be entitled to the following tax deductions:

Fee type	ITAA 1997 section	Year 1 deductions	Year 2 deductions	Year 3 deductions
Trellising	42-15	Must be calculated - See Note (iii) below	Must be calculated – See Note (iii) below	Must be calculated – See Note (iii) below
Landcare operations	387-55	$1,458 - See Notes (iv) and (vi) below	$82 – See Notes (iv) and (vi) below	
Irrigation costs	387-125	$475 – See Notes (v) and (vi) below	$1252 - See Notes(v) and (vi) below	$1252 – See Notes (v) and (vi) below
Dams	387-125	$220 – See Notes (v) and (vi) below	$220 – See Notes (v) and (vi) below	$330 – See Notes (v) and (vi) below
Power supply cost	387-355		$31 - See Note (vii) below	$31 – See Note (vii) below

Establishment of horticultural plants	387-165	Nil - see note (viii) below	Nil	Nil

(iii) The tax deduction for depreciation of trellising will depend upon whether or not the Grower is a 'small business taxpayer' (see paragraphs 71 to 73 below).

For a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the tax deduction for depreciation of **trellising** is determined using the rates in section 42-125 and the formula in either subsection 42-160(1) ('diminishing value method') or subsection 42-165(1) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising and the extent to which the trellising is installed ready for use during the year. The Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended 30 June 2001. Depending upon the method the Grower elects to use, the rate for calculating the tax deduction will be 13% prime cost method or 20% diminishing value method.

Note: The depreciation deductions for 'small business taxpayers' discussed above apply until the introduction of the Simplified Tax System on 1 July 2001 (see paragraphs 68 to 70).

For a Grower who is NOT a 'small business taxpayer' or who is a 'small business taxpayer' who does not satisfy the conditions in section 42-345, the tax deductions for depreciation of **trellising** is determined using the formula in either subsection 42-160(3) ('diminishing value method') or subsection 42-165(2A) ('prime cost method'). The tax deduction calculated under these formulae depends upon the number of 'days owned', being the number of days in the income year in which the Grower owned an interest in the trellising and the extent to which each is installed ready for use during the year. The formulae use 'effective life' rather than rate to determine the deduction for depreciation. The Project's manager is to advise Growers of relevant details to calculate their depreciation deductions for the year ended

30 June 2001. Note: This is only applicable to plant acquired after 21 September 1999.

In certain circumstances, a Grower who is NOT a 'small business taxpayer' is able to allocate plant to a 'low value pool' (see paragraphs 79 to 83 below). Note: This choice is only available from 1 July 2000.

(iv) A deduction is allowable under section 387-55 for capital expenditure incurred for landcare operations. The deduction is allowed in the year that the expenditure is incurred.

(v) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.

(vi) A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on landcare operations and/or facilities to conserve or convey water. This is an alternative to claiming deductions under sections 387-55 and 387-125.

(vii) A deduction is allowable under section 387-355 for capital expenditure incurred for the connection of power to the Project land. The deduction is calculated on the basis of one tenth of the capital expenditure in the year in which the expenditure is incurred, and one tenth in each of the next nine years of income.

(viii) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of grapevines for use in a horticultural business. The deduction is allowable when the grapevines, as horticultural plants, enter their first commercial season. If the grapevines have an 'effective life' for the purposes of section 387-185 of greater than '13 but fewer than 30 years', this results in a write-off rate of rate of 13% prime cost. The Project's manager will inform Growers of when the grapevines enter their first commercial season.

Deduction available for Growers who invest after 22 June 2001

48. For a grower who invests in the Project after 22 June 2001, who incurs the fees set out in Paragraph 38, the deductions shown in year 1 above will be available in year 2 together with the deductions shown as being available in year 2, with the exception of irrigation and dam expenditures which are deductible in the amounts of $1,252 and $220 respectively in the final year. The second year deductions for irrigation and dam expenditure will be $1,252 and $330 respectively.

Deductions where a Grower is registered or is required to be registered for GST

49. Where a Grower who is registered or is required to be registered for GST:

- participates in the Project by 30 June 2001 to carry on the business of growing grapes;
- incurs the fees shown in paragraph 38; and
- is entitled to an input tax credit for the fees;

then the tax deductions shown in the Table(s) above will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example at paragraph 122.

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

50. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2005 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

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

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies (see paragraph 98 in the Explanations part of this Ruling, below).

52. Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

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

Sections 82KZM, 82KZMB – 82KZMD, 82KZME – 82KZMF, 82KL and Part IVA

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

- expenditure by the Grower does not fall within the scope of section 82KZM (but see paragraphs105 to 112);
- expenditure by the Grower does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs105 to 112);
- expenditure by the Grower does not fall within the scope of sections 82KZME-82KZMF (but see paragraphs105 to112);
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 8-1

55. Consideration of whether the primary service fee, ongoing management fees, compliance costs, research and development costs, water licence fees, water infrastructure fees and land licence fees are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer contractually commits themselves 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.

Is the Grower carrying on a business?

56. A viticulture scheme can constitute the carrying on of a business. Where there is a business, or a future business, the Gross Harvest Proceeds each year from grapes from vinelots comprising the Project will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the grapes each year from the vinelot. Generally, a Grower will be carrying on a business of viticulture where:

- the Grower has an identifiable interest in specific growing vines coupled with a right to harvest and sell the grapes each year from the vines;
- the viticulture activities are carried out on the Grower's behalf; and

- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

57. For this Project Growers have rights under the Allotment Agreement in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of growing vines. Under the Management Agreement Growers engage the Responsible Entity to acquire vine rootlings and plant out the rootlings on the licensed land and to provide ongoing services to care and maintain the vines. Growers are considered to have control of their operations.

58. The Allotment Agreement provides Growers with more than a chattel interest in the vines. The Project documentation contemplates Growers will have an ongoing interest in the vines.

59. Growers have the right to use the land in question for viticulture purposes and to have the Responsible Entity come onto the land to carry out its obligations under the Management Agreement. The Growers' degree of control over the Project Manager as evidenced by the Management Agreement, and supplemented by the Corporations Law, is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Responsible Entity's activities. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as cases of default or neglect. The viticulture activities described in the Management Agreement are carried out on the Growers' behalf.

60. 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 arrangement's description for all the indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

61. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify which vines Growers have an interest in. These services are based on accepted viticulture practices and are of the type ordinarily found in viticulture ventures that would commonly be said to be businesses.

62. Growers have a continuing interest in the vines from the time they are acquired until the cessation of the Project. 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. The Growers' viticulture activities will constitute the carrying on of a business.

63. The primary services fee, ongoing management fees, compliance costs, research and development costs, water licence fees, water infrastructure fees and land licence fees associated with the viticulture activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which income (from the regular sale of grapes) is to be gained from the business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of either the primary services fee or ongoing management fees. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Expenditure of a capital nature

64. Any part of the expenditure of a Grower entering into a viticultural business that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, the costs of trellising, landcare, irrigation, power supply and the establishment of horticultural plants are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

Section 42-15: depreciation of trellising

65. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose or purposes of producing assessable income where they are the owner or quasi-owner of that plant. However, where an item is affixed to land so that it becomes a fixture, at common law it becomes part of the land and is legally absolutely owned by the owner of the land.

66. It is, however, accepted in certain circumstances that a lessee is entitled to claim depreciation where they are considered to be the owner of those improvements. Taxation Ruling IT 175 sets out the views of the Tax Office on this issue. Where a lessee is considered to own the improvements under a state law, as detailed in the Ruling, or where they have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the lessee is entitled to claim depreciation for the fixture.

67. Under section 42-15 Growers in the Project are entitled to depreciation deductions for capital expenditure in relation to the acquisition and installation of trellises on the land. The deduction available, however, will depend upon the date the investment is made,

when the plant is installed ready for use and whether or not a Grower is a 'small business taxpayer' (see paragraphs 71 to 73).

68. For plant acquired or constructed after 11:45am by legal time in the Australian Capital Territory on 21 September 1999, accelerated rates of depreciation are no longer available except to some 'small business taxpayers'. The Government has announced that 'small business taxpayers' who meet the conditions in section 42-345 will have access to accelerated rates of depreciation until the introduction of the proposed Simplified Tax System on 1 July 2001.

69. The immediate deduction for items of plant costing $300 or less has been removed from 1 July 2000, except for 'small business taxpayers'. The Government has announced that 'small business taxpayers' will be able to claim the immediate deduction until the introduction of the proposed Simplified Tax System.

70. The depreciation of trellising as explained in this Product Ruling is based on existing legislation and may be subject to change.

Small business taxpayers

71. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than $1,000,000 or their turnover recalculated under section 960-350 is less than $1,000,000.

72. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

73. Whether a Grower is a 'small business taxpayer' depends upon the circumstances of each Grower and is beyond the scope of this Product Ruling. It is the responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

Depreciation deductions for Growers who are 'small business taxpayers'

74. The depreciation deduction for **trellising** available to a Grower who is a 'small business taxpayer' and who complies with the conditions contained in section 42-345 is calculated using the formula in either subsection 42-160(1) or subsection 42-165(1). The depreciation deduction depends on the cost of the trellising and the number of days the trellising was owned by the Grower during the

income year. It also depends on the extent to which the trellising is installed ready for use during the year.

75. The deduction is calculated using a rate of 13% prime cost or 20% diminishing value. These accelerated rates of depreciation are shown in section 42-125 and apply to plant with an effective life of between 13 and 30 years. The Responsible Entity will advise Growers of the date that the trellising is installed and begins to be used for the purpose of producing assessable income.

Depreciation deductions for Growers who are not 'small business taxpayers'

76. A Grower who is NOT a 'small business taxpayer' or is a 'small business taxpayer' who does not satisfy the conditions in section 42-345 will not be able to claim accelerated depreciation on plant used in the Project because of section 42-118. The depreciation deduction for trellising for such a Grower is calculated using the formula in either subsection 42-160(3) or subsection 42-165(2A).

77. The deduction depends on the cost of the plant, the number of days the plant was owned by the Grower during the income year and the 'effective life' of the plant. It also depends upon the extent to which the plant is installed ready for use during the year. The Responsible Entity will advise Growers of the date that the trellising is installed and begin to be used for the purpose of producing assessable income.

Determination of effective life

78. Subdivision 42-C provides the choice of methods for determining the 'effective life' of plant. Growers can either self-assess the effective life of plant or use the effective life specified by the Commissioner. In the schedule, the Commissioner has determined that the effective life of trellising is 20 years.

Low value pool option

79. From 1 July 2000 the immediate 100% depreciation deduction for plant costing $300 or less has been replaced by a 'low value pool' arrangement for all taxpayers except 'small business taxpayers'

80. Under subsection 42-455(1), a Grower who is not a 'small business taxpayer' can choose to allocate 'low cost plant' to a 'low value pool' in the year of acquisition. 'Low cost plant' is plant costing less than $1,000. Once the choice is made to allocate 'low cost plant' to the pool, all 'low cost plant' acquired in that income

year and subsequent income years must be included in the pool (subsection 42-460(1)).

81. A 'low value pool' is depreciated using a diminishing value rate of 37.5%. However, low cost plant is depreciated at 18.75% in the year it is allocated to the pool, irrespective of the date it is allocated. The value of plant included in or disposed from such a pool will be added to or subtracted from the value of the pool.

82. Under the Management Agreement, for each interest acquired in the Project, a Grower incurs expenditure of $1,072 for trellising and will first be entitled to claim a deduction for depreciation in the year ended 30 June 2002.

83. As the cost of trellising exceeds $1,000 for a Grower who acquires a single interest in the Project it will not qualify as 'low cost plant'. However, provided the Grower uses the diminishing value method to depreciate the trellising, the plant can be allocated to a 'low value pool' after it has been depreciated below $1,000 (paragraph 42-455(3)(b)).

Subdivision 387-A - Expenditure for landcare operations

84. Section 387-55 allows a taxpayer a deduction for capital expenditure incurred on a landcare operation for land used to carry on a primary production business. Growers need not own the land to qualify for the deduction, so long as it is used by them to carry on a primary production business.

85. 'Landcare operation for land' includes constructing surface or subsurface drainage works on the land as well as an operation primarily and principally for the purpose of eradicating or exterminating from the land animals that are pests and/or eradicating, exterminating or destroying plant growth detrimental to the land.

86. A Grower in the Project is accepted as carrying on a business of primary production and these expenses will be deductible under section 387-55.

87. However, a deduction under section 387-55 is denied where the Grower is entitled to claim a landcare tax offset under section 388-55 and chooses to do so. A Grower can only choose a landcare tax offset where:

- had the Grower chosen a deduction instead of the tax offset, the Grower's taxable income for the income year would have been $20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Subdivision 387-B – Irrigation expenditure

88. Section 387-125 allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three-year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed would be covered by this Subdivision.

89. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or licensee who is conducting a primary production business on land in Australia, a deduction would be available to a Grower in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

90. However, a deduction under section 387-125 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Grower can only choose a water facility tax offset where:

- had the Grower chosen a deduction instead of the tax offset, the Grower's taxable income for the income year would have been $20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

Subdivision 387-C - Vines and horticultural provisions

91. Section 387-165 allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. A lessee or licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land (section 387-210).

92. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For a plant, such as the grapevines in this Project, with an effective life of 13 to 30 years, that rate is 13%.

Division 387-E – Connection of Power Supply

93. Section 387-355 allows a taxpayer to deduct capital expenditure on connecting or upgrading the supply of mains electricity to land upon which it is intended to carry on a business if the taxpayer has an interest in the land when that business is carried on. The deduction is allowed over a ten year period commencing in the income year in which the expenditure is incurred.

94. As the growers in the Project have an interest in the land as licencees and intend to carry on a business of viticulture on the Project land, a deduction would be available to the growers at a rate of ten per centum, commencing in Year 2 of the Project.

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

95. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law partnership) from certain business activities will not be allowable in an income year unless:

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

96. 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.

97. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity, or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

98. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity of less than $40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who

participate in the Project, they are beyond the scope of this Product Ruling and are not considered further.

99. In broad terms, the objective 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 are used on a continuing basis in carrying on the business activity in that year (section 35-45).

100. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project is unlikely to pass one of the objective tests until the income year ended 30 June 2005. Growers who acquire more than one interest in the Project may, however, pass one of the tests in an earlier income year.

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

102. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) for the term of this Product Ruling. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

(i) the business activity has started to be carried on; and

(ii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

103. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried

on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 13), in the manner described in the Arrangement (see paragraphs14 to 43), the Commissioner's discretion will not have been exercised because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

104. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent viticulturist expert provided with the application by the Responsible Entity;
- the binding Grape Sale contracts with Simeon Wines Limited and BMWL and contracts currently being finalised with Orlando Wyndham Group Pty Ltd, BVE Pty Ltd, for the sale of the grapes setting out prices that realistically reflect the existing market and/or the projected market in the geographical region where the grapes are grown;
- independent, objective, and generally available information relating to the viticulture industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.

Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD, and 82KZME – 82KZMF

105. The prepayments provisions of the ITAA operate to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

106. In this Project, the initial cost of $9,202 is charged for providing services to a Grower by 30 June of the year of execution of the relevant Agreements. In particular, the Primary Services Fee and Ongoing Management Fee are expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Primary Services Fee and/or the Ongoing Management Fee has been inflated to result in reduced fees being payable for subsequent years.

107. There is also no evidence that might suggest the management services covered by the fees could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Responsible Entity doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the agreements as set out in paragraph 38, then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

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

108. Although not required under either the Management Agreement or the Allotment Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 107 above, the prepayments provisions of the ITAA will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

109. The amount and timing of tax deductions for any prepaid Primary Services Fee, Ongoing Management Fees, Compliance Costs, Research and Development Costs, Water Licence Fees, Water Infrastructure Fees and Land Licence Fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means, generally, the period over which the services are to be provided. The relevant provision of the ITAA will depend on a number of factors including the amount and timing of the prepayment and, where the 'eligible service period' exceeds 13 months, whether the Grower is a 'small business taxpayer'.

110. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

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

In the formula, the 'eligible service period' means, generally, the period to which the services are to be provided.

111. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Grower is a 'small business taxpayer' or section 82KZMD if the Grower is not a 'small business taxpayer'. For a 'small business taxpayer' (see paragraphs 71 to 73 the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same, or effectively the same as that shown in paragraph 110 above, concerning section 82KZMF.

112. A prepaid management fee and/or a prepaid licence fee of less than $1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(7) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than $1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of a prepaid management fee or a prepaid licence fee is $1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

Interest deductibility

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

114. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in sections 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

115. Therefore, unless the prepaid interest is 'excluded expenditure', where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. Where a prepayment is for more than 13 months, any tax deduction that may be

allowable must be determined under section 82KZM (for a 'small business taxpayer') or section 82KZMD (for a taxpayer who is not a 'small business taxpayer'). The relevant formula is the same, or effectively the same as that shown above in paragraph 110 above.

Section 82KL - recouped expenditure

116. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

117. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

118. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Here, there may be a loan provided to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Part IVA - general tax avoidance provisions

119. 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).

120. The Tanunda Hill Vineyard Project will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 46 and 47 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.

121. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the grapes. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and

no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

Example

Entitlement to 'input tax credit'

122. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of $5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees, however, is reduced by the amount of any 'input tax credit' to which she is entitled. The Project Manager provides Margaret with a 'tax invoice' showing its ABN and the 'price of the taxable supply' for management services as $5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

1/11 x $5,500 = $500

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is $5,000 ($5,500 *less* $500).

Detailed contents list

123. Below is a detailed contents list for this Product Ruling:

Commissioner of Taxation
17 January 2001

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
PR 1999/95; TR 92/1; TR 97/11; TR 97/16; TR 92/20; TR 98/22; IT 175; TD 93/34

Subject references:
- carrying on a business
- commencement of a business
- interest expenses
- harvesting expenses
- management fees
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes
- tax avoidance
- tax benefits
- viticultural expenses

Legislative references:
- 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(3)
- 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 42-15
- ITAA 1997 42-118
- ITAA 1997 42-125
- ITAA 1997 42-160
- ITAA 1997 42-160(1)
- ITAA 1997 42-160(3)
- ITAA 1997 42-165
- ITAA 1997 42-165(1)
- ITAA 1997 42-165(2A)
- ITAA 1997 42-345
- ITAA 1997 42-455(1)
- ITAA 1997 42-455(3)(b)
- ITAA 1997 42-460(1)
- ITAA 1997 Subdiv 387-A
- ITAA 1997 387-55
- ITAA 1997 Subdiv 387-B
- ITAA 1997 387-125
- ITAA 1997 387-165
- ITAA 1997 387-185
- ITAA 1997 387-210
- ITAA 1997 387-355
- ITAA 1997 Subdiv 387-C
- ITAA 1997 Subdiv 387-E
- ITAA 1997 388-55
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
- ITAA 1936 82KH(1)
- ITAA 1936 82KH(1F)(b)
- ITAA 1936 82KL
- ITAA 1936 82KL(1)
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZM
- ITAA 1936 82KZM(1)
- ITAA 1936 82KZMA
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
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