PR 2000/69 - Income tax: Peel River Vineyards

Product Ruling
Income tax: Peel River Vineyards

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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 in future years to confirm the arrangement has been implemented as described below and to ensure that participants in the arrangement include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of person, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Peel River Vineyard Project', or just 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 27-5 (ITAA 1997);
- section 27-30 (ITAA 1997);
- section 42-15 (ITAA 1997);
- section 387-55 (ITAA 1997);
- section 387-125 (ITAA 1997);
- section 387-165 (ITAA 1997);
- section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZM and 82KZMB-82KZMD (ITAA 1936); and
- Part IVA (ITAA 1936).

3. On 11 November 1999, the Government announced further changes to the tax system as part of The New Business Tax System. A number of those changes, especially those to do with 'tax shelters', could affect the tax laws dealt with in this Ruling. Some of the changes apply from the date of announcement and others are proposed to apply from nominated dates in the future.

4. Although this Ruling mentions certain of those announced changes, the information given on the treatment of expenditure which may be affected by them is not binding on the Commissioner. Legally binding advice in respect of those changes cannot be given until the relevant law(s) are enacted.

5. However, if the changes become law the operation of that law will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded. If requested, when the relevant law(s) are enacted, the Commissioner will formalise the non-binding

information shown in this Ruling by issuing a new Product Ruling that describes the operation of those law(s).

Class of persons

6. 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'.

7. 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

8. The Commissioner rules on the precise arrangement identified in this 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.

9. This Ruling is based on the assumption that minimum subscription will be reached by 30 June 2000.

Date of effect

11. This Ruling applies prospectively from 7 June 2000, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute

agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this 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 2002. 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 material difference 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 is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Application for Product Ruling Peel River Vineyards Project ('the Project') received 3 April 2000;
- **Peel River Vineyards Project Prospectus,** issued by Lushvale Limited, received 15 May 2000;
- **Management Agreement** between Lushvale Limited (the Manager) and the Grower, received 3 April 2000;
- **Licence Agreement** between Lushvale Limited (the Manager) and the Grower, received 3 April 2000;
- **Peel River Vineyards Scheme Constitution** between the Manager, Lushvale Limited (LL) and the Growers

of the Peel River Vineyards Project received 3 April 2000;

- Peel River Vineyards Compliance Plan for Lushvale Limited as the Responsible Entity, received 3 April 2000;
- Option for Peel River Vineyards Limited to purchase Land received 27 April 2000; and
- Agreement to Lease between Peel River Vineyards Limited (the Landowner) and Lushvale Limited received 27 April 2000.

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

15. The documents highlighted are those Growers enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be party to. The effect of these agreements is summarised as follows.

Overview

16. This arrangement is called the "Peel River Vineyards Project".

Location	**Tamworth and Bendemeer Vineyards**
Type of business each participant is carrying on	A long term commercial viticulture business.
Number of hectares under cultivation	Up to 1,000 Hectares
Name used to describe the project	Peel River Vineyards Project
Size of the leased area, plot etc	0.0833 hectares (12 Allotments per hectare)
Number of vines per hectare	1680 vines per hectare (140 per Allotment)
Expected production	Will come into production in the year ended 30 June 2002. Production will progressively increase, reaching an average of 16 tons per hectare in the year ended 30 June 2004.
The term of investment in years	15
Initial cost	$5,960 (first 3 years)
Initial cost per hectare	$71,520 (first 3 years)

17. The Project will carry out a large scale planting of grapevines on two properties located in the Tamworth Area of NSW. Both vineyards, Tamworth and Bendemeer, will be owned by Peel River Vineyards Limited. Each Grower must subscribe for a minimum of 750 shares in Peel River Vineyards Limited at $1 per share.

18. The term of the Project is 15 years. On entering the Project, the Manager (Lushvale Limited) will provide a licence to the Grower to use and occupy an area of land for cultivating and harvesting wine grapes for sale. The Growers pay for the roads, buildings, irrigation and trellising system that will be installed on their Allotment. Growers may choose to contract with the Manager for the establishment and management of a vineyard on this land and the harvesting of their grapes. Growers who contract with the Manager may elect to harvest and to take possession of their grapes. Otherwise, the Manager will harvest and sell the grapes on behalf of the Grower.

19. The establishment of the Project is subject to a minimum subscription of 3,000 interests. This ruling does not apply if minimum subscription requirement is not achieved.

20. The minimum individual holding is one Allotment of 0.0833 hectare (12 Allotments per hectare). Overall, it is proposed that 750 hectares (9,000 Allotments) will be planted, but this can be increased to 1,000 hectares. The Allotments will be allocated in accordance with the vineyard development plan. Once the Grower's Allotment has been allocated it will be separately identified. Approximately 140 vines per Allotment (1,680 vines per hectare) will be planted before 30 June 2001.

21. Projected returns for Growers are outlined in the prospectus. The projected returns depend on a range of assumptions and the Manager does not give any assurance or guarantee whatsoever in respect of the future success of or financial returns associated with entering into the Project. Growers will execute a power of attorney enabling Lushvale Limited to act on their behalf as required when they make an application for Allotments.

22. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

Constitution

23. The Peel River Vineyards Scheme Constitution sets out the terms and conditions under which the Project Manager agrees to act for the Growers and to manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project.

Licence Agreement

24. The Manager and the Grower enter into the Licence Agreement for the period to 31 May 2015, under which the Manager grants a licence to the Grower.

25. Under the terms of the Licence Agreement the Grower agrees not to:

- use or permit any other person to use the Allotment for any purpose other than that of commercial horticulture and the Project;
- do anything which would invalidate or increase the premiums of any insurance policies in respect of the Grower's Allotment; and
- cause nor permit anything on the Grower's Allotment that will cause a nuisance, disturbance, obstruction or damage.

26. In return, Growers have the right to enter the Allotment at any time. Growers will at all times have full right, title and interest in the vines and fixtures on the allotment and any grapes produced from those vines. Growers may remove vines or fixtures from their Allotments at the end of the licence.

27. At the expiration of the term of the Licence and Management Agreements, the vines and fixtures and any improvements remaining on the Grower's Allotment shall vest in the lessors and no compensation will be payable to the Grower or the Manager.

Management Agreement

28. The Manager and the Grower may enter into a Management Agreement in respect of each of the Grower's Allotments. The term of the agreement will run until 31 May 2015.

29. Where a Grower appoints the Manager under the agreement the Manager will plant, develop, manage and maintain the vines on the Grower's Allotment and, unless the Grower elects otherwise, will harvest the grapes from the Grower's Allotment. The Manager accepts the appointment upon the terms and conditions in the Management Agreement and undertakes to provide the services on behalf of the Grower. This Ruling will not apply in circumstances where the investor does not appoint the Manager to run the Project.

30. The Manager is responsible for the day to day running of the Project including, but not limited to, the provision of the following services:

- Conduct the Grower's Project in a commercial manner in keeping with accepted wine industry standards including maintenance of the trickle irrigation systems, maintenance of suitable trellising systems and cultivating, pruning, fertilising, spraying and otherwise tending to the vines on the Grower's Allotment;
- Control vermin, diseases, animals, insects, pests, thistles, bracken, other noxious plants and weeds;
- Harvest or arrange for the harvesting of grapes grown on the Grower's Allotment;
- Provide sales, marketing and advertising services in relation to the grapes harvested from the Grower's Allotment, unless the Grower elects to collect and market the produce personally; and
- Negotiate and implement long term arrangements for the sale of the grapes on the Grower's behalf, for the best possible commercial price.

31. The Manager will arrange and pay crop insurance premiums at its own expense for the term of the Project.

Fees

32. The following costs per Allotment are payable for the first three years, assuming acceptance into the Project by 30 June 2000.

	Year 1	Year 2	Year 3	Total
Shares in Peel River Vineyards Limited (Payable on acceptance)	$750			$750
Licence Fee ($50 per year prepaid for 3 years) (Payable on acceptance)	$150			$150
Roads and Buildings (Payable on acceptance)	$8			$8
Trellising (Payable on acceptance)	$767			$767
Vine guards (Payable on acceptance)	$210			$210
Pre-planting including Purchase of vines (Payable on acceptance)	$743			$743
Irrigation (Payable on acceptance)	$847			$847
Landcare- (Payable on acceptance or immediately after primary production business commenced)	$160			$160

Management Fee – post planting	$205	$1,284	$836	$2,325
Total	$3,840	$1,284	$836	$5,960

(Note: All figures shown are exclusive of GST)

33. The liability for the 'ongoing' management fees arises as follows:

- $304 for the initial 2 months after commencement of the agreement
- $1,185 for the following period to 30 June 2001
- $836 for the following 12 months.

34. Fees will be payable as follows;

- a payment of $3,840 will be required on acceptance into the Project. This will include a part payment of $205 for management fees of $304 due for the first 2 months after acceptance into the project.
- A payment of $2,120, (which covers the $99 remaining in relation to the management fee of $304 payable for the first two months plus the management fees of $1,185 and $836 for the period to 30 June 2001 and 30 June 2002 respectively) will be payable by way of equal monthly payments until 31 May 2002. A final payment in June 2002 will allow for any rounding differences in the monthly calculation.

35. After the first three years of the Project, the annual licence and management fees will fall due at the beginning of each respective year. This liability may be satisfied out of sales proceeds held for the Grower. If gross project income is not sufficient to pay the fees for the year the Grower will need to make separate payment of the fees, and if the Grower fails to do so the Manager may commence debt recovery proceedings against the Grower.

36. The Application Monies, totalling $3840 per Grower, will be banked into a trust account. These amounts will only be released following acceptance of the Grower into the Project which will occur when:

- The Grower has entered into a Licence and Management Agreement;
- Minimum subscription has been achieved;
- The Lessor of the land has entered into a binding contract to purchase the land on which the Project will be located; and

- The Manager and the Lessor have entered into a binding agreement to lease the Project Land.

Finance

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

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

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

39. Other than the arrangement referred to in paragraph 35 of this Ruling, there is no agreement, arrangement or understanding between any entity or party associated with the Project and any financial or other institution for the provision of any finance to the Grower for any purpose associated with the Project.

Ruling

Goods and Services Tax

40. For a Grower who invests in the Project, sections 27-5 or 27-30 of the ITAA 1997 will apply to reduce the amount of any deduction allowable by any GST input tax credit to which the Grower is entitled or, in the case of section 27-5, a decreasing adjustment that a Grower has.

Allowable deductions

41. For a Grower who invests in the Project, the deductions available will depend on the date that the investment is made and, in some cases, whether or not the Grower is a 'small business taxpayer'.

42. **IMPORTANT: Paragraph 45 (relating to 'small business taxpayers') and paragraphs 46 to 53 (relating to taxpayers who are not 'small business taxpayers') describe the deductions allowable under the current law, but Growers are advised to carefully examine the information contained in paragraphs 58 to 64 relating to proposed changes. Paragraphs 70 to 73 explain the meaning of 'small business taxpayer' for the purposes of this ruling.**

43. Under section 8-1 of the ITAA 1997 no deduction is allowable to a Grower for the acquisition of shares in Peel River Vineyards Limited. The cost of the shares is a capital outgoing and is excluded from deductibility by subsection 8-1(2).

44. Similarly, no deduction is allowable to a Grower for expenditure on roads and buildings.

Growers who are 'small business taxpayers'

45. For a Grower who invests in the Project and is **a small business taxpayer** deductions will be available as indicated below:

(a) Growers who are **small business taxpayers** who invest **on or before 30 June 2000** and pay all fees only as they become due will be entitled to the following deductions for the years ended 30 June 2000 to 30 June 2002.

Small business taxpayers who invest on or before 30 June 2000					
Expenses	**Legislation ITAA 1997**	**Refer Note**	**Year 1**	**Year 2**	**Year 3**
			30/6/2000	**30/6/2001**	**30/6/2002**
Management Fee	8-1	(i)	205	1284	836
Licence Fee	8-1	(ii)	150		
Irrigation	387-125	(iii)	282	282	283
Landcare	387-55	(iv)	160		
Trellising	42-15	(v)		35	100
Vine Guards	42-167	(vi)		105	105
Pre planting, including vines	387-165	(vii)			97
Total			797	1,706	1,421

(Note: All figures shown are exclusive of GST)

(i) Management fees for the 'non capital' services (ongoing expenses such as insect eradication, weeding, fertilising) outlined in the Management Agreement will be allowable deductions under section 8-1 of ITAA 1997 to a Grower, who is a small business taxpayer, in the year in which they are incurred. However, proposed legislative change applying to expenditure incurred after 1.00pm AEST 11 November 1999 means that for all Growers, including small business taxpayers, the full deduction for any amounts allowable under section 8-1 which are prepaid may not be allowed in the year ended 30 June 2000 or later years (see non-binding advice in paragraphs 64 to 66 and Example 2).

Investors who pay in full on application should be aware that deductions will only be available in accordance with the law prevailing at the end of the relevant financial year and that a deduction for some of the 'non capital' management fees paid in advance in this financial year may not be available till a later year.

(ii) Section 82KZM operates 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. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not to be wholly done within

13 months after the day on which the expenditure is incurred. Subparagraph 82KZM (b)(ii) excludes expenditure of less than $1,000 from the scope of section 82KZM. The prepaid Licence Fee of $150 incurred for the first 3 years on acceptance into the Project will be less than $1,000, as long as a Grower does not acquire more than 6 Allotments. Where a Grower is allocated more than 6 Allotments the prepaid licence fees will amount to more than $1,000 and the deduction will be spread over the period to which the prepaid licence fees relate.

(iii) Fees paid under the Management Agreement in relation to irrigation will constitute an allowable deduction to the Grower under section 387-125. A deduction for capital expenditure for the irrigation system 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 two years.

(iv) Fees paid under the Management Agreement in relation to Landcare activities will be an allowable deduction under section 387-55 in the year the expenditure is incurred.

(v) For a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, the 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 deduction allowed in any year will depend 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 was installed ready for use during the year. Trellising is to be installed in Years 1 and 2. The Manager is to advise Growers of the number of days in which the Growers owned an interest in the trellising. The deductions available in Years 2 and 3 have been calculated for a full year on a cost of $267 for Year 2 and for a full year on a cost of $767 for Year 3 using the prime cost method at a rate of 13%, assuming that is the method that the Grower has chosen under section 42-25. If the

Grower chooses to use the diminishing value method the rate for calculating the deduction will be 20%.

(vi) For a Grower who is a 'small business taxpayer' and who complies with the conditions in section 42-345, a deduction in full is available for vine guards costing $105 each as items of plant costing $300 or less (section 42-167) The deduction arises at the time the items are installed ready for use (section 42-170).

(vii) A deduction under section 387-165 for expenditure on acquiring and planting the vines will be calculated on the basis of the grapevines, as horticultural plants, entering their first commercial season in the year ended 30 June 2002 and a Grower determining, under section 387-175, that they have an 'effective life' for the purposes of section 387-185 of greater than 13 but less than 30 years. This results in a write-off rate of 13%.

(b) Growers who are **small business taxpayers** who invest **after 30 June 2000** and pay all fees only as they become due, will be entitled to the following deductions for the years ended 30 June 2001 and 30 June 2002.

Small business taxpayers who invest after 30 June 2000					
Expenses	**Legislation ITAA 1997**	**Refer Note**	**Year 1**	**Year 2**	**Year 3**
			30/6/2000	**30/6/2001**	**30/6/2002**
Management Fee	8-1	(i) above		1489	836
Licence Fee	8-1	(ii) above		150	
Irrigation	387-125	(iii) above		282	282
Landcare	387-55	(iv) above		160	
Trellising	42-15	(v) above		35	100
Vine Guards	42-167	(vi) above		105	105
Pre planting, including vines	387-165	(vii) above			97
Total				2,221	1,420

(Note: All figures shown are exclusive of GST)

Growers who are not 'small business taxpayers'

46. Deductions available for a Grower who invests in the Project and who is **not a 'small business taxpayer'** are discussed in the paragraphs 47 to 53 below.

Management Fees of a non-capital nature

47. For a Grower who invests in the Project on or before 30 June 2000 who is **not a 'small business taxpayer'** and is carrying on a business, the deduction available in respect of the Management Fees which are of a non-capital nature is determined under subsection 82KZMB(2), using the formula in subsection 82KZMB(3) and the percentages shown in Columns 3 and 4 of the Table in subsection 82KZMB(5). (Example 1 and 2 at paragraphs 129 and 130 illustrate the application of this method).

48. In calculating the deductions available, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 whose 'eligible service period' ends not more than 13 months after it is incurred by the taxpayer. The 'eligible service period' (defined in subsection 82KZL(1)) commences on the later of:

(a) the day, or the first day on which services to be done under an agreement are to commence being done; or

(b) the day on which that expenditure is incurred.

49. The Manager will inform affected taxpayers of the number of days in the eligible service period in the expenditure year. This figure is necessary for the deduction for management fees to be calculated.

50. Investors who pay in full on application should be aware that deductions will only be available in accordance with the law prevailing at the end of the relevant financial year and that a deduction for some of the 'non capital' management fees paid in advance in this financial year may not be available till a later year.

51. The calculation of the deduction for management fees of a non-capital nature for a taxpayer who is not '**a small business taxpayer**' is as follows;

Year 1: Expenditure incurred on or before 30 June 2000

Available deduction = A + B

Where :

$$A = \text{Expenditure X } \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

B = (Expenditure *less* A) x 80%

Year 2: Expenditure is incurred on or after 1 July 2000 and on or before 30 June 2001

Available deduction = A + B + C

Where :

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

B = (Expenditure *less* A) x 60%

C = balance of the Year 1 expenditure not previously deducted

Year 3: Expenditure incurred on or after 1 July 2001 and on or before 30 June 2002

Available deduction = A + B + C

Where :

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

B = (Expenditure *less* A) x 40%

C = balance of the Year 2 expenditure not previously deducted.

Management Fees of a capital nature

52. For a Grower who invests in the Project **on or before 30 June 2000** who is **not a 'small business taxpayer'** and is carrying on a business, the deductions available in respect of expenditure other than 'non capital' management fees are shown in the Table below in relation to the years ended 30 June 2000 to 30 June 2002:

Non small business taxpayers who invest on/before 30 June 2000					
Expenses	**Legislation** ITAA 1997	**Refer Note**	**Year 1**	**Year 2**	**Year 3**
			30/6/2000	**30/6/2001**	**30/6/2002**
Licence Fee	8-1	(viii) below	150		
Irrigation	387-125	(iii) above	282	282	283
Landcare	387-55	(iv) above	160		
Trellising	42-15	(ix) below		18	51
Vine Guards	42-167	(x) below		105	105
Pre planting, including vines	387-165	(vii) above			97

(Note: all figures shown are exclusive of GST)

(viii) Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Section 82KZMD governs the deductibility of prepaid expenditure where the eligible service period ends more than 13 months after the date the expenditure was incurred. An amount of expenditure that is less than $1,000 is fully deductible in the year incurred (subsection 82KZMA (4) ITAA 1936). The prepaid Licence Fee incurred for the first 3 years on acceptance into the Project is less than $1,000, as long as the Grower does not acquire more than 6 Allotments. Where a Grower is allocated more than 6 Allotments the prepaid licence fees will amount to more than $1,000 and the deduction will be spread over the period to which the prepaid licence fees relate.

(ix) For 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 the deduction for depreciation of trellising is determined using the formulas in either subsection 42-160(3), 'Diminishing value method', or 42-165(2A), 'Prime cost method'. The formulas use 'effective life' to determine the deduction for depreciation. The deductions will depend 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 trellising is to be installed in Years 1 and 2. The Manager is to advise any affected Growers of relevant details of their depreciation deductions. The deductions for Years 2 and 3 have been calculated using the prime cost method on the assumption that the effective life of the trellising is 15 years, using the 'Prime cost method'. If the Grower elects to use the diminishing value method the rate for calculating the deduction will be 10%. **Paragraphs 62 to 63 contain information relating to proposed changes to apply from 1 July 2000. These changes, if implemented, will affect deductions in respect of expenditure on both trellising and vine guards for non-small business taxpayers.**

(x) For Growers who are not 'small business taxpayers' and 'small business taxpayers' who do not satisfy section 42-345, an immediate deduction for vine guards is available when installed and ready for use if acquired before 1 July 2000. The Manager will advise the Grower of the date the vine guards are installed ready for use in each of the years ended 30 June 2001 and 2002.

53. For a Grower who invests in the Project **after 30 June 2000** who is **not a 'small business taxpayer'** and is carrying on a business, the deductions available in respect of expenditure other than 'non capital' management fees are shown in the Table below in relation to the years ended 30 June 2001 to 30 June 2002:

Non small business taxpayers who invest after 30 June 2000					
Expenses	**Legislation ITAA 1997**	**Refer Note**	**Year 1**	**Year 2**	**Year 3**
			30/6/2000	**30/6/2001**	**30/6/2002**
Licence Fee	8-1	(i) above		150	
Irrigation	387-125	(iii) above		282	282
Landcare	387-55	(iv) above		160	
Trellising	42-15	(ix) above		18	51
Vine Guards	42-167	(x) above		105	105
Pre planting, including vines	387-165	(vii) above			97

(Note: All figures shown are exclusive of GST)

Assessable Income

54. For a Grower who invests in the Project, any income received from the sale of Grapes from the Grower's Allotment will be assessable income under section 6-5.

55. Any dividends received by way of the shareholding in Peel River Vineyards Limited will be assessable income to the Grower pursuant to section 6-10.

Sections 82KL and Part IVA

56. Section 82KL does not apply to deny the deductions otherwise allowable.

57. The relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained by any Grower under a tax law dealt with in this Ruling.

Proposed new laws

Losses from non-commercial business activities

58. Provisions introduced into Parliament, but not yet enacted, will mean that in some circumstances, losses arising from a business activity will not be allowed as deductions in the year that they arise. These provisions will only apply from 1 July 2000 to individual taxpayers (including individual taxpayers in general law partnerships) carrying on a business activity. They will not apply however, to an

individual with a loss from a primary production business activity where their non primary production assessable income for the income year (excluding any net capital gain) is less than $40,000 (proposed subsection 35-10(4)).

59. Under proposed subsection 35-10(2), where an individual taxpayer's business activity does not meet one of the objective tests set out in proposed sections 35-30, 35-35, 35-40 and 35-45 then, unless the Commissioner exercises the discretion in proposed section 35-55, a loss arising in an income year from the taxpayer's business activity cannot be claimed as a deduction in that year. A loss, in this context, refers generally to the excess of a taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

60. The Project's agreements, its prospectus, and its cash flow projections, show that Growers are expected to incur losses relating to interests in the Project during the Project's early years and, that none of the objective tests are expected to be met in those years. However, provided that a Grower's business activity under the Project is carried on during the income years specified below in the manner described in the Arrangement, the Commissioner will exercise his discretion under proposed paragraph 35-55(1)(b). The discretion will be exercised for each of the income years commencing 1 July 2000 and ending 30 June 2002.

61. In accordance with the decision to exercise the discretion during this period, and subject only to the above condition relating to the Arrangement (discussed below at paragraphs 124 and 125), Growers can deduct losses arising from interests they hold in the Project in the years that such losses arise.

Proposed changes to the tax treatment of low cost plant.

62. Provided the proposed changes are enacted as announced, the immediate 100% depreciation deduction for plant costing $300 or less will be abolished from 1 July 2000 for all taxpayers except small business taxpayers. The immediate deduction will be replaced by a low value pool arrangement.

63. Under proposed section 42-455(1), a Grower, who is not a small business taxpayer, would be able to choose to allocate the cost of all newly acquired plant costing less than $1,000 each to a low value pool in the year of acquisition. Once the choice is made to allocate low cost plant to the pool, <u>all</u> low cost plant acquired in that income year and subsequent years must be included in the pool (section 42-460 (1)). Growers who are not small business taxpayers would have the option of including both trellising and vine guards within this pool. The pool is to be depreciated using a diminishing

value rate of 37.5%. The value of plant included in or disposed of from the pool will be added to or subtracted from the value of the pool.

Proposed changes to prepayment rules

64. On 11 November 1999, the Government announced a number of changes to the deductibility of certain prepaid expenditure incurred in respect of 'tax shelter arrangements'. Provided the proposed changes are enacted as announced, the Project will be a 'tax shelter arrangement' and all Growers, including 'small business taxpayers', who invest in the Project after 1pm, AEST, 11 November 1999, will be subject to these changes.

65. For these Growers all 'non capital' Management fees will be deductible over the period to which the fees relate using the formula shown. In the calculation, the term 'expenditure' refers to expenditure otherwise allowable under section 8-1 ITAA 1997 whose 'eligible service period' ends not more than 13 months after it is incurred by the taxpayer. The 'eligible service period' (defined in subsection 82KZL(1)) means, generally, the period over which the services are to be provided.

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

66. The excess remaining after the application of this formula is deductible in the year that the services to which the excess relates are performed.

Note to promoters and advisers

67. 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 Australian Taxation Office suggests that promoters and advisers ensure that potential investors are fully informed of the announcement requiring prepayments in respect of 'tax shelter' arrangements to be deductible over the period services are provided. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Explanations

Sections 27-5 and 27-30: Goods and Services Tax

68. Section 27-30 operates to deny a deduction that would otherwise be available under section 8-1 for the year ended 30 June 2000 to the extent that the loss or outgoing (incurred after 30 November 1999 and before 1 July 2000) includes an amount relating to an input tax credit to which a Grower will be entitled after 1 July 2000. This is as a consequence of the application of section 10 of the *A New Tax System (Goods and Services Tax Transition) Act 1999*.

69. Section 27-5 operates to deny a deduction, that would be otherwise available under section 8-1, to the extent that the loss or outgoing incurred (after 1 July 2000) includes an amount relating to an input tax credit to which a Grower is entitled or a decreasing adjustment that a Grower has.

Subdivision 960-Q: Small business taxpayers

70. In this Product Ruling the term 'small business taxpayer' is relevant for the purposes of certain prepaid expenditure and depreciation of trellising and vine guards.

71. Whether or not a Grower is a 'small business taxpayer' depends upon the individual circumstances of each Grower. It is the responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

72. 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.

73. '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).

Section 8-1: Licence and management fees

74. It is appropriate, as a starting point, to consider whether licence and management fees are deductible under paragraph 8-1(1)(a). This consideration 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 outgoing is not deductible under paragraph 8-1(1)(b) if it is incurred when the business has not commenced; and
- where taxpayers contractually commit 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 paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoing in question would have a sufficient connection with activities to produce assessable income of the taxpayer.

75. A vineyard project can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from grapes from the scheme will constitute assessable income under section 6-5. 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 vines.

76. Generally, a Grower will be carrying on a business of a vineyard where:

- the Grower has an identifiable interest in specific grape vines coupled with a right to harvest and sell the grapes produced;
- the vineyard 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.

77. Under the Licence and Management Agreements, Growers have rights in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of a commercial vineyard. Under the Licence and Management Agreements, Growers also appoint (where they so choose) Lushvale Limited, as Manager, to provide services such as planting. The Agreements give Growers full right, title and interest in the grapes produced and the right to have the grapes sold for their benefit.

78. Under the agreements, Growers appoint the Manager to provide services such as pre planting and planting of grape vines (which are owned and paid for by the Grower licensee), the installation of trellising and irrigation, and all operations necessary to develop and maintain a mature fruit bearing vine. The Manager is also responsible for harvesting and selling the grapes.

79. The Licence and Management Agreement gives Growers an identifiable interest in specific vines and a legal interest in the land by virtue of a licence. Growers have the right to have their Allotment harvested separately (by engaging the Manager or otherwise) and to then take and personally market the produce attributed to their Allotment. Alternatively, they can allow the Manager to harvest and market the produce for them.

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

81. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections 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.

82. Growers will engage the professional services of a Manager with appropriate credentials. The services are based on accepted viticulture practices and are of the type ordinarily found in viticulture activities.

83. Growers have a continuing interest in the vines from the time they are acquired until they reach the end of the most productive period of their life. There is a means to identify which vines Growers have an interest in. The vineyard 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' vineyard activities will constitute the carrying on of a business.

84. The ''non capital'' management fees and licence fees associated with the vineyard activities will relate to the gaining of income from this business and, hence, have a sufficient connection to

the operations by which this income (from the sale of grape produce) is to be gained from this business. They will, thus, be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The tests of deductibility under paragraph 8-1(1)(a) are met. The exclusions of subsection 8-1(2) do not apply.

Expenditure of a capital nature

85. Any part of the expenditure of a Grower entering into a horticultural 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 irrigation, trellising, vine guards, pre-planting and construction of roads and buildings are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, expenditure of this nature can fall for consideration under specific capital write-off provisions of the ITAA 1997.

Section 42-15: Trellising expenditure

86. Growers accepted into the Project incur expenditure on trellising upon which the vines are attached and are to be used on their behalf in the operation of the vineyard business. This is attached to the land as a fixture. This expenditure is of a capital nature.

87. Under section 42-15, a taxpayer can deduct an amount for depreciation of a unit of plant used for the purpose 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.

88. It is, however, accepted in certain circumstances that a licensee is entitled to claim depreciation where the licensee is considered to be the owner of those improvements. Income Tax Ruling IT 175 sets out the Australian Taxation Office's (ATO's) views on this issue. Where a licensee is considered to own the improvements under a state law, as detailed in the Ruling, or where he/she have a right to remove the fixture or are entitled to receive compensation for the value of the fixture, the ATO accepts the licensee is entitled to claim depreciation for the fixture.

89. Under section 42-15 Growers are entitled to depreciation deductions for expenditure of $767, relating to the acquisition and installation of trellises on the land. The deduction available, however, will depend on when the plant is installed ready for use and whether

or not a Grower is a 'small business taxpayer' as defined in section 960-335 and, if so, whether the Grower complies with the conditions contained in section 42-345.

90. The depreciation deduction 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 cost of the trellising and 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.

91. Growers who are not 'small business taxpayers' or are 'small business taxpayers' who do not satisfy the conditions in section 42-345 will have entered the Project after 11:45am, by legal time in the ACT, 21 September 1999, and will not be able to claim accelerated depreciation on plant used in the Project because of section 42-118. The deduction for such Growers is based on the effective life of the plant. Subdivision 42-C provides the choice of methods available for determining the effective life of plant.

92. A Grower accepted into the Project enters into a licence for a right to occupy certain land upon which they are entitled to grow grapes to conduct a viticulture business. Subject to the terms and conditions of the Licence Agreement, they have a right to remove the vines and fixtures within their Grower's Allotment.

93. The Manager will advise Growers the date the trellising is installed and begins to be used for the purpose of producing assessable income. Therefore, the cost that relates to the acquisition and installation of trellises on the land will be eligible for depreciation deduction by the Growers, who are small business taxpayers, under section 42-125. Growers, who are not small business taxpayers, will be eligible for a depreciation deduction under subsections 42-160(3) or 42-165(2A). **Paragraphs 62 to 63 contain information relating to proposed changes to apply from 1 July 2000. These changes, if implemented, will affect deductions in respect of expenditure on low cost plant, acquired by other than 'small business taxpayers', after 1 July 2000 and will apply to both trellising and vine guards.**

94. Under section 42-167 a Grower who is a 'small business taxpayer' is also entitled to 100% depreciation deductions for expenditure totalling $210 on vine guards, being items with a cost less than $300.

95. Where a Grower is not a 'small business taxpayer' this 100% deduction may not apply after 1 July 2000. **Proposed changes to the treatment of low cost plant, acquired by non 'small business taxpayers' after 1 July 2000 are described in paragraphs 62 to 63.**

Subdivision 387-B: Irrigation expenditure

96. Subdivision 387-B 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.

97. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant or lessee, a deduction would be available to the Growers in the Project based on one-third of the cost of the irrigation system in the year in which the expenditure in incurred, and for each of the next two income years.

Section 387-165: Horticulture expenditure

98. Section 387-165 allows capital expenditure on establishing horticultural plants for use in a horticultural business to be written off for tax purposes. Costs of establishing horticultural plants may include the cost of acquiring the plants; the cost of establishing the plants; and the costs of ploughing, contouring, top dressing, fertilising and stone removal. Expressly excluded is expenditure incurred on draining swamps or clearing land. Under subsection 387-170(3), the definition of 'horticulture' includes the cultivation of grapevines. For the purpose of this Subdivision, a lessee or licensee of land carrying on a business of horticulture is treated as owning the plants growing on that land rather than the actual owner of the land.

99. The write-off commences from the time the vines are used or held ready for use for the purpose of producing assessable income in commercial horticulture. The write-off deductions will commence when the vines enter their first commercial season. Where the vines are planted in or about September 2000, it is projected that these vines will become commercially productive after a period of 2.5 years. The Manager will advise the Grower when this occurs.

100. Under this Subdivision, if the effective life of the plant is more than 3 years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period.

101. The effective life of a plant is to be determined objectively and should take into account all relevant circumstances. It is estimated that the vines will have an effective life in excess of 13 years. The write-off rate for horticultural plants with an effective life of 13 to 30 years is 13%.

Alternative view

102. The applicant has indicated disagreement with the view that the grapevines do not commence to be used for the purpose of producing assessable income in a horticultural business until their first commercial season, and has submitted an alternative view that the grapevines commence to be so used immediately after their establishment. This view is submitted by the applicant to be more consistent with the inclusion of propagation and cultivation within the meaning of 'horticulture' under the relevant provisions, the timing aspects of other distinctions drawn between capital and revenue costs and the acceptance of the use of the trellises for income producing purposes from the earlier time.

Section 82KZM: prepaid expenditure for small business taxpayers

103. Section 82KZM operates 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. The section affects the deductibility of prepaid expenses where the taxpayer is a small business taxpayer or where the expenditure is not incurred in carrying on a business. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not to be wholly done within 13 months after the day on which the expenditure is incurred.

104. Subparagraph 82KZM (b)(ii) excludes expenditure of less than $1,000 from the scope of section 82KZM. The prepaid Licence Fee incurred for the first 3 years on acceptance into the Project is less than $1,000, as long as no more than 6 Allotments are acquired by the Grower. The basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the prepaid Licence Fee by Growers who are 'small business taxpayers'.

82KZMA to 82KZMD: prepaid expenditure for taxpayers other than small business taxpayers

105. For a Grower who is not a 'small business taxpayer' and is carrying on a business, sections 82KZMA to 82KZMD determine the amount of a deduction otherwise allowable under section 8-1 where expenditure is incurred under an agreement for the doing of a thing that is not to be wholly done within the income year in which the expenditure is incurred (the expenditure year). Generally, these provisions operate to limit the amount of deduction available in the expenditure year to the amount that relates to that income year.

106. Section 82KZMA is a gateway provision that sets out when the new treatment will apply. Sections 82KZMB and 82KZMC set out the rules for prepayments incurred in the transitional period, for things to be done wholly within 13 months. For Growers investing in the Project on or after 1 June 2000, transitional treatment applies to expenditure incurred in the 1999-2000 income year. Section 82KZMD governs the deductibility of prepaid expenditure where the eligible service period ends more than 13 months after the date the expenditure was incurred.

107. An amount of expenditure that is less than $1,000 is fully deductible in the year incurred (subsection 82KZMA (4) ITAA 1936). The prepaid Licence Fee incurred for the first 3 years on acceptance into the Project is less than $1,000, as long as no more than 6 Allotments are acquired by the Grower.

Proposed changes to prepayment rules

108. The changes announced by the Government to apply from 11 November 1999 but not yet enacted will affect all taxpayers that participate in a 'tax shelter arrangement' and prepay expenditure for up to 13 months. It is proposed that deductions otherwise allowable under section 8-1 of the ITAA 1997 be spread over the period to which the prepayment relates. Under the proposed changes, there will be no exemption for small business taxpayers and no transitional rules will apply.

109. An amount of expenditure that is less than $1,000 is indicated in the announcement as being excluded from these changes, so that the position regarding the initial prepaid Licence Fee will still be deductible when incurred as long as no more than 6 Allotments are acquired by the Grower.

110. A tax shelter arrangement is described as existing where:

- under the arrangement, the taxpayer's allowable deductions exceed the assessable income for that year; and
- all significant aspects of the arrangement during the income year are conducted by people (e.g., a manager) other than the taxpayer; and
- either:
    - more than one taxpayer participates in the arrangement; or
    - the manager, or an associate of the manager, also manages similar arrangements on behalf of others.

111. The arrangement relating to the Project and described at paragraph 14 to 39 of this product ruling is within the description of a 'tax shelter arrangement'. Therefore, the ''non capital'' Management Fees incurred by Growers who invest in the Project after 11 November 1999 will be deductible over the period the services are provided. The formula for calculating the deductible amount is expected to be the same as that currently shown in subsection 82KZMD(2).

Section 82KL

112. 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'.

113. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received 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.

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

Part IVA: General anti-avoidance provision

115. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into or carrying out the scheme to enable the relevant taxpayer to obtain a tax benefit in connection with the scheme (section 177D).

116. The Peel River Vineyards Project will be a 'scheme'. The Growers will obtain a 'tax benefit' from entering into the scheme, in the form of the tax deductions per Allotment 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 enabling the relevant taxpayer to obtain this tax benefit.

117. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the sale of

the grapes from the vines. Further, there are no features of the Project, such as the payment of excessive management fees and non-recourse loan financing by any entity associated with the Project, that might suggest the Project was so 'tax driven', and so designed to produce a tax deduction of a certain magnitude, that it would attract the operation of Part IVA. No ruling is given on the application of Part IVA to financing arrangements entered into between investors and other financiers in respect of lending arrangements to invest in the Project.

Proposed changes to losses from non-commercial business activities

118. Under the rule in proposed subsection 35-10(2), a deduction for losses incurred by individuals (including individuals in general law partnerships) from certain business activities will not be allowable in an income year unless:

- one of four statutory objective tests is met; or
- the Commissioner exercises a discretion to allow the losses.

119. In broad terms, the statutory 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).

120. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities of a similar kind. And, under subsection 35-10(4), there is an 'Exception' to the general rule in section 35-55(2) where the losses are from primary production business activities and the individual taxpayer has other assessable income for the income year of less than $40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of taxpayers they are beyond the scope of this Product Ruling and are not considered further.

121. Information provided with the application for this Product Ruling indicates that investors in the Project are unlikely to pass one of the statutory tests until the income year ended 30 June 2006 and therefore, unless the Commissioner exercises a discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer the loss from the business activity to a future year.

122. 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 individual investors who acquire interests in the Project, the Commissioner has determined that it would be unreasonable not to exercise the discretion in paragraph 35-55(1)(b).

123. The discretion in paragraph 35-55(1)(b) may be exercised 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 with an interest in the Project will either pass one of the statutory tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

124. 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 in the manner described in the Arrangement, the Commissioner's discretion will not have been exercised as one of the key conditions in paragraph 35-55(1)(b) will not have been met.

125. In deciding to exercise his discretion the Commissioner has relied upon:

- the report of Dr Richard Smart, an independent viticulturist;
- the binding Grape Sales Contract with Cameron Estates for a period of 15 years. The contract's pricing mechanism is fixed for the first 3 years and ensures that, after that time, Cameron Estates is obligated to accept the grapes based on the published weighted average price of the most comparable viticultural region for each of the vineyards; and
- 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.

Assessable income

126. Gross sale proceeds derived from the sale of grapes harvested from the Project will be assessable income of the Growers, under section 6-5.

127. Once harvested, a Grower's grapes will, in most circumstances, be trading stock of the Grower. As a consequence, if grapes are on hand at the end of the income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Division 70 of the ITAA 1997.

128. Any dividends received by way of the shareholding in Peel River Vineyards Limited will be assessable income to the Grower pursuant to section 6-10.

Examples

129. **Example 1: Obligation to prepay expenditure arising on or after 21 September 1999 and before 1pm AEST 11 November – applies to taxpayers who are not small business taxpayers and are carrying on a business:**

Joseph Gardener has extensive business interests and his turnover for the 1999/2000 income year exceeds $1 million. Therefore, he is not a small business taxpayer and is subject to the 21 September 1999 changes to the tax laws relating to prepaid expenditure. Joseph enters into a contract with Pinetree Pty Ltd to manage his one hectare interest in the No 2 Pine Plantation. Joseph's management contract is executed on 20 October 1999 for management services to be provided from 1 June 2000. Under the contract, the first five year's management fees, payable 12 months in advance on 1 June each year, are $6,000 in the first year and $1,200 for each of the following four years. Joseph is unable to deduct the whole of his prepaid management fees in the years in which they are incurred. The fees are instead deductible over the eligible service period over which the management services will be provided. However, as the law currently stands, Joseph is able to take advantage of certain transitional rules that 'shade-in' the effect of the changes to the prepayment laws.

For 1999/2000 Joseph can claim a deduction of $4,899 for expenditure incurred before 30 June 2000 on management fees. This amount is calculated as A + B where:

$$A = \text{Management fee} \times \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$= \$6{,}000 \ X \ \frac{30}{365} = \$493$

B = (Management fee *less* A) X 80%

= ($6,000 - $493) X 80% = $4,406

The balance of the $6,000 management fees that were prepaid on 1 June 2000 (i.e. $1,101) is carried forward and can be claimed as a deduction in the 2000/2001-income year.

For 2000/2001, Joseph can claim a deduction of $1,861 for expenditure incurred after 1 July 2000 and before 30 June 2001 on management fees. This amount is calculated as A + B + C where:

$A = \$1{,}200 \ X \ \frac{30}{365} = \$99$

B = ($1,200 - $99) X 60% = $661

C = $1,101

Note that the third component (Part C) is the amount carried forward from 1999/2000. As in the first year, the balance of the $1,200 management fees prepaid on 1 June 2001 (i.e. $440) is carried forward and can be claimed as a deduction in the 2001/2002 income year. It should also be noted that in certain circumstances, not present in most projects with product rulings, 'capping provisions' will apply in the second and subsequent transitional years. These are complex and are not explained in this example.

Similarly, for 2001/2002, Joseph can claim a deduction of $980 for expenditure incurred after 1 July 2001 and before 30 June 2002 on management fees. This amount is calculated as A + B + C where:

$A = \$1{,}200 \ X \ \frac{30}{365} = \$99$

B = ($1,200 - $99) X 40% = $441

C = $440

Note that the third component (Part C) is again the amount carried forward from 2000/2001. As in the first two years, the balance of the $1,200 management fees prepaid on 1 June 2002 (i.e. $660) is carried forward and can be claimed as a deduction in the 2002/2003-income year.

130. **Example 2: Obligation arising after 1pm AEST 11 November 1999 to prepay expenditure – applies to all taxpayers investing in 'tax shelter arrangements':**

Assume the same facts as above except that the management agreement is executed after 11 November 1999. Assume also that the No 2 Pine Plantation is a 'tax shelter arrangement'. For the Management fee of $6,000 incurred on 1 June 2000 for management services to be provided between that date and 31 May 2001, Joseph can claim a deduction for the 1999/2000 income year determined in the following way:

$$\text{Management fee X} \quad \frac{\text{Number of days of eligible service period in the expenditure year}}{\text{Total number of days of the eligible service period}}$$

$$\$6{,}000 \text{ X } \frac{30}{365} = \$493$$

In the following year Joseph can claim the balance of the $6,000 prepayment (ie $5,507) because that is the year in which the services are to be provided. The second and third year's management fees are calculated using the same method.

Detailed contents list

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

Commissioner of Taxation
7 June 2000

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
PR 1999/95; TR 92/1; TR 92/20; TR 97/11; TR 97/16; TR 98/22; TD 93/34; IT 175; IT 2001

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

Legislative References:
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 27-5
- ITAA 1997 27-30
- ITAA 1997 42-15
- ITAA 1997 42-118
- ITAA 1997 42-125
- ITAA 1997 42-345
- ITAA 1997 42-160
- ITAA 1997 42-165
- ITAA 1997 387-125
- ITAA 1997 387-165
- ITAA 1997 960-335
- ITAA 1997 960-340
- ITAA 1997 960-345
- ITAA 1997 960-350
- ITAA 1997 387-170
- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZM
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
- ITAA 1936 82KZMD
- ITAA 1936 Pt IVA

ATO references:
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