



PR 2001/11 - Income tax: Palandri 2000 Project - Second Offering

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 This document has changed over time. This is a consolidated version of the ruling which was published on *7 February 2001*



Product Ruling

Income tax: Palandri 2000 Project – Second Offering

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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.

Potential investors may wish to refer to the ATO’s Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

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 Palandri 2000 Project, or just simply as 'the Project'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- section 6-5 *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 8-1 (ITAA 1997);
 - section 17-5 (ITAA 1997);
 - Part 2-25 (ITAA 1997);
 - Division 27 (ITAA 1997);
 - Division 35 (ITAA 1997);
 - section 82KL *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KZM and 82KZMB - 82KZMD (ITAA 1936);
 - section 82KZME - 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 Member) to be entitled to claim input tax credits for the GST included in its expenditure, the entity 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 'Members'.

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 arrangements 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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apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

11. This Ruling applies prospectively from 7 February 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 2004. 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 6 November 2000;
- The Margaret River Wine Business Project 2001 Draft Prospectus dated 2 November 2000;

- **Constitution for the Margaret River Wine Business Project 2001 between Palandri Wines Ltd [the ‘Responsible Entity’], and the Member, undated;**
- **Lease and Management Agreement between Palandri Wines Ltd [the ‘Responsible Entity’], Palandri Production Ltd [the Wine Production Company] and the Member, undated;**
- Vineyard Management and Maintenance Agreement between Palandri Wines Ltd and Quenby Viticultural Services Pty Ltd, undated;
- Vineyard Establishment Agreement between Palandri Production Ltd and Quenby Viticultural Services Pty Ltd, undated; and
- Additional correspondence dated 30 November 2000, 19 December 2000, 21 December 2000, 22 January 2001 and 1 February 2001,

Note: certain information received from Palandri Wines Ltd 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 the Members enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Member, or any associate of the Member, will be a party to, with the exception of finance agreements, to which paragraphs 41 and 42 apply. The effect of these agreements is summarised as follows.

Overview

16. These arrangements are called the Palandri 2000 Project.

Location	South West Region of Western Australia, 50 kms west of Mt Barker in the Frankland River wine region.
Type of business each participant is carrying on	A commercial viticulture and wine production business for a period of 18 years.
Number of hectares under cultivation	60 hectares
Name used to describe the product	Palandri 2000 Project
Size of each Vineyard Lot	0.023 hectares
Number of vines per hectare	1,852

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Expected production	108,300 cases per annum
The term of the investment in years	18 years
Initial cost	\$11,000
Initial cost per hectare	\$478,260
Ongoing costs	Annual Management Fees and Rent.

17. Members applying under the Draft Prospectus dated 2 November 2000 enter into a Management and Lease Agreement. Palandri Production Ltd agrees to sub-lease to the Member an identifiable area of land called a 'Vineyard Lot' until the Project is terminated on 30 June 2018. Each Vineyard Lot is 0.023 hectares in size.

18. The Project Land is situated in the South West Region of Western Australia, approximately 50kms west of Mt Barker. Palandri Production Ltd holds a Head Lease over the land.

19. Palandri Production Ltd will sub-lease the Vineyard Lot to the Member for the purpose of Cultivating Vines and Harvesting Grapes. The vines must be planted by Palandri Production Ltd at the rate of 42 vines per Vineyard Lot either at the commencement date or within three months after the commencement date.

20. The Prospectus states that there is no minimum subscription for the Project. Each investor may subscribe for a minimum of one Vineyard Lot. Members may also acquire a minimum of 400 shares in Margaret River Wine Production Ltd at a cost of \$5 per share.

21. Possible projected returns for Members are outlined on pages 34 and 35 of the Prospectus. The projected returns are subject to the inherent risks of primary production and the commercial risks of a long term venture of establishing, growing and harvesting a commercial vineyard and the production, marketing and sale of wine. The risks associated with the Project have been outlined in the Prospectus. Members will execute a Power of Attorney enabling the Responsible Entity, Palandri Wines Ltd, to act on their behalf as required when they make an application for a Vineyard Lot.

22. The Prospectus expires on 30 June 2001. The first year services under the Lease and Management agreement will be performed by 30 June 2001, only where the Member has invested in the Project by 31 May 2001. The first year services for Members who invest in the Project between 1 June 2001 and 30 June 2001 will be carried out in the period 1 June 2001 to 31 July 2001

Constitution

23. The Constitution for the Project sets out the terms and conditions under which the Responsible Entity agrees to act for the Members and to manage the Project. The Responsible Entity will keep a register of Members. Members are entitled to assign their Member's Interest in certain circumstances. As stated in paragraph 7 above, this ruling only applies to those Members who have a purpose of staying in the arrangement for the full term of the Project. The Management and Lease Agreement will be executed on behalf of a Member following the Member signing the Application and a Power of Attorney Form in the Prospectus. Members are bound by the Constitution and the Management and Lease Agreement by virtue of their participation in the Project.

Compliance Plan

24. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Law. Its purpose is to ensure that the Responsible Entity meets its obligations as the Responsible Entity of the Project and that the rights of the Members are protected.

Interest in Land

25. A sub-lease is granted by the Head Lessor, Palandri Production Ltd, to the Members under the terms of the Management and Lease Agreement (cl.3.1). Members are granted an interest in land in the form of a sub-lease to use their Vineyard Lots for the purpose of cultivating Vines and Harvesting Grapes to produce, then market and distribute wine grown from the grapes on their Vineyard Lot (Recital D). Members must pay rent to the Lessor of an amount of \$165 per Vineyard Lot per annum commencing on application and thereafter on 1 July of each year. This fee will be indexed annually. This amount includes GST. The term of a Member's lease is from the Commencement Date until 30 June 2018.

Lease and Management Agreement

26. Each Member enters into a Lease and Management Agreement with the Responsible Entity. The termination of the project is the date of completion of final harvest of the Grape Produce (Item 3 of Schedule). Members contract with the Responsible Entity to manage, maintain and harvest grapes from the vines and to produce and market wine on their behalf. Members pay a Management Fee of \$10,835 in Year One, \$4,642 in Year Two, \$4,010 in Year Three and an amount annually thereafter which is the Members' proportion of the

Management Costs (indexed) plus the Corporate Costs for performing the services under this agreement.

27. The Responsible Entity will carry out the following services under this agreement:

- Maintain a trickle irrigation system to the Vines on the relevant Vineyard Lot;
- Cultivate, tend, prune, fertilise, spray and otherwise care for the vines as when required;
- Use all reasonable measures to keep the relevant Vineyard Lot free from vermin, noxious weeds, pests and disease;
- At all times maintain the relevant Vineyard Lot and the Second Stage Vineyard Lot according to good viticultural practice;
- take all reasonable steps to prevent and manage land degradation on the relevant Vineyard Lot and to attend to the maintenance and management of the soil quality on the relevant Vineyard Lot;
- harvest the Vines on the relevant Vineyard Lot and delivery of the Grape Produce to transport vehicles in accordance with good viticultural practice;
- purchase grapes and juice to supplement grapes grown on the relevant Vineyard Lot;
- arrange for the Wine to be bottled, corked and packaged and for the bottled wine to be placed in cartons;
- carry out the marketing strategy referred to in the Prospectus; and
- carry out the distribution and sales strategies referred to in the Prospectus.

28. The Responsible Entity will be responsible for paying the cost of public risk insurance in respect of the Vineyard Lot and insurance against destruction or damage from usual risks in accordance with approved wine industry practices in respect of the grape produce and the wine (cl.19.1).

29. A Member can terminate the Lease and Management Agreement where there has been a breach (of a substantial nature) by the Responsible Entity which has not been remedied after written notice by the Member to do so or where the Responsible Entity commits an act of bankruptcy or goes or is placed into liquidation (cl.13.2).

30. The Responsible Entity will provide a report to Members on or before 31 July and 31 January each financial year containing a review of the operations of the Member's Wine Business during the relevant period (cl.17.1).

31. The Responsible Entity will tend to the Vines according to good viticultural practices. The services to be provided by the Responsible Entity over the term of the project are outlined in the Management and Lease Agreement (Item 11 of Schedule).

Harvesting

32. The Responsible Entity will be responsible for the harvesting of the grapes, and/or purchase of grapes and delivery of these grapes to the Winery and for production of Wine from those grapes and storage of the wine. Commencing from the date of the first commercially harvestable grape crop, or at such time or times as the Responsible Entity in its absolute discretion considers appropriate, the Responsible Entity will harvest or arrange for some other person to harvest the Grape Produce at such time or times as, in the opinion of the Responsible Entity, will result in Grape Produce suitable for the purposes of making quality wines.

33. The Receipts from the sale of Wine will be paid into the Proceeds Fund established by the Responsible Entity. Receipts received by the Responsible Entity are to be distributed in the following order of priority:

- Payment of any Annual Payments payable by the relevant Member;
- Payment of any other amounts payable by the relevant Member under the Lease and Management Agreement or any provision of the Constitution; and
- Distribution of the remainder to the relevant Member (cl.19.2 of the Lease and Management Agreement.).

Fees

34. The total Fee payable in the first year under the Lease and Management Agreement for the Project is \$11,000 per Vineyard Lot. This fee includes the Management Fee of \$10,835 and the Rent Fee of \$165 and is payable either in full on application or under a Time Payment Option. Under the Time Payment Option, a first instalment of \$2,200 is payable on application and monthly payments of not less than \$600 are payable each month with any outstanding balance of the Fees due and payable on 15 June 2001. The Time Payment Option will not be available to Members who invest in the Project after

31 May 2001. Where the Member lodges an application prior to 1 June 2001, the services to be carried out for these Fees will be commenced after the Member has been accepted into the Project and will be completed on or before 30 June 2001. Where the Member lodges an application after 31 May 2001, the services to be carried out for these fees will be commenced after the Member has been accepted into the Project and will be completed on or before 31 July 2001.

35. Where a Member invests in the Project before 1 June 2001, a Management Fee of \$4,642 is payable for services to be carried out in the period commencing 1 July 2001 and continuing until 30 June 2002 and is payable on 1 July 2001. Where a Member invests in the Project after 31 May 2001, a Management Fee of \$4,642 is payable for services to be carried out in the period commencing 1 August 2001 until 30 June 2001, and is payable on 1 July 2001. These fees are payable in advance of the services being provided.

36. A Management Fee of \$4,010 is payable for services to be carried out in the period commencing 1 July 2002 and continuing until 30 June 2003 and is payable on 1 July 2002.

37. For the years from 1 July 2003 to 30 June 2018, Management Fees are payable by the Member each year for the Member's proportion of the estimated management costs (indexed by the Inflation Adjustment Factor for the Relevant Financial Year) plus the Member's proportional interest of the estimated Corporate Costs.

38. For Members who invest in the Project prior to 1 June 2001 rent of \$165 per year, indexed annually by the Inflation Adjustment Factor for the relevant Financial Year, is payable by the Member. Rent is incurred on application and thereafter on 1 July each year. For Members who invest in the Project after 31 May 2001, rent of \$165 is payable for the period from the time of application to 31 July 2001. Rent is payable in advance on 1 July 2001 for the period 1 August 2001 to 30 June 2002. Rent of \$165, indexed annually, is payable on 1 July each year thereafter.

39. The Viticulturist Consultant has stated in the report, at pages 54 - 59 of the Prospectus, that with appropriate establishment procedures and sound management, this project can achieve its aims and objectives as outlined in the Prospectus.

40. The Application Monies will be held in the Trust Account by the Responsible Entity as Bare Trustee formed under the Project's Constitution (cl.12.1).

Finance

41. Members can fund their investment in the Project themselves, borrow from Palandri Finance Ltd or United Pacific Finance Pty Ltd

(lenders associated with the Responsible Entity) or borrow from an independent lender.

42. Palandri Finance Ltd will borrow funds from a financial institution to on-lend to Members. Where Members obtain finance from United Pacific Finance Pty Ltd, Palandri Finance Ltd will provide a guarantee to United Pacific Finance Pty Ltd that, upon default by a Member, Palandri Finance will be responsible for the debt. The Directors of Palandri Finance Ltd have signed an undertaking that Palandri Finance Ltd will seek to recover all debts on normal commercial terms. All loans are fully recourse in nature.

43. This Ruling does not apply if a Member 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 other than Palandri Finance Ltd or United Pacific Finance Pty Ltd, are involved, or become involved, in the provision of finance to Members for the Project.

Ruling

Section 6-5 Assessable Income

44. A Member's share of the Gross sale proceeds derived from the sale of wine from the Project, less any GST payable on these

proceeds, will be assessable income of the Member under section 6-5 of ITAA 1997. Section 17-5 of the ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply. If grapes or grape juice or bottled wine are on hand at the end of the income year, the Member will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of ITAA 97.

Section 8-1

Deductions where Members invest in the Project before 1 June 2001 and are not registered or required to be registered for GST

45. Members may claim tax deductions in the Table below where they :

- participate in the Project to carry on the business of growing grapes and producing and marketing wine;
- incur the fees shown in paragraphs 34-38 by 31 May 2001; and
- are not registered or required to be registered for GST.

Fee Type	ITAA 1997 Section	Year 1 30/6/2001	Year 2 30/6/2002	Year 3 30/6/2003
Management Fee	8-1	\$10,835	\$4,642 See note (i) below	\$4,010 See note (i) below
Lease Fee	8-1	\$165	\$165 See note (i) below	\$170 See note (i) below
Interest	8-1	See note (ii) below	See note (ii) below	See note (ii) below

Notes:

- (i) Where a member incurs the management fees and the lease fees and the rent as required by the Lease and Management Agreement those fees are deductible in full in the year incurred. However, if a Member 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 prepayment 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 paragraph 50 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 entered into with financiers other than Palandri Finance Pty Ltd or United Pacific Finance Pty Ltd (i.e., the associated lenders) is outside the scope of this Ruling. However, all Members who finance their participation in the Project other than with Palandri Finance Ltd or United Pacific Finance Pty Ltd should read carefully the discussion of the prepayment rules in paragraphs 85 and 86 below as those rules may be applicable if interest is prepaid.

Deductions where a Member invests in the Project before 1 June 2001 and is registered or is required to be registered for GST

46. Where a Member who is registered, or required to be registered, for GST:

- participates in the Project to carry on the business of growing grapes and producing and marketing wine;
- incurs the fees shown in paragraphs 34-38 by 31 May 2001; and
- is entitled to an input tax credit for the fees,

then the deductions will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). See example 1 at paragraph 105.

Sections 82KZM, 82KZMB - 82KZMD and 82KZME – 82KZMF

47. For a Member who invests in the Project before 1 June 2001 and incurs expenditure in accordance with the Lease and Management Agreement, the following provisions of the ITAA 1936 have application as indicated:

- expenditure by the Member does not fall within the scope of section 82KZM (but see paragraphs 73 to 78);
- expenditure by the Member does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 73 to 78);
- expenditure by the Member does not fall within the scope of sections 82KZME – 82KZMF (but see paragraphs 73 to 78);

Deductions where a Member invests in the Project after 31 May 2001 and is not registered nor required to be registered for GST

48. A Member may claim tax deductions using the methods and Tables in paragraphs 49 and 50, where the Member:

- participates in the Project by 30 June 2001 to carry on the business of growing grapes and producing and marketing wine;
- incurs the fees shown in paragraphs 34-38; and
- is not registered nor required to be registered for GST.

Section 8-1 – prepaid fees

49. Expenditure incurred by a Member who participates in the Project after 31 May 2001 is subject to the prepayment rules contained in sections 82KZME and 82KZMF. Therefore, a Member who prepays fees that are otherwise allowable under section 8-1 **cannot** claim a tax deduction for the fees in the year in which the expenditure is incurred unless it is ‘excluded expenditure’ (see note (ii) below).

50. The amount and timing of tax deductions allowable each year for such fees must be determined using the formula in subsection 82KZMF(1). In that formula, which is shown below, the ‘eligible service period’ means, generally, the period over which the services are to be provided.

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

In this Project, the tax deductions allowable for the Rent and Management Fees (detailed at paragraphs 34-35 in the Arrangement) must be calculated by applying the formula to the amount incurred each year by the Grower. The application of this method is shown in the Example at paragraph 106.

Fee type	ITAA 1997 section	Year 1 deduction 30/6/2001	Year 2 deduction 30/6/2002	Year 3 deduction 30/6/2003
Management fees (for services to be completed by 31 July 2001)	Section 8 –1	Amount must be calculated – see notes (i) & (iv) below	Amount must be calculated – see notes (i) & (iv) below	

Management fees (for services to be completed after 30 June 2001)	Section 8-1		\$4,642 See note (iv) below	\$4,010 See note (iv) below
Rent (for rent payable for the period 1 June – 31 July 2001)	Section 8 –1	Amount must be calculated – see notes (i), (ii) & (iv) below	Amount must be calculated – see notes (i) (ii) & (iv) below	
Lease fees (for Years 2 and 3)	Section 8-1		\$165 See note (iv) below	\$170 See note (iv) below
Interest	Section 8 –1	As incurred – see notes (ii), (iii) & (iv) below	As incurred – see notes (ii), (iii) & (iv) below	As incurred – see notes (ii), (iii) & (iv) below

Notes:

- (i) The Rent and Management fees shown in the Table at paragraph 50 above are **NOT** deductible in full in the year ended 30 June 2001. The deduction for each year's fees must be determined using the formula above (see paragraph 50). The Project Manager will inform Members of the number of days in the 'eligible service period' in the first 'expenditure year'. This figure is necessary to calculate the deduction allowable for the fees incurred. See Example 2 at paragraph 106.
- (ii) Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. Deductibility of amounts of \$1,000 or more, such as may occur where a Member acquires a number of interests in the Project, will be determined on the same basis as the prepaid Management fees, i.e., using the formula shown above (in paragraph 50).
- (iii) The deductibility or otherwise of interest arising from agreements entered into with financiers other than Palandri Finance Ltd or United Pacific Finance Pty Ltd (i.e., the associated lenders) is outside the scope of this Ruling. However, all Members who finance their participation in the Project other than with Palandri Finance Ltd or United Pacific Fiance Pty Ltd should read carefully the discussion of the prepayment rules in

paragraphs 85 and 86 below as those rules may be applicable if interest is prepaid.

- (iv) Where a Member **chooses** to prepay fees beyond 13 months, sections 82KZME and 82KZMF will not apply to set the amount and timing of that Member's tax deductions. Instead, unless the expenditure is 'excluded expenditure', the amount and timing of the tax deductions is determined under either subsection 82KZM(1) or subsection 82KZMD(2) (see paragraphs 76 to 78). To apportion the expenditure over the eligible service period, these provisions, which apply respectively to 'small business taxpayers' and taxpayers who are not 'small business taxpayers', effectively use the same formula as that shown above.

Deductions where a Member invests in the Project after 31 May 2001 and is registered or required to be registered for GST

51. Where a Member who is registered or required to be registered for GST:

- participates in the Project by 30 June 2001 to carry on the business of growing grapes and producing and marketing wine;
- incurs the fees shown in paragraphs 34-38; and
- is entitled to an input tax credit for the fees,

then the tax deductions calculated using the methods and Tables in paragraph 50 (above) will exclude any amounts of input tax credit (Division 27 of the ITAA). See Example 1 at paragraph 105.

Section 35-55 – losses from non-commercial business activities

52. For a Member 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 his/her involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 and 30 June 2002 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.

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

- a Member'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 90 in the Explanations part of this ruling, below).

54. Where either the Grower's business activity satisfies one of the objective tests, the discretion in sub-section 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Member 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.

55. Members are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Members should not see the Commissioner's decision to exercise the discretion in paragraph 35-55(1) 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.

Section 82KL

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

Part IVA

57. 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 - ITAA 1997

58. Consideration of whether lease and management fees are deductible under section 8-1, begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings 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 a taxpayer contractually commits himself/herself 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 paragraph 8-1(1)(a), and determining whether the outgoings in question have a sufficient connection with activities to produce assessable income.

Is the Member carrying on a business?

59. A viticultural scheme can constitute the carrying on of a business. Where there is a business, or a future business, the gross sale proceeds from the sale of the grape produce and wine from the scheme will constitute assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending, maintaining and harvesting of the grapes each year from the vines, and the production, marketing and sale of wine.

60. Generally, a Member will be carrying on a business of viticulture where:

- the Member has an identifiable interest in specific growing vines coupled with a right to harvest and sell the produce from the vines and the wine produced;
- the viticulture activities are carried out on the Member'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.

61. For this Project Members have, under the Lease and Management Agreement, rights in the form of a lease over an identifiable area of land consistent with the intention to carry on a business of growing grapes and the production, marketing and sale of wine. Under the Lease and Management Agreement Growers appoint Palandri Wines Ltd, as Responsible Entity, to cultivate, tend, train, prune, fertilise, replant, spray and otherwise care for the grape vines as and when required that is consistent with Good Viticultural Practice

and to use all reasonable measures to keep the Leased Area free from vermin, noxious weeds, pests and diseases. Members are considered to control their investment.

62. The Lease and Management Agreement provides Members with more than a chattel interest in the vines. The Project documentation contemplates Members will have an ongoing interest in the vines.

63. Members have the right to use the land in question for viticulture purposes and wine production and to have the Responsible Entity come onto the land to carry out its obligation under the Lease and Management Agreement. The Members' degree of control over the Responsible Entity, as evidenced by the Lease and Management Agreement and supplemented by the Corporations Law, is sufficient. Under the Project, Members are entitled to receive regular progress reports on the Project by Palandri Wines Ltd. Members are able to terminate arrangements with the Responsible Entity in certain instances, such as where there has been any substantial breach by the Responsible Entity of any material obligation under the Lease and Management Agreement or the Responsible Entity being placed in liquidation or official management. The viticultural activities described in the Lease and Management Agreement are carried out on the Members' behalf.

64. 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 Draft Prospectus that suggest the Project should return a 'before-tax' profit to the Members, i.e, a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

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

66. Members 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 Members' viticulture activities will constitute the carrying on of a business.

67. The rent and management fees associated with the viticulture activities and wine production 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 and wine) 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 the management fee. The tests of deductibility under section 8-1 are met. The exclusions do not apply.

Sections 82KZME and 82KZMF – prepaid fees

68. Expenditure prepaid by Members who invest in the Project after 31 May 2001 for management fees and rent meets the requirements of subsections 82KZME(1) and (2) and the expenditures are incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies to the expenditures, the amount and timing of tax deductions for those expenditures are determined under section 82KZMF.

69. In relation to the requirements of subsection 82KZME(1) and (2), the prepaid management fees and rent incurred by a Member who participates in the Project:

- are otherwise deductible under section 8-1; and
- have 'eligible service periods' (for each of the fees) that end not more than 13 months after the Member incurs the expenditure; and
- are incurred in return for the doing of a thing under the agreement that is not wholly to be done within the expenditure year.

The 'eligible service period' (defined in subsections 82KZL(1)) means, generally, the period over which the services are to be provided.

70. In relation to an 'agreement' referred to in subsection 82KZME(3), the Project is an 'agreement' where, during the term of this Product Ruling:

- the Member's allowable deductions attributable to the Project for each expenditure year exceeds the Member's assessable income from the Project (if any) for the expenditure year; and
- the Member does not have day-to-day control over the operation of the Project; and
- there is more than one Member participating in the Project.

71. The prepaid management fees incurred by Members do not fall within any of the 5 exceptions to section 82KZME and, therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF overrides section 8-1 and apportions the management fees over the period that the services for which the prepayment is made are performed.

72. The prepaid rent, being amounts of less than \$1,000 in the year ended 30 June 2001, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is not subject to section 82KZMF and is, therefore, deductible in full in the year in which it is incurred. However, where a Member acquires more than one interest in the Project and the quantum of prepaid rent is \$1,000 or more, then the deduction allowable for those amounts will also be subject to apportionment under section 82KZMF.

Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD and 82KZME – 82KZMF – for those Members who invest in the Project before 1 June 2001

73. 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.

74. In this Project, the Management Fee of \$10,835 and a Rent of \$165 per Vineyard Lot will be incurred on execution of the Lease and Management Agreement. The Management Fee and the Rent are charged for providing management services or leasing land to a Member by 30 June of the year of execution of the Agreement. In particular, the Management Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Management Fee has been inflated to result in reduced fees being payable for subsequent years.

75. There is also no evidence that might suggest the management services covered by the fee 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 Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Member incurs expenditure as required by the agreements as set out in paragraph 34, 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.

Prepayments where the eligible service period exceeds 13 months

76. Although not required under the Arrangement described in this Product Ruling, some Members may choose to prepay some or all of their fees for periods longer than the agreements require. Specifically, this will occur when the 'eligible service period' relating to the prepaid amount ends more than 13 months after the Member incurs the expenditure. Where the 'eligible service period' exceeds 13 months, sections 82KZME and 82KZMF will not apply, as the requirement of paragraph 82KZME(1)(b) is not met.

77. Instead, for a Member who is a 'small business taxpayer' (see paragraphs 79 to 81), subsection 82KZM(1) applies to apportion the expenditure and determine the amount and timing of the deductions. Alternatively, for a Member who is not a 'small business taxpayer', subsection 82KZMD(2) applies to apportion the expenditure and determine the amount and timing of the deductions.

78. Both of these provisions, although slightly different in form, apportion deductible expenditure over the 'eligible service period' in the same way as the formula contained in paragraph 50 (above). However, expenditure, which is 'excluded expenditure', is an exception to both provisions (subparagraph 82KZM(1)(b)(ii) and subsection 82KZMA(4) respectively). A tax deduction for 'excluded expenditure' can be claimed in full in the year in which the expenditure is incurred.

Small business taxpayers

79. 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.

80. '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).

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

Interest deductibility***(i) Members who use Palandri Finance Ltd or United Pacific Finance Pty Ltd as the finance provider***

82. Some Members may finance their participation in the Project through a loan facility with Palandri Finance Ltd or United Pacific Finance Pty Ltd. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of rent and management fees.

83. The interest incurred for the year ended 30 June 2001 and in subsequent years of income will be in respect of a loan to finance the Project business operations of growing grapes and production of wine and is therefore directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

(ii) Members who DO NOT use Palandri Finance Ltd or United Pacific Finance Pty Ltd as the finance provider

84. The deductibility of interest incurred by Members who finance their participation in the Project through a loan facility with a bank or financier other than Palandri Finance Ltd or United Pacific Finance Pty Ltd 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.

85. While the terms of any finance agreement entered into between relevant Members and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in section 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.

86. 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 Members will be required to determine any tax deduction using the formula in subsection 82KZMF(1). The relevant formula is shown above in paragraph 50 and the method is explained in the Example at paragraph 106.

Division 35 - losses from non-commercial business activities

87. 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.

88. 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.

89. Losses that cannot be claimed as a tax deduction because of the rule in subsection 35-10(2) are able to be offset to the extent of future profits from the business activity, or are quarantined until one of the objective tests is passed.

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

91. 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).

92. A Member 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 Member 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 2003. Members who acquire more than one interest in the Project may, however, pass one of the tests in an earlier income year.

93. 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 Member's participation in the Project.

94. 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 Member 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.

95. 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.

96. This Product Ruling is issued on a prospective basis (i.e., before an individual Member'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 52), in the manner described in the Arrangement (see paragraphs 14 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.

97. 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; and
- independent research carried out by the ATO.

Section 82KL - recouped expenditure

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

Part IVA - general tax avoidance provisions

99. 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).

100. The Palandri 2000 Project will be a 'scheme'. A Member will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed in the Ruling section above 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.

101. Members 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 Members 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.

Section 6-5 ITAA 1997: assessable income

102. A Member's share of the Gross sale proceeds derived from the sale of wine from the Project, less any GST payable on these proceeds, will be assessable income of the Member, under section 6-5 of ITAA 1997. Section 17-5 of the ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

103. Once harvested, a Member's grapes will be trading stock of the Member, as will any bottled wine from those grapes. As a consequence, if grapes or grape juice or bottled wine are on hand at the end of the income year, the Member will need to account for that

trading stock in accordance with the trading stock provisions in Part 2-25 of ITAA 1997.

104. Each Member will be notified by Palandri Wines Ltd of the respective amounts to be brought to account in proportion to their total holding in the Project, in accordance with Part 2-25 and Taxation Ruling IT 2001.

Examples

Example 1 – entitlement to ‘input tax credit’

105. Margaret is registered for GST, and participates as a grower in the Green Circle Bluegums Project. She incurs management fees which are payable on 1 July each year for 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 is reduced by the amount of any ‘input tax credit’ to which she is entitled. The Project Manager provides Margaret with a ‘tax invoice’ which includes its ABN and shows the ‘price of the taxable supply’ for management services (\$5,500). Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

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

Example 2 – apportionment of fees

106. Murray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year’s fee increased by the CPI. The first year’s fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a ‘Power of Attorney’ allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray’s agreements are duly executed and management services start to be provided on that date.

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Murray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

Management fee x $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Murray's total tax deduction in 2001 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2002 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2002 income year).

\$4,643 + \$85 = \$4,728 (The sum of these two amounts is Murray's total tax deduction for management fees in 2002).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

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Commissioner of Taxation

7 February 2001

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Not previously issued in draft form	- tax avoidance
	- tax benefits under tax avoidance\
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<i>Related Rulings/Determinations:</i>	- tax shelters
PR 2000/93; PR 1999/95;	
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TR 97/11; TR 97/16;	<i>Legislative references:</i>
TD 93/34; TR 98/22; IT 175;	- ITAA 1997 6-5
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NO 2000/018929

BO

FOI number: I 1021737

ISSN: 1441-1172