

PR 2002/13 - Income tax: Palandri America Wine Business

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 This document has changed over time. This is a consolidated version of the ruling which was published on *6 February 2002*



Product Ruling

Income tax: Palandri America Wine Business

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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. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out 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, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants should be aware that the 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 participants 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 America Wine Business 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);
 - Division 70 (ITAA 1997);
 - Division 328 (ITAA 1997);
 - section 82KL *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KZL (ITAA 1936);
 - section 82KZME (ITAA 1936);
 - section 82KZMF (ITAA 1936); and
 - Part IVA (ITAA 1936).

Goods and Services Tax

3. In this ruling, all fees and expenditure referred to include Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this ruling as a 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 taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is 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 arrangement identified in the Ruling. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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Date of effect

11. This Ruling applies prospectively from 6 February 2002, 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 arrangement incorporates the following documents:

- Application for Product Ruling dated 3 October 2001;
- The Palandri USA Wine Business Draft Prospectus, dated 15 January 2002;

- **Draft Constitution for the Palandri America Wine Business between Palandri Wines Ltd [‘Responsible Entity’], and the Member, undated;**
- **Draft Lease and Management Agreement between Palandri Wines Ltd [‘Responsible Entity’], Palandri Production Ltd [‘Lessor’] and the Member, undated;**
- Draft Palandri America Wine Business Compliance Plan, undated;
- Vineyard Management and Maintenance Agreement between Palandri Wines Ltd and Quenby Viticultural Services Pty Ltd;
- Vineyard Establishment Agreement between Palandri Production Ltd and Quenby Viticultural Services Pty Ltd;
- Palandri America Wine Business and Marketing Plan, undated;
- Licence Agreement between Palandri Production Ltd and Palandri Wines Ltd dated 22 March 1999;
- Loan Deed between Palandri Finance Ltd and the Borrower undated;
- Additional correspondence dated 29 October, 31 October, 17 December, 23 January 2002 and 29 January 2002.

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 an associate of the Member, will be a party to that are part of the arrangement to which this Ruling applies.

16. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

Overview

17. This arrangement is called the Palandri America Wine Business.

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Location	Vineyard: Frankland River, Western Australia. Winery: Margaret River, Western Australia.
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 at the Palandri Frankland River Vineyard No. 2 and 20 hectares of Frankland River Vineyard No. 1.
Size of each Vineyard Lot	0.040
Number of vines per hectare	1,852
The term of the investment in years	18 years
Initial cost	\$13,200
Initial cost per hectare	\$330,000
Ongoing costs	Annual Management fees, rent and insurance.

18. The Palandri America Wine Business is registered as a managed investment scheme under the Corporations Act. There are 2,000 Vineyard Lots on offer under the Prospectus. The Prospectus states that there is no minimum subscription for the Project. Each Member may subscribe for a minimum of one Vineyard Lot. Members applying under the Prospectus enter into a Lease and Management Agreement.

19. The Project Land is situated in Western Australia. Palandri Production Ltd holds a Lease over the land. 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 2020. Each Vineyard Lot is 0.040 hectares in size. A Vineyard Lot is defined as a portion of the Palandri Frankland River Vineyard No. 2 comprising 0.030 hectares and a portion of the Palandri Frankland River Vineyard No. 1 comprising 0.010 hectares.

20. 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 or have been planted by Palandri Production at the rate of 74 vines per Vineyard Lot. The portion of the Vineyard Lot in the Palandri Frankland River Vineyard No. 2 will be planted on or about 30 September 2002. Where Members enter the Project after September 2002 they will be allotted a fully planted Vineyard Lot.

21. Under the Lease and Management Agreement each Member appoints Palandri Wines Ltd (the 'Responsible Entity') to produce, then market and distribute, wine made from the grapes grown on the relevant Vineyard Lot and additional grapes and base wine to be sourced from contract suppliers.

22. Palandri Production Ltd and Palandri Wines Ltd have entered into a licence agreement in relation to the trade marks, business names and other intellectual property relating to the Palandri brand and associated labels owned by Palandri Production Ltd. Pursuant to the terms of the agreement Palandri Production Ltd has granted to Palandri Wines Ltd a licence to use the Palandri brand and associated labels for the promotion and sale of wine by Palandri Wines Ltd. If Palandri Wines Ltd is removed as Responsible Entity of the Project under clause 25 of the Constitution, the replacement Responsible Entity will become a party to the licence agreement.

23. 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.

24. The Prospectus expires on 1 December 2002.

Constitution

25. 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 Lease and Management 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 Lease and Management Agreement by virtue of their participation in the Project.

Compliance Plan

26. 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

27. A sub-lease is granted by the Lessor, Palandri Production Ltd, to the Members under the terms of the Lease and Management Agreement (cl.3.1). Members are granted an interest in land in the form of a sub-lease to use their Vineyard Lots to produce, then market and distribute wine made from their grapes on their Vineyard Lot and additional grapes and base wine sourced from contract grape growers (Recital D). The term of a Member's sub-lease is from the 'Commencement Date' (the date the Member's application is accepted by Palandri Wines Ltd) until 30 June 2020.

28. Members who participate in the Project on or before 31 May 2002 must pay, on application, rent of \$290.40 per Vineyard Lot to the Lessor for the period from the Commencement Date until 30 June 2002. Rent of \$290.40 (indexed) is payable on 1 July 2003 for the period 1 July 2003 to 30 June 2001 and annually thereafter on 1 July of the relevant year indexed annually.

29. Members who participate in the Project on or after 1 July 2002 must pay, on application, rent of \$290.40 per Vineyard Lot to the Lessor for the period from the Commencement Date to 31 December 2002. Rent of \$290.40 (indexed) is payable on 31 December 2002 for the period 1 January 2003 to 30 June 2003 and annually thereafter on 1 July of the relevant year indexed annually.

Lease and Management Agreement

30. 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 6 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.

31. Members who participate in the Project on or before 31 May 2002 must pay an initial management fee, on application, of \$12,909.60 per Vineyard Lot for services to be provided in the period from the Commencement Date to 30 June 2002. A management fee of \$7,409.60 is payable, on 1 July 2002 for services to be provided from 1 July 2002 to 30 June 2003, and \$7,401.90 is payable on 1 July 2003, for services to be provided during the period 1 July 2003 to 30 June 2004. An amount is payable annually thereafter which is the Members' proportion of the Management Costs (indexed) plus the Corporate Costs for performing the services under this agreement.

32. Members who participate in the Project on or after 1 July 2002 must pay an initial management fee, on application, of \$12,909.60 for

services to be provided in the period from the Commencement Date to 31 December 2002. A management fee of \$7,409.60 is payable on 31 December 2002 for services to be provided during the period 1 January 2003 to 30 June 2003, and \$7,401.90 is payable on 1 July 2003, for services to be provided during the period 1 July 2003 to 30 June 2004. An amount is payable annually thereafter which is the Members' proportion of the Management Costs (indexed) plus the Corporate Costs for performing the services under this agreement.

33. The Responsible Entity will carry out the following services under this Agreement in accordance with good business management and industry practice as determined by Palandri Wines:

- 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;
- maintain the relevant Vineyard Lot and maintain fire-breaks in and about the relevant Vineyard Lot;
- at all times maintain the relevant Vineyard Lot according to good viticultural practice;
- maintain a trickle irrigation system to the vines on the relevant Vineyard Lot;
- 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;
- attend to the ongoing control of weed and plant growth 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;
- properly maintain all plant and machinery used by Palandri Wines in the performance of the services;
- purchase grapes and base wine to supplement grapes grown on the relevant Vineyard Lot in the amounts described in Item 11 of the Schedule to the Lease and Management Agreement;
- obtain professional services and advice which Palandri Wines may consider as necessary or desirable in connection with the maintenance of the relevant Vineyard Lot and the vines;

- maintain the entryways to the relevant Vineyard Lot in order to prevent trespassers entering the relevant Vineyard Lot and to take such other security measures as it considers appropriate;
- maintain the boundary fencing around the relevant Vineyard Lot if applicable;
- 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.

34. 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).

35. 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.12.2).

36. The Responsible Entity will provide a report to Members on or before 30 September and 31 March each financial year containing a review of the operations of the Member's Wine Business during the relevant period (cl.16.1).

37. 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 Lease and Management (Item 11 of the Schedule).

Harvesting

38. The Responsible Entity will be responsible for the harvesting of the grapes, and/or purchase of grapes and base wine and delivery of these grapes and base wine 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.

39. 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.18.2 of the Lease and Management Agreement.).

Fees

40. The total fee payable on application under the Lease and Management Agreement for the Project is \$13,200 per Vineyard Lot. This amount includes a management fee of \$12,909.60 and rent of \$290.40 and is payable either in full on application or under a Time Payment Option. Under the Time Payment Option, an amount of \$4,400.00 per Vineyard Lot is payable on application and a minimum payment of \$800 must be remitted to Palandri Wines Ltd by the 25th of each month thereafter. Any outstanding balance is due and payable on 25 June 2002 with respect to Members whose application is accepted on or before 31 May 2002 and 25 December 2002, with respect to Members whose application is accepted on or after 1 July 2002.

41. A management fee of \$7,409.60 is payable on 1 July 2002 for Members accepted on or before 31 May 2002 and on 31 December 2002 for Members accepted on or after 1 July 2002, for services to be completed during the period 1 July 2002 to 30 June 2003 or 1 January 2003 to 30 June 2003 respectively. A management fee of \$7,401.90 is payable on 1 July 2003 for services to be performed in the period 1 July 2003 to 30 June 2004.

42. For the years from 1 July 2004 to 30 June 2020, 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.

43. Members who participate in the Project on or before 31 May 2002 must pay, on application, rent of \$290.40 per Vineyard Lot to the Lessor for the period from the Commencement Date until 30 June 2002. Members who participate in the Project on or after

1 July 2002 must pay, on application, rent of \$290.40 per Vineyard Lot to the Lessor for the period from the Commencement Date to 31 December 2002.

44. Rent of \$290.40 (indexed) for the period 1 July 2002 to 30 June 2003 or 1 January 2003 to 30 June 2003 is payable on 1 July 2002 for Members accepted on or before 30 June 2002 or 31 December 2002 for Members accepted on or after 1 July 2002 respectively. Rent of \$290.40 (indexed) is payable annually thereafter on 1 July of the relevant year and will be indexed annually.

45. 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

46. Members can fund their investment in the Project themselves, borrow from Palandri Finance Ltd (lenders associated with the Responsible Entity) or borrow from an independent lender.

47. Those Members may enter into into the following finance arrangement with Palandri Finance Ltd :

- 5 year (maximum) Principal and Interest Loan with payments of \$626 monthly in arrears per Vineyard Lot;
- 1 year interest only followed by 4 years Principal and Interest Loan with payments of \$676 monthly in arrears during the Principal and Interest period per Vineyard Lot;
- 5 year (maximum) Principal and Interest loan subject to a deposit of \$3,300 per Vineyard Lot and Principal and Interest payments of \$212 monthly in arrears plus annual lump sum payments per Vineyard Lot ;
- Interest rate 11.30% pa variable ;
- Application fee:
 - (a) \$275 for loans equal to or less than \$75,000 ; or
 - (b) \$275 plus 0.5% of the borrowed sum for loans greater than \$75,000.

48. 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, are involved, or become involved, in the provision of finance to Members for the Project.

Ruling

Application of this Ruling

49. This Ruling applies only to Members who are accepted to participate in the Project on or before 30 June 2002 or 30 June 2003 and who have executed a Lease and Management Agreement before that date. The Member's participation in the Project must constitute the carrying on of a business of primary production.

50. A Member is not eligible to claim any tax deductions until the Member's application to enter the Project is accepted and the Project has commenced.

The Simplified Tax System ('STS')

Division 328

51. For a Member participating in the Project, the recognition of income and the timing of tax deductions, including those related to capital allowances, is different depending on whether the Member is an 'STS taxpayer'. To be an 'STS taxpayer' a Member:

- must be eligible to be an 'STS taxpayer'; and

- must have elected to be an ‘STS taxpayer’.

Qualification

52. This Product Ruling assumes that a Member who is an ‘STS taxpayer’ is so for the income year in which their participation in the Project commences. A Member may become an ‘STS taxpayer’ at a later point in time. Also, a Member who is an ‘STS taxpayer’ may choose to stop being an ‘STS taxpayer’, or may cease to be eligible to be an ‘STS taxpayer’, during the term of the Project. These are contingencies relating to the circumstances of individual Members that cannot be accommodated in this Ruling. Such Members can ask for a private ruling on how the taxation legislation applies to them.

Tax outcomes for Members who are not ‘STS taxpayers’

Assessable Income

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

54. The Member recognises ordinary income from carrying on the business of growing grapes and producing and marketing wine at the time that income is derived.

Trading Stock

Section 70-35

55. A Member who is not an ‘STS taxpayer’ may, in some years, hold grapes, grape juice, base wine or bottled wine that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Member must include the amount of that excess in assessable income.

56. Alternatively, where the value of trading stock on hand at the start of an income year exceeds the value of trading stock on hand at the end of an income year, a Member may claim the amount of that excess as an allowable deduction.

Deductions for Management fees, Rent, and Interest

Section 8-1

57. A Member who is not an ‘STS taxpayer’ may claim tax deductions for the following revenue expenses:

**Members who were accepted into the Project on or before
31 May 2002**

Fee Type	ITAA 1997 Section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1	\$12,909.60 See Notes (i) & (ii) below	\$7,409.60 – See Notes (i) & (ii) below	\$7,401.90 See Notes (i), (ii) & (iv) below
Rent	8-1	\$290.40 See Notes (i) & (ii) below	\$290.40 – See Notes (i), (ii) & (v) below	\$290.40 (indexed) – See Notes (i), (ii) & (v) below
Interest	8-1	As incurred See Note (iii) below	As incurred See Note (iii) below	As incurred See Note (iii) below

**Members who were accepted into the Project on or after
1 July 2002**

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1	\$20,319.20 (\$12,909.60 + \$7,409.60) See Notes (i) & (ii) below	\$7,401.90 See Notes (i) (ii) & (iv) below
Rent	8-1	\$580.80 (\$290.40 + \$290.40) See Notes (i), (ii) & (v) below	\$290.40 See Notes (i), (ii) & (v) below
Interest	8-1	As incurred See Note (iii) below	As incurred See Note (iii) below

Notes:

- (i) If the Member is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits). See example at paragraph 128;
- (ii) The Management fees and the rent shown in the Lease and Management Agreement are deductible in full in the year that they are incurred. However, if a Member **chooses** to prepay fees for the doing of a thing (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, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **MUST** be determined using the formula shown in paragraph 104 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000;

- (iii) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Palandri Finance Ltd is outside the scope of this Ruling. However, all Members, including those who finance their participation in the Project other than with Palandri Finance Ltd, should read carefully the discussion of the prepayment rules in paragraphs 98 to 112 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Member's choice;
- (iv) For each year commencing from 1 July 2004 until 30 June 2020, Management Fees are payable by each Member yearly consisting of 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;
- (v) Annual rent of \$290.40 is to be indexed annually by the Inflation Adjustment Factor for the relevant financial year, commencing on 1 July 2002 for Members who participate in the Project on or before 31 May 2002, or 31 December 2002 for Members who participate in the Project on or after 1 July 2002.

Tax outcomes for Members who are 'STS taxpayers'

Assessable Income

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

59. The Member recognises ordinary income from carrying on the business of growing grapes and producing and marketing wine at the time the income is received (paragraph 328-105(1)(a)).

Trading stock

Section 328-285

60. A Member who is an 'STS taxpayer' may, in some years, hold grape, grape juice, base wine or bottled wine that will constitute trading stock on hand. Where, for such a Member, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than \$5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

61. Alternatively, a Member who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

Deductions for Management fees, Rent, and Interest

Section 8-1 and section 328-105

62. A Member who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

Members who were accepted into the Project on or before 31 May 2002

Fee Type	ITAA 1997 Sections	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1 & 328-105	\$12,909.60 – See Notes (vi) & (vii) below	\$7,409.60 – See Notes (vi), (vii) & (viii) below	\$7,401.90 – See Notes (vi), (vii), (viii) & (x) below
Rent	8-1 & 328-105	\$290.40 See Notes (vi) & (vii) below	\$290.40 – See Notes (vi), (vii), (viii) & (xi) (below)	\$290.40 – See Notes (vi), (vii), (viii) & (xi) below
Interest	8-1 & 328-105	When paid - See Note (ix) below	When paid – See Note (ix) below	When paid - See Note (ix) below

PR 2002/13**Members who were accepted into the Project on or after
1 July 2002**

Fee Type	ITAA 1997 Sections	Year ended 30 June 2003	Year ended 30 June 2004
Management Fee	8-1 & 328-105	\$20,319.20 (\$12,909.60 + \$7,409.60) See Notes (vi) & (vii) below	\$7,401.90 See Notes (vi), (vii), (viii) & (x) below
Rent	8-1 & 328-105	\$380.80 (\$290.40 + \$290.40) See Notes (vi), (vii) & (xi) below	\$290.40 – See Notes (vi), (vii), (viii) & (xi) below
Interest	8-1 & 328-105	When paid – See Note (ix) below	When paid – See Note (ix) below

Notes:

- (vi) If the Member is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits). See example at paragraph 128;
- (vii) If, for any reason, an amount shown in the Table above is not fully paid in the year in which it is incurred by a Member who is an 'STS taxpayer' then the amount is only deductible to the extent to which it has been paid, or has been paid for the Member. Any amount or part of an amount shown in the Table above, which is not paid in the year in which it is incurred, will be deductible in the year in which it is actually paid;
- (viii) Where a Member who is an 'STS taxpayer', pays the Management fees and the rent in the relevant income years shown in the Lease and Management Agreement, those fees are deductible in full in the year that they are paid. However, if a Member chooses to prepay fees for the doing of a thing (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, 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 104, unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules,

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

- (ix) The deductibility or otherwise of interest arising from loan agreements entered into with financiers other than Palandri Finance Ltd, is outside the scope of this Ruling. However all Members, including those who finance their participation in the Project other than with Palandri Finance Ltd, should read carefully the discussion of the prepayment rules in paragraph 98 to 112 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Member's choice;
- (x) For each year commencing from 1 July 2004 until 30 June 2020, Management Fees are payable by each Member yearly consisting of 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;
- (xi) Annual rent of \$290.40 is to be indexed annually by the Inflation Adjustment Factor for the relevant financial year commencing on 1 July 2002 for Members who participate in the Project on or before 31 May 2002, or 31 December 2002 for Members who participate in the Project on or after 1 July 2002.

Tax outcomes that apply to all Members

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

Section 35-55 – Commissioner's discretion

63. For a Member who is an individual and who enters the Project during the years ended 30 June 2002 or 30 June 2003 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2002, for Members who are accepted into the Project on or before 31 May 2002 and 30 June 2003 for Members who are accepted into the Project after 1 July 2002, to 30 June 2004 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.

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

- the ‘exception’ in subsection 35-10(4) applies (see paragraph 116 in the Explanations part of this ruling, below); or
- a Member’s business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the Member’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

65. Where, the exception in subsection 35-10(4) applies, the Member’s business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, 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.

66. 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)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from this perspective has not been made.

Sections 82KZME – 82KZMF, 82KL and Part IVA

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

- expenditure by a Member does not fall within the scope of sections 82KZME - 82KZMF (but see paragraphs 98 to 112);
- section 82KL does not apply to deny the deductions otherwise allowable; and

- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Is the Member carrying on a business?

68. For the amounts set out in the Tables above to constitute allowable deductions the Member's viticulture activities as a participant in the Palandri America Wine Business must amount to the carrying on of a business of primary production.

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

70. For schemes such as that of the Palandri America Wine Business, Taxation Ruling TR 2000/8 sets out the circumstances in which the Member's activities can constitute the carrying on of such a business (see paragraph 89 of Taxation Ruling TR 2000/8). As Taxation Ruling TR 2000/8 discusses, these have been established in court decisions such as *FCT v. Lau* 84 ATC 4929.

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

- the Member has an identifiable interest (by lease or by licence) in the land on which the Member's grapevines are established;
- the Member has a right to harvest and sell the grapes each year from those grapevines and to sell the wine produced;
- the viticulture activities are carried out on the Member's behalf; and
- the viticulture activities of the Member are typical of those associated with a viticulture business; and
- the weight and influence of general indicators point to the carrying on of a business.

72. In this Project, each Member enters into a Lease and Management Agreement.

73. Under the Lease and Management Agreement each individual Member will have rights over a specific and identifiable area of 0.040 hectares of land consistent with the intention to carry on a business of growing grapes and the production, marketing and sale of wine. The Lease and Management Agreement provides the Member with an ongoing interest in the specific grapevines on the sub-leased area for the term of the Project. Under the sub-lease the Member must use the land in question for the purpose of carrying out viticultural activities, and for no other purpose. The sub-lease allows the Responsible Entity to come onto the land to carry out its obligations under the Lease and Management Agreement.

74. Under the Lease and Management Agreement the Responsible Entity is engaged by the Member to maintain a Vineyard Lot on the Member's leasehold land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to maintain the Vineyard Lots on the Member's behalf.

75. Under the Lease and Management Agreement Members engage the Responsible Entity, Palandri Wines Ltd, 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 Vineyard Lot free from vermin, noxious weeds, pests and diseases. The Responsible Entity is also engaged to harvest on the Member's behalf, the grapes grown on the Member's Vineyard Lot.

76. 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.

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

78. The pooling of grapes grown on the Member's Vineyard Lots with the grapes of other Members does not detract from a view that the Member is carrying on a business of viticulture. Each Member's proportionate return from the sale of the wine will reflect the number of Vineyard Lots held by that Member.

79. The Responsible Entity's services are based on accepted viticulture practices. They are of the type ordinarily found in viticulture ventures that would commonly be said to be businesses. While the size of the Member's allotment is relatively small, it is of a size and scale that would allow it to be commercially viable,

particularly when it is part of a larger overall project such as the Palandri America Wine Business (see Taxation Ruling IT 360).

80. The Member's degree of control over the Responsible Entity as evidenced by the Lease and Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Member with regular progress reports on the Member's Vineyard Lots and the activities carried out on the Member's behalf. Members are able to terminate arrangements with the Responsible Entity in certain instances, such as cases of default or neglect.

81. The viticulture activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Member's viticulture activities in the Palandri America Wine Business will constitute the carrying on of a business.

The Simplified Tax System

Division 328

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

83. The question of whether a Member is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Member who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

Deductibility of management fees and rent

Section 8-1

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

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

that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

85. The rent and management fees associated with the viticulture activities will relate to the gaining of income from the Member's business of viticulture (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of grape produce and wine) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Possible application of prepayment provisions

86. Under the Lease and Management Agreement neither the management fees nor the rent are for things to be done beyond 30 June in the year in which the relevant amounts are incurred. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

87. However, where a Member chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 98 to 112) will apply to determine the amount and timing of the deductions regardless of whether the Member is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

Timing of deductions

88. In the absence of any application of the prepayment provisions, the timing of deductions for the management fees or the rent will depend upon whether a Member is an 'STS taxpayer' or is not an 'STS taxpayer'.

89. If the Member is not an 'STS taxpayer', the management fees and the rent are deductible in the year in which they are incurred.

90. If the Member is an 'STS taxpayer' the management fees and the rent are deductible in the income year in which they are paid, or are paid for the Member (paragraph 328-105(1)(b)). If any amount that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid or is paid for the Member.

Interest deductibility

Section 8-1

(i) Members who use Palandri Finance Ltd as the finance provider

91. Some Members may finance their participation in the Project through a loan facility with Palandri Finance 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.

92. The interest incurred for the year ended 30 June 2002 and in subsequent years of income will be in respect of a loan to finance the Project business operations – the cultivation and of growing grapes and the lease of the land on which the grapevines will have been planted 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.

93. As with the management fees and rent, in the absence of any application of the prepayment provisions (see paragraphs 98 to 112), the timing of deductions for interest will again depend upon whether a Member is an 'STS taxpayer' or is not an 'STS taxpayer'.

94. If the Member is not an 'STS taxpayer', interest is deductible in the year in which it is incurred.

95. If the Member is an 'STS taxpayer' interest is not deductible until it has been both incurred and paid, or is paid for the Member. If interest that is properly incurred in an income year remains unpaid at the end of that income year, the unpaid amount is deductible in the income year in which it is actually paid, or is paid for the Member.

(ii) Members who DO NOT use Palandri Finance Ltd as the finance provider

96. 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 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.

97. 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. Alternatively, a Member may choose to prepay such interest. Unless such prepaid interest is 'excluded expenditure' any tax deduction that is allowable will be subject to the prepayment provisions of the ITAA 1936 (see paragraphs 98 to 112).

Prepayment provisions

Sections 82KZL to 82KZMF

98. The prepayments provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

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

Sections 82KZME and 82KZMF

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

101. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- either :
 - (a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
 - (b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

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

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

104. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

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

105. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day

on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

Application of the prepayment provisions to this Project

106. In this Project, an initial Vineyard Lot Management Fee of \$12,909.60 and Rent of \$290.40 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 Agreements. Under the agreements, further annual expenditure is required each year during the term of the Project for the provision of management services and land until 30 June in those years.

107. 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 initial Management Fee has been inflated to result in reduced fees being payable for management fees in subsequent years.

108. There is also no evidence that might suggest the management services covered by the fee could not be provided within the relevant expenditure year. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial management fee, and the fees for subsequent years, is for the Manager doing 'things' that are not to be wholly done within the expenditure year. Under the Lease and Management Agreement, rent is payable annually in advance for the sub-lease of the land during the expenditure year. Similarly, under the loan agreements to be executed between Members and Palandri Finance Ltd interest is payable monthly in arrears.

109. On this basis, provided a Member incurs expenditure as required under the Project agreements, as set out in paragraphs 40 to 44, then the basic precondition in subsection 82KZME(2) not satisfied and, in these circumstances, section 82KZMF will have no application.

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

110. Although not required under either the Lease and Management Agreement or the Loan Agreement with Palandri Finance Ltd, a Member participating in the Project may **choose** to prepay fees/interest for a period beyond the 'expenditure year'. Similarly, Members who use financiers other than Palandri Finance Ltd may

either choose, or be required to prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 109 above, section 82KZMF will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

111. For these Members, the amount and timing of deductions for any relevant prepaid Management Fees, prepaid Rent, or prepaid interest will depend upon when the respective amounts are incurred and what the 'eligible service period' is in relation to these amounts.

112. However, as noted above, prepaid fees of less than \$1,000 incurred in an expenditure year will be 'excluded expenditure' and will be not subject to apportionment under section 82KZMF.

Deferral of losses from non-commercial business activities

Division 35

113. 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.

114. 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.

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

116. For the purposes of applying the 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.

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117. In broad terms, the tests require:

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

118. 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 Vineyard Lot in the Project is unlikely to have their activity pass one of the objective tests until the income year ended 30 June 2007. Members who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

119. 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.

120. 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, 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) because of its nature, it has not satisfied one of the objective tests; and
- (iii) 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.

121. Information provided with this Product Ruling indicates that a Member who acquires the minimum investment of one Vineyard Lot in the Project is expected to be carrying on a business activity that will

either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2005. The Commissioner will decide for such a Member that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2004. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

122. This Product Ruling is issued on a prospective basis (ie, before an individual Member's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 63), in the manner described in the Arrangement (see paragraphs 14 to 48). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9). Members may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

123. 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, objective, and generally available information relating to the viticultural industry.

Section 82KL - recouped expenditure

124. 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

125. 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).

126. The Palandri America Wine Business 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 at paragraphs 57 and 62 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.

127. Members to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting of the grapes and sale of the wine. 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.

Example

Example 1: Entitlement to GST input tax credits

128. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2002 to 30/6/2002	\$4 400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2 200*</u>
Total due and payable by 1 January 2002 (includes GST of \$600)	<u>\$6 600</u>

*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

$$1/11 \times \$4400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4400 *less* \$400, or \$4000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

$$1/11 \times \$2200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2200 *less* \$200, or \$2000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4000 (not \$4400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2000 only, not one tenth of \$2200).

Detailed contents list

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

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