

# ***PR 2002/144 - Income tax: Palandri America Wine Business - 2003***

⚠ This cover sheet is provided for information only. It does not form part of *PR 2002/144 - Income tax: Palandri America Wine Business - 2003*

⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *18 December 2002*

## Product Ruling

### Income tax: Palandri America Wine Business - 2003

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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**, **Previous Ruling**, **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.

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.

## Terms of Use of this Product Ruling

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

## What this Product Ruling is about

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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 - 2003, 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

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11. This Ruling applies prospectively from 18 December 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

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. 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**

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

- Application for Product Ruling dated 8 October 2002;
- The draft Palandri America Wine Business Prospectus, undated;
- **Constitution for the Palandri America Wine Business between Palandri Investment Management Ltd (formerly known as Palandri Wines Ltd) [‘Responsible Entity’], and the Member, dated 18 October 2001;**
- **Draft Lease and Management Agreement between Palandri Investment Management Ltd (formerly known as Palandri Wines Ltd) [‘Responsible Entity’], Palandri Wine Production Ltd (formerly known as Palandri Production Ltd) [‘Lessor’] and the Member, undated;**
- Palandri America Wine Business Compliance Plan, dated 5 November 2001;
- Vineyard Management and Maintenance Agreement between Palandri Investment Management Ltd (formerly known as Palandri Wines Ltd) and Quenby Viticultural Services Pty Ltd;
- Vineyard Establishment Agreement between Palandri Wine Production Ltd (formerly known as Palandri Production Ltd) and Quenby Viticultural Services Pty Ltd;
- Palandri America Wine Business and Marketing Plan, undated;
- Licence Agreement between Palandri Wine Production Ltd (formerly known as Palandri Production Ltd) and Palandri Investment Management Ltd (formerly known as Palandri Wines Ltd), dated 22 March 1999;
- Winery Lease between Palandri Wine Production Ltd (formerly known as Palandri Production Ltd) and Palandri Investment Management Ltd (formerly known as Palandri Wines Ltd), undated;
- Loan Deed between Palandri Finance Ltd and the Borrower, undated;

- Additional correspondence dated 22 October 2002, 24 October 2002, 28 October 2002, 30 October 2002, 1 November 2002, 13 November 2002, 14 November 2002, 18 November 2002, 28 November 2002, 4 December 2002, 9 December 2002.

**Note: certain information received from Palandri Investment Management Ltd (formerly known as 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 - 2003.

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	45 hectares at the Palandri Frankland River Vineyard No. 2.
Size of each Vineyard Lot	0.030ha
Number of vines per hectare	1,852
The term of the investment in years	18 years
Initial cost	\$11,000
Initial cost per hectare	\$366,666
Ongoing costs	Annual Management Fees, Rent and insurance.

18. The Palandri America Wine Business 2003 is registered as a managed investment scheme under the Corporations Act. There are 1,500 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 Wine Production Ltd (formerly known as Palandri Production Ltd) owns the land. Palandri Wine Production Ltd agrees to 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 0.030 hectares in size. A Vineyard Lot is defined as a portion of the Palandri Frankland River Vineyard No. 2 comprising 0.030 hectares.

20. Palandri Wine Production Ltd will lease the Vineyard Lot to the Member for the purpose of cultivating vines and harvesting Grapes. The vines have been planted by Palandri Wine Production Ltd at the rate of 55 vines per Vineyard Lot. The Vineyard Lot in the Palandri Frankland River Vineyard No. 2 has been fully established. Members will be allotted a fully planted Vineyard Lot.

21. Applications must be received by the Responsible Entity by 15 June 2003, or on or after 1 July 2003. However, the Responsible Entity may accept late applications for 2003 Members during the period 16 June to 30 June 2003 where the services to be provided in the Initial Period can be completed by 30 June 2003. Services will not be provided prior to the Commencement Date of the Member entering into the Project.

22. Under the Lease and Management Agreement, each Member appoints Palandri Investment Management 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.

23. Palandri Wine Production Ltd and Palandri Investment Management Ltd (formerly known as 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 Wine Production Ltd. Pursuant to the terms of the agreement, Palandri Wine Production Ltd has granted to Palandri Investment Management Ltd a licence to use the Palandri brand and associated labels for the promotion and sale of wine by Palandri Investment Management Ltd. If Palandri Investment Management 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.

24. Members will execute a Power of Attorney enabling the Responsible Entity, Palandri Investment Management Ltd, to act on their behalf as required when they make an application for a Vineyard Lot.

25. The Prospectus expires on 19 December 2003.

## **Constitution**

26. 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**

27. 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**

28. A lease is granted by the Lessor, Palandri Wine Production Ltd (formerly known as 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 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/base wine suppliers (Recital D). The term of a Member's lease is from the 'Commencement Date' (the date the Member's application is accepted by Palandri Investment Management Ltd) until 30 June 2020.

29. Members who participate in the Project during the year ended 30 June 2003 must pay Rent of \$110 per Vineyard Lot for the period from the Commencement Date to 30 June 2003 to the Lessor on application. Rent of \$220 per Vineyard Lot is payable on 30 June

2004 for the period 1 July 2003 to 30 June 2004. Rent of \$226.60 (indexed annually) per Vineyard Lot is payable annually thereafter .

30. For Members who participate in the Project on or after 1 July 2003, Rent of \$110 is payable on application for the period from the Commencement Date to 31 December 2003. Rent of \$220 is payable in arrears on 30 June 2004 for the period 1 January 2004 to 30 June 2004 and \$226.60 (indexed annually) per Vineyard Lot is payable annually thereafter.

### **Lease and Management Agreement**

31. 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.

32. For Members who participate in the Project during the year ended 30 June 2003, an initial Management Fee of \$10,890, for services to be provided in the period from the Commencement Date to 30 June 2003, is payable on application. A Management Fee of \$10,230 is payable for services to be provided during the period 1 July 2003 to 30 June 2004. This amount is payable in two instalments, one payment of \$5,500 on 1 December 2003 and another payment of \$4,730 on 30 June 2004. For the year 1 July 2004 to 30 June 2005 and each subsequent year, a Management Fee is payable which is determined as a percentage of a Member's wine proceeds on an ongoing basis. This amount must not be less than \$1,000 (indexed) for the relevant year.

33. For Members who participate in the Project on or after 1 July 2003, a Management Fee of \$10,890, for services to be provided in the period from the Commencement Date to 31 December 2003, is payable on application. A Management Fee of \$10,230, for services to be provided during the period 1 January 2004 to 30 June 2004, is payable on 30 June 2004. For the year 1 July 2004 to 30 June 2005 and each subsequent year, a Management Fee is payable which is determined as a percentage of a Member's wine proceeds on an ongoing basis. This amount must not be less than \$1,000 (indexed) for the relevant year.

34. 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 Investment Management Ltd:

- 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 Investment Management Ltd 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 9 of the Schedule to the Lease and Management Agreement;
- obtain professional services and advice which Palandri Investment Management Ltd 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.

35. 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.27.3).

36. 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.20.2).

37. The Responsible Entity will provide a report to Members on or before 30 September and 31 March of each financial year containing a review of the operations of the Member's Wine Business during the relevant period (cl.24.1).

38. 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 Agreement (Item 9 of the Schedule).

### **Harvesting**

39. The Responsible Entity will be responsible for the harvesting of the grapes, and/or purchase of grapes and base wine, delivery of these grapes and base wine to the Winery, production of wine from these 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.

40. 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.26.2 of the Lease and Management Agreement.).

**Fees**

41. The total fee payable on application under the Lease and Management Agreement for the Project for services to be rendered in the Initial Period is \$11,000 per Vineyard Lot. The Initial Period for Members who enter into the Project on or before 30 June 2003 is from the Date of Commencement to 30 June 2003 and for Members who enter into the Project on or after 1 July 2003, the Date of Commencement to 31 December 2003. This amount includes a Management Fee of \$10,890 and Rent of \$110 and is payable either in full on application or under a Time Payment Option. Under the Time Payment Option, an amount of \$2,000 per Vineyard Lot is payable on application and a minimum payment of \$1,500 must be remitted to Palandri Investment Management Ltd by the 25<sup>th</sup> of each month thereafter. Any outstanding balance is due and payable on 25<sup>th</sup> June 2003 for Members who are accepted into the Project on or before 31 May 2003 and 25<sup>th</sup> December 2003 for Members whose applications are accepted on or after 1 July 2003.

42. For Members who enter into the Project during the year ended 30 June 2003, a Management Fee of \$10,230 is payable for services to be provided during the period 1 July 2003 to 30 June 2004. This amount is payable in two instalments, \$5,500 on 1 December 2003 and \$4,730 on June 2004. For Members who enter into the Project on or after 1 July 2003, the Management Fee of \$10,230 is payable on 30 June 2004 for services to be completed during the period 1 January 2004 to 30 June 2004.

43. For the years from 1 July 2004 to 30 June 2020, Management Fees are payable by the Member each year which are determined as a percentage of a Member's wine proceeds for the relevant year and will be deducted from the Member's wine proceeds on an ongoing basis. This amount must not be less than \$1,000 (indexed) for the relevant year. Where there are insufficient funds from the Members wine proceeds to meet this amount, the balance becomes due and payable in arrears on 30 June of the relevant year.

44. For Members who enter into the Project during the year ended 30 June 2003, Rent of \$220, for the period 1 July 2003 to 30 June 2004, is payable on 30 June 2004. For Members who participate in the Project on or after 1 July 2003, Rent of \$220 for the period 1 January 2004 to 30 June 2004 is payable on 30 June 2004.

45. For the years from 1 July 2004 to 30 June 2020, Rent of \$226.60 (indexed) is payable annually and is to be deducted from the Members wine proceeds on an ongoing basis. This amount is to be

indexed annually. Where there are insufficient Funds from the Members wine proceeds to meet this amount, the balance becomes due and payable in arrears on 30 June of the relevant year.

46. 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**

47. 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.

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

- (i) 10 Year (maximum) Principal and Interest Loan with:
  - monthly Principal and Interest payments in arrears per Vineyard Lot;
  - variable interest rate, set at a published market rate;
  - Application fee:
    - (a) \$350 for loans equal to or less than \$75,000 ; or
    - (b) \$350 plus 0.5% of the borrowed sum for loans greater than \$75,000.
- (ii) 10 Year (maximum) Loan with a mix of Interest only and Principal and Interest. The interest only period will be a maximum of two years, with:
  - monthly Interest payments in arrears per Vineyard Lot during the Interest only period;
  - then, monthly Principal and Interest payments in arrears per Vineyard Lot during the Principal and Interest period;
  - variable interest rate, set at a published market rate;
  - Application fee:
    - (a) \$350 for loans equal to or less than \$75,000 ; or
    - (b) \$350 plus 0.5% of the borrowed sum for loans greater than \$75,000.

- (iii) 10 Year Principal and Interest Loan with:
- the first 5 years interest only payable in equal monthly instalments in arrears plus additional repayments of principal per Vineyard Lot in the amounts and on the dates set out in Item 5 of the Schedule to the Loan Deed;
  - the following 5 years Principal and Interest payable in equal monthly instalments in arrears plus additional repayments of principal per Vineyard Lot in the amounts and on the dates set out in Item 5 of the Schedule to the Loan Deed;
  - Interest will be calculated at the Higher Variable Rate set out in Item 6 of the Schedule to the Loan Deed. If the Interest and Principle are paid on the due date the Lender will accept Interest at the Lower Variable Rate set out in Item 6 of the Schedule to the Loan Deed;
  - Application fee:
    - (a) \$350 for loans equal to or less than \$75,000 ; or
    - (b) \$350 plus 0.5% of the borrowed sum for loans greater than \$75,000.

49. 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**

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### **Application of this Ruling**

50. This Ruling applies only to Members who are accepted to participate in the Project:

- on or before 15 June 2003;
- during the period 16 June to 30 June 2003 (provided the Responsible Entity can wholly provide the services in consideration of the moneys payable on application by 30 June 2003); or
- during the period 1 July 2003 to 19 December 2003, and the Member has executed a Lease and Management Agreement. A Member's participation in the Project must constitute the carrying on of a business of primary production.

51. 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***

52. 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**

53. 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***

#### *Section 6-5*

54. 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.

55. 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*

56. 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.

57. 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*

58. A Member who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

## **Members who were accepted into the Project in the year ended 30 June 2003**

Fee Type	ITAA 1997 Section	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005
<b>Management Fee</b>	8-1	\$10,890 – See Notes (i) & (ii) below	\$10,230 See Notes (i) & (ii) below	See Notes (i), (ii) & (iv) below
<b>Rent</b>	8-1	\$110 – See Notes (i) & (ii) below	\$220 – See Notes (i) & (ii) below	\$226.60 – (indexed) See Notes (i), (ii) & (v) below
<b>Interest</b>	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 2003**

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005
<b>Management Fee</b>	8-1	\$21,120 (\$10,890 + \$10,230) See Notes (i) & (ii) below	See Notes (i), (ii) & (iv) below.
<b>Rent</b>	8-1	\$330 (\$110 + \$220) See Notes (i) & (ii) below	\$226.60 (indexed) See Notes (i), (ii) & (v) below
<b>Interest</b>	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): Division 27. 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 a percentage of the Member's wine proceeds for the year to be deducted on an ongoing basis. The fee calculated in this manner must amount to at least \$1,000 (indexed) for the relevant year.
- (v) For each year commencing from 1 July 2004 until 30 June 2020, Annual Rent of \$226.60 is to be indexed annually by the Inflation Adjustment Factor for the relevant financial year for Members who participate in the Project.

## **Tax outcomes for Members who are 'STS taxpayers'**

### ***Assessable Income***

#### *Section 6-5 and section 328-105*

59. 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.

60. 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*

61. 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)).

62. 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*

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

**Members who were accepted into the Project in the year ended 30 June 2003**

<b>Fee Type</b>	<b>ITAA 1997 Sections</b>	<b>Year ended 30 June 2003</b>	<b>Year ended 30 June 2004</b>	<b>Year ended 30 June 2005</b>
<b>Management Fee</b>	8-1 & 328-105	\$10,890 – See Notes (vi), (vii) & (viii) below	\$10,230 – See Notes (vi), (vii) & (viii) below	See Notes (vi), (vii), (viii) & (x) below
<b>Rent</b>	8-1 & 328-105	\$110 - See Notes (vi), (vii) & (viii) below	\$220 – See Notes (vi), (vii) & (viii) (below)	\$226.60 (indexed) – See Notes (vi), (vii), (viii) & (xi) below
<b>Interest</b>	8-1 & 328-105	When paid - See Note (ix) below	When paid – See Note (ix) below	When paid - See Note (ix) below

**Members who were accepted into the Project on or after  
1 July 2003**

<b>Fee Type</b>	<b>ITAA 1997 Sections</b>	<b>Year ended 30 June 2004</b>	<b>Year ended 30 June 2005</b>
<b>Management Fee</b>	8-1 & 328-105	\$21,120 (\$10,890 + \$10,230) - See Notes (vi), (vii) & (viii) below	See Notes (vi), (vii), (viii) & (x) below
<b>Rent</b>	8-1 & 328-105	\$330 (\$110 + \$220) - See Notes (vi), (vii) & (viii) below	\$226.60 (indexed) - See Notes (vi), (vii), (viii) & (xi) below
<b>Interest</b>	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 capital expenditure would need to be adjusted as relevant for GST (e.g. input tax credits): Division 27. 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 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.
- (x) For each year commencing from 1 July 2004 until 30 June 2020, a Management Fee is payable by each Member. This annual fee is determined as a percentage of a Member's wine proceeds for the year to be deducted on an ongoing basis. The fee calculated in this manner must amount to at least \$1,000 (indexed) for the relevant year.
- (xi) For each year commencing from 1 July 2004 until 30 June 2020, Annual Rent of \$226.60 is to be indexed annually by the Inflation Adjustment Factor for the relevant financial year for Members who participate in the Project.

### **Tax outcomes that apply to all Members**

#### ***Deferral of losses from non-commercial business activities***

##### ***Division 35***

###### ***Section 35-55 – Commissioner's discretion***

64. For a Member who is an individual and who enters the Project during the year ended 30 June 2003 or the year ended 30 June 2004, 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 2003 to 30 June 2005 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

65. 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)).

66. 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.

67. 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**

68. 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 within this Ruling.

## **Explanations**

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### **Is the Member carrying on a business?**

69. 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 - 2003 must amount to the carrying on of a business of primary production.

70. For schemes such as that of the Palandri America Wine Business - 2003 Project, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Member's activities can constitute the carrying on of such a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929; (1984) 16 ATR 55.

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 from those grapevines each year and to sell the wine produced;
- the viticulture activities are carried out on the Member's behalf;
- 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 0.030 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 leased area for the term of the Project. Under the lease the Member must use the land in question for the purpose of carrying out viticultural activities, and for no other purpose. The 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 Investment Management 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 - 2003 (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 - 2003 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 2003 and in subsequent years of income will be in respect of a loan to finance the Project business operations – the cultivation and growing of grapes and the lease of the land on which the grapevines 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.

Number of days of eligible service

Expenditure X period in the year of income

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 \$10,890 and Rent of \$110 per Vineyard Lot will be incurred on the Commencement Date of the Member being accepted into the Project under 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 in which the Commencement Date occurs. Under the Agreement, further annual expenditure is required each year during the term of the Project for the provision of management services and lease of 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 for the 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 41 to 45, then the basic precondition in subsection 82KZME(2) is 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. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2) a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

- the exception in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the 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.

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 2008. 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. 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.

119. 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 the business activity has started to be carried on and for that, or those income years;

- because of its nature, the business activity has not satisfied, or will not satisfy one of the tests set out in Division 35; and
- there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

120. 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 tests in the income year ended 30 June 2008, or will produce a taxation profit, for the year ended 30 June 2006.

121. 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 2005.

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 64), in the manner described in the Arrangement (see paragraphs 14 to 49). 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 (Revised Arrangement) 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 58 and 63 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 1/1/2003 to 30/6/2003	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2003 (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:

$$1/11 \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4,400 *less* \$400, or \$4,000.

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

$$1/11 \times \$2,200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2,200 *less* \$200, or \$2,000.

In preparing her income tax return for the year ended 30 June 2003, Susan is aware that the management fee is deductible in the year

incurred. She calculates her management fee deduction as \$4,00 (not \$4,400).

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 \$2,000 only, not one tenth of \$2,200).

## **Detailed contents list**

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## **Commissioner of Taxation**

18 December 2002

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<i>Previous draft:</i>	- ITAA 1997 Division 27
Not previously issued in draft form	- ITAA 1997 Division 35
	- ITAA 1997 35-10
<i>Related Rulings/Determinations:</i>	- ITAA 1997 35-10(2)
TR 2000/8; PR 1999/95; TR 92/1;	- ITAA 1997 35-10(3)
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<i>Subject references:</i>	- ITAA 1997 35-40
- carrying on a business	- ITAA 1997 35-45
- commencement of business	- ITAA 1997 35-55
- primary production	- ITAA 1997 35-55(1)
- primary production expenses	- ITAA 1997 35-55(1)(a)
- management fee expenses	- ITAA 1997 35-55(1)(b)
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