



PR 2004/47 - Income tax: Palandri America Wine Business - 2004

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Product Ruling

Income tax: Palandri America Wine Business - 2004

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Preamble

*The number, subject heading, **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 IVA 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.*

*[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

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.

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 - 2004, 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);
 - Division 328 of the *Income Tax (Transitional Provisions) Act 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.

Changes in the Law

4. Although this Ruling deals with the laws 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 28 April 2004, 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).

Note: The Addendum to this Ruling that issued on 1 September 2004, applies on and from 1 September 2004.

Note 2: The Addendum to this Ruling that issued on 28 June 2006, applies on and from 1 July 2005.

Withdrawal

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

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

- Application for Product Ruling dated 9 February 2004;

- The draft Palandri America Wine Business Product Disclosure Statement (PDS), undated, received 8 April 2004;
- **Replacement Constitution for the Palandri America Wine Business between Palandri Investment Management Ltd ('Responsible Entity'), and the Member, received 11 February 2004;**
- **Draft Lease and Management Agreement between Palandri Investment Management Ltd ('Responsible Entity'), Palandri Wine Production Ltd ['Lessor'] and the Member, received 8 April 2004;**
- Palandri America Wine Business Replacement Compliance Plan, received 11 February 2004;
- Vineyard Management and Maintenance Agreement between Palandri Investment Management Ltd (formerly known as Palandri Wines Ltd) and the Vineyard Manager received 26 March 2004;
- 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), received 11 February 2004;
- Loan Deed between Palandri Finance Ltd and the Borrower, received 26 March 2004;
- Additional correspondence received 4 August 2004;
- Modification of Constitution received 4 August 2004;
- Draft Collateral Sub-Lease received 4 August 2004;
- Draft Supplementary Product Disclosure Statement received 10 August 2004;
- Additional correspondence, including emails, received 5 March 2004, 16 March 2004, 26 March 2004, 1 April 2004, 6 April 2004, 8 April 2004, 13 April 2004 and 15 April 2004.

Note: certain information received from Palandri Investment Management 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 – 2004.

Location	Vineyards: 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 17 years.
Number of hectares under cultivation	20 hectares at the Palandri Frankland River Vineyard No.1 and 30 hectares at the Palandri Frankland River Vineyard No.2.

Size of each Frankland Vineyard Lot	0.02 hectares at the Palandri Frankland River Vineyard No.1 and 0.03 hectares at the Palandri Frankland River Vineyard No.2. or 0.05 hectares at either the Frankland River Vineyard No.1 or the Frankland River Vineyard No.2.
Number of vines per hectare	1,852
The term of the investment in years	17 years
Initial cost	\$11,000
Ongoing costs	Annual Management Fee Rent Insurance Potential Incentive Fee

18. The Palandri America Wine Business 2004 is registered as a managed investment scheme, ARSN 098 544 908, under the Corporations Act 2001. There are 1,000 Frankland Vineyard Lots on offer under the PDS. The PDS states that there is no minimum subscription for the Project. Each Member may subscribe for a minimum of one Frankland Vineyard Lot. Members applying under the PDS enter into a Lease and Management Agreement.

19. The Project Land is situated in Western Australia. Palandri Wine Production Ltd holds a lease over the land at Frankland River Vineyard No.1 and owns the land at Frankland River Vineyard No. 2. Palandri Wine Production Ltd agrees to lease to the Member an identifiable area of land called a 'Frankland Vineyard Lot' until the Project is terminated on 30 June 2020. Each Frankland Vineyard Lot is 0.05 hectares in size. A Frankland Vineyard Lot is defined as either:

- a portion of the Palandri Frankland River Vineyard No. 2 comprising 0.03 hectares and 0.02 hectares of the Palandri Frankland River Vineyard No. 1;
- 0.05 hectares of Palandri Frankland River Vineyard No. 2; or
- 0.05 hectares of Palandri Frankland Vineyard No. 1.

20. Palandri Wine Production Ltd will lease the Frankland 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 1852 rootlings per hectare. The Palandri Frankland River Vineyards No.1 and No. 2 are fully established. Members will be allotted a fully planted Frankland Vineyard Lot.

21. Applications must be accepted by the Responsible Entity by 15 June 2004, or between 1 July 2004 and 31 March 2005. For the purposes of this Ruling, Members accepted by 15 June 2004 will be known as '2004 Members'. Members accepted between 1 July 2004 and 31 March 2005 will be known as '2005 Members'. Applications will only be accepted if the conditions in clause 11.1 of the Constitution are satisfied.

22. 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 Frankland Vineyard Lot. Clause 28 of the Lease and Management Agreement also appoints Palandri Wine Production to act on behalf of the Member.

23. 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 Frankland Vineyard Lot and additional grapes and base wine to be sourced from contract suppliers.

24. Palandri Wine Production Ltd and Palandri Investment Management 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.

25. The PDS expires on 31 March 2005.

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, 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 PDS, and acceptance of the Application by the Responsible Entity. Members are bound by the Constitution and the Lease and Management Agreement by virtue of their participation in the Project.

26A. The Responsible Entity acts as Bare Trustee for the Members to enable the member's interest to be registered at the Department of Land Information (clause 18.4).

27. The Application Monies will be held in the Trust Account by the Responsible Entity as Bare Trustee formed under the Project's Constitution (clause 12.1). The Application Monies will be released when the conditions in clause 15 are met. The proceeds from the sale of wine are placed into the Proceeds Fund for distribution to the Members pursuant to clause 16 of the Constitution.

Compliance Plan

28. 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

29. A lease is granted by the Lessor, Palandri Wine Production Ltd, to the Members under the terms of the Lease and Management Agreement (clause 3.1). Members are granted an

interest in land in the form of a lease to use their Frankland Vineyard Lots to produce grapes for the purpose of commercial viticulture (clause 5). 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 the earlier of 31 December 2017 or the date of completion of the final harvest of the Grape Produce (Item 6 of Schedule). Members who participate in the Project must pay Rent for their interest in the land.

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 the Responsible Entity completes the final distribution of the Proceeds. 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. The Responsible Entity will carry out the following services under this Agreement in accordance with good business management and viticultural practices as determined by Palandri Investment Management Ltd (Item 9A Initial Period, Item 9B Second Period, Item 9C Ongoing Services, of the Schedule to the Lease and Management Agreement):

- cultivate, tend, prune, fertilise, spray and otherwise care for the vines as when required;
- use all reasonable measures to keep the relevant Frankland Vineyard Lot free from vermin, noxious weeds, pests and disease;
- maintain the relevant Frankland Vineyard Lot and maintain fire-breaks in and about the relevant Frankland Vineyard Lot;
- at all times maintain the relevant Frankland Vineyard Lot according to good viticultural practice;
- maintain a trickle irrigation system to the vines on the relevant Frankland Vineyard Lot;
- take all reasonable steps to prevent and manage land degradation on the relevant Frankland Vineyard Lot and to attend to the maintenance and management of the soil quality on the relevant Frankland Vineyard Lot;
- attend to the ongoing control of weed and plant growth on the relevant Frankland Vineyard Lot;
- harvest the Vines on the relevant Frankland 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 Frankland 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 Frankland Vineyard Lot and the vines;
- maintain the entryways to the relevant Frankland Vineyard Lot in order to prevent trespassers entering the relevant Frankland Vineyard Lot and to take such other security measures as it considers appropriate;
- maintain the boundary fencing around the relevant Frankland 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 PDS; and
- carry out the distribution and sales strategies referred to in the PDS.

32. The Responsible Entity will be responsible for paying the cost of public risk insurance in respect of the Frankland 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 (clause 19.1). Members may take additional insurance at their own cost (clause 19.2).

33. 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 (clause 12.2).

34. 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 (clause 16.1).

Harvesting and Wine Production

35. The Responsible Entity will be responsible for the:

- harvesting of the grapes;
- purchase of grapes and base wine;
- delivery of these grapes and base wine to the Winery;
- marketing
- 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.

36. The Responsible Entity will arrange for the Grape Produce to be processed into Wine and suitably stored in accordance with generally accepted wine industry standards.

37. 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 in the Initial Period are to be distributed in the following order of priority:

- Payment of any amounts due and unpaid under the Lease and Management Agreement by the relevant Member;
- Payment of any other amounts payable by the relevant Member under the Constitution; and
- Distribution of the remainder to the relevant Member (clause 18.2 of the Lease and Management Agreement).

38. Receipts received by the Responsible Entity in the Second Period are to be distributed in the following order of priority:

- Payment of any amounts due and unpaid under the Lease and Management Agreement by the relevant Member;
- Payment of any other amounts payable by the relevant Member under the Constitution; and
- Distribution of the remainder to the relevant Member (clause 18.5 of the Lease and Management Agreement).

39. Receipts received by the Responsible Entity from Year 3 onwards are to be distributed in the following order of priority:

- By deducting the rent payable;

- Payment of any other amounts payable by the relevant Member under the Lease and Management Agreement or the Constitution; and
- Distribution of the remainder to the relevant Member (clause 21.3 of the Lease and Management Agreement).

In any event that the Net Funds are not sufficient cover the amounts payable by the Member, then those amounts are due and payable in arrears on 30 June of the relevant Financial year.

Fees

40. 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 Frankland Vineyard Lot. The Initial Period for 2004 Members is from the Date of Commencement to 30 June 2004 and for 2005 Members the Date of Commencement to 30 April 2005. This amount is payable either in full on application or under a Time Payment Option.

41. Under the Time Payment Option, an amount of \$2,000 per Frankland Vineyard Lot is payable on application and a minimum payment of \$1,500 must be remitted to Palandri Investment Management Ltd by the 25th of each month thereafter. Any outstanding balance is due and payable on 25th June 2004 for 2004 Members and 25th April 2005 for 2005 Members.

42. For 2004 Members, a Management Fee of \$5133.70 is payable for services to be provided during the Second Period, 1 July 2004 to 30 June 2005. This amount is due on 15 October 2004. For 2005 Members, the Management Fee of \$5133.70 is payable on 30 June 2005 for services to be completed during the period 1 May 2005 to 30 June 2005, the Second Period.

43. For the years from 1 July 2005 to 30 June 2020, Management Fees are payable by the Member each year. These 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 \$4,400 in the year ended 30 June 2006 and \$1100 (indexed) from 30 June 2007 until the end of the Project. 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 2004 Members, no Rent is payable from the period of acceptance into the Project to 30 June 2004. Rent of \$366.30 is payable on 15 October 2004 for the period 1 July 2004 to 30 June 2005.

45. For 2005 Members, who enter the Project from 1 July 2004 to 30 March 2005, no Rent is payable for this period. Rent of \$366.30 is payable on 30 June 2005 for the period 1 May 2005 to 30 June 2005.

46. For the years from 1 July 2005 to 30 June 2017, Rent of \$366.30 is payable annually and is to be deducted from the Members wine proceeds on an ongoing basis. This amount is 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.

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 Frankland Vineyard Lot;
 - variable interest rate, set at a published market rate (Item 6 of the Schedule to the Loan Deed);
 - 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.
- (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 Frankland Vineyard Lot during the Interest only period;
 - then, monthly Principal and Interest payments in arrears per Frankland Vineyard Lot during the Principal and Interest period;
 - variable interest rate, set at a published market rate (Item 6 of the Schedule to the Loan Deed);
 - 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.
- (iii) 10 Year Principal and Interest Loan with:

- the first 5 years interest only payable in equal monthly instalments in arrears 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 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) \$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.

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

Application of this Ruling

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

- on or before 15 June 2004; or
- during the period 1 July 2004 to 31 March 2005, 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. Any Members accepted into the Project between 16 June 2004 and 30 June 2004 are not covered by this Product Ruling.

52. 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

53. 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'.

53A. Changes to the STS rules apply from 1 July 2005. From that date, 'STS taxpayers' may use the accruals accounting method. For a Member participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Member who was an 'STS taxpayer' prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see section 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

Qualification

54. 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

55. 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.

56. 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

57. 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.

58. 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

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

2004 Members

Fee Type	ITAA 1997 Section	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Management Fee	8-1	\$11,000 See Notes (i) & (ii)	\$5133.70 See Notes (i) & (ii)	Minimum of \$4,400 See (i), (ii) & (iv)
Rent	8-1	Nil See Notes	\$366.30 – See Notes	\$366.30 – (indexed)

		(i) & (ii)	(i) & (ii)	See Notes (i), (ii) & (v)
Interest	8-1	As incurred - See Note (iii)	As incurred - See Note (iii)	As incurred - See Note (iii)

2005 Members

Fee Type	ITAA 1997 Section	Year ended 30 June 2005	Year ended 30 June 2006
Management Fee	8-1	\$16,133.70 (\$11,000 + \$5133.70) See Notes (i) & (ii)	Minimum of \$4,400 See (i), (ii) & (iv)
Rent	8-1	\$61.04 See Notes (i), (ii) & (vi)	\$366.30 (indexed) See Notes (i), (ii) & (v)
Interest	8-1	As incurred - See Note (iii)	As incurred - See Note (iii)

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 119.
- (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 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 2005 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 a minimum of \$4,400 in the year ended 30 June 2005 and at least \$1,100 (indexed) thereafter.
- (v) For each year commencing from 1 July 2005 until 30 June 2017, Annual Rent of \$366.30 is to be indexed annually by the Inflation Adjustment Factor for the relevant financial year for Members who participate in the Project.
- (vi) The Rent of \$366.30 payable on 30 June 2005 is to be apportioned over the period that the Member leases the land. Therefore Rent of \$30.52 for each month that the Member leases the land is deductible in the year ended 30 June 2005 as it will be paid in the year in which it is incurred. See paragraphs 84 to 85.

Tax outcomes for Members who are 'STS taxpayers'

Assessable Income

Section 6-5 and section 328-105

60. 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.

61. For the 2005 and prior income years, a 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)). For the 2005-06 and later income years, a Member who is an 'STS taxpayer' using the accruals accounting method will be assessable on this income in the income year in which the income is derived and a Member who is an 'STS taxpayer' using the cash accounting method will be assessable on this income in the income year in which the income is received.

Trading stock**Section 328-285**

62. 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)).

63. 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**

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

2004 Members

Fee Type	ITAA 1997 Sections	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Management Fee	8-1	\$11,000 See Notes (vii), (viii) & (ix)	\$5133.70 See Notes (vii), (viii) & (ix)	Minimum of \$4,400 See Notes (vii), (viii) (ix) & (xi)
Rent	8-1	Nil See Notes (vii), (viii) & (ix)	\$366.30 See Notes (vii), (viii) & (ix)	\$366.30 (indexed) See Notes (vii), (viii), (ix) & (xii)
Interest	8-1	When paid – See Notes (viii) and (x)	When paid – See Notes (viii) and (x)	See Notes (viii) and (x)

2005 Members

Fee Type	ITAA 1997 Sections	Year ended 30 June 2005	Year ended 30 June 2006
Management Fee	8-1	\$16,133.70 (\$11,000 + \$5133.70) – See Notes (vii), (viii) & (ix)	Minimum of \$4,400 See Notes (vii), (viii), (ix) & (xi)
Rent	8-1	\$61.04	\$366.30 (indexed)

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		See Notes (vii), (viii), (ix) & (xiii)	See Notes (vii), (viii), (ix) & (xii)
Interest	8-1	When paid – See Notes (viii) and (x)	See Notes (viii) and (x)

Notes:

- (vii) 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 119;
- (viii) If, for any reason, an expense referred to in the Tables above is not fully paid in the year in which it is incurred by a Member who is an 'STS taxpayer' (for the 2005 and prior income years) or is an 'STS taxpayer' using the cash accounting method (for the 2006 and later income years) then the amount is only deductible to the extent to which it has been paid, or has been paid for the Member (paragraph 328-105(1)(b)). For these taxpayers, any expense or part of an expense shown in the Tables 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;
- (ix) Where a Member who is an 'STS taxpayer', (for the 2005 and prior income years) or is an 'STS taxpayer' using the cash accounting method (for the 2006 and later income years) 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 (for example, 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;
- (x) 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 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;

- (xi) For each year commencing from 1 July 2005 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 a minimum of \$4,400 in the year ended 30 June 2005 and at least \$1,100 (indexed) thereafter;
- (xii) For each year commencing from 1 July 2005 until 30 June 2017, Annual Rent of \$366.30 is to be indexed annually by the Inflation Adjustment Factor for the relevant financial year for Members who participate in the Project; and
- (xiii) The Rent of \$366.30 payable on 30 June 2005 is to be apportioned over the period that the Member leases the land. Therefore Rent of \$30.52 for each month that the Member leases the land is deductible in the year ended 30 June 2005 as it will be paid in the year in which it is incurred. See paragraphs 84 to 85.

Tax outcomes that apply to all Members

Deferral of losses from non-commercial business activities

Division 35

Section 35-55 – Commissioner's discretion

65. For a Member who is an individual and who enters the Project by 15 June 2004 or from 1 July 2004 to 30 March 2005, 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 2004 to 30 June 2006 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. This conditional exercise of the discretion will allow those losses to be offset against the Member's other assessable income in the income year in which the losses arise.

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

66. 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.

Explanation

Is the Member carrying on a business?

67. 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 2004 must amount to the carrying on of a business of primary production. These viticulture activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

68. For schemes such as that of the Palandri America Wine Business - 2004 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* 6 FCR 202, 84 ATC 4929; (1984) 16 ATR 55.

69. 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.

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

71. Under the Lease and Management Agreement each individual Member will have rights over a specific and identifiable area of 0.05 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.

72. Under the Lease and Management Agreement the Responsible Entity is engaged by the Member to maintain a Frankland 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 Frankland Vineyard Lots on the Member's behalf.

73. 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 Frankland 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 Frankland Vineyard Lot and all aspects of wine production for the Members.

74. 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.

75. 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.

76. The pooling of grapes grown on the Member's Frankland 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 Frankland Vineyard Lots held by that Member.

77. 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 - 2004 (see Taxation Ruling IT 360).

78. 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 Frankland 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.

79. 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 - 2004 will constitute the carrying on of a business.

The Simplified Tax System

Division 328

80. 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.

81. 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

82. 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.

83. 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 fees is identifiable from the arrangement. The fees appear 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.

84. One of the exclusions under section 8-1 relates to expenditure which is capital, or capital in nature. Any part of the expenditure of a Grower entering into a viticulture business which is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and hence will not be deductible under section 8-1. The Commissioner is of the view that a portion of the Rent is capital expenditure and therefore the amount allowed as a deduction under section 8-1 will be reduced as follows.

85. A Member who enters the Project between 1 July 2004 and 31 March 2005 does not lease the land for a full income year in the Second Period. As there is no reduction in the Rent in the Second Period to reflect the actual period of the lease, it is considered that part of the Rent is a premium paid by the Member for the grant of the lease and is capital in nature. Therefore, Members will be entitled to a partial deduction of \$61.04, calculated on a pro-rata monthly basis for each month that they lease the land, in the initial year.

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' for the 2005 and prior income years and on whether a Member is an 'STS taxpayer' using the cash accounting method or the accruals accounting method for the 2006 and later income years.

89. For the 2005 and prior income years, if the Member is not an 'STS taxpayer', the Management Fees and the Rent are deductible in the year in which they are incurred. For the 2006 and later income years, if the Member is not an 'STS taxpayer' or is an 'STS taxpayer' using the accruals accounting method, the Management Fees and the Rent are deductible in the year in which they are incurred.

90. For the 2005 and prior income years, if a member is an 'STS taxpayer' (or in the case of the 2006 and later income years is an 'STS taxpayer' using the cash accounting method), the Management Fees and Rent are deductible in the income year in which they are paid, or are paid for the Member. If any amount that is properly incurred in an income year remains unpaid at the end of the 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 2004 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, the timing of deductions

for interest will again depend upon whether a Member is an 'STS taxpayer' for the 2005 and prior income years and on whether a Member is an 'STS taxpayer' using the cash accounting method or the accruals accounting method for the 2006 and later income years.

94. For the 2005 and prior income years, if the Member is not an 'STS taxpayer', interest is deductible in the year in which it is incurred. For the 2006 and later income years, if the Member is not an 'STS taxpayer' or is an 'STS taxpayer' using the accruals accounting method, interest is deductible in the year in which it is incurred.

95. For the 2005 and prior income years, if the Member is an 'STS taxpayer' (or in the case of the 2006 and later income years is an 'STS taxpayer' using the cash accounting method), interest is deductible in the income year in which it is paid, or is paid for the Member. If interest that is properly incurred in an income year remains unpaid at the end of the 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;
- 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.

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

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 Management Fee of \$11,000 per Frankland 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 is charged for providing management services to a Member by the end of the Initial Period. 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 40 to

46, 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, 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

Section 35-55 – Exercise of Commissioner's discretion

113. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years 30 June 2004 to 30 June 2006 the Commissioner has applied the principles set out in Taxation Ruling TR 2001/14 *Income tax: Division 35 – non commercial business losses*. Accordingly, based on the evidence supplied, the Commissioner has determined that for those income years ended 30 June 2004 up to and including 30 June 2006:

- it is because of its nature the business activity of a Member will not satisfy one of the four tests in Division 35;
- there is an objective expectation that within a period that is commercially viable for the viticulture industry, a Member's business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- A Member who would otherwise be required to defer a loss arising from their participation in the Project under subsection 35-10(2) until a later income year is able to offset that loss against their other assessable income.

114. The exercise of the Commissioner's discretion under paragraph 35-55(1)(b) is conditional on the Project being carried on in the manner described in this Ruling during the income years specified. If the Project is carried out in a materially different way to that described in the Ruling a Member will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL - recouped expenditure

115. 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

116. 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).

117. The Palandri America Wine Business 2004 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 59 and 64 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.

118. 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: Entitlement to GST input tax credits

119. 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 2003 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 1/1/2004 to 30/6/2004	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>
Total due and payable by 1 January 2004 (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 \$4,400 (not \$4,000).

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

28 April 2004

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
 TR 97/11; TR 97/16; TD 93/34;
 TR 98/22; TR 2000/8;
 TR 2001/14; IT 360

Subject references:

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

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