



PR 2006/153 - Income tax: Harrington Brook Project 2007

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 This document has changed over time. This is a consolidated version of the ruling which was published on *15 November 2006*



Product Ruling

Income tax: Harrington Brook Project 2007

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① This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

No guarantee of commercial success

The Tax Office **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 and how the product fits an existing portfolio. 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 in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document.

If the scheme is not carried out as described, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the scheme will be carried out as described in this Product Ruling.

Potential participants should be aware that the Tax Office will be undertaking review activities to confirm the scheme has been implemented as described below and to ensure that the participants in the scheme 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 entity(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 Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates. In this Ruling, this scheme is referred to as the 'Harrington Brook Project 2007' or just simply as 'the Project'.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 8-1 of the ITAA 1997;
 - section 17-5 of the ITAA 1997;
 - section 25-25 of the ITAA 1997;
 - Division 27 of the ITAA 1997;
 - Division 35 of the ITAA 1997;
 - Division 40 of the ITAA 1997;
 - Subdivision 61-J of the ITAA 1997;
 - Division 328 of the ITAA 1997;
 - Division 328 of the *Income Tax (Transitional Provisions) Act 1997*;
 - section 82KL of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 82KZL of the ITAA 1936;
 - sections 82KZME and 82KZMF of the ITAA 1936; and
 - Part IVA of the ITAA 1936.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

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 'Grower') to be entitled to claim input tax credits for the GST included in its expenditure, it 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. Entities 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 participants are fully informed of any legislative changes after the Ruling is issued.

Class of entities

7. The class of each entity to which this Ruling applies is the entity more specifically identified in the Ruling part of this Product Ruling (refer to paragraphs 70 to 71) and who enters into the scheme specified below, on or after the date this Ruling is made. The entity will have a purpose of staying in the scheme until it is completed (that is, 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 scheme. In this Ruling, the entity is referred to as a 'Grower'.

8. The class of entity to whom this Ruling applies does **not** include:

- an entity who is accepted in the Project before 15 November 2006 or after 31 May 2007;
- an entity that has not paid the application fee (Application Price) by 31 May 2007, where they have not entered into a finance arrangement;
- an entity that has their application conditionally accepted by Questus Funds Management Ltd subject to finance for the payment of the Application Price, where the finance has not been approved by the lender by 31 May 2007 or the finance has been approved but the funds have not been made available to Questus Funds Management Ltd by 30 June 2007;
- an entity who finances their participation in the Project with Questus Mortgage Funds Ltd other than the arrangement with Questus Mortgage Funds Ltd described at paragraphs 63 to 68 of this Ruling;

- an entity who finances their participation in the Project with Questus Mortgage Funds Ltd and receives a discount off the rates provided at paragraph 65 of this Ruling;
- an entity that elects to carry out their own maintenance on their Vineyard Lot(s) in accordance with clause 5.1 of the Management Agreement;
- an entity that elects to take and sell their grapes from a harvest of their Vineyard Lot(s) in accordance with clause 5.2 of the Management Agreement; and
- an entity who intends to terminate their involvement in the scheme prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 17 to 69 of this Ruling.

10. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

12. This Ruling applies prospectively from 15 November 2006, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

13. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

14. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

15. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

16. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. The Ruling continues to apply, in respect of the relevant provisions ruled upon, to all entities within the specified class who enter into the scheme specified below. Thus, the Ruling continues to apply to those entities, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entity's involvement in the scheme.

Scheme

17. The scheme that is the subject of this Ruling is specified below. This scheme incorporates the following documents:

- Application for a Product Ruling dated 3 July 2006 as constituted by the following documents and additional correspondence, including emails, received 1, 22 and 27 September 2006, 30 and 31 October 2006 and 1, 2, 5 and 6 November 2006;
- Draft Product Disclosure Statement (PDS) for the Harrington Brook Project 2007 and the Harrington Brook Property Trust issued by Questus Funds Management Ltd (the 'Responsible Entity'), received 3 July 2006;
- Draft Constitution for the Harrington Brook Project 2007, received 27 September 2006;
- Draft Constitution for the Harrington Brook Property Trust, received 3 July 2006;
- Draft **Management Agreement** between the Responsible Entity and the Grower, received 2 November 2006;
- Draft Farm Management Agreement between the Responsible Entity and Barwick Wines Pty Ltd (as 'Manager'), received 3 July 2006;
- Draft Grape Purchase Agreement between Questus Funds Management Ltd and Barwick Wines Pty Ltd, received 3 July 2006;
- Draft Compliance Plan for the Harrington Brook Project 2007, received 3 July 2006;
- Draft Compliance Plan for the Harrington Brook Property Trust, received 3 July 2006;
- Call Option Deed for the purchase of the Cundinup property between the Owner and the Custodian for the Harrington Brook Property Trust (as Option Holder), received 3 July 2006;
- Draft Lease between the Custodian and the Responsible Entity, received, 3 July 2006;
- Draft **Sublease Agreement** between the Responsible Entity and the Grower, received 3 July 2006;
- Viticulture Consultant's Report on the viticultural potential for Wine Grape Growing at Cundinup dated 10 March 2006, received 3 July 2006;

- Custodian Agreement dated 5 October 2005 between the Responsible Entity and the Custodian, received 27 September 2006; and
- Draft **Loan Agreement** between the Responsible Entity and the Grower, received 3 July 2006.

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

18. The documents highlighted are those that a Grower may enter into. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows.

19. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

Overview

20. This scheme is called the Harrington Brook Project 2007. The main features are as follows:

Location	Cundinup, Donnybrook Shire in the South West region of Western Australia
Type of business to be carried on by each participant	Commercial growing of wine grapes, specifically Sauvignon Blanc, Semillon, and Cabernet Sauvignon varieties
Number of hectares offered for cultivation	80 hectares
Size of each Vineyard Lot	0.05 hectares
Number of vines per hectare	1,667
Term of the Project	22 years
Initial Cost per Vineyard Lot	\$4,180
Ongoing and other costs	<ul style="list-style-type: none"> • Annual rent; • Ongoing fees; • Marketing fees; and • Annual insurance.

21. The Project has been registered as a Managed Investment Scheme under the *Corporations Act 2001*. Questus Funds Management Ltd has been issued with Financial Services Licence Number 286318 and will be the Responsible Entity for the Project.

22. The Project involves the cultivation of three varieties (Sauvignon Blanc, Semillon and Cabernet Sauvignon) of grapevines and the harvest and sale of the grapes.

23. The Project will be conducted on 80 hectares of land located in the Cundinup area of the Donnybrook Shire in the South West region of Western Australia on Nelson Locations 5259 and 1231 White Road, Cundinup.

24. The Owner of the Project Land has granted a Call Option Deed over the Project Land to the custodian of the Harrington Brook Property Trust (the 'Option Holder'), which may be exercised at any time on or before 25 January 2007. It is the intention of the Option Holder to exercise its rights under the option upon the minimum subscription of 480 Vineyard Lots being reached.

25. If additional land is acquired for use in the Project, the Responsible Entity will notify the Tax Office and will apply for an addendum to this Product Ruling to include that land.

26. A Grower that participates in the Project will do so by acquiring an interest in the Project, which will consist of a minimum of one Vineyard Lot of 0.05 hectares in size. Growers must also acquire a unit in the Harrington Brook Property Trust for each Vineyard Lot interest acquired.

27. The Vineyard Lots will be planted at the rate of approximately 1,667 vines per hectare. Water for irrigation of the grapevines will be supplied from four water dams constructed on the project land.

28. An offer to participate in the Project will be made through a Product Disclosure Statement (PDS). The offer made under the PDS is for 80 hectares, which corresponds to 1,600 Vineyard Lots in the Project. The term of the Project is a minimum of 22 years. The Project will not commence if the minimum subscription of 480 Vineyard Lots has not been reached by 31 May 2007.

29. Applicants execute a Power of Attorney contained in the PDS. The Power of Attorney irrevocably appoints the Responsible Entity to enter into, on behalf of the Grower, a Sublease Agreement, a Management Agreement and any other agreements required to hold an interest in the Project.

Constitution

30. The Constitution establishes the Project and operates as a deed binding on all of the Project's Growers and the Responsible Entity. The Constitution sets out the terms and conditions under which Questus Funds Management Ltd agrees to act as Responsible Entity and thereby manage the Project. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 8 of the Constitution, the Responsible Entity will maintain a register of all Growers that are accepted to participate in the Project.

31. All Application Money must be paid to the Responsible Entity in the form of cash or cash equivalent. The Responsible Entity (or its agent) will hold this money on trust for the Applicants in an Application Fund. The Responsible Entity may transfer the Application Money when certain specified conditions in the Constitution have been met (clause 14).

32. Among other things the Constitution sets out in detail the following:

- Grower's income and distributions, clause 15;
- Responsible Entity's powers, clause 19;
- complaints handling, clause 21;
- winding up the Project, clause 28; and
- dispute resolution, clause 29.

Compliance Plan

33. As required by the *Corporations Act 2001*, the Responsible Entity has prepared a Compliance Plan. The purpose of the Compliance Plan is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

Lease Agreement and Sublease Agreement

34. Under the Lease Agreement, the custodian of the Harrington Brook Property Trust (as 'Lessor') leases the Project Land to the Responsible Entity (as 'Lessee'). The Lessor agrees that the Responsible Entity may enter into Sublease Agreements with Growers for the purposes of the Project (clause 11.3).

35. Under the Sublease Agreement, between the Responsible Entity and the Grower, the Responsible Entity grants to the Grower a sublease to use and occupy a Vineyard Lot for the purpose of planting, growing, maintaining, cultivating and harvesting the Vines under the terms and conditions as set out in the agreement.

36. The Sublease Agreement will commence on the date the Responsible Entity accepts the Grower's application under the PDS and will continue for a period of approximately 22 years or until the Project is terminated.

37. In consideration of being granted the sublease by the Responsible Entity, the Grower must pay the Responsible Entity the rent set out in clause 6.1 of the Sublease Agreement.

Management Agreement

38. Growers participating in the scheme will enter into a Management Agreement with Questus Funds Management Ltd in its capacity as Responsible Entity of the Project. The Management Agreement commences on the date the Responsible Entity accepts the Grower's application under the PDS. Under the Management Agreement, the Responsible Entity agrees to carry out the establishment services, the initial management services and the on-going duties in accordance with sound viticultural and environmental practices as well as in accordance with industry practices for similar vineyards.

39. The establishment services and the initial management services must be carried during the period from the commencement of the Management Agreement to 30 June 2007. These services are listed in clause 4.1 and clause 4.2 of the Management Agreement. They include:

- preparing the Vineyard Lot for planting including soil management, applying herbicides and fertilisers;
- ensuring that there is sufficient run-off control (by way deep drainage ripping and contour banks);
- installation and maintenance of trellising;
- installation of the Internal Irrigation System and keeping these facilities in good repair and condition;
- installation and maintenance of infrastructure (including construction of roads, bird netting, a chemical store, and sheds);
- preventing and combating land degradation;
- monitoring and controlling weeds, pests, vermin and diseases;
- inspection of rootlings in preparation for planting; and
- administration services.

40. The ongoing management services, harvesting duties and processing duties are listed in clauses 4.4 and 4.5 of the Management Agreement. These services will be carried out during the period from 1 July 2007 until the end of the Project. They include:

- planting of at least 83 rootlings per Vineyard Lot and applying fertiliser and herbicide as appropriate (the planting will be conducted in the spring of the 2007 calendar year);
- cultivating, tending, culling, pruning, spraying and otherwise caring for the Vineyard Lot as necessary;
- maintaining fences, trellising, irrigation, firebreaks and all other infrastructure as required;
- monitoring and controlling weeds, pests, vermin and diseases;
- obtaining a report from an independent viticulture expert within nine months after completion of planting and then annually to be provided to the Grower;
- notifying the Grower when the Vines enter their first commercial season;
- harvesting and processing the grapes;
- marketing and selling the Growers' Produce;
- maintaining insurance of the Grower's Produce; and
- administration services in respect of the above.

41. The Responsible Entity may engage contractors or others to perform its obligations under the Management Agreement. Under the Farm Management Agreement, the Responsible Entity has agreed to engage Barwick Wines Pty Ltd (the 'Manager'), to establish the Growers' Vineyard Lots and to manage and maintain the Vineyard Lots on the terms and conditions in the Farm Management Agreement. The Manager will be subject to the direction of the Responsible Entity in all matters pertaining to the Farm Management Agreement.

42. The Responsible Entity will be responsible for the cost of insurance against public risk and ordinary risks associated with the Vineyard Lots (clause 8.1(a)). The Grower's must take out insurance over the Grower's Produce and appoint the Responsible Entity as the Grower's agent for the purposes of arranging the insurance of the Grower's Produce. The Grower is liable to reimburse the Responsible Entity for the cost of the insurance (clause 8.2(b)). The Grower is at liberty to take out additional insurance at the Grower's own cost and expense (clause 8.3).

Harvesting and sale

43. The Grower has a right to the grapes grown on the Vines and is entitled to the proceeds from the sale of those grapes. The Responsible Entity will determine when there is a commercially harvestable crop and arrange for the grapes to be harvested.

44. A Grower may elect to take the Grower's Produce by making an election under clause 5.2 of the Management Agreement. This Product Ruling does not apply to Grower's who make such an election.

45. The Responsible Entity will market and sell the Grower's Produce of those Growers who do not make an election under clause 5.2. The Responsible Entity will use reasonable endeavours to obtain the maximum price available.

46. Under the Grape Purchase Agreement between the Responsible Entity and Barwick Wines Pty Ltd, Barwick Wines Pty Ltd agrees to purchase the Contracted Tonnages of grapes from the Responsible Entity subject to the terms and conditions of the Grape Purchase Agreement.

Pooling of grapes and distribution of proceeds

47. The Management Agreement at clause 4.7 and the Constitution at clauses 7 and 15 set out the circumstances relating to the pooling of Growers' Produce and the distribution of proceeds from the sale of the produce. This Product Ruling only applies where the following principles apply to those pooling and distribution arrangements:

- only Growers who have contributed produce from a harvest to a pool are entitled to benefit from distributions from the proceeds of sale; and
- produce can only be pooled with the produce of Growers who are accepted to participate in the Project on or after 15 November 2006 and on or before 31 May 2007.

48. The Grower's share of the pool or Proceeds Fund is based on the proportion of the Vineyard Lots they sublease in relation to total number of the Growers' Vineyard Lots (clause 7.2 of the Constitution).

49. However, before the distribution, the proceeds will be reduced by any of the Grower's fees payable under the Sublease Agreement, Management Agreement or amounts payable by the Grower under the Constitution (clause 15.4 of the Constitution).

50. In the event that a Grower's Vineyard Lot(s) is destroyed or partially destroyed, the Grower's sale proceeds will be reduced in accordance with the terms of clause 4.7(c) of the Management Agreement.

Harrington Brook Property Trust

51. Each Grower must subscribe for a unit in the Harrington Brook Property Trust for each Vineyard Lot acquired. The cost of each unit is \$1,060 which is payable on application.

Fees

52. Under the Management Agreement and the Sublease Agreement the following fees are payable by the Grower:

- Application Price;
- Ongoing fees;
- Rent;
- Insurance; and
- Marketing Fee.

Application Price

53. The **Application Price** payable to the Responsible Entity on application is \$4,180 per Vineyard Lot. This fee consists of:

- Initial management fee of \$1,317.30;
- Establishment fee (landcare operations) of \$664.90;
- Cost of irrigation of \$1,409.10;
- Cost of vines and horticultural services of \$420.75; and
- Cost of infrastructure and trellising of \$367.95.

Ongoing fees

54. The **ongoing fees** (for ongoing management, harvesting and processing duties) for the year ending 30 June 2008 and onwards are payable by 31 October in each year. These fees may be deducted from the gross income attributed to the Grower's Vineyard Lot, where applicable. The fees are as follows:

- \$614.08 for the year ending 30 June 2008;
- \$598.24 for the year ending 30 June 2009;
- \$635.09 for the year ending 30 June 2010;
- \$648.84 for the year ending 30 June 2011;
- \$657.09 for the year ending 30 June 2012; and
- an amount equal to the fee for the previous income year increased at the rate of the Consumer Price Index for the year ending 30 June 2013 and onwards, until the end of the Project.

Rent

55. Annual **rent** is payable as follows:

- nil for the year ending 30 June 2007;
- \$110 for the year ending 30 June 2008, payable by 31 October 2007; and
- an amount equal to the rent for the previous income year increased at the rate of the Consumer Price Index payable by 31 October each Year.

Insurance

56. The Responsible Entity will arrange insurance of the Grower's Produce and invoice the Grower for the cost of the insurance each year in which there is a harvest of grapes.

Marketing fee

57. In consideration of the Responsible Entity carrying out the marketing and selling of the Grower's Produce, the Grower must pay the Responsible Entity a marketing fee. For the first harvest the marketing fee will be 5.5% of the total sale price per tonne of the Grower's Produce. For each subsequent harvest period the marketing fee is the marketing fee calculated in the previous period increased at the rate of the Consumer Price Index.

58. The marketing fee will be paid out of the gross income attributable to the Grower's Vineyard Lot.

59. The Responsible Entity may elect not to charge the Grower a marketing fee.

Finance

60. Growers may fund their participation in the Project themselves, borrow from an independent lender or borrow from Questus Mortgage Funds Ltd (a finance company associated with the Responsible Entity).

61. Growers cannot rely on this Product Ruling if they enter into a finance package with Questus Mortgage Funds Ltd that materially differs from those provided to the Tax Office by the Responsible Entity as part of the application for this Product Ruling. This finance package is summarised below.

62. In addition, Growers cannot rely on this Product Ruling if they enter into a finance package with Questus Mortgage Funds Ltd and receive a discount off the rates provided at paragraph 65 of this Ruling.

Finance by Questus Mortgage Funds Ltd

63. A Grower choosing to pay the Application Price of \$4,180 per Vineyard Lot by entering into a finance arrangement with Questus Mortgage Funds Ltd must complete the Loan Application Form and enter into a Loan Agreement with Questus Mortgage Funds Ltd. The Responsible Entity on behalf of the Grower will execute the Loan Agreement. All finance arrangements will be on a full recourse basis and recovery action will be taken in respect of any default.

64. Growers who enter into a Loan Agreement with Questus Mortgage Funds Ltd are required to pay a deposit of 10% of the Application Price on application. In addition a Grower is required to pay an Application Fee of 1.1% of the loan advance (subject to a minimum of \$600) and a legal administration and registration fee of \$275.

65. The balance after the 10% deposit is repayable under the following payment options:

- Option 1 – 2 to 3 years principal and interest with interest charged at 11.0%;
- Option 2 – 4 to 5 years principal and interest with interest charged at 11.5%;
- Option 3 – 6 to 7 years principal and interest with interest charged at 12.0%;
- Option 4 – 8 to 9 years principal and interest with interest charged at 12.5%;
- Option 5 – 10 to 11 years principal and interest with interest charged at 13.0%; or
- Option 6 – 12 to 13 years principal and interest with interest charged at 13.5%.

66. The instalments of principal and interest are due and payable on the last business day of each month beginning with the last business day of the month in which the loan term commences.

67. Questus Mortgage Funds Ltd will take security over the Grower's Vineyard Lot.

68. Questus Mortgage Funds Ltd will only provide loans to Growers where it has sufficient funds to do so.

69. This Ruling does not apply if the finance arrangement entered into by the Grower 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 of the ITAA 1936 or the funding arrangements transform the Project into a 'scheme' to which Part IVA of the ITAA 1936 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 Questus Mortgage Funds Ltd are involved or become involved in the provision of finance to Growers for the Project.

Ruling

Application of this Ruling

70. Subject to paragraph 8 of this Ruling and the specific exclusions set out in paragraphs 44, 47, 61, 62 and 69, this Ruling will only apply to a Grower who is accepted to participate in the Project and who has executed a Sublease Agreement and a Management Agreement on or after 15 November 2006 and on or before 31 May 2007.

71. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

Minimum subscription

72. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced. Under the terms of the Product Disclosure Statement, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 480 interests is achieved.

The Simplified Tax System (STS)***Division 328***

73. To be an 'STS taxpayer', a Grower must be eligible to be an 'STS taxpayer' and must have elected to be an STS taxpayer (Division 328 of the ITAA 1997). For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower who was an STS taxpayer prior to 1 July 2005 continues to use the cash accounting method (called the 'STS accounting method') – see sections 328-120 and 328-125 of the *Income Tax (Transitional Provisions) Act 1997*.

74. For such Growers, a reference in this Ruling to an amount being deductible when 'incurred' will mean that amount is deductible when paid and a reference to an amount being included in assessable income when 'derived' will mean that amount is included in assessable income when received.

25% entrepreneurs tax offset***Subdivision 61-J***

75. For the first income year starting on or after 1 July 2005, Subdivision 61-J provides for a tax offset of up to 25% of income tax liability related to the business income of a business in the STS with annual group turnover of less than \$75,000. Entitlement to the offset varies depending on the type of entity and is therefore outside the scope of this Ruling.

Assessable income***Section 6-5***

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

77. The Grower recognises ordinary income from carrying on the business of viticulture at the time that income is derived.

Deduction for the initial management fee, ongoing fees, rent, insurance, interest and borrowing expenses**Section 8-1 and section 25-25**

78. A Grower may claim tax deductions for the following fees and expenses on a per 'Vineyard Lot' basis, as set out in the Table below:

Fee Type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Initial management fee	\$1,317.30 See Notes (i) & (ii)		
Ongoing fees		\$614.08 See Notes (i), (ii) and (iv)	\$598.24 See Notes (i), (ii) and (iv)
Rent		\$110 See Notes (i), (ii) and (iv)	\$110 (indexed) See Notes (i), (ii) and (iv)
Insurance	Nil See Note (ii)	Nil see Note (ii)	Nil see Note (ii)
Interest on loans with Questus Mortgage Funds Ltd	See Notes (iii) and (iv)	See Notes (iii) and (iv)	See Notes (iii) and (iv)
Finance application Fee, legal administration & registration fee	See Note (v)	See Note (v)	See Note (v)

Notes:

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (for example, input tax credits): Division 27.
- (ii) The initial management fee, ongoing fees, rent and insurance are deductible in the year that they are incurred under section 8-1. Note that the cost of insurance is expected to be incurred from the year ending 30 June 2010 (when the first harvest is expected) onwards.
- (iii) Interest paid to Questus Mortgage Funds Ltd under the finance arrangements described at paragraphs 63 to 68 of this Ruling is deductible in the year in which it is incurred under section 8-1. The deductibility or otherwise of interest incurred under any other finance arrangements (including finance arrangements entered into with financiers other than Questus Mortgage Funds Ltd), is outside the scope of this Ruling.

- (iv) This Ruling does not apply to Growers who choose to prepay fees or rent or who choose to, or are required to prepay interest under a finance arrangement (including finance arrangements with Questus Mortgage Funds Ltd). Any Grower who prepays such amounts may request a private ruling on the taxation consequences of their participation in the Project.
- (v) The Application Fee and the legal administration and registration fee payable to Questus Mortgage Funds Ltd are borrowing expenses and are deductible under section 25-25. They are incurred for borrowing money that is used or is to be used during that income year solely for income producing purposes. The deduction is spread over the period of the loan or 5 years, whichever is the shorter. The deductibility or otherwise of borrowing expenses arising from finance arrangements other than the finance arrangements described at paragraphs 63 to 68 of this Ruling with Questus Mortgage Funds Ltd is outside the scope of this Ruling.

Deductions for capital expenditure

Division 40 and Division 328

79. A Grower will also be entitled to tax deductions relating to the irrigation, vines, establishment fee (landcare operations), cost of trellising and certain costs of infrastructure. The deductions are shown in the following Table and accompanying notes:

Fee type	Year ended 30 June 2007	Year ended 30 June 2008	Year ended 30 June 2009
Irrigation (Internal Irrigation System)	\$469.70 See Note (vi)	\$469.70 See Note (vi)	\$469.70 See Note (vi)
Vines and horticultural services	Nil See Note (vii)	Nil See Note (vii)	Nil See Note (vii)
Establishment fee (landcare operations)	\$664.90 See Note (viii)		
Infrastructure and trellising	Amount must be calculated See Notes (ix) & (x)	Amount must be calculated See Notes (ix) & (x)	Amount must be calculated See Notes (ix) & (x)

Notes:

- (vi) The Internal Irrigation System is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure of \$1,409.10 per Vineyard Lot incurred by each Grower on the installation of the water facility in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).

STS taxpayers may choose to calculate their deduction under Subdivision 40-F (as discussed in the paragraph above) or under Division 328. For Division 328 to apply, the Grower must be an STS taxpayer for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the cost apportionable to the asset is less than \$1,000, the asset is treated as a 'low cost asset' and the amount is deductible in full (section 328-180). If the asset is not treated as a low cost asset, the tax deduction allowable in the year ending 30 June 2007 is determined by multiplying its cost by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply (section 328-190).

- (vii) A 'horticultural plant' is a 'depreciating asset' as defined in section 40-30 and grapevines are a 'horticultural plant' as defined in subsection 40-520(2). As Growers hold the land under a lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the grapevines is determined using the formula in section 40-545 and is based on the capital expenditure of \$420.75 per Vineyard Lot incurred that is attributable to their establishment. If the grapevines have an 'effective life' of greater than 13 but fewer than 30 years for the purposes of section 40-545, this results in a straight-line write-off at a rate of 13%. The deduction is allowable when the grapevines enter their first commercial season (section 40-530, item 2). The Responsible Entity will inform Growers of when the grapevines enter their first commercial season.

- (viii) Capital expenditure incurred for a 'landcare operation' (as defined in section 40-635) is deductible in the year that it is incurred under Subdivision 40-G, section 40-630.
- (ix) The shed, chemical store, tools, bird netting and trellising that form part of the 'infrastructure and the trellising' are each a depreciating asset as defined in section 40-30. The deduction, which is, the 'decline in value' of each asset is calculated using the formula in either subsection 40-70(1) (diminishing value method) or subsection 40-75(1) (prime cost method). Both formulas rely on the 'cost' and 'effective life' of each asset.

The cost of each asset, per Vineyard Lot, is \$24 for the shed, \$5.50 for the chemical store, 0.70c for the tools, \$55 for the bird netting and \$277.20 for the trellising.

Growers can either self-assess the effective life (section 40-105) or use the Commissioner's determination of effective life (section 40-100). The Responsible Entity has determined that each asset has an effective life of 22 years.

A 'low cost asset' can be allocated to a 'low-value pool'. A low cost asset is an asset costing less than \$1,000.

However, once any low-cost asset of a Grower is allocated to a low-value pool, all other low-cost assets the Grower starts to hold in that year or a later year must be allocated to that pool. If the Grower has already allocated an asset to a low-value pool, the low cost assets that are part of the infrastructure and the trellising, would also have to be allocated to that pool.

If an asset is allocated to a low-value pool, the capital expenditure on the asset will be deducted under the diminishing value methodology of the pool based on a rate of 18.75% in the year the asset is first used and a rate of 37.5% in subsequent years (section 40-440).

If the asset is not allocated to a low-value pool, it can be written off based on the effective life of the asset.

STS taxpayers will calculate the deduction under Division 328, for each asset that is part of the infrastructure and the trellising. For Division 328 to apply the Grower must be an STS taxpayer for the income year in which it holds the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

If the cost apportionable to an asset is less than \$1,000, the asset is treated as a 'low cost asset' and the amount is deductible in full in the year ending 30 June 2007. If the asset is not treated as a low cost asset, the tax deduction allowable in the year ending 30 June 2007 is determined by multiplying its cost by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply (section 328-190).

- (x) The amount paid towards roads that form part of the infrastructure is not an allowable deduction. The amount does not qualify for a deduction under Division 40 and 328.

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

Section 35-55 – exercise of Commissioner's discretion

80. A Grower who is an individual accepted into the Project by 31 May 2007 may have losses arising from their participation in the Project that would be deferred to a later income year under section 35-10. Subject to the Project being carried out in the manner described above, the Commissioner will exercise the discretion in paragraph 35-55(1)(b) for these Growers for the income years ending **30 June 2007 to 30 June 2012**. This conditional exercise of the discretion will allow those losses to be offset against the Grower's other assessable income in the income year in which the losses arise.

Section 82KL and Part IVA of the ITAA 1936

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

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Is the Grower carrying on a business?

82. For the amounts set out in the Ruling above to constitute allowable deductions, the Grower's viticulture activities as a participant in the Harrington Brook Project 2007 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.

83. For schemes such as that of the Harrington Brook Project 2007, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As TR 2000/8 sets out, these circumstances have been established in court decisions such as *Commissioner of Taxation v. Lau* (1984) 6 FCR 202; 84 ATC 4929; (1984) 16 ATR 55.

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

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's grapevines are established;
- the Grower has a right to harvest and sell the grapes each year from those grapevines;
- the viticulture activities are carried out on the Grower's behalf;
- the viticulture activities of the Grower 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.

85. In this Project, each Grower enters into a Sublease Agreement and a Management Agreement.

86. Under the Sublease Agreement each individual Grower will have rights over a specific and identifiable area of land. The Sublease Agreement provides the Grower with an ongoing interest in the specific grapevines on the leased area for the term of the Project. Under the Sublease Agreement the Grower must use the land in question for the purpose of carrying out viticultural activities and for no other purpose. The Sublease Agreement allows the Responsible Entity to come onto the land to carry out its obligations under the Sublease Agreement and the Management Agreement.

87. Under the Management Agreement the Responsible Entity is engaged by the Grower to establish and maintain a Vineyard Lot on the Grower's identifiable area of 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 establish and maintain the Vineyard Lot on the Grower's behalf.

88. In establishing the Vineyard Lot, the Grower engages the Responsible Entity to maintain the grapevines on the Vineyard Lots according to the principles of sound viticulture practice, which includes irrigation, fertilization, weed control and pruning. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the grapes grown on the Grower's Vineyard Lot.

89. 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 Project's description for all the indicators.

90. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of its grapes that will return a before-tax profit, that is, a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

91. The pooling of grapes grown on the Grower's Vineyard Lot with the grapes of other Growers is consistent with general viticulture practices. Each Grower's proportionate share of the sale proceeds of the pooled grapes will reflect the proportion of the grapes contributed from their Vineyard Lot.

92. The Responsible Entity's services on the Grower's behalf are also consistent with general viticulture practices. The assets are of the type ordinarily used in carrying on a business of viticulture. While the size of a Vineyard Lot is relatively small, it is of a size and scale to allow it to be commercially viable.

93. The Grower's degree of control over the Responsible Entity as evidenced by the Management Agreement, and supplemented by the *Corporations Act 2001*, is sufficient. During the term of the Project, the Responsible Entity will provide the Grower with regular progress reports on the Grower's Vineyard Lot and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as in cases of default or neglect.

94. 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 Growers' viticulture activities in the Harrington Brook Project 2007 will constitute the carrying on of a business.

The Simplified Tax System***Division 328***

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

96. The question of whether a Grower is eligible to be an STS taxpayer is outside the scope of this Product Ruling. Therefore, any Grower 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 the initial management fees, ongoing fees, rent and insurance***Section 8-1***

97. Consideration of whether the initial management fees, ongoing fees, rent and insurance 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 is contractually committed 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.

98. The initial management fees, ongoing fees, rent and insurance associated with the viticulture activities will relate to the gaining of income from the Grower's business of viticulture (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of grapes) 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 scheme. The fee appears to be reasonable. There is no capital component of the initial management fees, ongoing fees, rent and insurance. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

Interest deductibility

Section 8-1

(i) Growers who enter into finance arrangements with Questus Mortgage Funds Ltd

99. Some Growers may finance their participation in the Project with finance arrangements with Questus Mortgage Funds Ltd as described at paragraphs 63 to 68 of this Ruling. Whether the resulting interest costs are deductible under section 8-1 depends on the same reasoning as that applied to the deductibility of the initial management fees, ongoing fees, rent and insurance.

100. The interest incurred for the year ending 30 June 2007 and in subsequent years of income will be in respect of a loan to finance the Grower's business operations (the cultivation and growing of grapes) that will continue to be directly connected with the gaining of 'business income' from the Project. Such interest will, therefore, have a sufficient connection with the gaining of assessable income to be deductible under section 8-1.

(ii) Growers who enter into other finance arrangements

101. The deductibility of interest incurred by Growers who finance their participation in the Project through a finance arrangement other than the finance arrangements described at paragraphs 63 to 68 of this Ruling with Questus Mortgage Funds 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.

Prepayment provisions

Sections 82KZL to 82KZMF of the ITAA 1936

102. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 (sections 82KZL to 82KZMF) 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 (for example 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.

Application of the prepayment provisions to this Project

103. Under the scheme to which this Product Ruling applies, the initial management fees, ongoing fees, rent, insurance and interest are incurred in the same income year that the services for these costs are provided. Accordingly, the prepayment provisions in sections 82KZME and 82KZMF of the ITAA 1936 have no application to this scheme.

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

104. Although not required under either the Management Agreement or the Sublease Agreement, a Grower participating in the Project may choose to prepay fees for a period beyond the 'expenditure year'. Similarly, Growers who use financiers may either choose or be required to, prepay interest. Where this occurs, contrary to the conclusion reached in paragraph 103 of this Ruling, section 82KZMF of the ITAA 1936 will apply to apportion the expenditure and allow a deduction over the period in which the prepaid benefits are provided.

105. For these Growers, the amount and timing of deductions for any relevant prepaid fees, prepaid rent, prepaid insurance or prepaid interest will depend upon when the respective amounts are incurred and what the eligible service period is in relation to these amounts. The prepayment provisions will apply to determine the amount and timing of the deductions regardless of whether the Grower is an STS taxpayer or not.

106. As noted in the Ruling section (at paragraph 78, Note (iv)) of this Ruling, Growers who prepay fees or interest are not covered by this Product Ruling and may instead request a private ruling on the tax consequences of their participation in the Project.

Expenditure of a capital nature

Division 40 and Division 328

107. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to the irrigation system, the establishment of the grapevines, landcare operations, the installation of trellising and the installation of infrastructure are of a capital nature. Apart from the cost of the roads, which is part of the infrastructure, this expenditure falls for consideration under Division 40 or Division 328.

108. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an STS taxpayer.

109. The tax treatment of capital expenditure has been dealt with in a representative way in paragraph 79 of this Ruling in the Table and the accompanying notes.

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

Section 35-55 – exercise of Commissioner’s discretion

110. In deciding to exercise the discretion in paragraph 35-55(1)(b) on a conditional basis for the income years ending **30 June 2007 to 30 June 2012**, 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 ending 30 June 2007 up to and including 30 June 2012:

- it is because of its nature the business activity of a Grower 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 Grower’s business activity will satisfy one of the four tests set out in Division 35 or produce a taxation profit; and
- a Grower 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.

111. 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 Grower will need to apply for a private ruling on the application of section 35-55 to those changed circumstances.

Section 82KL of the ITAA 1936 – recouped expenditure

112. The operation of section 82KL of the ITAA 1936 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 of the ITAA 1936 – general tax avoidance provisions

113. For Part IVA of the ITAA 1936 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).

114. The Project will be a scheme. A Grower will obtain a tax benefit from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 78 and 79 of this Ruling 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.

115. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the grapes. There are no facts that would suggest that Growers 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 at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) of the ITAA 1936 it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/11; TR 98/22; TR 2000/8;
TR 2001/14

Subject references:

- borrowing expenses
- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- non-commercial losses
- producing assessable income
- product rulings
- public rulings
- tax avoidance
- taxation administration

Legislative references:

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- TAA 1953 Sch 1 357-75(1)
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
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- ITAA 1936 82KZMB
- ITAA 1936 82KZMC
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NO: 2006/11246
ISSN: 1441-1172
ATOlaw topic: Income Tax ~~ Product ~~ vineyards & wineries